

February 18, 2004

VIA FAX AND COURIER

Mr. Peter O'Dell
Assistant Board Secretary
P.O. Box 2319
2300 Yonge St.,
26th flr.
Toronto, ON
M4P 1E4

Dear Mr. O'Dell:

**Re: RP 2004-0020 Submission of the
Vulnerable Energy Consumers Coalition (VECC)
Notice of a Consultation to Review Further Efficiencies
in the Electricity Distribution Sector**

We have enclosed the submission of the Vulnerable Energy Consumers Coalition (VECC) with respect to the above-noted proceeding.

As requested we have also enclosed 6 hard copies as well as disk containing an Adobe Acrobat version, and a Word version.

We trust the enclosed to be satisfactory.

Thank you.

Yours truly,

Sue Lott
Counsel for VECC

Introduction

This is the Vulnerable Energy Consumers Coalition's (VECC's) response to the OEB's Notice of a Consultation to Review Further Efficiencies in the Electricity Distribution Sector. VECC consists of the Federation of Metro Tenants Association, the Ontario Coalition of Senior Citizens' Organizations and the Ontario Coalition Against Poverty. In terms of electricity matters, VECC represents the interests of consumers and, in particular low income and vulnerable users of electricity.

The matter of driving further efficiencies in the electricity distribution sector is of interest to VECC and its constituents, as it can impact directly on the rates consumers will pay in the future. However, the means by which such efficiencies are achieved is also of concern to VECC as it can impact on the customer's reliability and quality of service.

The comments provided below are not meant to address the issue on a comprehensive basis but rather to offer some initial thoughts and impressions on the issue for the Board's consideration. Indeed, VECC is of the view that, given the scope of the issue as suggested by the Discussion Paper, the timelines (and resources) provided in the current consultation process are not sufficient to do the topic justice. VECC strongly urges the Board to view the current consultation process as a scoping exercise which will, based on the input received, allow it to more clearly define the issues and opportunities and prioritize them for more detail study and discussion.

Definition of the Issue

The introduction to the Discussion Paper indicates that the objectives of the consultation exercise are to address two questions¹:

1. Are further efficiency improvements in the electricity distribution sectors available and, if so,
2. What are the alternative (and preferred) ways of driving such efficiency improvements?

¹ Page 1

In VECC's view, any efforts to address these issues should start with an assessment as to the current efficiency of the sector in both a static and dynamic sense. Static refers to the looking at the relative efficiency of different utilities at a fixed point in time; whereas dynamic refers to the efficiency (productivity) improvements demonstrated by utilities over a period of time.

Development of such efficiency metrics is critical.

The Discussion Paper offers anecdotal evidence (regarding the increased use of shared services, outsourcing and similar service arrangements) and the post-1999 utility consolidations as both examples of past progress in achieving efficiency improvements and as opportunities for future improvements. current (efficiency) performance of utilities, it would be possible to not only determine if improvements are possible but to identify superior performers for purposes of establishing "best practices". Such an approach would also provide stakeholders (including the OEB) with the necessary tools to gauge the success of future efficiency improvement initiatives. VECC acknowledges that there are difficulties in developing such metrics, particularly in terms of how to allow for uncontrollable cost drivers². However, without the appropriate tools and measures the OEB will ill-equipped to pursue its objectives in this regard.

[Link to OEB Objectives](#)

Issues of whether further efficiencies³ are available in the electricity distribution sector and how best to achieve such efficiencies are critical issues both for the OEB and consumers. As the Ontario Energy Board Staff Discussion Paper (the Discussion Paper) noted⁴, achieving further efficiencies in the electricity distribution sector is directly linked to the fourth and fifth policy objectives of the OEB with respect to promoting economic efficiency and maintaining a financially viable electricity industry. However, it is VECC's view that third objective of the Board (i.e., promoting the interests of consumers with respect to prices and the reliability and quality of service) is also a relevant consideration when looking at the question of improving efficiency. In fact, this point is readily acknowledged elsewhere in the Discussion Paper.

² Page 11

³

⁴ Page 18

VECC agrees with the Discussion Paper that the goal is to reduce total distribution costs without noticeably affecting (and perhaps even improving) the safety and reliability of the distribution system, customer service or any other features of distribution service that are valued by customers. The Discussion Paper notes that it is the recognition of this concern that leads to the inclusion of service quality indicators in most PBR regimes (including the OEB's first generation PBR scheme for electricity distributors).

The OEB has established a Work Group to develop proposals for service quality regulation (i.e., what service quality measures and targets should be used?) as part of the second generation PBR scheme. In VECC's view it is important that these measures (and targets) be clearly defined before any initiatives are undertaken to aggressively pursue further efficiency improvements in the electricity distribution sector. Furthermore, the Board needs to ensure that the utilities are all calculating the measures on a comparable basis. Without the ability to properly monitor service quality, there is a real risk that utility efficiency gains will be made at the expense of customer value.

Utility Consolidation

The Discussion Paper suggests that there are a number of utilities that are still below what is considered a minimum efficient size and that further utility consolidation is "the most obvious approach to furthering efficiency through exploiting scale economies"⁵. It is VECC's opinion that this view not be accepted on faith and that the issue needs to be looked at more closely, particularly before there is any move to mandatory consolidation:

- Given the options open to utilities to reduce costs through outsourcing and collaboration the question arises (and needs to be answered) as to what are the additional efficiencies to be gained through "consolidation".
- While there has been significant industry consolidation in the last 5 years, there is no evidence to demonstrate that this has led to any net gains in terms of efficiency improvements in the industry. Indeed, even the original MADDs applications made by most utilities only addressed this issue in a superficial manner.

⁵ Page 9

- While “local control” is viewed in the Discussion Paper as a non-economic objective, there may be value-added from a customer perspective in having local input, and
- Mandatory consolidation in other jurisdictions was undertaken for purposes other than efficiency improvements (e.g., as a prelude to privatisation).
- Consolidations consume considerable time and intellectual capital that may be better spent improving efficiency in other ways.
- Consolidations also create problems in areas such as rate harmonization.

Use of PBR

In VECC’s view, PBR is one of the key regulatory tools available to the Board to drive efficiency improvements in the electricity distribution sector. Its use in the Ontario Electricity Distribution Sector necessitated in part because of the administrative difficulties inherent in individual cost of service reviews. However, for a PBR framework to be successful it must not only incentivize distributors to improve efficiency but must also provide assurance to customers that the resulting rates are just and reasonable and the service quality will be maintained. This is important since while PBR is meant to “simulate” a competitive market, in reality customers do not have choice. In a competitive market, if a firm’s plans for innovation fail such that prices increase or service quality declines, then customers can readily choose another supplier. In the case of electricity distribution, this is not the case.

It is also VECC’s view that clarity and certainty as to how the PBR will work is critical to driving future efficiency improvements as is certainty regarding the overall regulatory framework for LDCs. If the events of the past 4 years have taught us anything it is that an uncertain and ever changing regulatory environment does not contribute to effective performance in the electricity distribution sector (or for that matter the electricity sector overall).

In this regard, one critical element (for both distributors and customers) in establishing a second generation PBR scheme is the rate rebasing required. It is important that just and reasonable base rates be established for each utility and that the rules be clear as to how the rebasing will be done at the end of the “second generation”. Another, critical element is “transparency” during

the process and utilities should be required to report annually on their operations and the results made available publicly.

Finally, the PBR scheme must safeguard service quality. This may require permitting cost of service type reviews for those utilities who claim that they can not “live” within the PBR framework and maintain adequate service and/or requiring formal cost of service reviews for those utilities who fail to maintain service quality. The fact that there are a significant number of electricity LDCs should not preclude the OEB from adopting a cost of service approach to their regulation when and as necessary. The Board should also consider linking either allowed ROE or shareholder/customer sharing mechanism under PBR to service quality performance or other similar financial reward/penalty mechanisms.