ONTARIO ENERGY ASSOCIATION
2012 PROVINCIAL PRE-BUDGET SUBMISSION

45 Sheppard Avenue East, Suite 409
Toronto, Ontario M2N 5W9
T 416.961.2339 | F 416.961.1173

March 1, 2012

The Honourable Dwight Duncan
Minister of Finance and Deputy Premier
c/o Budget Secretariat
Frost Building North, 3rd Floor
95 Grosvenor Street
Toronto, ON M7A 1Z1

Dear Minister Duncan:

On behalf of the Ontario Energy Association's (OEA) Board of Directors and members, I would like to offer my appreciation for the opportunity afforded to the OEA to participate in your 2012 provincial pre-budget consultation. As a follow up, please find attached our OEA 2012 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 2012 budget to the benefit of the sector and the provincial economy as a whole.

The submission outlines recommendations that would result in reduced barriers to private investments, greater regulatory streamlining, improved cost-efficiencies in the energy sector; and reduced impacts on consumer bills.

We look forward to continuing to work together. If you have any questions regarding this submission please contact Tina Arvanitis, Vice President, Communications and Stakeholder Relations at 647.920.3269 or tarvanitis@energyontario.ca.

Yours truly,

Elise Herzig
President and CEO
Ontario Energy Association

Cc: The Honourable Chris Bentley, Minister of Energy

EXECUTIVE SUMMARY

The key contribution of the Ontario Energy Association (OEA) to Ontario's pre-budget process is to identify how the energy sector can assist the government in meeting its overall policy objectives and provide recommendations to the province's fiscal challenges.

To allow the economy and the province to benefit from opportunities provided by the energy sector, the OEA recommends the following to the Government of Ontario:

I. Remove impediments to private sector investments in Local Distribution Companies (LDC)

- Abolish the transfer tax and review the regulatory framework for LDCs to ensure they can maximize opportunities for public-private partnership where it is economical to do so.

II. Increase cost efficiencies in the energy sector

- Align the role of electricity prices and generation procurement with power system needs and market signals;
- Clarifying the mandates of energy agencies to prevent overlap in their responsibilities; and
- Continue with conservation programs (e.g., building codes and standards) while ensuring their efficiency and cost-effectiveness.

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.

I. REMOVE BARRIERS TO PRIVATE SECTOR INVESTMENTS

RECOMMENDATION 1

The OEA recommends that the Government of Ontario abolish the Transfer Tax. Concurrently the government should consider solutions addressing the potential loss of Payments In Lieu of Taxes (PILs) revenues accruing to the Ontario Electricity Financial Corporation (OEFC) that are used for paying off the stranded Ontario Hydro debt. The government should also review the regulatory framework for LDCs to ensure they can maximize opportunities for public-private partnership where it is economical to do so.

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 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 Ontario Electricity Financial Corporation (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.

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.

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.

II. INCREASE COST EFFICIENCIES IN THE ENERGY SECTOR

RECOMMENDATION 2

The OEA recommends the Government of Ontario align the role of price in signaling consumption and conservation activities. Also, for the Government of Ontario review the present framework for generation procurement to better align procurement with power system needs and market signals.

Achieving greater cost-efficiencies in the energy sector can result in outcomes equivalent to implementing fiscal stimulus measures, and therefore are an alternative to public spending. Incremental cost-efficiencies within the energy sector will also result in productivity gains and lower input costs for all businesses, which should attract investment to the province, create new jobs and therefore contribute to economic growth. It will also keep the bills for residential consumers more affordable.

Recent reports and studies argue that Ontario should make changes to the electricity pricing scheme that better encourages conservation by consumers, optimize the operation of the electricity system and result in reduced bill impacts. The recent reports are as follows:

- The Environmental Commissioner of Ontario says in his last annual report (2011) on Conservation: "In light of Ontario's proposed supply mix for the next twenty years, two goals appear desirable for variable electricity pricing: price should reflect the real-time marginal cost of power; and price should send a signal to avoid extreme price events".

- The report from the Drummond Commission (2012) argues that " the inextricable link between electricity prices and economic performance requires us to review possible avenues to reduce long-term costs to electricity consumers." His recommendations are to "make wholesale electricity prices inclusive of transmission costs such as capacity limitations and congestion as part of a comprehensive restructuring of the wholesale electricity market" and to "make regulated prices more reflective of wholesale prices by increasing the on-peak to off-peak price ratio of time-of-use pricing and by making critical peak pricing available on an opt-in basis".

- A C.D. Howe paper (2010) argues that "A pricing system that equates consumer costs with the actual cost of production would encourage consumers to conserve electricity at all times – especially peak times – reduce the strain on the generation and transmission systems and reduce the fiscal cost of the electricity system"[1]. The paper further points to the key benefit of economically efficient pricing that maximizes the welfare of all Canadians, both consumers and producers, with many of the latter being government-owned.

(1) The Price Isn't Right: The Need for Reform in Consumer Electricity Pricing, Donald N. Dewees, C.D. Howe Institute, Backgrounder, January, 2010.

- The most recent report issued by the Electricity Market Forum[2] also emphasizes the role of markets, transparent price signals, and demand-side solutions in addressing Ontario's short- and long-term electricity sector challenges. The report put forward ten recommendations, three of which call for a review of electricity prices and costs (the wholesale price, global adjustment, and the OEB's regulated price plan) with the goal of ensuring that all consumers can rely upon clear and transparent price and cost signals to help manage their electricity usage and costs.

- The Electricity Market Forum also recommends reviewing the OPA's procurement process to ensure that "procurement decisions are informed by market and system needs and system limitations and that new and existing contracts contain strong market based incentives". The OEA concurs with this recommendation provided that the sanctity of existing procurement contracts is preserved. As Ontario currently has a more than adequate supply of electricity, now is the time to review existing procurement practices, mechanisms and processes without causing undue shocks to consumers and market participants.

Energy prices should be transparent and reflect the true costs of generation at any given point in time to elicit optimal behaviours by consumers and market participants. Time-of-use pricing is a huge step forward from the two-tier pricing system previously in use, though further fine-tuning should be pursued to improve the allocation of fixed and variable costs relative to the time-of-use. The OEA believes that true-cost pricing and an improved price signal will better signal optimal usage and will contribute to a more efficient conservation effort in the province.

RECOMMENDATION 3

The OEA recommends the Government of Ontario streamline the mandates of energy agencies to eliminate any overlap in responsibilities.

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

Streamlining these agencies' mandates would result in a much easier-to-navigate system as well as clearer lines of responsibility and accountability amongst the energy agencies. Ultimately, streamlining of mandates will improve coordination of both energy planning and energy program delivery functions and result in better outcomes for all market participants.

(2) A stakeholder initiative established to review the IESO administered market and to make recommendations on how to address issues with the roles of the market, contracts and regulation.

RECOMMENDATION 4

The OEA recommends that the Government of Ontario continue to recognize the long-term nature of conservation and supply investments and continue to include conservation and demand response resources in long-term plans. As well, the Government of Ontario should maintain support for cost-effective conservation including building codes and standards. Concurrently, the Government of Ontario should review the policy framework for conservation to ensure that it supports cost-effective solutions.

With considerable funds being spent on conservation and energy efficiency, there is a need to coordinate such spending with broader system supply needs to ensure that conservation offsets the need for new generation procurement in the most optimal way.

Investments in conservation are significant in Ontario. Electricity LDCs invested over $167 million as part of the OEB-approved conservation and demand management (CDM) programs (2005-2007) and the OPA invested over $1.7 billion in such programs between 2006 and 2010. Under the latest CDM framework (2011-2014) the OPA expects to fund conservation initiatives worth over $1.4 billion, and additional funding is expected to flow through OEB-approved LDC programs. In addition, natural gas utilities have invested approximately $385 million since OEB started approving demand-side management (DSM) funding in 1995. Between 2012 and 2014, the OEB estimates DSM spending could total nearly $200 million. All levels of government also fund a variety of energy efficiency and conservation initiatives (as does the private sector).

In its last Conservation Results Report covering the period between 2009 and 2010, the OPA reported to have acquired energy savings at an average cost of less than 5¢ per kWh. As such, conservation remains by far the cheapest supply resource, including any available form of new generation.

This should be done with an eye on an ever-evolving landscape for conservation that includes now more private and public entities delivering energy efficiency and demand response programs. Economically attractive solutions are more diversified today and not all of them need dedicated funding. The introduction of higher efficiency standards for new buildings and major appliances, including water heaters and furnaces, has resulted in higher adoption rates by consumers without the need for financial incentives.

Thus, to minimize overall system costs and to generate greater savings to consumers, the existing framework may need to be reviewed to ensure that it: (i) supports an integrated and cost-effective approach to system planning that minimizes inefficiencies, (ii) results in a streamlined system free of duplicative or overlapping functions, (iii) clarifies the responsibility and accountability of conservation providers; and (iv) improves the role of pricing in incenting consumers to conserve.

ONTARIO'S**ENERGY**VOICE

Ontario Energy Association
CELEBRATING 10 YEARS

45 Sheppard Ave. East, Suite 409
Toronto, Ontario M2N 5W9
T 416.961.2339 | F 416.961.1173
energyontario.ca