ONTARIO ENERGY BOARD
FILE NUMBER RP-2004-0020

"CONSULTATION ON EFFICIENCIES IN THE LDC SECTOR"

WRITTEN SUBMISSION FROM THE CITY OF STRATFORD & FESTIVAL HYDRO

presented by:

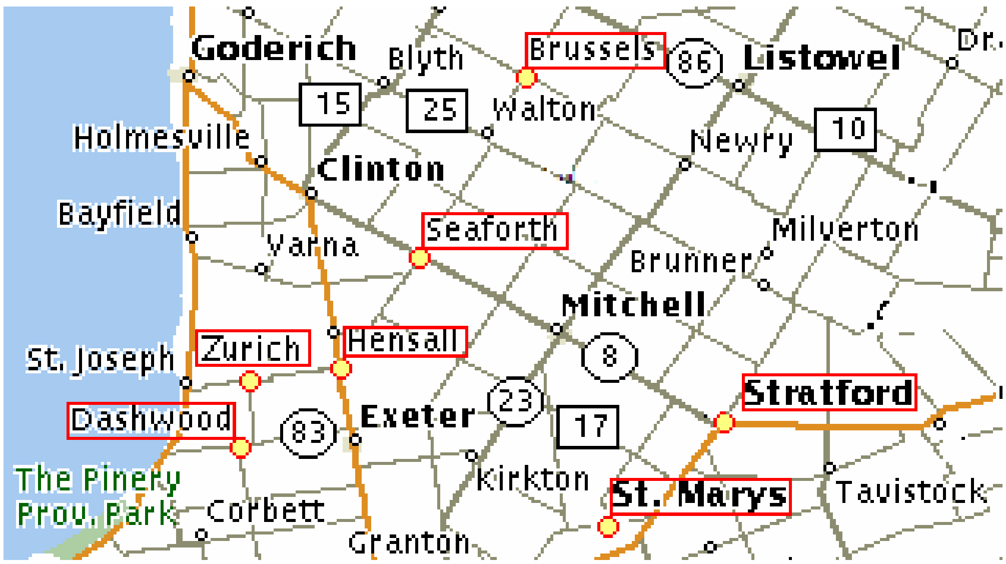
Mayor Dan Mathieson
The City of Stratford
(Shareholder)
PO Box 818
1 Wellington Street
Stratford, ON N5A 6W1
Phone 519-271-0250
Fax 519-271-2783
Email dmathieson@city.stratford.on.ca

Bill Zehr, President & CEO
Festival Hydro Inc.
(Local Distribution Company)
PO Box 397
187 Erie Street
Stratford, ON N5A 6T5
Phone 519-271-4700
Fax 519-271-7204
Email: bzehr@festivalhydro.com

February 17, 2004

1 Background

The City of Stratford is the sole shareholder of Festival Hydro Inc., a Local Distribution Company (LDC) serving 18,500 customers in the City of Stratford, the Town of St. Marys, and the former municipalities of Brussels, Dashwood, Hensall, Seaforth, and Zurich. Service centres are strategically located in Stratford and Seaforth, ensuring emergencies and power outages are responded to well within Ontario Energy Board requirements.



FESTIVAL HYDRO SERVICE AREA
CITY OF STRATFORD, TOWN OF ST. MARYS, AND THE FORMER
MUNICIPALITIES OF DASHWOOD, ZURICH, HENSALL, SEAFORTH, AND BRUSSELLS.

When the City of Stratford invested in the purchase of the six other utilities in our area, the decision was based on sound business principles with the objective of generating a commercial rate of return for the shareholder. Festival Hydro has been able to achieve that objective without compromising safety, reliability, or customer service. Specifically, Festival Hydro provides their shareholder with annual interest and dividend payments, and has not had a single lost time injury in the past 3 years. Festival Hydro consistently exceeds the minimum standards outlined in the OEB Service Quality Indicators, and has been able to meet all filing deadlines for reporting and record keeping.

Combining the operations of seven (7) utilities was not easy, but it has resulted in a utility that is more efficient and better able to meet the challenges of our ever changing industry. In addition to finding efficiencies in areas such as billing, warehousing, engineering, and operations, the combined utility has better access to capital funds to make the necessary investments in infrastructure to meet growth and reliability targets. For one municipality in particular, Festival Hydro has invested a significant amount of capital to alleviate an overload condition and provide capacity to facilitate economic growth within the community.

2 Further Consolidation

The City of Stratford and Festival Hydro agree that there are opportunities for additional efficiencies to be gained through further consolidation within the distribution sector. There are four (4) guiding principles that we believe must be taken into consideration prior to exploring these opportunities:

- Any consolidation must be voluntary for all parties involved. As with any private business, the pressure to provide the shareholder with a commercial rate of return while maintaining competitive rates should be the prime motivating force driving consolidation. Forcing any business to sell or merge, either through direct methods or indirect pressure from onerous rules and regulations will not achieve efficiencies.

- There must be a clear business plan that indicates all parties involved in a consolidation will benefit, without adversely impacting safety, reliability, or customer service. The ability to be able to respond quickly to emergencies and power outages must be an integral part of the business plan.

- Ownership by Municipalities should be encouraged. Investing in a profitable distribution company is one of the only ways a Municipality can earn a commercial rate of return on an investment. Municipalities such as the City of Stratford are dependent on the revenue generated by their distribution company, using the funds to invest in infrastructure upgrades and minimize tax increases. The Municipality has a natural connection to their community and it will ensure that the local distribution company does not adversely impact customer service for the sake of increased profits.

- Many efficiencies can be gained without consolidation. Festival Hydro has benefited from various arrangements such as supplier alliances, outsourcing meter reading, shared business services (such as Enerconnect), and using a common billing system application (Daffron). The City of Stratford and Festival Hydro continue to benefit from efficiencies obtained by Festival Hydro providing street light maintenance and the meter reading, billing, and customer service for water & sewer customers within the City of Stratford. In turn, the City of Stratford provides Festival Hydro with tree trimming and tree removal services. The City and Festival Hydro also benefit by utilizing common auditors, banking services, office equipment rental and servicing contracts, and office supply contracts. The Shareholder, via the Board of Directors, has mandated Festival Hydro management to investigate and continue to obtain further efficiencies within their organization.

The City of Stratford recommends the following measures to encourage further consolidation in the distribution sector:

- Do nothing. Be patient. Recent changes resulting from the provincial and municipal elections, coupled with yet another change in the way electricity is priced, will require time and effort to work through. The new Municipal Councils are working on their budgets, trying to minimize tax increases. The LDCs are preparing their rate applications and changing their billing systems to accommodate two tiered pricing. The LDCs are also anticipating the release of details regarding their involvement in conservation and demand side management. If we want to be successful in achieving conservation objectives, we should not be distracted by further attempts by the government to encourage consolidation of LDCs.

- Extend the deadline for the transfer tax exemption. The freezing of distribution rates, the subsequent downgrade of utilities' bond ratings, and the constraints on supply have all contributed to an unstable environment. Municipalities that might have considered selling their LDC have likely postponed that decision knowing the market value of their assets has dropped significantly. Those that were considering acquisitions or mergers have not been able to find willing partners for their ventures. Extending the deadline for the transfer tax exemption will allow the market to stabilize and give the shareholders time to evaluate their options. There are natural financial pressures that will encourage further consolidation once stability has returned.

3 Incentives

The Performance Based Regulation regime has the potential to provide incentives to drive further efficiencies in the distribution sector. However, it can also lead to increased cost or reductions in service levels by imposing regulations that are heavy handed or do not add value to the consumer. The following points should be considered when reviewing existing and proposed Performance Based Regulations:

- The LDCs should not be asked to collect and report information that is never analyzed or benchmarked. Collecting, processing, and submitting the information is time consuming, and is of little value to the consumer if the data is not used appropriately.

- Penalties or incentives should be based on performance issues that are within the control of the LDC. Statistical data should not be the only consideration used to identify excellent or poor performing LDCs. A comprehensive, long term approach should be used to determine if performance is improving or degrading, and causes clearly identified.

- There should be reasonable performance expectations that have been reviewed by stakeholders with a clear understanding of the potential impacts of specific requirements.[1] Consumers and the OEB need to understand that achieving some performance objectives may result in increased cost and/or decreased service levels.

- Festival Hydro currently receives incentives through direction from the Board of Directors and the Shareholder to achieve efficiencies without compromising safety, reliability, and customer service. Management is keenly aware of the

[1] For example, reducing outage frequency and momentary outages may require much more extensive tree trimming that may not be aesthetically pleasing to the consumer. Most LDCs wage a constant battle with the public when dealing with tree trimming and tree removals.

need to operate their functional areas as businesses, and they receive training and performance appraisals to assess their ability to achieve specific efficiency goals.

- The LDCs continue to work together on best practices particularly in the areas of safety (through E&USA), regulatory and industry changes (through the EDA), and operational excellence (through numerous formal and informal groups such as the Daffron user group). It is quite common for engineering and operations staff to meet with their peers at neighbouring LDCs to discuss work methods and new products. The results of pilot projects that test new products are freely communicated between LDCs. Supplier alliances and purchasing groups are commonplace, and most municipally owned LDCs share in the purchase of common goods and services such as bulk fuel purchases, financial and human resource services, and building usage.

4 Load Serving Entities

The OEB should proceed cautiously with the development of Load Serving Entities. A Load Serving Entity will be in direct competition with retailers for the supply of the electrical commodity to end use customers.

In the OEB "*Electricity Distribution Efficiencies - Discussion Paper*" issued on February 9, 2004, the description of the role of the Load Serving Entity sounds very much like the business plan of an electricity retail company. The customer is offered a fixed price, while the load serving entity purchases the power on the spot market and/or through bilateral contracts with power producers. This is the same activity that energy retailers have been pursing since Market Opening was announced. Default supply customers will have to make a decision between the price and terms offered by the energy retailers or accepting the price and terms offered by the load serving entity. The load serving entity will be forced to compete against the prices and terms offered by the retailers if they hope to retain any default supply customers. To mitigate the risks associated with this type of activity, they will need to contract with as many default customers as they can which will require some level of marketing activity.

The suggestion that the LDCs should be encouraged or even permitted to engage in this activity seems to be in direct contradiction to the current rules that specifically prohibit this type of activity by an LDC. The LDCs already have the option of entering into the retailer arena through an affiliate, provided they comply with the Affiliate Relationships Code. The vast majority of LDCs made a strategic business decision to not become energy retailers and have structured their companies to focus on their core competency – electricity delivery.

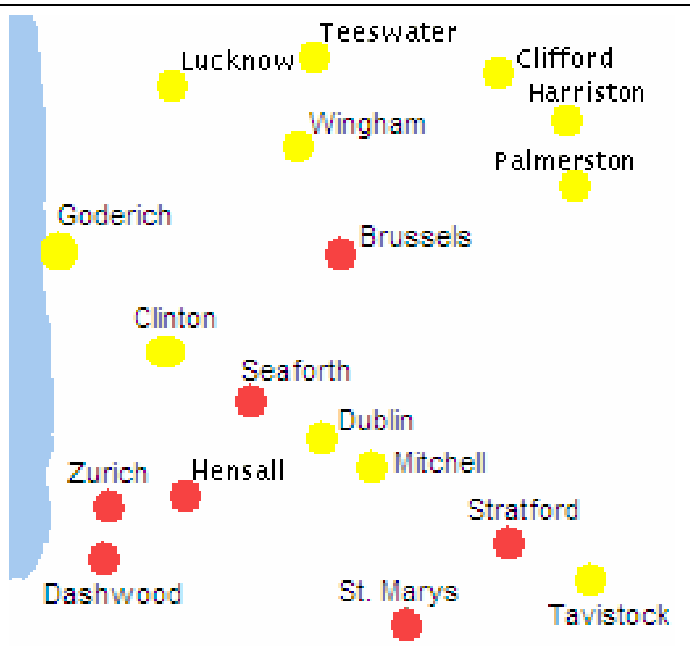
If LDCs are required to become the load serving entity for default supply, we foresee three major problems that could occur regardless of the size of the LDC. First, operating as a load serving entity within the LDC will have the potential for cross-subsidization which may enable the LDC to offer lower energy prices than a competing retailer – this will undoubtedly spur the retailers into action against the LDCs and the OEB. Second, the financial risks associated with the purchase and re-sale of electricity could lead to significant losses to the LDC which will have to be recovered through higher rates. Thirdly, engaging in the high risk activity of energy trading will increase the cost of obtaining financing, which will increase the cost of building and maintaining the distribution system.

The retailing of energy is a highly specialized business that has significant financial risk. Any LDC that is not currently operating an energy retail affiliate would have to make a significant investment in talent, equipment, and finances to be able to operate as a load serving entity. This will not create any efficiency within the distribution sector, and could actually lead to higher costs to the end consumers.

The LDCs should at least have the option of obtaining the default supply through an external load aggregator, in a contractual arrangement that will not expose the LDC to the financial risks associated with energy retailing.

5 Distribution System Planning

The OEB should facilitate the cooperation of LDCs to investigate natural boundaries that make sense from a servicing point of view. Across the province there is a "swiss cheese" effect, where some LDCs (including Festival Hydro) own pockets of customers within a territory dominated by Hydro One. The map below shows detail on the locations of LDCs in our immediate area.



THE AREA IN WHITE IS HYDRO ONE TERRITORY, THE AREAS IN RED ARE FESTIVAL HYDRO, THE AREAS IN YELLOW ARE OTHER LDCS.

Collectively, we need to look at which LDC is in the best position to service the customers in their area. A customer located just outside the designated territory of one LDC should not have to wait an extended period of time for power to be restored, when resources are available only minutes away in a nearby municipality. One LDC should not be making significant investments in their distribution system to connect a customer that can be adequately serviced by an adjacent LDC. Even if the assets do not change ownership, each LDC should be able to provide service to all electrical customers within a natural, geographically based service area. Allowing the closest LDC to serve the customer will decrease costs and improve service.

Although there has been some cooperation between LDCs regarding emergency response, system planning, and sharing resources, there is room for improvement. However, differences in the strategies of the neighbouring shareholders, collective agreement issues, and disputes over boundaries will need to be overcome before much progress is made in this area. Ideally, the pressure to provide the best service possible to our customers at the lowest cost should lead us to work together on these issues.

6 Technological Innovation

Market opening and Y2K forced all LDCs to review their information systems and make significant investments in upgrades. Although the larger LDCs had a natural economy of scale that made these upgrades more manageable, the medium and smaller sized LDCs demonstrated their creativity and innovation by forming groups that achieved the same result. Some chose to outsource their customer information system and billing to a third party (often another LDC), while others shared in the cost of implementing and adapting a common system. In our case, we believe that pooling our talents and resources with other LDCs gave us an advantage over some of the large LDCs that elected to develop and implement systems on their own.

There has been some discussion and uncertainty whether LDCs will be able to continue to produce monthly bills that combine the hydro charges with the water and sewer charges for their municipality. This option should continue to be available to the LDCs as it represents a significant efficiency for the LDC and municipality. Likewise, LDCs who have affiliates that provide rental water heaters, fibre optics, and sentinel lights should continue to have the option of providing billing services to their affiliates through appropriate service agreements. By utilizing our customer information system for all these components, Festival Hydro has effectively increased their customer base from 18,500 electrical customers to a total of over 33,000 customer accounts.

We do not see the need for new incentive (or dis-incentive) structures that would further the adoption of new technologies to improve efficiency in the distribution sector. All LDCs will adopt new technologies that will improve their efficiency once it has been demonstrated that costs will be reduced and/or service levels improved. The pressure to provide excellent customer service at the lowest possible cost will naturally drive LDCs to adopt new technologies and new methods that will improve efficiency. For example, Festival Hydro is currently in the process of installing a SCADA system to access feeder information from the Hydro One Operating Centre in Barrie. Analysis indicates that this information will improve response time to outages, decrease outage duration, and aid in planning system upgrades and maintenance projects. We are also investigating the use of technology that will allow interval metered customers to view their load information on-line, providing better customer service without increase operating costs. We are reviewing our materials management system to gain efficiencies by automating functions and reducing paper flow.

7 Conclusion

The City of Stratford and Festival Hydro have fully embraced the OEB's vision of utilities consolidating their efforts to improve service and gain efficiencies. The funds invested in the purchase of the distribution assets of our neighbouring communities were part of a long term strategy to provide a commercial rate of return to the shareholder. It is our goal to continue to grow our utility business through acquisitions, mergers, or other methods that fit with our business objectives.

Building on our successes of the past three years, we look forward to exploring new opportunities as they develop in the coming years.

We invite Board Members and staff of the OEB to contact us directly to discuss our business plans and review potential opportunities for further efficiencies in our area.

Sincerely,
FESTIVAL HYDRO INC.

Bill Zehr, CGA
President & CEO

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