Submission to the Ontario Energy Board

On RP – 2004-0020
Notice of a Consultation to Review Further
Efficiencies in the Electricity Distribution Sector

Greater Sudbury Utilities and its Subsidiary Greater Sudbury Hydro Inc.

Sudbury, Ontario

February 12, 2004

Executive Summary

This report forms the submission of Greater Sudbury Utilities (GSU) to the Ontario Energy Board (OEB or Board) relative to the Board's Notice of Consultation RP-0020-2004.

Greater Sudbury Utilities provides electrical distribution service to in excess of 43,000 customers in the City of Greater Sudbury in Northeastern Ontario. Over the past 5 years GSU has seen an increase of 10% in its customer base with the amalgamation of the former Nickel Centre and Capreol distribution systems. During the same period, GSU has experienced a 20% reduction in staff count including a 40% reduction in senior management positions and 15% reduction in middle management. Over the same period GSU did not increase its rate to achieve Market Adjusted Rate of Return (MARR) but continued to make interest payments on debt to its shareholder in the amount of $2.4 M. GSU's reduction in operating resources was accomplished through strategic outsourcing and the development/procurement of improved business systems and processes. This was no small feat, given the significant increase in workload, due to administrative activities required to support the deregulated retail market, regulation and wholesale settlement. GSU is committed to distribution system efficiency and acts on that commitment daily.

We applaud the Board's effort to ensure the electricity delivery system in Ontario is as effective as possible, however, we respectfully submit that the Board should exercise equal or greater diligence and energy in its review of other components of the electricity industry. We submit further that the Board should, in its review of industry efficiency, be guided by the principle of enhanced customer and shareholder value. Having said that, we are mindful of Board staff recommendations for a Central Agency to oversee Demand Side Management/Demand Reduction efforts in the Province, which in turn will add costs to the end customer. Doubtless some observers in considering that recommendation against this consultation will conclude that we are trying to "rob Peter to pay Paul". We remind the Board that distribution costs in the Province are less than 20% of the consumer's bill. We submit that the attention of policy makers and regulators is best turned to the area where it can have the greatest impact, and that area in our submission is increased generation.

Since the opening of the Electricity Market in Ontario, a crushing burden of regulatory and administrative weight has descended on the Electric Utilities in the Province from the OEB and Independent Electricity Market Operator (IMO). This weight has been carried by Utilities, in part, through the introduction of new, more efficient business systems, staff restructuring and generally learning to do more and more with less and less. While we recognize that there are certain economies of scale that can be achieved from larger Utility Corporations, in operational areas where economies of scale are effective, we submit that the value that can be excised from the distribution portion of the industry continues to be absorbed by the weight of regulatory requirements. We encourage the Board to consider the guiding principal espoused by the Macdonald Advisory Committee members at page 101 of their report, "The regulator must, however, be guided by two main objectives – that is, to promote and safeguard competition, and that it should regulate with a light-hand".

Further, we caution against the belief that a single approach will provide one correct methodology for determining optimal distribution territory and size across the Province. We expect that the size of the distribution utility will outgrow the opportunity for scales of economy based on diverse factors such as customer density and system configuration. We submit that a solution that may work well in a large portion of the south may prove disastrous in the Northeastern part of the Province based on the distance between customers and the ruggedness of the terrain over which the systems travel.

We submit that the proper framework for Distribution System rationalization in the Northeast is generally along district boundaries provided that all customers supplied from a circuit are serviced

by a single Utility along the boundary. Further, we submit that ownership of the asset be transferred from the Province to the Municipality in which the assets are contained. Ownership of the Utility Corporation would be vested with the municipalities in a percentage equal to the total percentage of assets of the Corporation.

We submit that the regulatory regime be revised to provide for light handed, complaint driven regulatory oversight similar to the activities of the Ontario Municipal Board.

To achieve the goals outlined above, we propose two alternative structures after consideration of some general issues that are common to all decisions.

The first structure proposed is for new Distribution Companies based on boundaries defined by economic operation within political districts, Rural Utilities to service the remainder and a mandated Utility Cooperative. The separation of Urban/Rural customer groups allows for more transparent understanding of distribution rates based on cost of service while the Cooperative will provide economies of scale for services that would benefit from a larger subscriber base.

The second alternative considers the establishment of District Distribution Companies defined loosely along the political District borders. This new Distribution Company would recover revenue through multiple rate structures that would recognize the varying cost of service based on areas of customer density.

General Issues

Ownership Issues

When the provincial government enacted the Electricity Act S.O.1998 it recognized that the assets of the Municipal Electric Utilities belonged to the members of the community since they were the ones who had paid for it. In so recognizing the government handed the assets from public Commissions to the local municipal government.

Based on that logic, we suggest that the provincially owned assets managed by Hydro One within municipalities should be turned over to those municipalities and that those municipalities then in turn use those assets as an investment in the new Distribution Utility. Shares in the corporation would be allocated based on the percentage of assets turned over to the new Utility. We note that the Macdonald Advisory Committee, at page 81 of their report, recommended a process that, in principle, is similar to our submission.

Transfer of the assets to the municipal entity not only recognizes the contribution of the citizens of that community to the acquisition of the asset but also provides a return to the community on that investment by its members. Municipalities in Ontario continue to face grave budgetary difficulties as a result of provincial downloading of responsibilities. Revenue from the Utility is becoming of ever-greater importance, not to build discretionary infrastructure such as parks and playgrounds but rather to maintain required infrastructure.

Further municipal ownership of the assets allows for local decisions related to economic development as discussed in our submission under Regulatory.

We submit that for reasons of service assurance, local ownership and governance best serve customers. There is little comfort that a complaint of poor service from a Northeastern customer to a head office in the south of the Province or to an offshore corporate head office will provide any degree of response. A complaint to a Member of a Board or Directors in the same or nearby community, on the other hand, is far more likely to invoke a quick response to the customer’s concern and the implementation of abiding remedial action where warranted.

Any stranded assets that might add to overall generation would then be added to the current stranded debt and the debt retirement charge reviewed to ensure fairness and to pay down the full debt within 10 years.

Rate Issues

In the early 1920's the Hydro Electric Power Commission, the predecessor to Ontario Hydro was mandated to electrify rural areas. This mandate continued through for decades resulting in what must be recognized as many uneconomic kilometers of distribution lines. There are many such lines in the north running many kilometers through boreal forests and over hard Canadian Shield rock formations. It goes without saying that the cost to service the few customers at the end of these lines far exceeds the cost to service customers in a subdivision in an urban setting. The rural customer receiving the same rate as the urban customer represents a significant cross subsidy between those two customers based on cost of service as is evidenced by the Hydro One rate structure and Rural Rate Assistance.

The decision to electrify rural areas was a public policy decision that gave consideration to a perceived public good rather than the long-term sustainability of the system itself. As is recognized in the Discussion Paper prepared by Board staff, no amount of efficiency improvement will assist in appreciably reducing the cost of providing physical services to these areas, as the cost drivers for these installations more often than not are distance and difficulty due to limited access or site conditions and as such are uncontrollable.

We submit that in light of the aforementioned, two options remain or a combination thereof:

- Continuance of the assistance programs currently in place indefinitely or alternatively;
- A multi-tiered rate structure that would recognize cost of service issues for customer density as is currently recognized between customer classes; or
- A combination of the two.

To not take one option, the other, or a combination of the two, would be to inappropriately penalize customers in the more populated areas of the Distribution Company by asking them to pay more for the maintenance of customers in the more rural areas.

Service Issues

For the reasons outlined in our submission related to rate issues immediately above, we submit that the standard that a Rural Utility be held to, for the provision of physical services, be different than the standard for a Local Distribution Company (LDC) in an urban setting. The reduced revenue associated with rural customer bases does not allow for many of the tools and resources available to urban utilities. Systems such as modern computer based System Control and Data Acquisition (SCADA) systems are possible and prevalent within urban LDCs. Travel distances alone provide significant impairment in the rural setting to reducing the duration of outages when they occur. Combined with many kilometers of line running through bush and under lakes in the North the task of minimizing outages through regular maintenance is daunting and cost prohibitive.

Labour Relations Issues/Costs

Greater Sudbury Utilities is committed to the careers of its employees and to compensating employees in a fair competitive manner.

Having said that, in forming any new corporation we are of the opinion that the obligations of the Hydro One Collective Bargaining Agreement would seriously affect the chances of gaining any efficiency from the effort. Restrictive job security language, very high pay scales and expensive benefits packages all make a merger under Hydro One's CBA uneconomic. We note that there is

a tendency in negotiating such mergers to seek to standardize on the highest common denominator. This would introduce a host of monetary and restrictive contracting out language that would reduce or remove the economic benefit of scale by increasing the cost to operate the current non Hydro One distribution systems.

The reality of this concern has been fully explored in several recent rounds of negotiations with Hydro One intended to setup a Northeastern Utility. It was realized during those discussions that the CBA would provide a significant cost increase in the servicing of current LDC customers, thereby eliminating the principle of lower overall cost of service, which underpinned the merger discussions. This factor contributed significantly to the failure of the discussion.

Further, Board Staff have recognized the potential effectiveness of contracting for services and shared services in their consultation paper released February 10, 2004 at page 9 under the heading Controllable Structural Efficiency. We submit that unless close scrutiny is given to the restrictive CBA terms and unless steps are taken to mitigate their effect then sharing of services and contracting out (notionally the two may be viewed as similar to the Ontario Labour Relations Board or a Board of Arbitration) then these two vehicles for efficiency improvement may be removed from any successor Distribution Company.

We submit that the provincial government should enact legislation to limit the liability placed on successor corporations by the Hydro One CBA.

Option A - A New Structure

We submit that, to derive the fullest extent of efficiency in the distribution of electricity in Northeastern Ontario, a radical new structure is required that would see the implementation of Local Distribution Companies based on economic centres, a rural Utility to fill in the gaps and a Utility Cooperative that would provide administrative and logistical support based on industry best practice. Under this proposal, no new LDCs would be permitted but a voluntary process based on economics could be considered within the District for operation of newly acquired distribution assets on behalf of a Municipality either by the LDC or Rural Distribution Company.

Restructuring distribution companies based on customer density and the economics of operating the Utility, what the consultation paper calls “Uncontrollable Structural Efficiency”, would recognize the benefit of shared cost in customer dense areas while the implementation of the rural Utility would allow for a differential distribution rates and service level benchmarks based on the cost and relative difficulty of servicing these more remote customers.

New LDC Boundaries

In determining the boundaries, the suggestion of the Macdonald Advisory Committee to structure LDCs along political boundaries would be used as a starting place. Beyond the municipal boundary the economics of including customer base in the new LDC would be evaluated on the basis of no geographic cross subsidization similar to the test between customer classes in ratemaking. Additionally, any increased benefit in terms of service level to the customer base, as a whole, would be weighed in the decision making process.

In addition, the resizing of the Distributor would overlay the political and customer density boundary with an electrical boundary established by way of technical conferences convened by the boundary entities and overseen by OEB staff. The guiding principle of the electrical boundary would be to ensure for the sake of customer service that all customers supplied from a particular feeder would be the customers of the Distribution Company with operational control of that feeder. In some cases this may mean that customers inside a political boundary are serviced by the Utility outside of that municipal unit and vice versa. It may mean as well that the practical alternative is for either of the boundary entities to give up operational control to the other.

Establishing a Rural Utility

Having established the LDC boundary the remainder of the customers to be serviced would fall to the Rural Distribution Company. We recognize that rural customers would see significant increase in distribution cost based on the cost of physical service (no power call responses, meter reads etc.), however, the government could continue with the current subsidy regime if it so desired. As that decision is a public policy, we make no comment on it.

The Cooperative

We recognize that several attempts, both formal and informal, have been made in the Province to establish some form of cooperative between Utilities. Some benefit has been derived from each of these exercises; however, large-scale efficiency from shared administrative service has been elusive. This is most likely a result of a perception of loss/gain as in each of the current models one LDC came out as the ultimate service provider, while others perceived that they were giving up part of their workforce and service offering to customer. We submit that there are significant benefits from economies of scale for services that do not require physical attendance at a customer's service location.

We propose that a cooperative of the sort long enjoyed by distributors in the United States be established to provide services that are not dependant on physical attendance at a customer's premise. Billing, customer service, distribution system planning and engineering, purchasing and procurement, demand side management, regulatory affairs, etc., are all examples of services that could be provided at a lower cost and, in many cases, at increased levels of sophistication and accuracy by a Cooperative.

Participation in the Cooperative could initially be mandated to ensure that it establishes itself with a sure footing. Continued participation in the Cooperative and the continued efficiency of the cooperative would then be based on a balance of commercial terms and regulatory oversight. That is to say, if a member of the Cooperative determined to go it alone for a service offered by the Cooperative it would fall to that member to prove to the Board in a subsequent rate hearing that they had procured a service of essentially the same quality for a lesser cost.

An oversight board established to govern the operation of the Cooperative and made up of representatives of the Cooperative members would enhance the regulatory leverage by ensuring that the interests of the individual members were considered in enhanced or continuing service offerings.

A New Regulatory Approach

A Move to Light-Handed Regulation

We submit that one of the greatest new challenges to LDCs in the Province has been the almost overwhelming weight of regulatory requirement. We are not convinced that the current regulatory regime is what the Macdonald Advisory Committee anticipated when they included the phrase "light handed" in their discussion on regulatory oversight. We recognize that, as a natural monopoly in the energy business, a balance must be struck between the ability to operate the business and rights of the customer to expect service, safety and value from their LDC.

We submit that the interests of the customer, shareholder and industry, can be better served by a regulatory regime resembling the Ontario Municipal Board. Under this more "light handed" regulatory approach, the shareholder through the Board of Directors would be the primary responsible agent for rate and service issues as is currently the case for water/wastewater tariffs. The OEB could impose a regulatory scheme that would allow the municipality a bandwidth of options depending on the need of the community. For example, the Board could establish a continuing rate requirement that would require that reliability statistics remain at a fixed level and

that the overall distribution costs not exceed a certain percentage of the bill. Aside from, that the rate set would be the responsibility of the shareholder through the Board of Directors.

Full policy disclosures would allow customers and other interested parties to make submissions to the Corporation's Shareholder and Board of Directors relative to its policy position. If the Directors do not address stakeholder concerns satisfactorily, then the stakeholder would be free to raise objection to the OEB. The Corporation would then be required to prove compliance with all regulatory instruments and with the legislative principles on which the industry is founded.

A Real Incentive to Drive Efficiency

Included in the Performance Based Rate Making regime is an efficiency factor that we submit is flawed in that it does not effectively consider the most significant cost driver for LDC's labour costs.

A full 60% of GSU's operating expense is made up of direct labour and benefit costs. These costs escalate based on the market for labour and collective bargaining settlements. It is near impossible to resist the standard for bargaining wage settlements in Canada, the CPI. This reality, however, is not reflected in the IPI (Industrial Price Index) used to determine allowable escalation of costs for the distributor. The IPI, together with the productivity factor of late, has required a reduction in rates while true costs to the Utility continued to increase due primarily to labour cost increases.

Further, the 1.5% productivity factor required under PBR does not consider the position of the Utility at the start of the process. At the outset we listed the steps that Greater Sudbury Utilities has undertaken to re-fashion itself into a more efficient and responsive organization. Many of the efficiency initiatives undertaken at Greater Sudbury Utilities were completed before the implementation of the productivity factor. Having worked towards efficient operations prior to the productivity factor and IPI there is less room available to GSU to drive efficiency. As a result, Greater Sudbury Utilities is facing difficulty in finding additional efficiencies without affecting service to customers or longer-term system reliability.

We propose that the Board review the current PBR and introduce new measures such as adding all or a portion of any identifiable savings through efficiency to the IPI when determining a LDC's rates.

Option B - Alternatively Shoulder-to-Shoulder Utilities With a Cooperative

In May of 1996, the Macdonald Report was delivered to the Minister of Energy. After detailed analysis, the Macdonald Advisory Committee Members recommended, inter alia "that Ontario Hydro Retail be absorbed into the local distribution system" and "The Advisory Committee recommends the shoulder-to-shoulder structure following county/regional lines and not just local municipal boundaries. The overriding principle in any restructuring of boundaries should be that no serviced area will be left without service."

While the Committee suggested shoulder-to-shoulder utilities based on political boundaries, it did not turn its attention to the negative impact that the absorption of lower density customers might have on customers in an urban setting. This issue is of significant importance to Municipalities in the North where increasingly these communities are reliant on economic diversification for their survival. Economic diversification requires a competitive community in terms of total costs for businesses to relocate and invest in the community. Any increase to the distribution rate as a result of the absorption of uneconomic customer bases will have a deleterious effect on the economic development of that community. Alternatively, we submit that shoulder-to-shoulder

Distribution Utilities in Northeastern Ontario could be established together with a mandated Utility Cooperative to provide administrative services that will benefit from economies of scale. Further, we submit that if this alternative finds favour with policy makers it should only be contemplated with a multi-tiered rate structure designed to recognize the differences in cost of service for areas of varying customer density.

Establishing Boundaries

At page 81 of their report, the Macdonald Advisory Committee suggested that LDCs be redrawn based on political boundaries. We agree that political boundaries can be used as a general guide for determining the service territory of the Utility; however, we submit that all customers serviced by a utility must be included in the operating control of that Utility. That is to say, where customers are located along or near the political boundary of one district and are supplied from a line originating in another district, those customers should be included in the customer base of the Utility in which the line originates. With this goal in mind an electrical boundary would be drawn by way of technical conferences attended by the engineering representatives of each of the new entities and presided over by Board staff. The new electrical boundary would be overlaid on the political boundary would generally be drawn at the end of a radial feeder and at the normal open point of any feeders that are capable of being operated in parallel.