

**RP-2004-0020**  
**Oral and Written Submission to the Ontario Energy Board**  
February 16, 2004

Good afternoon, my name is Jim Huntingdon and I am General Manager of Niagara-on-the-Lake Hydro. I would like to thank the O.E.B. for this opportunity to present my company's views of Efficiencies in the Electricity Distribution Sector relating to the efficiency factors outlined in your discussion paper.

Niagara-on-the-Lake Hydro is one of the 42 small municipally-owned Ontario Electricity Distributors described in your report. We distribute to just over 7000 customers in an area of 135 square kilometres bordered by Niagara Falls, St. Catharines, the Niagara River and Lake Ontario. Records in our archives indicate that Niagara-on-the-Lake Hydro was formed in 1892, making it one of the original distributors in the province. This agriculturally based historic area is home to the Shaw Festival theatre, dozens of fine wineries and Fort George and hosts close to 2 million tourists annually. Our growth rate has remained just under 2% over the last 10 years.

What is the true measure of efficiency in our industry? The O.E.B. discussion paper offers three measures including operational, controllable structure and uncontrollable structure. **In our view, the only true goal of a distributor should be the provision of exceptional customer service at a reasonable rate.** This principle is legislated in the Ontario Energy Board Act by which the Ontario Energy Board's regulating authority is directed. I'm sure there are times when an overwhelmed staff at the O.E.B. may describe efficiency as regulating only 6 or 7 LDC's. But will this reduction in numbers assist in complying with the legislation? There will be a group presenting on Thursday that will tout a "bigger is better" view and suggest that LDC's with a customer base of at least 500,000 are required to drive efficiencies. Only two LDC's in the province currently meet that criteria and they possess the highest rates in the province. Is the Ontario Energy Board's legislated regulating principle best met by moving in this direction?

I'd like to first examine the factor of operational efficiency. The discussion paper suggests "The goal is to reduce the total distribution costs without noticeably affecting the safety and reliability of the distribution system, customer service or any other features of distribution service that our valued by our customers." Upon the inception of Niagara-on-the-Lake Hydro as an OBCA company in late 2000, our municipal shareholder hand-picked business-minded individuals to serve as Board of Directors. The Board of Directors were mandated to ensure that the company continued to provide exceptional customer service at a reasonable rate while balancing their obligation to improve shareholder value. This same process occurred almost simultaneously across the province. Since the year 2000, records will indicate that we have improved our safety numbers and system outage statistics while continuing to greet our customers on the phone or at the counter and meet all of our PBR obligations. This was achieved at the same time we have steadily reduced our operating costs. In fact, Niagara-on-the-Lake Hydro recently completed construction of our own \$2.8 Million transformer station. This

investment will ensure safe, reliable transformation capacity well into the next decade. Our yearly capital investment into our distribution system continues to exceed \$1 million ensuring on-going system improvements.

I would now like to examine the controllable structural efficiency factor. The discussion paper states, “The most obvious example of a structural efficiency factor that is controllable is economies of scale.” I’m sure a presentation on Thursday will show you a large flat-bottomed “U” shaped graph illustrating economies of scale. This data was prepared by a Wall Street writer based on American electricity distribution cost. The start of the “economical” zone is difficult to interpolate and it indicates that at some point in increased LDC size, the economy of scale is lost and costs rise sharply. Could this explain the higher distribution rates associated with Ontario’s two largest LDC’s? Based on our experience, we will not dispute the fact that “volume” is an important factor in receiving cost breaks in many of the goods and services we purchase. Small and medium-sized LDC’s have been particularly resourceful in driving down these costs over the past few years. Niagara-on-the-Lake Hydro is a member of the Niagara Erie Public Power Alliance or NEPPA. NEPPA is a group of 11 LDC’s from Brantford to Fort Erie that has worked cooperatively to utilize its customer base of 200,000 to achieve economy of scale for its members. NEPPA members share employees, equipment, facilities, expertise, advertising and circulation costs. Two NEPPA members have jointly constructed a transformer station. We train our employees jointly, purchase goods and services cooperatively and utilize subcommittees to examine complicated issues such as market opening, PBR and PIPEDA legislation. The benefits of NEPPA have obviously assisted all members achieve economies of scale and controllable efficiencies. It is interesting to note that one recent Canadian study examined distribution markets similar to Ontario and concluded that LDC’s with a customer base of 20,000 could in fact be operating at the most efficient size.

The final measure of efficiency mentioned in the discussion paper is uncontrollable structural efficiency. This measure examines output density and customer density and suggests that operating costs should be reduced by higher customer density and larger energy usage within an LDC’s area. Ontario’s LDC’s have a wide range of operating area sizes, customer densities and customer usage ranges which in part answers why distribution rates vary greatly across the province. The discussion paper recognizes that merging an area of high density and lower cost with that of a low density and higher cost “...would not result in improved structural efficiency because total costs would not be lower with the consolidation than without it, unless there are efficiency gains related to factors other than output and customer density.” Boards and management of LDC’s considering any merger or amalgamation must assess such efficiency gains and net benefit to the customer and shareholder. In other words, it must be a voluntary decision to merge or amalgamate that benefits the customer and makes economic sense.

On Thursday, during a “bigger is better” presentation you may hear a suggestion that LDC’s should be at least 500,000 customers in size to serve as load serving entities or LSE’s for the purpose of procuring default supply of electricity to customers. The IMO has made it known that despite receiving millions of dollars from the people of Ontario to

develop the software to serve the market, they don't want the burden or risk of aggregating the default supply. Our company suggests that a smoothed market rate be utilized to pass on default supply with seasonally high and low rates blended by the IMO. Unless the IMO plan to refund the initial cost of this development, millions of additional dollars will be spent on development by LSE's. This development cost will need to be recovered from ratepayers adding a further burden on the already escalating cost to the customer. Let distributors distribute electricity. We are proficient at what we do and deliver power at a reasonable cost. Do not use the requirement to form LSE's as a rationale to merge LDC's. Higher cost will result and distributors will begin to lose the focus of distributing efficiently.

Distribution system planning can benefit by a more integrated approach. The transmission system is a natural monopoly for this reason and must continue to be operated efficiently in the best interest of the customers it serves and not motivated by profit maximization. Small and medium-sized LDC's have been cooperatively resourceful in system planning. New transformer stations will jointly serve Grimsby and Pen West as well as Brantford and Brant County. New market rules have placed the responsibility of ensuring adequate transformation capacity for the communities they serve on the LDC's and away from Hydro One. For this reason we believe that for improved system planning efficiency, existing Hydro One transformation facilities be offered for sale at a fair market value to the appropriate LDC's whom are ultimately responsible for adequate capacity. True, efficient regional planning will develop as a result. Proceeds from such sales should be utilized for debt reduction while ensuring that a majority of the facilities remain "publicly-owned".

Technological innovations develop naturally as a means of improving efficiency or reducing costs. It is argued that only large LDC's can perhaps afford such expensive new technologies. In this day and age of high-speed communication, there are no barriers to resourceful LDC's sharing the cost of such technology.

One final point not examined in the discussion paper is municipal ownership and this affect on the efficiency of LDC's. In many instances, municipally-owned LDC's are subject to requests or expectation that may be perceived as "inefficient". One example may be the requirement for Niagara-on-the-Lake Hydro to bury our facilities in the historic district of Old Niagara. While overhead facilities could be installed at a much lower cost, burying facilities may be perceived as inefficient. Our municipal shareholder would argue that the additional costs are a worthy investment in future tourism revenue. The group presenting on Thursday may suggest that municipal shareholders are reluctant to sell their LDC's due to a perceived reduced value today. We disagree with this notion since private companies able to earn a 9.88% ROR still value LDC's at pre-market values. Municipal shareholders are retaining their LDC's for the purpose of attracting industry through lower distribution rates or through superior distribution systems. Other municipal shareholders are retaining their LDC's due to success in related services companies. Niagara-on-the-Lake Hydro's affiliated services company is currently launching an initiative with 3 other municipal service company partners that will extend a broadband fibre optic network to hospitals, libraries, school boards and regional facilities

in an under serviced Niagara Peninsula. Regional politicians are pleased by the prospect of attracting high-tech jobs to Niagara. Would this initiative have proceeded with private LDC ownership? The question must be asked whether forced mergers and amalgamations are in the best interest of customers in general.

In conclusion, Niagara-on-the-Lake Hydro would like to emphasize that bigger does not mean better and that any future mergers or amalgamations must be voluntary, make economic sense and most importantly provide a real benefit to the customer. Efficiencies can be achieved by moving to a light handed regulatory environment. Currently, many resources are required to prepare regulatory filings. Niagara-on-the-Lake Hydro would be pleased to participate in a process to derive a simplified distribution rates process. This new scheme would consider return on assets to encourage reinvestment in infrastructure with a working capital allowance. A new aspect of the rates would consider the unique characteristics of the individual LDC including factors such as density and geographic location. As a result, provincial distribution rate benchmarks could be established in perhaps 6 broad rate categories. PBR compliance could be tied in with the rate group and be enforced in a "light-handed" manor. The resulting regulatory process would allow the Ontario Energy Board to regulate the current number of LDC's more easily and effectively. We believe that the IMO or a department thereof, aggregate the standard supply for Ontario with a smoothed rate system. Hydro One transformer assets should be offered to the LDC's responsible for ensuring transformer capacity in their community at a fair market value. Proceeds should be dedicated to debt reduction. Let Ontario's Distributors distribute. Its what we do best. We don't need to be preoccupied by notions of load serving entities. We are confident that these measures will result in improved efficiencies in the Distribution sector.

Thank you for providing me with the opportunity to address our views.