

ONTARIO ENERGY BOARD

INTERPRETIVE GUIDANCE TO THE AFFILIATE RELATIONSHIPS CODE FOR GAS UTILITIES

December 9, 2004

This document provides guidance on how the Board will interpret the December 9, 2004 amendments to the Affiliate Relationships Code for Gas Utilities (“ARC”). The amendments relate to the transfer pricing rules and to affiliate information disclosure.

Part 1 - General

Section 2.3.1 requires that the term of a contract between a utility and an affiliate shall not exceed five years, unless otherwise approved by the Board.

At the end of the a contract with an affiliate, the Board expects:

- Where the transfer price was established under the cost-based rule, the utility will fully explore whether a market has developed for the outsourced item. If a market has developed, then a utility shall undertake a fair and open competitive bidding process.
- Where the transfer price was established under the market-based rule, the utility shall undertake a further fair and open competitive bidding process.

The Board does not recognize the renewal of a contract as being different from a new contract. An automatic right to renew an affiliate contract has no special status and will be viewed as a new contract for compliance under the ARC.

Part 2 - Interpretation

Market-based pricing

Section 2.3 is intended to strengthen the use of tendering to establish the transfer price where a market exists.

Tendering

The effect of sections 2.3.4 and 2.3.5 is that a utility must tender all contracts of a significant size where a market exists for the service or product.

Whether a fair and open competitive bidding process was followed by a utility is a question of fact that can be reviewed on a case-by-case basis.

The Board would not find that an open and fair bidding process in compliance with the ARC had occurred under the following circumstances:

- where an affiliate was allowed to match any offer provided by another bidder, or
- where “shadow tendering”, a practice to seek price quotations from third parties without the intention to award the contract, was used for contracts above the prescribed threshold.

How should utilities apply the threshold tests?

The threshold tests in sections 2.3.6 and 2.3.7 are based on the total dollar value over the life of the contract.

For affiliate contracts that do not have a fixed dollar amount, the utility shall make a reasonable estimate of the likely total dollar value of the contract. An internal budget estimate may be useful for this purpose.

The anti-avoidance provision in section 2.8 is intended to apply to multiple contracts for a similar service from the same provider. This rule is not intended to apply to similar services from multiple affiliates, or to non-similar services from a single affiliate.

Affiliate information disclosure

Section 2.3.1.2 requires that all contracts between a utility and its affiliate contain a provision requiring the affiliate to comply with the Board’s requests for information relating to the affiliate’s cost of providing any service or product to the utility under that contract.

The Board will generally expect to review affiliate financial information when the cost-based pricing rule is used. The Board will likely not need such information where a fair and open competitive bidding process has been successfully undertaken since a market-based transfer price will result.

Transfer of assets between utility and affiliate

Sections 2.3.12 to 2.3.16 are intended to promote fairness by requiring an independent valuation of market prices when significant assets are transferred to, or purchased from, an affiliate, and by requiring assets utility sell to an affiliate be priced at the higher of the market price or net book value.

The final disposition of a capital gain or loss on the sale of utility assets to an affiliate will be dealt with at the subsequent rate hearing. In order to provide stakeholders guidance, the Board will generally expect that any capital gains or losses on the transfer of utility assets to an affiliate should be shared 50/50 between ratepayers and utility shareholders. Panels on rates cases will determine if there are exceptional circumstances justifying different treatment.

Part 3 - Other Matters

Generally, the Board will treat compliance with the relevant ARC transfer pricing requirements as sufficient evidence supporting the recovery in rates of the amounts paid to the affiliate service provider.

The Board will address in a rates case the reasonableness of a cost paid to a service provider that has close economic links to the utility but is not an affiliate as defined by the *Ontario Business Corporations Act*.