Submission to the Ontario Energy Broad

On RP – 2004-0020

Notice of a Consultation to Review Further
Efficiencies in the Electricity Distribution Sector

PUC Distribution Inc.
Sault Ste. Marie, Ontario
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SUMMARY

1. PUC Distribution is concerned about the very short time frame in which to express opinions on a possible OEB initiative that will have significant consequences for the electrical distribution industry in Ontario.

2. PUC Distribution supports the position of the Electricity Distributors Association that any further rationalization or consolidation of the electric distribution industry in Ontario proceed on a voluntary basis and according to the principles of an open market.

3. There is no hard evidence that consolidation will lead to better customer service or lower distribution rates.

4. Many LDCs are affiliated with other utility service companies that offer economies of scale opportunities through shared administrative services, major equipment and fixed assets. These relationships would be lost or jeopardized if LDCs were forced in some way to merge into larger entities.

5. LDCs are currently working cooperatively to lower their operating costs and have demonstrated a long history of cooperation.

6. Mergers and acquisitions can involve significant costs, are disruptive to staff and can create inefficiencies for some period of time before the new organizations are established.

7. The LDCs have been the steel thread that has maintained secure and reliable electricity service to millions of customers in Ontario despite significant administrative, regulatory, and technical challenges and discriminatory legislation that threatens their long term financial viability.

8. Rather than devote resources to further LDC consolidation the OEB should focus its attention on the role that LDCs must play in attracting more generation to the province through the signing of long term supply contracts for the procurement of default supply.

9. The OEB should support the evolution of the LDC industry into a strong customer service oriented, efficient sector within its scope as a regulator of the industry and advisor to government.

1. Consultation Process

PUC Distribution received notice on January 21, 2004 that the OEB intended to seek consultation on the review of further efficiencies in the electricity distribution sector. On February 10, 2004 we received the OEB staff discussion paper, "Review of Further Efficiencies in the Electricity Distribution Sector". The deadline for submissions of written briefs to the OEB is February 16, 2004. We believe that the time to digest the information in the discussion paper and to prepare a comprehensive response to the points raised in the document is inadequate. Nevertheless, given the importance of this matter we believe that we must provide the position of PUC Distribution on those issues that we believe are most relevant to the current circumstances of the electrical industry in Ontario. We expect that there will be further opportunities for future input in this consultation process.

2. PUC Distribution's Support of EDA Position

PUC Distribution strongly supports the position articulated by the EDA that rationalization or consolidation of the distribution industry occur on a voluntary basis and that business considerations should drive acquisitions and amalgamations. While in any association with a large membership such as the EDA, some difference of opinion is bound to arise on various issues, PUC Distribution believes that the vast majority of LDCs supports this position.

3. The Link between Consolidation, Better Service and Lower Electricity Rates

The point of industry consolidation should be to benefit all stakeholders not one or two interested parties. The big versus small argument has been a matter of constant study since business became as much a matter of study as practice. In the electric industry we have had large and small utilities operating for many decades in Ontario and throughout North America. We need not look only at recent history to make conclusions concerning where efficiencies may lie. A report entitled "Elements of Effective Productivity Regulation" by E. Masud contained in the 1986 Fall Industrial Engineering Conference Proceedings concluded that a utility's cost of service could not be correlated with size.

The report referenced above would appear to contradict the findings of the reports referenced in the OEB discussion paper. Current Ontario experience would appear to support the 1986 report conclusions. From a recent survey conducted by MEARIE on behalf of its subscribers, in which the results of a large number of 2001 operating characteristics were categorized into large, medium and small LDCs, there was no indication of greater service reliability based on SAIDI, SAIFI or CAIDI statistics. As for the relationship between utility size and rates to residential customers, a survey of 58 LDCs in Ontario indicated there was no correlation. The survey was based on 2002 rates, which for the most part have not changed. A copy of the survey is attached. A more recent survey of 23 distribution utilities included a comparison of rates charged to

commercial customers. Again there was no apparent pattern to suggest that the larger the utility the lower the rates charged to this group of customers.

The OEB discussion paper states that empirical evidence suggests that LDCs must have at least 20,000 in order to achieve economies of scale. Evidence in Ontario would indicate otherwise.

It is interesting to note that Quebec and B.C. are included in the jurisdictions cited for average number of customers per distributor. Customers served by these utilities enjoy much lower rates than customers in Ontario. Both utilities are vertically integrated, government owned but primarily hydro based. There are a number of reasons why rates and service differ from one utility to another. Size does not appear to be one of the determinants.

4. OEB Cited Experience

The four jurisdictions mentioned in the discussion paper do not appear to be relevant to conditions in Ontario. In Great Britain the LDCs were already large utilities prior to privatization of the industry. From 14 owners originally there are now nine with the consolidation taking place presumably according to the dictates of the market. Interestingly 66% of the country's electricity distribution sector is now in foreign hands.

In Australia consolidation was carried out to encourage privatization, not necessarily to achieve economies of scale. The distribution sector in Switzerland is even more fragmented than in Ontario; nevertheless, voters rejected a referendum on market reform, which presumably would have included a consolidation of distribution utilities. Again factors other than an expectation of achieving economies of scale are driving changes in that country.

Current problems in the electricity sector in South Africa likely have their origin in the pre apartheid era when black townships, where most of the population lived, had very poor infrastructure. The LDCs would not have had the resources to provide reliable service and given the economic challenges still facing the country that situation probably has not changed for the majority of LDCs.

5. Utility Affiliates

Prior to restructuring of the electricity sector many public utility commissions operated both the electrical distribution system as well as the water treatment and distribution systems for the municipality. The predecessor commission of PUC Distribution operated both systems. In order to maintain the organizational efficiency in operating both utilities, the successor to the Sault Ste. Marie Public Utilities Commission, PUC Inc., was created as a holding company with four subsidiaries, PUC Distribution, PUC Telecom, PUC Services and PUC Energies. The Public Utilities Commission survives and retains its responsibility for municipal waterworks but PUC Services, under a long term contract

to the Commission operates, maintains and manages the system. PUC Services has similar long term contracts with PUC Distribution, Telecom and Energies. Through this type of organizational structure, efficiencies are achieved in administrative and management support, and in the sharing of equipment and fixed assets. This efficiency would be lost to a great extent if the distribution system were to become part of a larger electric distribution utility.

PUC Telecom is an example how such an organizational model is able to exploit the requirement of an LDC for a reliable high speed telecommunications network to serve its SCADA system. A fibre optic loop was constructed by PUC Telecom to not only serve this need but to also provide high speed broadband service to other businesses and institutions in Sault Ste. Marie at a cost that customers in larger centres currently pay. The service has been successful and profitable for a number of years. It is providing service to PUC Distribution at a cost lower than it could have obtained from another telecom service provider. PUC Telecom pays the same pole attachment fee for its fibre optic cable as other telecom users of PUC Distribution poles. Recently PUC Telecom announced that it was installing broadband powerline (BPL) equipment, effectively integrating the electrical conductor with its fibre optic system. This is the first deployment of BPL technology in Canada. It is expected that BPL will bring greater convergence between telecom and electric utilities and will have substantial cost benefits to electricity users as it will allow two utilities to share the costs of a single delivery platform, in this case the electric distribution system. Not all progress comes from large companies.

6. LDC Cooperation

The seven LDCs of EDA's northeastern district have been engaged in collective procurement of materials for two years in order to reduce unit costs. While the smaller LDCs have seen the greatest benefit in the arrangement, the larger utilities have also benefited. A working group has been established to review individual utility specifications to see if they can be harmonized to expand the amount of equipment and material that can be collectively purchased. This is just one example of LDCs working in a cooperative manner to reduce costs and increase service.

Since market opening, PUC Distribution has been providing billing and other customer services for another smaller LDC, which would have had difficulty in meeting all of the regulatory requirements of electricity restructuring.

7. The Cost of Mergers & Acquisitions

History demonstrates that most mergers and acquisitions have not worked out as well as originally intended, resulting in diminished value to the shareholder, diminished competitiveness and in some cases, business collapse. Mergers, even when all parties favour them, are extremely challenging to pull off successfully. Different working

procedures and practices, even corporate cultures, must be harmonized and redundant staff must be reassigned or released. Management focus is deflected from the day to day running of the business until a new and effective organization has been created. Organizations are in a vulnerable state at this time and business can be very adversely affected. Problems can be compounded if the rationale for a merger is artificially created through government directive or distorted regulatory policies.

8. The Strength of LDCs in Ontario

The restructuring of the electricity industry in Ontario was not caused by problems in the distribution sector. Nevertheless, a significant consolidation has occurred with the number of LDCs declining from over 300 before restructuring to 100 today. That consolidation was in some cases caused by municipal amalgamations and in others for business driven reasons.

The fundamental energy challenge facing Ontario today is not how many LDCs there should be but whether there will be enough electricity for the LDCs to deliver in the next five years.

LDCs have demonstrated their ability to meet whatever challenges they have faced in the volatile electric industry in the province. If the number of LDCs is a problem to regulate, look at changes to regulatory procedures to accommodate this fact. The answer is not arbitrary or artificial measures to weight success to those LDCs that are already large or are compelled to merge.

9. Load Serving Entities

The future of the competitive electricity industry in Ontario may depend on the role that LDCs will have in securing long term supply contracts on behalf of their residential and small commercial customers. With the collapse of financing for merchant power plants, the availability of secure long term contracts for the supply of electricity will be essential if new privately financed generation is to be built. Given the looming imbalance between supply and demand with the intended closure of coal fired generation plants by 2007, arrangements need to be put into place as quickly as possible to allow new generation projects to be financed.

The discussion paper suggested only one possible structure for the procurement of default supply. Load serving entities would be established to take on the volume risks associated with electricity procurement. Load serving entities could be larger distributors that have the financial capacity and credit requirements to take on such risks. Smaller LDCs could aggregate their requirements but the creditworthiness of an association of LDCs would likely be more difficult to obtain than a single large LDC. If a load serving entity took on risk it would expect to earn a return to cover that risk

Another option would be for LDCs to aggregate their supply requirements without assuming volume risk. The cost of the commodity would be strictly a pass through with only the cost of aggregation without any margin added to the cost of supply. The risk would be passed on to the end user in this case but the commodity cost in this alternative would likely be less than if a load serving entity absorbed the risk and required an appropriate return for taking that risk.

10. OEB Support to LDCs

The OEB has an important role to play in the evolution of the electrical sector in the province. It can fulfill that role by focusing its resources on settling issues that have been outstanding for some period of time. It should ensure that its regulations equitably treat all stakeholders in the industry.

Identifying the process that would allow LDCs to enter into long term energy supply agreements must be seen as essential to attracting new sources of generation. LDC consolidation should not be seen as a prerequisite for this to occur. In fact, the effort and resources to accomplish this would detract from and possibly jeopardize the successful completion of such an important task as long term energy supply.

As a key advisor to government it should point out where legislative barriers should be removed to strengthen the industry. If larger LDCs are believed to offer benefits in the long term to customers, let the market decide how this should occur. Advise the government to allow LDCs their rightful rate of return on equity so that their value can be enhanced to their owners and potential purchasers. Suggest to the government that the transfer tax should be eliminated permanently to attract potential private sector buyers of LDCs.

COMPARATIVE DISTRIBUTION RATE ANALYSIS
1000 kwh / MONTH CUSTOMER
SORTED LOWEST TO HIGHEST COST
BASED ON 2002 APPROVED RATES

		FIXED DISTRIBUTION RATE:	VARIABLE DISTRIBUTION RATE:	TOTAL DISTRIBUTION CHARGE:
1	PUC DISTRIBUTION INC.	$6.37	$0.00950	$15.87
2	OSHAWA PUC NETWORKS INC.	$7.68	$0.00860	$16.28
3	ESPANOLA REGIONAL HYDRO DISTRIBUTION	$8.76	$0.00910	$17.86
4	ENERSOURCE HYDRO MISSISSAUGA INC.	$11.06	$0.00770	$18.76
5	KINGSTON ELECTRICITY DISTRIBUTION LTD.	$10.07	$0.00910	$19.17
6	COLLUS POWER CORP.	$7.62	$0.01210	$19.72
7	OTTAWA HYDRO INC	$6.85	$0.01300	$19.85
8	TILLSONBURG HYDRO INC.	$8.75	$0.01110	$19.85
9	KITCHENER - WILMOT HYDRO INC.	$10.52	$0.00970	$20.22
10	CAMBRIDGE & N. DUMFRIES HYDRO INC.	$9.22	$0.01160	$20.82
11	GREATER SUDBURY HYDRO INC.	$13.68	$0.00730	$20.98
12	LONDON HYDRO INC.	$11.73	$0.00930	$21.03
13	ESSEX POWERLINES CORP.	$11.15	$0.00990	$21.05
14	NORTH BAY HYDRO DISTRIBUTION SYSTEM	$12.98	$0.00810	$21.08
15	ERIE THAMES POWERLINES CORP.	$12.34	$0.00900	$21.34
16	WESTARIO POWER INC.	$11.29	$0.01010	$21.39
17	LAKEFRONT UTILITIES INC.	$12.05	$0.00940	$21.45
18	BLUEWATER POWER DISTRIBUTION INC.	$13.31	$0.00830	$21.61
19	BRANTFORD POWER INC.	$11.44	$0.01020	$21.64
20	THUNDER BAY HYDRO ELECTRIC DISTRIB. INC.	$10.88	$0.01100	$21.88
21	HALTON HILLS HYDRO INC.	$12.94	$0.00940	$22.34
22	VERIDIAN CONNECTIONS INC.	$11.58	$0.01120	$22.78
23	HYDRO VAUGHAN DISTRIBUTION INC.	$13.95	$0.00900	$22.95
24	ENWIN POWERTLINES LTD.	$7.68	$0.01540	$23.08
25	CORNWALL ELECTRIC	$7.26	$0.01620	$23.46
26	ST. CATHARINES HYDRO UTILITY SERV.INC.	$13.32	$0.01030	$23.62
27	OTTAWA RIVER POWER CORP.	$12.54	$0.01120	$23.74
28	NIAGARA ON THE LAKE HYDRO INC.	$15.37	$0.00870	$24.07
29	MIDDLESEX POWER DIST. CORP.	$13.20	$0.01100	$24.20
30	NIAGARA FALLS HYDRO INC.	$15.35	$0.00970	$25.05
31	NEWMARKET HYDRO LTD.	$14.51	$0.01060	$25.11
32	CANADIAN NIAGARA POWER INC.	$17.94	$0.00720	$25.14
33	MARKHAM HYDRO DISTRIBUTION INC.	$14.14	$0.01100	$25.14
34	PETERBOROUGH DISTRIBUTION INC.	$15.12	$0.01010	$25.22
35	WOODSTOCK HYDRO SERVICES INC.	$10.32	$0.01500	$25.32
36	AURORA HYDRO CONNECTIONS LTD.	$13.25	$0.01220	$25.45
37	WATERLOO NORTH HYDRO INC.	$16.21	$0.00930	$25.51
38	HAMILTON HYDRO INC.	$15.73	$0.00980	$25.53

39	TAY HYDRO ELECTRIC DISTRIBUTION CO. INC.	$15.97	$0.00970	$25.67
40	BURLINGTON HYDRO INC.	$12.82	$0.01290	$25.72
41	FESTIVAL HYDRO INC.	$14.66	$0.01127	$25.93
42	HYDRO ONE BRAMPTON NETWORKS	$12.55	$0.01350	$26.05
43	ST. THOMAS ENERGY INC.	$13.05	$0.01320	$26.25
44	BARRIE HYDRO DISTRIBUTION INC.	$17.03	$0.00980	$26.83
45	ORANGEVILLE HYDRO LTD.	$17.20	$0.01000	$27.20
46	MILTON HYDRO DISTRIBUTION INC.	$16.14	$0.01110	$27.24
47	OAKVILLE HYDRO CORPORATION	$15.67	$0.01170	$27.37
48	TORONTO HYDRO ELECTRIC SYSTEM LTD.	$14.03	$0.01340	$27.43
49	ORILLIA POWER DISTRIBUTION CORP.	$16.60	$0.01090	$27.50
50	MIDLAND POWER UTILITY CORP.	$12.08	$0.01640	$28.48
51	RICHMOND HILL HYDRO INC.	$16.31	$0.01240	$28.71
52	CENTRE WELLINGTON HYDRO LTD.	$12.85	$0.01590	$28.75
53	INNISFIL HYDRO DISTRIBUTION SYSTEMS LTD.	$20.03	$0.00890	$28.93
54	GUELPH HYDRO ELECTRIC SYSTEMS INC.	$11.77	$0.01810	$29.87
55	WELLINGTON ELECTRIC DISTRIBUTION CO. INC.	$11.77	$0.01810	$29.87
56	ATIKOKAN HYDRO INC	$24.63	$0.00740	$32.03
57	HYDRO ONE (R-1)	$15.95	$0.01817	$34.12
58	GREAT LAKES POWER LTD.	$19.98	$0.04120	$61.18