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February 19, 2004

Peter H. O'Dell
Assistant Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
26th Floor
Toronto, ON
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Dear Mr. O'Dell,

RE: RP-2004-0020 – Review of Further Efficiencies in the Electricity Distribution Sector

By way of Notice, on January 21, 2004 the Ontario Energy Board ('OEB', the 'Board') informed industry participants of its intent to hold both an oral and written consultation regarding the above subject matter. On February 10, 2004, Board staff issued a Staff Discussion Paper entitled *Review of Further Efficiencies in the Electricity Distribution Sector*.By way of letter on February 11, 2004, the Board provided further information regarding the oral and written consultation guidelines and timetable.

Ontario Energy Savings Corp ('OESC') has attended the oral consultation, in part, and provides OESC's written submission in accordance with the Board's request, as attached.

Sincerely,

Gord Potter
Director, Regulatory and Utility Management

ATTACHMENT

IN THE MATTER OF

RP-2004-0020 REVIEW OF FURTHER EFFICIENCIES IN THE ELECTRICITY DISTRIBUTION SECTOR.

WRITTEN SUBMISSION OF

ONTARIO ENERGY SAVINGS CORP.
('OESC')

DATED: FEBRUARY 19, 2004

On January 21, 2004 the Ontario Energy Board (the 'Board') issued to industry stakeholders a notice to review further efficiencies in the Ontario electricity distribution sector. OESC submits this written representation in response to the Board invitation to participate in this consultation.

In General

Significant progress has been achieved to date in the distribution sector through the consolidation of over 300 LDCs into approximately 100 individual operating entities serving the market currently[1].

Based upon the current number of LDCs serving very small customer bases, and the variety of differing costs and charges reflected across the LDC participants, it can be surmised that further opportunities to realize benefits through rationalization still exist.

OESC supports continuing progress in this area. However the approach to be determined must ensure that acceptable levels of service, quality and reliability are not sacrificed in attaining further efficiencies in the sector. A balanced approach which ensures that cost reductions are achieved in harmony with customer and shareholder needs is required.

[1] During the period leading up to Market Open May 2002 and thereafter

Operational and Controllable Efficiencies

It can be reasonably argued that varying degrees of efficiencies can be realized through a combination of mechanisms, including sharing services, outsourcing, collaboration or consolidation.

However given favorable conditions, such as like-parties with similar operations, consolidation may prove most beneficial in realizing maximum efficiencies. Under these same conditions, very little efficiency can be gained through sharing services or collaboration in comparison. Cost efficiencies are not maximized, in most cases, as the base cost drivers remain unchanged – administration, systems, etc.

Where consolidation does occur, cost reductions may be realized in areas such as:

- Customer service administration
- Installation and repair workforce and administration
- Duplication in administration is removed
- Work Centers and office space can be consolidated
- Production costs
- I.T. systems capital and maintenance expense
- Service contracts
- Settlement and billing responsibilities
- Regulatory costs

Lakeland Power provides a factual example of the opportunities to be realized through consolidation[2]. Lakeland is the result of an amalgamation of 5 LDCs and to summarize, realized the following efficiencies;

- 30 % workforce reduction
- Reduction from 6 centers to 1
- Consolidated operations from 5 billing systems into 1,
- And further;
    - Superior service levels are being provided to customers
    - costs have been lowered
- Retained all 5 municipalities willingly as shareholders

This clear example is indicative of the need for the Board to implement a mechanism(s) which encourages utilities to source out such same opportunities remaining in the market.

[2] Oral Presentation to the Board-Feb 17-2004

Incentives and Barriers

OESC would agree that further efficiencies to be gained in the sector should not adversely affect reliability of the system or customer service levels (which include retailers as customers) however realization of efficiencies should directly influence shareholder return. These components must be considered in concert to ensure that efficiencies are not achieved to the detriment of service delivery.

OESC supports Board staff view that customers are not homogenous and agree that competitive markets offer customers different alternatives and services to choose. It is OESC's belief that LDCs provide an essential base service to their customers. This base service- reliable distribution services and access to electricity- is the core service to be addressed through this consultation.

The opportunity to improve efficiencies or to consolidate may be provided for on a voluntary basis where an explicit mechanism to encourage efficiency gains is employed. This mechanism can be designed within the framework of Performance Based Regulation (PBR).

The establishment of meaningful Service Quality Indicators and objectives, which reflect minimum high standards and service quality metrics encompassing the key service deliverables of the utility, will provide a true measure of the utility's service levels.

Benchmark costs and efficiency targets would also be established within this mechanism. Further analysis is clearly required to assess the reasonableness of multiple benchmarks or objectives for utilities of similar characteristics.

The mechanism should ensure that efficiency and cost improvements are not rewarded at the expense of customer service and reliability, and those objectives met or missed for efficiencies and cost have positive or negative consequences respectively in the approval of rate cases and rate of return.

The Performance Based Regulation mechanism can be used effectively to achieve the right balance between the incentive to reduce costs and to maintain consistent, quality of service and rate of return.

Tax exemptions such as were used to incent earlier rounds of consolidation activity are an attractive means to encouraging further consolidation when coupled to compliment additional mechanisms such as PBR, but not in isolation. OESC supports the position that any incentives offered or structured to encourage consolidation should be equally applicable to municipal owners and to private sector investors.

Load Serving Entities (LSEs)

OESC supports the concept of a Load Serving Entity(s) and further encourages the development of such LSEs in conjunction with the design of a Default Supply mechanism which employs a stable rate methodology for low volume consumers. OESC submits that the LSE default supply pricing and portfolio mix should be subject to regulatory oversight.

However, it is OESC's belief that LDCs should not be accountable to perform this role. LDC's core service should be, and remain, the distribution of electricity to customers. LDCs should not bear any burden or accountability to assume commodity risk transferable to customers, or to manage the risks associated with portfolio management.

Other willing participants or stakeholders in the market such as wholesalers, generators, retailers or LDC affiliates could provide such a service. Retailers for example, are proficient in managing risk associated with commodity; have existing expertise and relationships for procurement and the creditworthiness desired by suppliers. Supply product management is a retailer's core business and efficiencies in delivering those products are critical to its commercial success.

Existing settlement and operational systems in the market can support the introduction of an LSE to manage the default supply. An LSE would function as a retailer in respect of default supply and settle with the LDC in the same manner employed today.

Further, creditworthiness requirements associated with procuring supply may be an issue for smaller LDCs, and this increase in risk to the LDC commercial business may negatively impact the LDC through increased cost of capital and borrowing costs from lenders. Issues such as the increased risk to consumers and the possibility of cross-subsidy to provide this service need to be considered.

Default Supply customers should not be subject to contractual terms or conditions. The purpose of Default Supply is to provide for access to electricity for all consumers in the event that they can not, or have yet to choose, a retail supplier. Customers who choose to leave default supply should not be required to pay exit fees or be subject to any other restrictions as this creates unnecessary barriers to competition.

An LSE is required to procure and price a default supply service which anticipates the fluctuations in load due to customer mobility. This role is best served by entities that specialize in risk and portfolio management.

Summary

OESC is of the belief that, among approx 100 utilities, there are further opportunities to achieve efficiencies. Consolidation or rationalization must be assessed based on sound commercial business decisions. The Board will need to analyze the root causes contributing to the differences in costs and consumers charges employed by the LDCs and establish clear benchmarks.

In order to encourage LDCs to seek out these opportunities for rationalization, the Board must create mechanisms in the market, such as within the PBR regime, to reward LDCs for meeting or exceeding benchmark expectations while providing a similar and opposite consequence for not meeting the objectives. A balance between customer service levels, reliability, and further efficiencies must be maintained.

The utilities have a defined role to provide access to, and distribute, electricity to customers and should not carry the accountability for providing default supply service in the province. Other parties are better suited to perform and manage this role.