

RECEIVED

Scheel

OCT 20 2004

ONTARIO ENERGY BOARD

133 Gloucester Ave
Oakville, Ontario
L6J 3W3
October 14, 2004

Mr. Peter O'Dell
Assistant Board Secretary
Ontario Energy Board
P.O.Box 2319
2300 Yonge Street, 26th Floor
Toronto, Ontario
M4P 1E4

Dear Mr. O'Dell, 20/10

Re: Board File No. RP-2004-0188

The attached document outlines my concerns about the privatization of local hydros. The implications of privatization link directly to the rationale the local hydros use to effect and substantiate their distribution charges. As I live in Oakville, I have addressed my questions to Oakville Hydro and The Town of Oakville which holds the only share in Oakville Hydro. I believe my comments apply universally across the Province.

Since asking the questions, neither the Town nor Oakville Hydro has provided answers to 80%+ of the questions. The new Energy Act gave exemption to privatized hydros from being accessed by the Freedom of Information Act. Starting with a Town "in camera" meeting and secret valuation report, the asset base of the old Oakville Hydro was stepped up to "market value". The new asset base gives Oakville Hydro all kinds of latitude regarding borrowing, depreciation policies, etc. This information is not for public consumption. As you will read, I posed many direct and derivative questions and have never had satisfactory answers.

Your efforts at soliciting public input to help establish local hydro distribution policy are admirable. However, I defy any citizen to input anything logical or credible as no one has a base of information upon which to base a critique or suggestions. On the surface it looks like we have democracy but in reality there is no such process in effect in this matter. The OEB and Provincial Government owe it to the citizens to open up access to local hydro costing and other relevant information so that we may indeed respond intelligently to enquiries such as you are now conducting.

I look forward to your in-depth response and trust that you will take up my issues with the Minister of Energy, the Provincial Cabinet and perhaps the Premier.

Sincerely yours,


John Scheel

Submitted by John Scheel of 133 Gloucester Avenue, Oakville, to the Oakville Hydro Corporation Board director Paul Benson (and John Bobyk) at Mr. Benson's request of January 31, 2003. Mr. Scheel understands that the Board will attempt to provide answers in an informal meeting on February 14, 2003 at 7:30 A.M.

Questions Regarding the Incorporation (Privatization) of Oakville Hydro

- 1) To start, all of Oakville's publicity surrounding the incorporation of the New Hydro specifically states that "*This action is required under Ontario's Bill 35 - Energy Competition Act, 1998, to introduce competition into all parts of the Ontario electricity industry, and to adopt a commercial operation and ownership.*" To my knowledge, although the incorporation was mandated, every municipality was given the choice of having hydro become a non-profit corporation (i.e. Minimum ROE) or becoming a corporation for profit (i.e. Market ROE). Oakville doesn't seem to have openly researched the pros and cons of each choice. How did Oakville decide which way to go? Was the public consulted? How? What was the logic? Who provided it? There is a big difference between the two types of companies. The former would equate to the status quo position of Oakville Hydro; the latter would be aggressive, take chances, assume increased risk, etc.
- 2) Explain how (e.g. and at what value) the assets of Oakville Hydro-Electric Commission ("Oakville Hydro") were transferred to Oakville Hydro Corporation ("New Hydro")? If transferred at a value other than book, how was the transfer valuation determined? (*The following line was added July 31, 2003*). If the valuation and resulting step-up of asset value has been aggressive, then the subsequent level of legislated borrowing will also be out of line or excessive.
- 3) How exactly are the shares held? i.e. "in trust" for citizens? Other method? Implications? Can the Town sell these shares at any time? I understand that the Fort Erie and Cornwall Hydros now belong to Fortis while Sault Ste. Marie was acquired by Great Lakes Power. (*The following line was added July 31, 2003*). To illustrate the importance of the valuation issue, Enbridge purchased Cornwall Electric in 1997 for \$68 million; it sold Cornwall Electric to Fortis in 2002 for \$67 million at a considerable loss as its investment did not appreciate.
- 4) Contrast the debt loads and controls on debt between Oakville Hydro and the New Hydro.
- 5) Are the accounting/GAAP rules the same for Oakville Hydro and New Hydro or were changes made at incorporation or after incorporation?
- 6) Has there been a re-capitalization of New Hydro? May I see the before and after financial statements?
- 7) Has or will New Hydro be acquiring assets of, for example, Hydro One? If so, this would constitute an assumption of Provincial debt by Oakville. Has an assumption of Provincial debt taken place? Comment.
- 8) What are the business mandates or objectives of the three operating subsidiaries of Oakville Hydro Corporation?

- 9) Can there be more such subsidiaries? Are there any limitations to growth? Are there businesses that cannot be entered? What risk is being considered (e.g. fibre optic cable installation)? In some correspondence, it was stated "*there are a number of other issues for the Board to resolve such as retail opportunities among others*". This needs explanation and explicit clarification.
- 10) Does the Town own or invest in other corporations (added July 31, 2003) directly or indirectly? If so, what are these?
- 11) Insurance exposure of corporations, especially aggressive growth ones, is much greater than that of passive divisions of a municipal government. Are citizens, as de facto shareholders, or the Town now exposed to much larger claims? I thought that the local public utilities always were self-insuring through Ontario Hydro - who is now writing the insurance policies?
Comment.
- 12) Why are the books of New Hydro not public? Mr. Bystrin states "*Our detailed financial information is not made public because we are operating in a competitive environment. Sensitive financial and operational data are commonly used by competitors to the detriment of the business that owns the information.*" There is nothing competitive about the monopoly distribution of electricity! - only the other businesses which displace private enterprise. It looks like the caboose is controlling the whole train.
- 13) How, for example, can the public determine that electricity distribution charges are *fair*? How can the public compare the new rate structure to the old structure? How do I know I am getting a "*competitive rate*" (in a monopoly!)? It is not sufficient to defer to the OEB.
- 14) How can New Hydro rationalize going into direct business competition with companies owned by citizens? Surely New Hydro has a very big advantage with its large asset base and guaranteed income from Oakville Hydro-Electric Distribution Inc. - a monopoly protecting/buffering the operations of the other two divisions? Is this fair?
- 15) Explain exactly how the OEB "*regulates*" profits. What numbers does it work from? How does anyone know what is fair in this process?
- 16) I understand that the local hydro distribution charges and the method of their calculation are supposed to be public. New Hydro will not provide this information because it fears revealing the profitability of the its other businesses that compete with private enterprise. How do you rationalize all of this?
- 17) The following statement was made in Harry Henderson's January 6, 2000 Report to the Town/Hydro Working Committee: "*direct the new Board that no third party financing be implemented until at least one year following incorporation, by which time it is anticipated that the Ontario electricity market will be open to competition and many of the regulatory and legislative uncertainties will have been settled*". Referencing this statement, please comment on the Board's actions and position in light of the complete disarray of the deregulation process.

- 18) The same report called for a business plan to be prepared by the Board no later than one year after incorporation e.g. for Feb/01. May I have a copy?
- 19) What are the profit/ROE targets of each subsidiary? How were these set? Is it logical for taxpayers to be paying these profits which are nothing but disguised taxes?
- 20) Surely these profits, which will themselves be taxed, represent excess unnecessary charges. Will they be credited against municipal property taxes? If not, why not?
- 21) Mr. Henderson's Report also calls for a report (before June 1, 2000) specifying the use of dividends and other revenues to be received by the Town. May I have access to this report/policy?
- 22) What are FibreWired Network, Blink Communications and DXStorm? Who owns them? Where outsiders are involved, was there a competitive review to get the best product? What exactly is the agreement whereby this product and these companies are owned/represented/sold by New Hydro's Communications subsidiary? Were development or setup costs associated with this product? Was there a license fee paid? If any of these costs were incurred, how were they financed? Why is New Hydro in this business? Wasn't Hydro One in similar businesses (through Hydro One Services) that were all shut down when the Government stepped in to cancel the IPO, etc. Why are we in this?
- 23) May I have the salaries of senior management of New Hydro and the annual stipends of the Board members? I would also like the rate of salary increases for 2000 through 2003.
- 24) How are Board members replaced? Is there a specific term? What happened on December 31, 2001, when Board terms expired? Were changes made?
- 25) How does New Hydro intend to be financially and operationally accountable to Oakville's citizens when the Town does not have an internal audit function? Is New Hydro actually responsible to Oakville's citizens? If so, how will it do so if it cannot be open?
- 26) I understand that I may request for any Town information through the provisions of The Freedom of Information Act. This freedom does not extend through to New Hydro. Why not? It should be allowed for the distribution subsidiary. Has New Hydro provided reports as required by The Business Corporations Act of Ontario? Comment.
- 27) The attached article relates to Hamilton's current pending decision to revert back to a non-profit status. I must say that the arguments to remain incorporated and proffered by the very biased President of the Hamilton Utilities Corp. are very weak. Can we do better to rationalize what was done? Is there a pending resolution to Council (as in Hamilton) requesting that New Hydro remain on an "as is" basis operating for profit? Can we reverse this? Can citizens make presentations pro/con?
- 28) What has happened to the Provincial Government guaranteed defined benefit pension plan run by OMERS? How can OMERS run the pension plan for a private competitive corporation which cannot qualify as a "local agency"? Who is running the plan now? Has the Town assumed responsibility and are its citizens now directly exposed?

29) From a DBRS press release of January 31/03 -

"DBRS is downgrading the corporate rating on Hydro Ottawa Holdings Inc ("Hydro Ottawa" or the "Company") to A (low) from "A." The trend is Stable. The rating remain "Under Review with Negative Implications," where it was placed under on November 12, 2002, following the announcement by the provincial government to lower electricity bills."

DBRS holds the same view for all local hydros (Financial Post - Feb 1/03)

"The rating action follows a full review, by DBRS, of the implications of Bill 210 on Hydro Ottawa and the Ontario electricity industry as a whole. Key factors that have driven the downgrade are as follows:

(1) The cap on distribution rates at current levels until at least 2006: (a) the Company will not receive the final one-third installment of its rate increase that it would have been entitled to charge beginning on March 1, 2003 to earn the previously approved 9.88% rate of return on equity. As such the ROE will essentially remain at 6.6%, which is low for a regulated distribution company; (b) continued uncertainty surrounding the recovery of certain items classified as regulatory assets; (c) the inability to recover increasing operating costs such as wage increases and higher pension costs; and (d) the inability to re-base its 1999 (the original test-year for setting unbundled rates) rate base amount to reflect capital additions and a growth in asset base. The rate cap will pressure the Company's cash flows and coverage ratios over the medium term. The initial rating assigned to Hydro Ottawa had incorporated the rate increases to earn 9.88% and recover transition costs, and the expectation that the Company's rate base would be re-based upward during the second generation of PBR (scheduled for 2004/2005). Clearly, this is no longer the case.

(2) Having to seek the Minister's approval to increase rates for extraordinary items, hence bypassing the original mandate of the Ontario Energy Board to regulate distribution rates. Thus, the process will become more onerous.

(3) The continued risk of further government intervention in the Ontario electricity market. The one-notch downgrade reflects these risks."

How is New Hydro affected by the Ontario Government's changing position? What can be undone and what are we stuck with? Are there now increased financial exposures? What have been New Hydro's responses? Is New Hydro looking at reverting back to being a not-for-profit division of the Town of Oakville? If not, why not?

Attachment from Hamilton Spectator (see point 27)

Jan. 30, 12:47 EDT Profit-making Hydro offers several benefits

Utility reform: Council must decide

A significant decision on the future of Hamilton Hydro faces city council. As part of their fast-track plans to stabilize electricity prices in time for the next provincial election, Ontario's ruling Conservatives shifted some policy-making responsibility to municipalities. Local councils are required to pass a resolution allowing municipal hydro companies to continue to operate for-profit. Otherwise, the companies will revert to the non-profit status they had before Ontario plunged into hydro restructuring. The idea of returning Hamilton Hydro to a non-profit model has a certain appeal, underlined by the turmoil after the province opened the electricity market to competition. It's consistent with the belief that a fundamental service like electricity should be supplied to consumers at cost, and managed for public benefit as opposed to private profit. So the decision of whether to revert to the non-profit tradition isn't to be taken lightly.

Enter Art Leitch, president and CEO of Hamilton Utilities Corp. (HUC), city-owned parent of Hamilton Hydro. In a presentation to The Spectator's editorial board this week, Leitch made a convincing case that maintaining the company as a for-profit corporation offers "the best of both worlds."

To cite some key advantages, Hamilton Hydro would continue to provide prices that are among the lowest in Ontario; its profits would provide much-needed revenue for the city; and the profit model would ensure proper

maintenance of hydro infrastructure. That would avoid a replay of the massive expense necessary to rebuild the water and sewer systems.

Granted, reverting to non-profit status would potentially allow lower rates. Bills could be reduced by \$17 a year for each of Hydro's 175,000 customers by forgoing the profits. But that strategy could mean short-term gain for long-term pain. As Leitch explained, reverting to non-profit status would be a step toward insolvency. Hydro would have to slash the \$20 million a year that it now spends to replace equipment by \$7 million. In any case, the city is counting on Hydro's profits to ease property tax increases.

A non-profit structure would also limit HUC's ability to generate revenues with a family of innovative companies. Leitch is justifiably optimistic about the potential of FibreWired, a subsidiary that has an extensive fibre-optic network across the city, and Hamilton Community Energy, a subsidiary that will soon provide a new natural gas-fired centre to generate electricity and produce heat for several downtown buildings. Leitch noted that, if it were a department of the city, Hamilton Hydro wouldn't have the freedom to develop commercial ventures promoting economic growth.

It's important to realize that a for-profit model shouldn't be equated to privatization per se. HUC is owned 100 per cent by the City of Hamilton. As such, profits will remain in public hands, and they will stay in this community. If anyone has a better strategy than outlined by Leitch, now is the time to debate it.

-- Gord McNulty