Ontario Energy Association

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March 2014

The Honourable Charles Sousa
Minister of Finance
c/o Budget Secretariat
Frost Building North, 3rd Floor
95 Grosvenor Street
Toronto, ON M7A 1Z1

Dear Minister Sousa:

On behalf of the Ontario Energy Association's (OEA) Board of Directors and members, we would like to offer our appreciation for the opportunity afforded to the OEA to participate in your 2014 provincial pre-budget consultation. As a follow up, please find attached our OEA 2014 pre-budget submission.

As Ontario's energy voice, the OEA has more than 150 corporate members who represent the full diversity of the energy industry in Ontario – power producers, firms that transport, transmit, and deliver natural gas and electricity, marketers and retailers, manufacturers, contractors, service providers, and energy consultants. Such diversity allows us to offer a broad and comprehensive perspective on Ontario's 2014 budget to the benefit of the sector and the provincial economy as a whole.

Ontario continues to experience fiscal challenges. The provincial energy sector can help to reduce such pressures by driving efficiencies by incentivising consolidation of services in order to help control future cost increases ultimately borne by energy customers. Resulting from bold policies, Ontario has attracted investment in energy infrastructure over the past several years and therefore enjoys sufficient supply to meet the energy demand needs of all customers. Which is why now is the time to turn our focus towards delivering services more efficiently to energy customers.

To effectively deliver services to energy customers within Ontario, our submission identifies a few solutions that will result in:

- Merging the Independent Electricity System Operator (IESO) and the Ontario Power Authority (OPA) in order to increase efficiencies, eliminate overlap, address rising costs to consumers, and improve the delivery of services;
- Incentivising consolidation of Ontario's electricity distribution companies and reducing barriers to private investment;

We look forward to continuing the dialogue with your government on how changes to Ontario's energy sector can help create new investment opportunities in Ontario, generate savings for Ontario families and businesses, and continue repositioning the energy sector to support economic growth. If you have any questions regarding this submission please contact me or our Vice President of Government Relations and Communications, Tina Arvanitis at 647.920.3269 or tina@energyontario.ca.

Let's unravel the most complex energy challenges, together.

Yours truly,

Mel Ydreos
Interim President and CEO
Ontario Energy Association

CC: The Hon. Bob Chiarelli, Minister of Energy.

ONTARIO ENERGY ASSOCIATION

2014 PRE-BUDGET SUBMISSION

March 2014

To shape our energy future for a stronger Ontario.

Ontario Energy Association

ABOUT THE OEA

The Ontario Energy Association (OEA) aspires to be the most credible and trusted voice of the energy sector. We earn our reputation by being an integral and influential part of energy policy development and decision making in Ontario. We represent Ontario's energy leaders including over 150 corporate members that span the full diversity of the energy industry.

The OEA takes a grassroots approach to policy development by combining thorough evidence based research with executive interviews and member polling. This unique approach ensures our policies are not only grounded in rigorous research, but represent the views of the majority of our members. This sound policy foundation allows us to advocate directly with government decision makers to tackle issues of strategic importance to our members.

Together, we are working to build a stronger energy future for Ontario.

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EXECUTIVE SUMMARY

Rationalising Ontario's Energy Sector to Address Rising Costs to Customers

The Ontario Energy Association (OEA) welcomes the commitment of the Government of Ontario to strengthen its fiscal management in an effort to pave the way to balanced budgets. The OEA's key contribution to Ontario's pre-budget process is to demonstrate how the energy sector can assist the government in meeting its overall policy objectives by ensuring affordable, reliable, and sustainable energy for Ontario consumers at the residential, commercial, and industrial levels. The importance of Ontario's energy sector cannot be underestimated:

- Ontario's electricity sector is a $15 billion annual industry that employs approximately 95,000 people in the province, 65,000 of those directly[1]; and
- Ontario's natural gas sector is a $2 billion annual industry that directly employs 7,500 people in Ontario[2].

In order to help address some of Ontario's fiscal challenges, the OEA recommends that the Government of Ontario:

I. Merge the Independent Electricity System Operator (IESO) and the Ontario Power Authority (OPA) in order to increase efficiencies, eliminate overlap, address rising costs to consumers, and improve the delivery of services

II. Incentivise consolidation of electricity Local Distribution Companies (LDCs) and remove barriers to private investment in LDCs

Our recommendations would create new investment opportunities for energy companies, will generate savings for Ontario families and businesses, and will continue repositioning the energy sector to support economic growth.

[1] Government of Ontario's Long-Term Energy Plan, 2010

[2] INC Global Insights, 2008

I. CONSOLIDATE ENERGY AGENCIES TO INCREASE EFFICIENCIES

RECOMMENDATION 1: ENERGY AGENCY FUNCTIONS

The OEA recommends that the Government of Ontario merge the IESO and the OPA in order to increase efficiencies, eliminate overlap, address rising costs to consumers, and improve the delivery of services.

There is overlap in the various functions of Ontario's energy agencies. For example, the OPA, the Ministry of Energy, and the IESO all do some form of power system planning; the OPA, Infrastructure Ontario, and the OEFC all procure generation projects and/or manage procurement contracts; while the OPA, the IESO, and the OEB either administer or regulate different conservation and demand management (including demand-response) programs/initiatives.

A survey conducted among potentially-impacted OEA members shows significant support for a merger of the IESO and OPA. The OEA believes a merger of the IESO and OPA will result in numerous benefits to Ontario's power sector, including:

- Eliminating duplication and providing cost savings to consumers by delivering electricity services more effectively;
- Simplifying the electricity sector so that consumers, businesses, and investors can have confidence regarding future direction and opportunities;
- Creating an electricity system that is more responsive to changing conditions;
- A stronger, more co-ordinated approach to planning, especially considering the integration of renewable generation, shut down of coal-fired generation, and increasing linkages to the natural gas sector; and
- Better alignment of market rules and procurement contracts in order to maintain efficient economic outcomes.

To ensure that proper consideration is given to the complexity of this important file, the OEA recommends a staged approach to merging the IESO and OPA, and suggests the following two-stage model:

1. To initiate the merger as soon as possible, we are encouraging the government to introduce legislation that amalgamates the two agencies into a single corporate entity, while provisionally maintaining the key functions of each. This bill would not change any of the functions of the IESO or OPA but merely administratively amalgamate the two agencies. The bill should also recognize the importance of maintaining appropriate confidentiality and ring-fencing of the wholesale market

functions with the procurement/contract management functions. We hope that this legislation could be passed expeditiously so that the process of amalgamating the two agencies – and eliminating unnecessary duplication and expense – can begin in earnest.

2. At the same time, we are recommending that the Government indicate, through an announcement, that it wishes to review and reconsider the roles and responsibilities of various entities in the Ontario energy sector, with a view to introducing legislation in the coming months to make appropriate adjustments.

Merging these agencies would result in a much easier-to-navigate system as well as clearer lines of responsibility and accountability amongst the energy agencies. Ultimately, this will improve coordination of both energy planning and energy program delivery functions and result in better outcomes for all market participants. The OEA recommends that work on the merger legislation begin immediately and be introduced as soon as possible. We believe that the continuing uncertainty about the future of the OPA should be settled definitively and as soon as possible, for the benefit of all consumers, the industry and the agency itself.

II. INCENTIVISE CONSOLIDATION OF LOCAL DISTRIBUTION COMPANIES AND REMOVE BARRIERS TO PRIVATE INVESTMENT IN LDCs

RECOMMENDATION 2: INVESTMENT IN ONTARIO'S LDCs

The OEA recommends that the Government of Ontario strengthen the incentives for LDCs to undertake voluntary consolidation, and should simultaneously remove barriers to private investment in Ontario's LDCs.

Over the last few years, Ontario's electricity LDCs have been given new obligations in addition to their core distribution business functions. For example, LDCs are connecting an increasing amount of renewable generation projects, meeting conservation and demand management (CDM) targets, and installing smart meters in Ontario homes.

In April 2012, the Ontario Minister of Energy established the Ontario Distribution Sector Review Panel (the "Panel") to provide expert advice to the government on how to improve efficiencies in Ontario's electricity sector with the aim of reducing the financial cost of electricity distribution for customers. In December 2012, the Panel delivered their report, Renewing Ontario's Electricity Distribution Sector: Putting the Consumer First, that reviewed Ontario's electricity distribution sector and made many recommendations.

The OEA believes that the Panel Report is a useful document, particularly with respect to its explanation for the need to pursue consolidation in Ontario. Although the OEA cannot support a number of the conclusions drawn and recommendations made in the Report, we hope that the government will strike a course with new policy direction that emphasizes positive incentives for consolidation.

In support of our advocacy of consolidation of electricity LDCs, the sub-sections below convey additional recommendations to incentivise consolidation and remove barriers to private sector investment.

RECOMMENDATION 3: ELIMINATION OF THE TRANSFER TAX

The OEA recommends that the Government of Ontario abolish the transfer tax. Concurrently, the government should consider solutions addressing the potential loss of PILs revenues accruing to the OEFC that are used for paying off the stranded Ontario Hydro debt.

Municipally-owned electricity LDCs in Ontario have limited financial resources with which to invest in critical infrastructure. Certain existing policy instruments continue to deter them from attracting private capital or from seeking voluntary mergers with private entities, either of which could solve access to capital issues. One example is the Transfer Tax that creates a distorted playing field for electricity distribution companies. The Electricity Act, 1998 imposes a 33% Transfer Tax on any sale of assets owned by a municipal LDC, payable to the Ontario Electricity Financial Corporation (OEFC). The OEFC uses proceeds from this tax, along with other revenue sources, to pay off the stranded Ontario Hydro debt.

Federal legislation exempts LDCs that are at least 90% owned by a municipality from paying federal income tax, while parallel provincial laws direct such LDCs to instead make payments in lieu of taxes (PILs) to the OEFC. Current regulation exempts certain transactions from the Transfer Tax, such as transfers between municipally-owned LDCs and Hydro One or OPG. However, this exemption does not extend to transfers of more than 10% of assets to private investors. One of the reasons for excluding transactions with private entities was that such an exemption would result in reduced revenues to apply to the stranded Ontario Hydro debt by creating "tax leakage" of revenues to the federal government.

Historically, the Government of Canada accommodated such situations by agreeing to forego collection of income taxes for a period of time from provincially- or municipally-owned public utilities which changed hands, allowing provincial governments to continue to collect PILs for a period lasting up to 10 years. The Ontario Government should seek such an accommodation from the federal government again. For example, a 10-year deal with the Government of Canada would allow PILs to continue for long enough that the residual stranded debt of Ontario Hydro would be eliminated.

Changing the Transfer Tax policy in a manner consistent with the Province's interest in eliminating the stranded Ontario Hydro debt would be a strong contributor to a healthier electricity distribution sector in the future, with greater capacity to deliver benefits to customers.

RECOMMENDATION 4: PUBLIC-PRIVATE PARTNERSHIPS

The OEA recommends that the Government of Ontario review the regulatory and legislative framework for LDCs to ensure that private sector investments can flow to LDCs where economical.

The continued exclusion of the private sector from the Ontario electricity LDC sector has reduced the options for capital-raising, prevented monetization of municipal value, and has discouraged additional consolidation and efficiency in the sector. For example, the fact that access to Infrastructure Ontario funding is limited to utilities that are 100%-owned by municipalities punishes those municipally owned utilities that have chosen to privatize up to 10% of their assets and, as such, forego access to cheaper public funding. Many of the OEA's electricity LDC members believe that greater private sector involvement would be beneficial for the sector, and LDCs must not be penalised for choosing to partner with private sector companies.

RECOMMENDATION 5: COORDINATED INFRASTRUCTURE PLANNING

The OEA recommends that the Government of Ontario continue to seek improved co-ordination of energy delivery infrastructure planning between all provincial energy agencies.

Ontario's electricity transmission and distribution systems are in need of greater infrastructure investment. Due to investment deficits, transmission and distribution infrastructure is aging while operating and maintenance costs are escalating. Any delays of refurbishment or replacement of this infrastructure may result in greater overall costs to customers should capital investments occur in an accelerated manner some time in the future.

The renewal of Ontario's energy infrastructure will underpin both the economic and demographic growth of the province. The Conference Board of Canada released a study in February 2012 that states that Canada's electricity system is in need of $347.5 billion in investment between 2011 and 2030. The direct, indirect, and induced impacts of that investment are expected to add an average of $10.9 billion per year to real GDP and create an average of 156,000 jobs per year[3]. Ontario's Long-Term Energy Plan estimates that the industry will invest over $87 billion in capital costs in Ontario over the same period[4].

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3 Shedding Light on the Economic Impact of Investing in Electricity Infrastructure, Conference Board of Canada, February 2012

4 Ontario's Long-Term Energy Plan, 2010, p. 55

Yet today disconnects exist between provincial distribution and transmission planning, municipal planning, and the Ontario Energy Board's (OEB) approval process for distributors' and transmitters' infrastructure upgrades – one that that needs to be addressed. Such plans (especially project timelines) should be better integrated and coordinated to ensure that infrastructure plans are implemented in a timely manner; the OEA is therefore following with interest the OEB's current Regional Planning proceeding.

SUMMARY

Recommendation 1: Energy Agency Functions

The OEA recommends that the government of Ontario merge the IESO and the OPA in order to increase efficiencies, eliminate overlap, address rising costs to consumers, and improve the delivery of services.

Recommendation 2: Investment in Ontario's LDCs

The OEA recommends that the government of Ontario strengthen the incentives for LDCs to undertake voluntary consolidation, and should simultaneously remove barriers to private investment in Ontario's LDCs.

Recommendation 3: Elimination of the Transfer Tax

The OEA recommends that the government of Ontario abolish the transfer tax. Concurrently, the government should consider solutions addressing the potential loss of PILs revenues accruing to the OEFC that are used for paying off the stranded Ontario hydro debt.

Recommendation 4: Public-Private Partnerships

The OEA recommends that the government of Ontario review the regulatory and legislative framework for LDCs to ensure that private sector investments can flow to LDCs where economical.

Recommendation 5: Coordinated Infrastructure Planning

The OEA recommends that the government of Ontario continue to seek improved co-ordination of energy delivery infrastructure planning between all provincial energy agencies.

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