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RE: RP - 2004-0020

Comments to the Ontario Energy Board re Review of Further Efficiencies in the Electricity Distribution Sector

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Table of Contents

Review of Further Efficiencies in the Electricity Distribution Sector

1. Introduction

Westario Power sees the occasion of the consultation this week as the start of a significant dialogue with the Board and stakeholders on a very important issue to not only the Board and Local Distribution Companies (LDCs), but also to electricity consumers in the Province of Ontario.

As a company that came about through the public/private partnership of one private and eight municipal shareholders, Westario Power has experienced first hand the challenges in customer service, organization, logistics, technology and financing associated with LDC consolidation. We have also seen the opportunities and benefits such a task can present.

With the issuance of the discussion paper just last week, and the deadline for this submission, there is only time to offer some empirical observations in response. Should a further process develop out of this consolation, Westario Power would welcome the opportunity to comment more fully.

This paper provides the Board with background information on Westario Power, lessons we have learned, and comments on the discussion paper issued by Ontario Energy Board (OEB) staff.

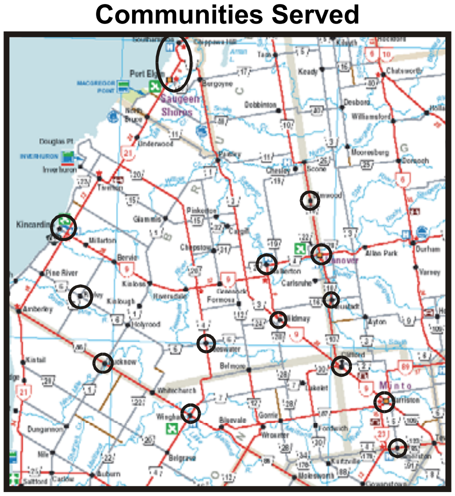
2. Westario Power

2.1 Background

Westario Power Holdings Inc. was created in November 2000 through the merger of eight (8) former utilities, and the investment of a private sector partner (Canadian Niagara Power Inc.).

Westario Power Holdings Inc. established two affiliate companies – Westario Power Inc. and Westario Power Services Inc. Westario Power Inc. (the LDC) owns the distribution assets serving approximately 21,000 customer accounts in fifteen (15) communities[i] in Bruce, Grey, Huron and Wellington counties, and contracts with Westario Power Services Inc. (Servco) to perform services for the LDC.

Communities Served



Master Services Agreements (MSA) between the three companies set out the financial arrangements and service level expectations of each business. Through these agreements, Servco must provide all administrative, operating and maintenance services needed by the LDC at a fee equivalent to the 1999 costs contained in the LDC's OEB approved rate submission.

This structure was chosen for a number of reasons:

- Protection of the LDC's equity by moving risk to Servco.
- Provides an incentive to drive efficiencies in Servco.
- Aids in the creation of a business culture within Servco.
- Allows Servco to offer competitive services beyond the licensed service territories of the LDC.

2.2 Lessons Learned

The consolidation of eight former utilities, serving fifteen communities, presented many challenges covering the full range of customer service, organization, logistics, technology, and financing issues. This consolidation was made even more challenging by the fact that it occurred during the restructuring of Ontario's electricity industry.

2.2.1 Efficiencies Obtained

Efficiencies through consolidation were achieved in the following areas:

- Labour
    - Reduction in total staff complement by approximately 18 percent. It should be noted that this reduction was principally in management positions.
- Business Processes
    - Business processes have been reviewed and streamlined.
- Offices/Service Centres
    - Eight former utility offices have been consolidated at one administration centre. Service centres have been reduced to three locations and expectations are that further reductions will take place. It should be noted that the large geographic area covered, and the response time required by the OEB's service quality standards, influences the extent to which additional reductions may be possible.
- Billing
    - Eight billing systems have been consolidated to one.
    - Meter reading services have been outsourced
- Engineering
    - Engineering standards have been adopted and materials rationalized.
    - Engineering records management (drafting and system optimization) have been outsourced.
- Fleet
    - The vehicle fleet, particularly large line trucks, has been reduced in number.

2.2.2 Partnerships

Partnerships have also produced costs savings and provided the business with resources that would otherwise be uneconomical for a company of our size to acquire on its own.

The following partnerships are of particular note:

- Canadian Niagara Power Inc. (CNP)
  In addition to being a valued member of the Westario Power Board of Directors, CNP has also been an important partner on a number of technical and operational matters. Most significantly, CNP and Westario Power share an implementation of SAP's enterprise resource planning and customer information

(billing) software. CNP hosts the supporting computer hardware and provides system administration services. This shared approach to software that is critical to our businesses has provided mutual operational benefits and costs savings.

- Cornerstone Hydro Electric Concepts Inc. (CHEC)
  CHEC is comprised of twenty (20) member LDCs representing approximately 200,000 electricity customers. Through CHEC, members have gained efficiencies in the form of reduced costs for a variety of goods and services. Equally important, CHEC members have provided support and mutual assistance to each other in areas of regulatory compliance, safety, training, and emergency planning. Additional opportunities continue to be explored.

2.2.3 New Costs

While savings brought were found through the synergies achieved in consolidating eight utilities, we must also note that new costs were incurred as result of the size of the former utilities and the restructuring of Ontario's electricity industry. The followings new costs are of significant note:

- Wholesale meter upgrades
- MSP fees
- Regulatory compliance costs
- New technology (billing, EBT, etc)
- Safety (the size of former utilities did not require a Joint Health and Safety Committee)
- Record management (consolidation of former utilities' records)
- Development of construction standards and rationalization of construction materials

3. Comments on OEB Staff Discussion Paper

3.1 Efficiencies

It is fair to say that improvements in efficiency are always possible in any organization, including LDCs. Distribution rates are influenced by how efficient an LDC is, but also by a number of other factors, such as:

- Customer Density
- Age of Distribution Assets
- System Growth
- Local Costs (labour, fuel, shipping, etc)

All of these factors need to be understood and considered when establishing efficiency improvement expectations.

Westario Power believes that it is difficult to assess efficiencies that may have been gained through consolidations that have occurred since industry restructuring started. We are not aware of any detailed examination of the subject and would encourage the OEB to conduct such research. This task has been made more difficult as new costs associated with changes in the market have occurred simultaneously.

In the case of many consolidations, including Westario Power's own circumstances, large areas of lands exist between many of the communities served by one LDC (the so called "Swiss-Cheese" effect). These lands have low densities of electricity customers and are serviced by Hydro One. Efficiencies may be derived by the acquisition of these customers by the local LDC. The business case would need to be examined for each situation.

In general, Westario Power supports the principals put forth by the Electrical Distributors Association (EDA) with respect to the basis upon which consolidations should proceed. Specifically that consolidation should take place between a willing selling and a willing buyer based on the business case specific to the transaction.

There are methods of obtaining efficiencies other than through mergers and acquisitions. Our experience with the CHEC group, as described above, has provided tangible benefits. We are convinced that further benefits can be derived through both informal cooperatives and structured joint services arrangements.

3.2 Barriers to Efficiencies

Since the market opened in 2001, LDCs have experienced many changes in the regulatory environment. Several of these changes have resulted in considerable expenditures being made by LDCs.

A consistent, predictable regulatory environment is needed to make informed long-term business decisions and plans.

As described above, a mechanism to permit LDCs to form contiguous service territories between existing service territories may afford opportunities for additional efficiencies; particularly with respect to distribution assets. The business case needs to be examined in each case. Consideration should be given to basing service territories on areas served by entire transformer stations or feeders to minimize costs associated with wholesale metering points.

3.3 Performance Based Regulation

The first (current) implementation of Performance Based Regulation (PBR) treated all LDCs the same. The result was that efficient LDCs were penalized while inefficient LDCs were not incented to find savings. This is not to say that all inefficient LDCs did not find efficiencies – many did – just that the regulatory regime did not directly contribute to the process. The original proposal to implement a yardstick grouping approach would have accomplished these goals.

The writer had the privilege of participating on the former OEB Yardstick Grouping Task Force. At the time, it became clear to the Task Force that reliable selection criteria could not be found to group LDCs for the purpose of benchmarking. Wide ranges in controllable cost per customer, for example, could not be correlated to utility size, growth rates, geography, age of plant or prevalence of underground/aerial distribution. The Task Force noted that reliable data needed to be collected during the first phase of PBR to enable yardstick grouping during PBR2. We do not know if this work has been carried out.

Some of the OEB Service Quality Indicators (SQI) do not accurately measure items within the control of the LDC. Reliability indicators do not differentiate outages resulting from loss of supply to the LDCs distribution system. While customers are impacted regardless of the source of an outage, we see little value in masking incidents within the LDC's control with those from external systems.

3.4 Load Serving Entities

Westario Power does not support the mandatory assignment of Load Serving Entity (LSE) obligations to LDCs. Some LDCs may choose to engage in this activity, based on their own individual business plans, but it should not be compulsory for all.

In advance of specific details of the rules associated with LSEs, we note the following concerns:

- More than one LSE will create differences in SSS rates – is this fair to, or expected by customers?

- Puts LDCs in competition with retailers (i.e. appears to be the same as retailing)
- Creates opportunity for cross subsidization.
- Financial risk may impact distribution rates.
- There are not enough skilled resources available for all LDCs to become LSEs.
- How will commodity risk be dealt with?

The Independent Market Operator (IMO) already has the experienced resources needed to perform this function. It would appear that assigning this function to the IMO would be both practical and cost effective. In lieu of this arrangement, we support the creation of one provincial aggregator.

4. Summary

In summary, Westario Power supports the principles for further consolidation proposed by the Electrical Distributors Association (EDA). These principles let the market determine further rationalizations on a business case basis. Consolidations need to assess the benefits derived to customers and shareholders.

To effectively plan our business, Westario Power needs to know, with reasonable predictability, what the market will look like. A clear and predictable regulatory environment is an important part of that vision.

Westario Power remains a strong supporter of restructuring Ontario's electricity system for the benefit of existing and future consumers. As a LDC that has demonstrated the success of public/private partnerships, we continue to seek ways to increase efficiencies while providing superior value to our customers.

Any significant changes in the structure of Ontario's electricity industry requires full consultation with all stakeholders to ensure that correct decisions are made. Making the wrong decisions will have a direct impact on electricity consumers.

Westario Power looks forward to actively participating in any such process.

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[i] The communities served include: The Town of Hanover, The Municipality of Kincardine (the former Town of Kincardine only), The Town of Saugeen Shores (the former towns of Port Elgin and Southampton only), The Village of Neustadt, The Village of Elmwood, The Township of Huron-Kinloss (the former villages of Ripley and Lucknow only), The Municipality of Brockton (the former Town of Walkerton only), The Town of Minto (the former villages of Clifford, Harriston, Palmerston only), The Municipality of South Bruce (the former villages of Mildmay and Teeswater only), The Township of North Huron (the former Town of Wingham only).