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February 19, 2004

Mr. Paul B. Pudge, Board Secretary
Ontario Energy Board
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Re: RP - 2004-0020 – Consultation to Review Further Efficiencies in the Electricity Distribution Sector

This submission has been developed to address the specific questions raised in the Notice to Stakeholders issued on January 21, 2004. The submission also references some of the issues raised in the Staff Discussion paper issued on February 10, 2004.

In its letter the Board indicates that it "*wishes to review alternative ways of driving further efficiencies in the delivery of electricity services and to better understand the impact of implementing these alternatives on distributors and the broader electricity industry*".

It is our belief that there are in fact alternatives to create efficiencies in the electricity distribution sector. For many years the City of Kingston has maintained a utility group that provides a variety of distribution services. Since 1998 these services have included, electricity distribution, water distribution and treatment, natural gas distribution, sewage collection and treatment and the provision of telecommunications services.

Each service is rate based and the accounting for the expenditures is segregated by utility. The division responsible for the provision of service was organized by like 'function' rather than by 'utility'. This organizational structure resulted in the creation of efficiencies by distributing administrative burden that would have been necessary for each of the utility businesses (i.e. administrative functions, meter reading, billing, payroll administration etc) through the appropriate allocation of these expenses. The department was established to capture all available 'economies of scope', as well as to maximize the provision of service to customers. In Kingston, customers can set up services with 'one call' and are billed with 'one bill'.

The introduction of the *Energy Competition Act* challenged this effective strategy by requiring the separation of the electricity distribution function from the other distribution activities. Kingston has met this challenge through the establishment of an affiliate company as required by the Act. This requirement to separate alone results in obvious inefficiency, by virtue of the need for a separate corporation and Board of Directors.

The Board has asked stakeholders to consider "*whether there are economic, service and other benefits to be gained from further consolidation of the electricity distribution sector*"?.

As outlined above it is inadequate for the Board to consider a structure that contemplates only the consolidation of electricity distribution companies without an examination of models such as the integrated service delivery model described above. Studies [1,2] have found that distribution services can be provided as cost effectively by distribution companies of as few as 8800 customers. Smaller, locally managed companies tend to be held accountable by their customers for their investment decisions. While it may be the case that accessing capital may be more difficult, management of these smaller companies is more likely to be directly involved in decisions regarding the spending of limited financial resources. Each decision is carefully considered and is invariably defensible. The smaller company by virtue of its relationship with the community is also far less likely to reduce costs by reducing service, reliability or compromise the safety of its customers.

While the Board itself may achieve savings through the consolidation of distributors and the direct reduction in the requirement to provide regulatory oversight, these 'savings' could also be achieved through a review of our current methods of regulation.

In its letter the Board also stated that *"Consolidation may provide additional benefits by allowing distributors to be more involved in commodity procurement and load aggregation, including acting as load serving entities, and in demand side management and system planning".*

The Report of the Electricity Conservation and Supply Task Forces references the concept of LDC'acting as load serving entities in several locations. The Staff discussion paper refers to section 3.2. This section is inconsistent with section 1.7 Recommendation 11 and section 5.12 Recommendation 11 both of which state that the parties that may be considered as load serving entities are "<u>subsidiaries</u> of local distribution companies".

The consideration of evolving distributors to a role as 'load serving entities' is inconsistent with the originally stated goals of separating 'competitive' and 'monopoly'. Retailing of electricity has clearly been defined as a 'competitive' function. These are commercial activities and the company shareholder clearly holds all of the risk associated with any loses that are incurred. Prior to the 'fixing' of the standard supply service price in 2002, one significant marketing; advantages held by retailers was the ability to offer a fixed price over a defined period of time.

While consolidated distributors may have access to capital, most of these organizations do not currently have the skill sets required to undertake commodity purchase. As it would be unacceptable to pass any losses through to the ratepayer, these activities should be limited to non-distribution companies that are licensed as retailers. Any losses must be assigned to the shareholder of those companies.

1. [illegible] Evidence on Scale Economics in Electricity Distribution and What it Implies: 'Is Bigger Better'?, John Kelly, Director of Economics and Research, American Public Power Association, March 2001
2. Electric Power Distribution Costs: Analysis and Implications for Restructuring. Report to the American Public Power Association, February 2001

As the role of the distributor in demand side management programs at this time is not well defined, it is unclear that the consolidation of distributors would assist in demand side management efforts. It does seem, however, that electricity distributors will have some role due to their pre-existing relationship with customers. This relationship tends to be closer between what are currently considered to be 'small' distributors and their customers. As a result further consolidations could negatively impact this type of activity.

In its discussion paper the Board indicates that consolidation could improve system planning and reduce costs at what are the 'fringes' of the distribution areas. It does not seem likely that the savings available through this effort would be considerable. There are however, savings to be achieved with the distribution area through improved coordination of all utility installations and road works. These savings can be significant and benefit all utility rate payers as well as the taxpayers that invest in road re-construction. These savings can achieved through the integrated distribution model described earlier in this submission.

In conclusion, Kingston wishes to note to the Board that we are concerned that the Board seems to be focussing on only one possible strategy to encourage efficiencies, consolidation of distributors. It is unproven that there are any significant savings to be achieved, through consolidation and there is a risk of negative impact through the removal of natural resistance to rate increase and reduced service levels – customers who know who to hold their local distributor accountable. Further it may be that focusing only on the component of the electricity bill that constitutes in most cases less than twenty five percent of the total, the distribution component, may not be the most effective way to create pricing efficiency.

Respectfully submitted by

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Yours truly,

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