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The Hon. Bob Chiarelli
Minister - MINISTER'S OFFICE
Hearst Block
4th Flr, 900 Bay St
Toronto ON M7A2E1

Dear Minister Chiarelli,

RE: Feedback on Ontario Distribution Sector Review Panel Report

Thank you for inviting the Ontario Energy Association (OEA) to contribute its thoughts on the Report of the Ontario Distribution Sector Review Panel. We have been engaged with the issue of consolidation of Ontario's local distribution companies for some time, in fact predating the Review Panel's work, and we believe that action should be taken to encourage change. We continue to be committed to working with you to advance policy on this important issue to Ontario's electricity customers and stakeholders.

The OEA recently held Executive Interviews with all of the Presidents and CEOs of our impacted members, and we are pleased to share their feedback with you. The LDC members within the OEA represent over 3 million out of the 4.5 million electricity customers in Ontario.

CRITICAL REPORT FINDINGS TO WHICH OUR MEMBERS REACTED

In our analysis of the Report, we extracted seven key points that we believe were stated, and upon which our members commented:

A. There are compelling reasons to support consolidation of Ontario electricity LDCs

Our members agree that there are compelling reasons to support consolidation. In the OEA Submission to the Panel, we highlighted a number of reasons, including cost efficiency, labour challenges, investment requirements, and capital constraints. These issues were all addressed by the Panel's Report, and we believe there to be near universal agreement that action is required.

B. Voluntary consolidation is preferable to forced consolidation

C. Forced consolidation should be required and implemented through legislation if voluntary consolidation does not occur rapidly

The Panel's contention that voluntary consolidation is favourable to forced action is wholeheartedly echoed by the members of the OEA. In fact, **OEA members strongly believe that voluntary consolidation is the only viable path forward, and commend the Minister and government for publicly declaring that there will be no forced consolidation of LDCs. Our members are completely united in opposition to forced consolidation, now or at any time in the future.**

D. Contiguous consolidation of LDCs is a paramount objective and should be mandatory, including the dismemberment of Hydro One to facilitate the creation of a series of territorially integrated distribution utilities across the province

The emphasis on contiguous consolidation is perhaps one of the most complicated issues in the Panel's Report, from the perspective of developing policy. While it is undeniable that contiguous consolidation often has advantages over non-contiguous consolidation, particularly with respect to the achievement of certain capital and operating savings over time, it is the position of OEA members that the Panel Report gives far too much weight to this fact.

Contiguity is one factor among many that parties must consider when a consolidation opportunity arises. In many cases, it is not determinative of which distributors may or should consider consolidating. Past experience in Ontario has demonstrated this repeatedly, given the continued existence, and in fact growth of LDCs which hold non-contiguous territory. Even recent experience, with the last two consolidation transactions announced, show opposite conclusions being drawn (Collus Power chose to conclude a transaction with PowerStream, a company with which it had no common boundaries, while Norfolk Hydro has recently announced a transaction with Hydro One, with whom it shares two borders).

OEA members strongly believe that individual shareholders should be free to pursue consolidation transactions that make the most sense in their individual circumstances, without the arbitrary imposition of contiguity requirements.

E. Certain LDCs should be exempted from participating in consolidation, because of specifically described unique circumstances

The Panel Report specifically excludes Toronto Hydro from participation in consolidation, as it does those utilities owned by Fortis Inc., and a few others. **OEA members disagree with any exclusions, and firmly believe that every utility in the province should be at liberty to consider purchases, sales, boundary changes, or mergers, as the case may be.**

F. The Government of Ontario should work with the Government of Canada to find a way to remove the Transfer Tax so as to allow the greater participation of the private sector in Ontario LDCs, but the Panel limited itself to referring to Canadian pension funds as potential investors, and clearly presented the Transfer Tax issue as a secondary priority as compared to contiguous consolidation

OEA members wholeheartedly support the elimination of the Transfer Tax, and encourage the Minister and the Government of Ontario to open discussions with the Government of Canada to this end. We believe that elimination of the Transfer Tax would allow for many more participants in the sector, more creative solutions to funding challenges, and potentially to Private Public Partnerships that could provide important benefits to customers. However, OEA members were concerned with the apparent focus of the Panel Report on only one class of potential new investors; namely, Canadian pension funds. While these are undoubtedly worthy potential partners, limiting new entrants to this group would grossly diminish the positive impact of Transfer Tax removal. **We would strongly advise the government to maintain a level playing field for all potential new participants in the sector.**

G. Labour, pension and rate issues are serious and will require considerable effort to solve, but they are secondary to the consolidation process, and should be resolved by the OEB acting in concert with the Boards and management of newly consolidated distributors

Finally, OEA members were disappointed at the Panel Report's dismissal of the "business challenges" that would be attendant on any consolidation program. Labour costs and arrangements are fundamental to managing operation, maintenance and administration expenses, and to achieving forecast efficiencies. Customer rate impacts of any consolidation often determine the public acceptability of the proposal, and are a primary consideration for all parties. Governance issues, in the case of mergers, are often more important than financial considerations. These and other "business" issues cannot be downplayed in any policy action taken by the government, as the ultimate success or failure of the consolidation program will hinge on these types of factors.

THE OEA POSITION IS UNCHANGED FROM OUR SUBMISSION

In our Submission to the Panel, which we have enclosed for your convenience, we affirmed our support for the following recommendations:

1. **Consolidation must be voluntary**
2. **All distributors should be eligible buyers and sellers**
3. **Transfer Tax is the most significant impediment that must be removed**
4. **Ratepayers must visibly benefit from consolidation**
5. **OEB policies should be adjusted to encourage rational consolidation**

The first three of our recommendations are already highlighted through our commentary on the Panel Report, above. Our fourth recommendation, that ratepayers must visibly benefit from consolidation, arises from the experiences of our members, who have participated in many of the transactions completed over the past 10 years. Success or failure of proposed consolidation hinges very much on public acceptance, and there is no better case that can be made for consolidation than delivering immediate and obvious benefits for ratepayers.

The issue of OEB policies was thoroughly addressed in our submission, and pertains directly to your request for feedback on potential incentives for consolidation. It is the view of the OEA and its members that the OEB's policies are critical to the future progress of consolidation. As we highlighted, the OEB could encourage consolidation by:

- Increasing the number of years post-merger during which consolidated entities have the option to return to the regulator for new rates: currently, the policy is that distributors may avoid "rate rebasing" for up to 5 years;
- Separating, for the purpose of rate-setting, the operating and capital portions of distributor costs. Given the impending need for significant reinvestment in assets across Ontario, such a separation would give distributors more flexibility to pursue and capture operational savings, while still providing the rate support necessary to allow them to raise the funds required for capital investment;
- Reviewing and perhaps rebalancing the apportionment of regulatory costs and obligations borne by large and small distributors, as these are now distributed in a fashion which reduces the incentive for smaller utilities to seek consolidation partners;
- Reviewing and amending the rate-setting policies for services provided by a surrounding distributor to a distributor electrically embedded in its territory: the current arrangements again favour the pre-existing smaller distributors, therefore reducing the incentive to consolidate.

The most important incentive for consolidation that could be effected by the Government of Ontario is, however, the removal of the Transfer Tax. Many potential private sector partners have inherent advantages in cost and availability of capital, which would both allow them to offer premium valuations for consolidation transactions, and act as capital partners to existing distributors. Abundant evidence from around the world, and in particular from the United States and the United Kingdom, demonstrates that utilities owned by the private sector are much more likely to pursue consolidation (in the United States, there are now only 200 investor-owned utilities, many with millions of customers, while there are more than 3000 municipally-owned or co-op utilities, a majority of which have fewer than ten thousand customers). There is no reason to believe that experience would prove otherwise in Ontario.

CONCLUSION

Minister, we continue to believe that the Panel Report is a useful document, particularly with respect to its explanation for the need to pursue consolidation in Ontario. It uncovered a substantial body of evidence which will no doubt be useful in ongoing policy-making.

Unfortunately, we and our members cannot support a number of the conclusions drawn and recommendations made in the Report. **We hope that you will instead strike a course with new policy direction that emphasizes positive incentives for consolidation, including the removal of the Transfer Tax barrier.**

Please contact Tina Arvanitis, Vice President, Communications and Stakeholder Relations at 647.920.3269 or tina@energyontario.ca should you have any questions or if would like to further discuss this file.

Yours truly,

Elise Herzig
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Ontario Energy Association

Brian Bentz
Chair of the Board
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