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Consultation to Review
Further Efficiencies in the Electricity Distribution Sector
Presentation of the Power Worker's Union

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The Power Workers' Union ("PWU") represents approximately 17,000 members in 40 different collective agreements with as many employers, mostly in the electricity industry including Ontario Hydro successor companies, their spin-offs and 23 local distribution companies, Hydro One, Ontario Power Generation, Bruce Power, TransAlta in Ottawa, Northwind Power, Mississagi Power, the Electrical Safety Authority as well as the Independent Market Operator. The PWU also represents workers at local cable and telephone companies, the County of Brant, Kinectrics, New Horizon System Solutions, Inergi, and operators at Atomic Energy of Canada Ltd. A full list is found in Appendix 1. In addition, the PWU is a partner in Bruce Power Inc.

Since the early 1990s the PWU has maintained high profile in regulatory and industry activities, to augment our core activity of effective membership representation. This has included regular participation in industry proceedings including those at the Ontario Energy Board ("OEB").

Our constituents have a large stake in the energy industry and are directly impacted by industry issues. Our expertise has been recognized in many OEB proceedings. In providing our input into the OEB's review on further efficiencies in the electricity distribution sector we raise practical issues that need to be considered to ensure sector stability and continued investment in a skilled workforce.

Our overarching issues that in the view of the PWU need to be addressed in considering further efficiencies in the electricity distribution sector are: the creation of an environment that provides industry certainty; ensuring employee stability and a smooth transition through any industry restructuring contemplated; and, ensuring ongoing investment in service quality and reliability, not only in terms of capital investment but the equally important investment in a skilled workforce.

In our comments we first address our overarching issues followed by other issues identified in the Board Staff Discussion Paper "Review of Further Efficiencies in the Electricity Distribution Sector" ("Discussion Paper").

1 INDUSTRY CERTAINTY

For the distribution sector to invest in efficiency measures requires an environment that provides industry certainty. Conditions that create uncertainty with regard to the distributors' commercial status include the requirement for the distributors to obtain the Minister of Energy's approval for a rate review by the OEB. In addition, the proposal of using the distributors' third installment towards a market-based rate of return to fund DSM precludes clarity on the distributors' commercial status.

While the current limitation on the distributors' rate of return is not conducive to investment, there also is uncertainty on the rate re-basing approach the Board might use and when such re-basing might occur.

Considering the significant amount of consolidation that occurred in 2000, the current lack of willing buyer – willing seller consolidation activity despite the opportunity for tax-exempt transfer of assets speaks volumes on the current distribution investment environment. In an environment that creates incentives through consolidation, a more efficient distributor could be expected to initiate consolidation with less efficient distributors confident that they can reap the benefit of increasing the latter's efficiency. The inability of a corporatized distribution company to realize a market-based rate of return devalues its investment potential, compromises its ability to obtain financing, and minimizes any incentive for voluntary consolidation.

Efficiency can be enhanced through technical innovation that requires substantial upfront investment. Efficiency is also enhanced by investment in ongoing training of the workforce that will ensure the implementation of operational efficiency. With industry uncertainty, distributors may tend to put on hold investments in system and training of the workforce.

The degree of industry certainty also directly impacts the workforce. A high level of industry certainty contributes to a healthy work environment for the workforce that results in efficiency enhancement of the workforce. Industry uncertainty, on the other hand, results in a stressful work environment and low morale among workers that is not conducive to efficiency improvements.

In its report the Electricity Conservation and Supply Task Force **(**ECSTF) identifies the increasing needs of modern economies for higher levels of reliability and power quality. If the distributors put on hold technical innovation, catching up in the future to meet their customers' higher level needs may result in higher future costs. Providing some certainty for the distribution sector will remove a major barrier to the adoption of new economic technologies.

Should the OEB decide to implement a second generation price cap PBR mechanism for the distributors, it is important that the PBR plan incorporate realistic efficiency expectations based on the distributors' recent productivity performance. Alternatively, should the OEB decide on a Yardstick PBR mechanism we would remind the OEB of the OEB PBR Yardstick Task Force's conclusion that Yardstick PBR is ideally suited for all but the largest LDCs[1]. Unrealistic expectations will exacerbate uncertainty and form a barrier to investment in technical innovation and training of the workforce. They may also result in unreasonable cost cutting measures that are not in the best interest of the customers or the distributors.

To provide industry certainty the Government needs to confirm by legislation whether distributors will be treated as commercial entities or introduce legislation that establishes the distributors as non-commercial, non-profit entities. The declaration, in either case, will help distributors understand how best to respond to efficiency incentives.

[1] Report of the Ontario Energy Board Performance Based Regulation Yardstick Task Force. May 18, 1999.

2 STABILITY

The PWU has been an active supporter of many aspects of industry restructuring over the last decade. We have focused on making the initial Ontario Hydro split and subsequent spin-offs workable by using innovative, principle-driven bargaining approaches wherever possible. Mutual gains are not a mystery to us and we have had more than a few positive outcomes when we shared issues and solutions across the bargaining table.

We have also managed numerous amalgamations, mergers and acquisitions including the absorption of embedded distributors by Hydro One with little labour relations turbulence.

These activities supported our goals of sustainable employment and investment in the facilities where our members work. We have always believed that, in the long run, the public interest and the interests of our members coincide. A healthy electricity industry is the best form of security of electricity service for the public and security of employment for our members.

Therefore any restructuring that may result from this review on further efficiencies in the distribution sector needs to recognize the importance of maintaining a skilled workforce. This is achieved through a smooth transition that maintains stability for the workforce.

In its report the ECSTF has identified the importance of addressing the need for skilled workers as the electricity industry goes through a major demographic shift. The present Canadian average age of utility members is 45 years, with only 3% in the 16 to 24 year age bracket. In the PWU membership the average age increases to 48. The demographics speak to the need to attract workers into the electricity industry. Maintaining a skilled workforce requires ongoing stability.

There are several ways in which stability can be maintained for our members.

Recently, the Board held a proceeding on service territory issues, a decision on which has not as yet been issued. Regular changes in service territories that can result from Board decisions results in workforce instability. To maintain workforce stability, it would be preferred that efficiency related to boundary issues be achieved through load

transfers with the Board's rate review process providing the opportunity for review of load transfer issues.

While further efficiencies through consolidation is one of the issues in this review, there are efficiency gains that can be found through voluntary commercial arrangements that preclude the need for consolidation. Such arrangements would be more conducive to stability for the workforce.

Should this review result in recommendations on consolidation, a voluntary approach would have a lesser impact on stability. Under a voluntary approach the PWU can participate in decisions on consolidation and ensure maximum stability for its members. In any case, the PWU, other unions and unrepresented employees should participate in decisions related to consolidation.

3 SERVICE QUALITY AND RELIABILITY

The Discussion Paper wisely cautions against focusing purely on costs in pursuing operational efficiency to avoid creating an environment where reliability and quality of service is sacrificed. As pointed out, cost reduction without efficiency improvement reduces services and we would add that such cost reductions are not sustainable.

To maintain service quality and reliability, we need to invest not only in the system, but equally in a skilled workforce. The risk of a purely cost cutting approach is likely to result in budgetary constraints for training and hiring of highly skilled staff, resulting in the loss of the skill set required to maintain service quality and reliability. In being guided by its legislated objective "to protect the interests of consumers with respect to prices and the reliability and quality of electricity service", the OEB needs to ensure that investment in the workforce is not sacrificed. Reliability, safety and customer satisfaction are natural outcomes of a well-trained, respected workforce carrying out their duties in a safe, stable and properly funded electricity sector.

If the OEB wants certainty on the maintenance of service quality and reliability it can enforce standards. In doing so, however, service quality and reliability, which encompasses workforce training, will need to be treated as an exogenous factor outside

of PBRs cost-reduction incentive, as suggested in the Discussion Paper. While service quality and reliability performance are included in the current PBR cost-reduction incentive, the current performance guidelines are minimum standards that have the distributors maintaining the standards of service that it had in place through local decision, under their First Generation PBR going-in rates. When standards are enforced, the standards required are not in the control of the distributor and therefore as indicated in the Board Staff Discussion Paper, would need to be treated as an exogenous factor. Such an approach gives emphasis to the importance that the Board places on service quality and reliability and is consistent with the ECSTF's recommendation that the OEB set and enforce transmission and distribution reliability and service standards. There needs to be some realism around expectations of service quality and the cost of meeting the expectations. Policies and measures that further the efficiency of the distribution sector by increasing customer value, rather than just reducing the distributor's costs, are absolutely preferred from both the customers' and the distributors' perspectives.

There are several recommendations we would like to make that will help ensure the maintenance of Ontario's skilled workforce.

One is to form a centrally coordinated training program for distribution staff. Ensuring an ongoing confident and highly skilled workforce is not as readily accomplished in the absence of a central training program that will result in consistent and up to date technical training to the workforce across the province. Such a program will provide broad access to information on opportunities and methods of enhancing efficiency in distribution functions, overcoming one of the barriers to enhancing efficiency identified in the Board Staff Discussion Paper.

Another recommendation is that a central manpower system for recruitment be established. The PWU has a mechanism in place through its hiring hall, which incidentally also trains apprentices, that provides the infrastructure for a central manpower system.

4 CONSOLIDATION IN THE DISTRIBUTION SECTOR

One of the primary issues addressed in the Discussion Paper is whether there are economic, service and other benefits to be gained from further consolidation of the electricity distribution sector. Consolidation in the electricity distribution sector that occurred in 2000, mainly on a voluntary basis in response to the opportunity for tax-exempt transactions, reduced the number of distributors from in excess of 270 in 1998 to 100 in 2004.

A 1999 productivity study[2] prepared for Board Staff by PHB Hagler Bailly Consulting indicated that the distribution sector had average annual efficiency gains of 0.8% in the ten-year period (1988-1997) prior to the consolidations in the absence of explicit Government intervention. The analysis included productivity studies on a sample of a total of 48 small, medium and large distributors. A similar productivity study for the post 2000 consolidation period has not as yet been conducted.

Information collected from the distribution companies through surveys conducted by the OEB Yardstick Mechanism Task Force in 1999 indicated that service agreements were widespread in the distribution sector prior to the 2000 consolidations. The "functional scale" economies achieved without consolidation through collaboration and service agreements, therefore, are not only a recent phenomenon but an ongoing one.

Hydro One's distribution infrastructure in place over its vast service area illustrated in Figure 1 of the Discussion Paper has and continues to provide province-wide opportunity for the operational strategy described in the Discussion Paper of generating efficiency gains through operational contiguity. The potential role of Hydro One's existing infrastructure in capturing efficiencies in the distribution sector, therefore, should not be overlooked.

As indicated in the Discussion Paper a voluntary approach allows the distributors to achieve "functional scale economies through corporate strategies". In the PWU's opinion this stated advantage of a voluntary approach is key in achieving efficiency

[2] Productivity And Price Performance For Electric Distributors in Ontario. Prepared for Ontario Energy Board Staff By F.J. Cronin, M. King and E. Colleran. PHB Hagler Bailly Consulting. July 6, 1999.

gains because efficiency initiatives requires management and staff commitment, which can be realized through corporate strategy. The continuous efficiency gains observed in the distribution sector in 1988-1997, supports a voluntary approach.

Functional scale economies are also captured in Hydro One's function as both transmission and distribution company and any restructuring contemplated should ensure that this efficiency is protected. As an example, Hydro One distribution lines and transmission lines are often on the same poles/towers and the same crew maintains both systems.

While the government should not infringe in any way on Hydro One's ability to operate in a manner identical to any other distributor in the province, there should be full recognition that Hydro One provides significant value as the province's electricity delivery safety net. This intrinsic value that comes from Hydro One's footprint in transmission and distribution across the province should never be jeopardized for the benefit of other distributors. Accordingly, we believe that it is inappropriate for the OEB to hold reviews on, or make regulatory decisions involving Hydro One service territory issues. The opportunity for ongoing OEB reviews of service territory creates instability in the workforce which only compromises maximization of efficiencies and benefits.

We also bring this matter up in this review because we believe, that Hydro One's current infrastructure can and does provide opportunity for efficiency to the distributors that are contiguous to its system throughout the province. We believe that services provided by Hydro One to other distribution companies, has contributed to the efficiency of the Ontario distribution sector.

While the OEB's Filing Requirements for Acquisitions, Divestitures and Amalgamations explicitly requires information that relate to the OEB's regulatory objectives, there is a lack of regulatory guidelines associated with the filing objectives that establish goals for economic efficiency gains through consolidation. Establishing goals requires specification of a metric to quantify the impact of consolidation on efficiency gains. The identification of such a metric will add realism to a review on distribution efficiencies and moves away from the academic towards the practical.

6. LOAD SERVING ENTITIES

The Discussion Paper states that "it would be feasible for distributors to be load serving entities provided they were able to mitigate their price and volume risks". Having described mechanisms by which the risks might be minimized, it suggests that some distributors may not be able to reach the "high level of credit worthiness" required to enter into risk mitigation contracts and that consolidation or joint venturing may be required. Alternatively, the distributors would need financial resources to manage the business.

The distributors have managed to successfully implement new responsibilities (e.g. SSS, Retail Settlement) assigned to them through legislation and regulation in recent years. While it is not our intent to minimize the expertise required to act as a load serving entity, we believe that as long as adequate financial resources are made available to carry out this function, the distributors will manage the responsibility. How they might set about doing so, should be a business decision that each distributor makes based on its own policies and circumstances. Leaving the distributors to make the decision on whether a consolidation,joint venture, service agreement or some other arrangement might be its best alternative will result in the most efficient choice.

On the concern with the distributors' credit worthiness and price and volume risks, assuming a distributor's activity as a load serving entity is a regulated activity, a regulatory framework that ensures prudency and expeditious cost recovery could minimize risks and concern on credit worthiness.

7. DISTRIBUTION SYSTEM PLANNING

The ECSTF identifies the adequacy and reliability of the transmission and distribution capacity as playing a critical role in rebuilding the province's electricity system over the next 20-years. The rebuilding of the electricity system could profit from collaborative efforts in system planning to ensure that the system remains cohesive. A forum should be created to ensure an expeditious start of the collaboration. This collaboration should maintain sensitivity to the needs of distributors as they manage specific customer service issues.

Appendix 1 – PWU Bargaining Units

OPG Nuclear
Bruce Power
AECL
Kinectrics
OPG Non-Nuclear
New Horizons System Solutions
TransAlta – Ottawa
Northwind Windsor
Mississagi Power Trust
Brighton Beach
Hydro One
Vertex
Inergi LP
ESA
IMO
Barrie Hydro
Brant County Power
Erie-Thames Power
Great Lakes Power
Grimsby
Halton Hills
Hydro Vaughan
Innisfil
Kenora
Kitchener-Wilmot
London Hydro
Markham
Middlesex Power
Milton
Newmarket
Norfolk Power
Orangeville
PUC Services
Sioux Lookout
Whitby PUC
Dryden Telephone
Kincardine Cable
Brant County