



Ontario Electricity Restructuring Forum: Hydro One

A Consultation Paper

May 2002

Dear Reader:

Your Ontario Government is committed to ensuring a safe, reliable supply of electricity at the lowest possible cost.

For almost 25 years, the former Ontario Hydro's performance deteriorated. The company accumulated debt and liabilities of more than \$38 billion – almost \$10,000 for every customer – and prices skyrocketed.

The government responded, beginning in 1995, with a comprehensive plan to restructure our electricity system. New electricity generators have been introduced and the electricity market has been opened to competition. Now it is time to take the next step. The government has signaled its intention to develop legislation to permit Ontarians to invest directly in Hydro One through a public offering of Hydro One shares.

We believe that individuals' direct investment will be our best guarantee that: a) there will be the investment needed for renewal and innovation, b) the existing debt will be paid down, c) taxpayer risk will be eliminated and d) costs and prices will be better controlled because investors will have a direct say in Hydro One's performance.

I want to hear directly from you on your views of the government's proposal to give everyone in Ontario a direct opportunity to invest in Hydro One. What features should the legislation contain? We would like to know your thoughts on:

- How do we ensure that the debt is paid down?
- How do we ensure adequate investment in the wires network that delivers electricity to customers?
- How do we ensure that Ontario jobs are protected?
- How do we ensure that Ontario citizens continue to have a say?
- How do we ensure that transmission and distribution rates remain reasonable?
- How do we ensure that Ontario citizens will benefit directly from this transaction?
- How do we ensure Hydro One efficiency and enhance safety and reliability?

The attached consultation paper may help to focus your thoughts on this important issue. I look forward to receiving your best advice.

Sincerely,

Chris Stockwell
Minister

Why electricity restructuring?

The old Ontario Hydro served our Province well for many years. But by the 1980s, the company began to falter. Between 1983 and 1993 the price of electricity almost doubled, increasing by 94 per cent. Debt and other liabilities ballooned from \$12 billion in 1980 to more than \$38 billion by 1999, almost \$10,000 for every customer in the Province. Through the 1990s, more than 35 per cent of every electricity bill in Ontario paid for debt interest – one of the highest percentages in the industrialized world.

Ontario Hydro's faltering financial performance was closely associated with the mismanagement of its nuclear power plants. The initial years of the nuclear program went well. But by 1996 the nuclear plants were operating at 65 per cent capacity, well below the 85 per cent capacity level considered excellent within the industry. In 1997, an all-party committee of MPPs called the Select Committee on Ontario Hydro Nuclear Affairs reported that the "failure of Ontario Hydro management to arrest the deterioration of nuclear plant performance had cost Ontarians billions of dollars in replacement energy costs."

There were many other problems. Out of control costs meant that required investments were not made. In particular, the network of towers and wires that delivers power over long distances (the "transmission" system), and to local homes and businesses (the "distribution" system), was neglected as more and more resources were poured into the nuclear plants and their operations. Without additional capital infusion, reliability of the grid is in question. Hydro One expects to make significant capital expenditures with respect to these assets for the next several years.

Ontario Hydro was clearly out of control. The government froze prices to provide some stability while Ontario Hydro attempted to turn itself around. However, the price freeze was only a temporary way of protecting customers. It was not sustainable.

As all of these difficulties accumulated in Ontario's electricity system, governments around the world, from Britain to Australia, began to address similar problems by reforming their electricity systems to deliver stable prices and better performance to customers through competition. The world wasn't standing still, and the electricity system that had long been an economic advantage to Ontario, was at risk of becoming a competitive disadvantage that would drive away jobs and investment.

How did the Government respond?

In 1995 a new provincial government committed to putting a stop to spiraling debt and high costs, and put a plan in place to restructure the electricity sector in Ontario. The government asked former federal Liberal finance minister the Honourable Donald Macdonald for advice. The Macdonald Committee consulted widely and heard from hundreds of people. In 1996, it issued its report, *A Framework for Competition*, which recommended major changes to Ontario's electricity system based on a competitive market, much like the one that has existed for natural gas in Ontario for a number of years.

After an 18-month review, the government responded with a policy statement (a "white paper") called *Direction for Change: Charting a Course for Competitive Electricity and Jobs in Ontario*, which endorsed these directions of the Macdonald Committee. To ensure that the best possible expertise was assembled to plan a system that would benefit customers, the government created a Market Design Committee chaired by Ron Daniels, Dean of the University of Toronto Law School, with industry and consumer representatives. The Market Design Committee developed a detailed plan to implement the new, competitive electricity system.

What has been accomplished?

The *Energy Competition Act* was proclaimed in October 1998 after much debate and public input. This new law responded to the recommendations of many customers and industry experts, including the Macdonald Committee and the Market Design Committee. The law transformed the old Ontario Hydro by splitting it into two main commercial companies incorporated under the Ontario *Business Corporations Act*: Hydro One and Ontario Power Generation, which would operate in a reformed and more effective regulatory framework. A new regulatory body, was created – the Independent Electricity Market Operator (IMO). The Ontario Energy Board (OEB) was strengthened.

The much-criticized practices of having the old Ontario Hydro regulate itself, and of having the transmission wires operated by the same company that owned most of the generating plants, were eliminated. Now, Hydro One owns and operates the province-wide electricity transmission grid (the towers and wires that transport high-voltage electricity across long distances). Hydro One also owns some local distribution systems currently serving more than 1,200,000 customers across Ontario. It does not own any generation plants connected to the transmission grid.

Hydro One and the other 94 local distribution companies (LDCs) are “natural monopolies” which are subject to independent regulation by the OEB and the IMO. The OEB must regulate and approve transmission and distribution rates. Performance Based Regulation (PBR) will provide incentives for Hydro One and the other utilities to lower costs and share their savings with customers. The IMO must protect the interests of consumers with respect to reliability and quality of service.

Competition has been introduced into the generation of electricity. Consumers now have an opportunity to choose to purchase their electricity from a retail seller. The OEB also licenses retail sellers of electricity and regulates to prevent abuse or fraud. Competitors can also provide other benefits, such as offering customers the choice of “green” sources of power, like wind or solar generation.

Ontario Power Generation (OPG) owns and operates the generating plants of the old Ontario Hydro. OPG is licensed by the Ontario Energy Board and is required, through selling or leasing of its plants, to reduce its dominance of the electricity generation business in order to ensure a truly competitive market. As part of its license, OPG is required to provide a rebate to consumers if prices rise above a specified level.

Some people have referred to the new governance structure for operating Ontario’s electricity systems as “deregulation”, suggesting that the system is no longer regulated. Nothing could be further from the truth. The old system was based on self-regulation by Ontario Hydro itself, and allowed the monopoly to set its own rates. Not surprisingly, self-regulation by a monopoly was ineffective, in large part because of an inherent conflict of interest. The new strengthened regulatory regime eliminates any self-regulation.

Under the new regime, no matter who owns the transmission, distribution, retailing or generation businesses in Ontario, all of them, including those that are already owned by the private sector, are licensed and regulated by the Ontario Energy Board and the Independent Electricity Market Operator. The IMO ensures the efficient, safe and reliable operation of the market, while the OEB ensures fair competition.

Environmental protection is one of the government’s main objectives in restructuring the electricity system. Ontario’s new environmental standards, and emission caps for electricity generation, are among the toughest in North America. Also, for the first time, customers will be able to choose cleaner types of electricity.

The restructuring of Ontario’s electricity system will create jobs, promote investment, and ensure that electricity customers in this province enjoy a reliable supply of power at the lowest possible cost. In fact, a recent analysis by Professor Fred Lazar of York University concluded that the competitive market could save Ontario electricity customers from \$3 billion to \$6 billion by 2010.

What needs to be done?

Ontario's aging electricity towers and wires require significant new investment to maintain and strengthen safety and reliability. For this year alone, capital expenditures are estimated at \$550 million for Hydro One's transmission and distribution businesses.

Government does not need to use taxpayer dollars to fund the investment required in electricity transmission, any more than it does in natural gas pipelines or local telephone or cable television networks. Government should not take funding away from priorities such as hospitals and schools to pay for electricity networks. Other provinces such as Alberta and Nova Scotia have transmission businesses that are owned by the private sector. Clearly government spending is not required, and history has shown that government too often makes the wrong decisions. Taxpayers should not, and will not accept the added burden of providing financial support for an electricity network that can be better provided by investors

Hydro One must improve its efficiency for the benefit of its customers. A company with private investors will more aggressively respond to the incentives under Performance Based Regulation to lower costs and share the benefits with consumers.

Taxpayers, the Provincial Auditor, and electricity ratepayers expect the \$38 billion in debt and other liabilities from the old Ontario Hydro to be paid down. The faster the debt is removed, the sooner the savings from competition will be reflected in lower electricity prices for consumers.

Ontarians' direct investment in shares of Hydro One would be the best guarantee that:

- a) there will be the necessary investment needed for renewal and innovation
- b) the existing debt will be paid down quickly
- c) taxpayer risk will be eliminated, and
- d) costs and prices will be better controlled because investors will have a direct say in Hydro One's performance.

How can you help us?

The Government has signaled its intention to develop legislation that would permit Ontarians to invest directly in Hydro One through a public offering of Hydro One shares. We would like to hear your views directly from you. What features should the legislation contain?

We would like to know your thoughts on:

- How do we ensure the debt is paid down?
- How do we ensure adequate investment in the wires network that delivers electricity to customers?
- How do we ensure that Ontario jobs are protected?
- How do we ensure that Ontario citizens continue to have a say?
- How do we ensure transmission and distribution rates remain reasonable?
- How do we ensure that Ontario citizens will benefit directly from this transaction?
- How do we ensure Hydro One efficiency and enhance safety and reliability?

Please send your comments to:

Minister Chris Stockwell
P.O. Box 1051
Station 'F'
50 Charles Street East
Toronto, Ontario M4Y 2T7

Fax: 416-326-3947

Email: EnergyDivision@est.gov.on.ca

The Ministry of Environment and Energy has been directed to consult with the public and stakeholders regarding electricity legislation. Any personal information you choose to provide in the context of this consultation will only be used for the purpose of informing such legislation and to assist us in assessing the results of the consultation and for no other purpose. Your comments, without your name or any other personal information that might identify you, may be disclosed to other participants, institutions and interested parties during and after the consultation. You will not be placed on any mailing lists or nor will personal information be disclosed to any third party. If you have any questions about the collection, use or disclosure of this information, please call collect: Padma de Souza at 416-327-2485.