FORTIS ONTARIO

OUTLINE FOR OEB PRESENTATION
CONSOLIDATION OF ELECTRICITY DISTRIBUTORS
February 17, 2004

Introduction

- **FortisOntario wishes to thank the OEB and staff for providing us the opportunity to address the Board on a subject very important to us all.**

History

- **FortisOntario operates transmission, distribution and hydro generation businesses in Ontario.**
- **Its parent company, Fortis Inc., has its head office in St. John's, Newfoundland and is listed on the TSX. Upon closing of its recent acquisitions in BC and Alberta, it will have assets totaling $3.6 billion.**
- **The company's Ontario operations date back to 1892, when Canadian Niagara Power Company was formed. In the early 1900's, construction commenced of what was later to become Rankine Power Station, a 75MW hydroelectric facility located at Niagara Falls. In addition to small hydro generation, the company serves four distribution areas: Fort Erie, Port Colborne, Cornwall and Gananoque through two licensed distributors: Canadian Niagara Power Inc. and Cornwall Electric.**
- **Recent investment initiatives in Ontario include the following:**
  1. **Granite Power (later changed to Eastern Ontario Power) was acquired in April 2003;**
  2. **Cornwall Electric was acquired from Enbridge in October 2002; and**
  3. **Port Colborne entered into a 10 year lease in April 2002.**
- **In total, FortisOntario serves 52,000 customers and has formed strategic investments with Rideau St. Lawrence and Westario, which serve an additional 27,000 customers.**
- **FortisOntario is an Ontario based growth company committed to growing its distribution and hydro generation businesses.**

Position Regarding Consolidation

- **Confirm that FortisOntario and its wholly owned distributors, Canadian Niagara Power Inc. (including Eastern Ontario Power) and Cornwall Electric are committed to the process of consolidation.**
- **Take the view that it is generally accepted that consolidation will result in greater efficiencies that can be passed through to customers through lower costs.**
- **We do not intend on debating the economics and believe that there is sufficient empirical support to prove the following:**

1. Further consolidation of the market will drive further efficiencies which will reduce fixed and variable distribution charges to customers.
2. Economies of scale have and will continue to be realized through consolidation in any one or more of the following: billing, settlement and call centres; elimination of redundancies and duplication in administration, service centres, inventory and fleet; being able to conduct more economical planning and asset management over larger areas; and reducing production costs as a result of standardization of material and equipment.
3. Fixed overhead costs also decline on a per customer basis as the number of customers increases. Fixed costs include information technology software, development of billing formats, design of communication materials, capital investments in transformers substations, and underground lines and feeders.[1]

- **We also believe that there is a clear need for positive incentives to consolidation and merger.**
- **Most important, we believe that there must be a "level playing field" on the path towards consolidation. Currently, there is not.**

Transfer Tax Exemption

- **The transfer tax exemption is clear example of a policy instrument being applied in a manner that creates an "unlevel playing field" for electricity distribution companies.**
- **Without going into great legislative detail, the Electricity Act imposes a transfer tax on the transfer of municipal electric utilities equal to 33% which is payable to the Ontario Electricity Financial Corporation ("OEFC"). This amount can be reduced by payments in lieu of corporate taxes ("PILs") and corporate taxes. Certain exemptions to this transfer tax have been applied on an "on again, off again" approach. Currently, the exemption applies only to transfer to other municipal electric utilities, Hydro One and OPGI and excluded the private sector.**
- **One theoretical argument is that including the private sector in this exemption creates tax leakage of revenues to the federal government; however, this is not the case.**
- **The argument is as follows: since the transfer tax was put in place to compensate for money flowing to Ottawa, exempting transactions that involve the private sector will result in reduced revenues to apply to the Ontario Hydro debt.**
- **The significance of this concern is less in practice than expected in theory for the following reasons:**
  1. **profitability of small to medium sized utilities (1,000-30,000 customers) is limited due the extraordinary cost of business transition and integration, and their size and lack of access to economies of scale on a "go forward" basis – the merged entity may**

[1] *Delivering Value: The Next Evolution of Electricity Distribution in Ontario,* The Distributors' Electricity Efficiency Policy Group. October 2003.

not be paying either corporate taxes or PILs for a number of years so there is nothing to leak.

2. **Certain municipalities are carrying on their electricity businesses to avoid paying PILs by not paying dividends – the province is therefore not realizing potential revenue streams and a move to profitability through having private sector ownership would partially offset the lost of PILs through an increase in total corporate taxes payable. Hence, private sector participation and increased profitability would increase the provincial portion of those taxes.**

- **Excluding investor owned utilities from this two year window on transfer tax exemptions, creates an unfair advantage for mergers of distributors with municipal corporations, municipal electric utilities, Hydro One and OPGI.[2] The continued opening and closing of these windows also creates regulatory uncertainty and weakens the investment climate.**
- **Investor owned utilities, such as FortisOntario and its electricity distributors must continue to pay this tax or use convoluted structures to avoid it.[3]**
- **Private investors are limited to ownership of less than 10% of the asset or using a lease structure to avoid this tax.**
- **FortisOntario's position is that the elimination of the transfer tax will encourage consolidation on a level playing field. Alternatively, any exemption from its application should be applied equally to investor owned utilities as well as the others that I have mentioned.**
- **Our customers should be entitled to the same incentives for consolidation as other customers throughout the province, and other customers throughout the province should have access to the benefits of private sector investment in consolidation.**
- **The elimination of the transfer tax would also provide for a stronger investment climate and promote regulatory certainty.**
- **The transfer tax exemption in its current form is an undesirable barrier to enhancing efficiency. Perhaps it should have been included in the OEB's list of impediments set out in section 3.3 of the OEB Staff Discussion Paper dated February 10, 2004 as it prevents private investors from access to a "level playing field" of electricity distributor consolidation. It is an unnecessary barrier and should be removed.**

The Regional Approach

- **FortisOntario has adopted a unique regional approach in its consolidation activities. This preserves the local identity and presence of the electricity distributor.**
- **Not only has FortisOntario been successful in realizing efficiencies through consolidation, but also it has done so in a way that respects and enhances the regional flavour of each utility. In Port Colborne, we have maintained a customer service department with employees from the region. Similarly, in**

[2] Subsection 94(1) of the Electricity Act creates a transfer tax on the transfer of municipal electricity property. Ontario Regulation 124/99 sets this tax at 33% and also provides for certain exemptions. Subsection 3(18) of the Regulation excludes transfers between March 27, 2003-March 28, 2005 to other MEUs, Hydro One and OPGI.

[3] Subsection 3(14) of the Regulation excludes a transfer of a leasehold interest and Port Colborne (10,000 customers) was acquired using this structure.

Gananoque we continue to maintain linemen and customer service personnel to serve the unique requirements of the customers in that region.

- **We have done this and achieved efficiencies. We are maintaining service levels and a local presence, while achieving sustained savings in the following areas: reduced IT consulting services, training customer service staff to use a universal representative system, consolidating T&D contracts, replacing HR consultants and Health, Safety & Environmental consultants with internal employees, consolidation of a number of service contracts (IT, security to insurance), business process changes, centralized billing, centralized corporate services, reduced legal fees, and improved telephone configuration.**

Relationship Building

- **FortisOntario's measured success as a small utility consolidator has been aided by its commitment to building relationships with key stakeholders of municipally owned utilities and communicating the value of its participation as an owner of their utility and a good corporate citizen in their communities.**
- **Our track record speaks for itself. Our consolidation successes include: Port Colborne, Cornwall, Gananoque, Westario and Rideau St. Lawrence.**

Conclusion

- **FortisOntario thanks the Board and staff for providing the opportunity to express our views on consolidation at such a critical stage in the development of the electricity industry.**
- **We finish by confirming our support for consolidation and stressing that whatever method is chosen to further this end that there be a level playing field that includes investor owned utilities such as FortisOntario. Positive signals and incentives to potential investors can only assist the electricity industry in Ontario.**