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January 26, 2015

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

Dear: Mr. Sousa

Re: 2015 Pre-Budget Consultation

The Power Workers' Union ("PWU") appreciates the opportunity to offer the following submission on Ontario's 2015 Pre-Budget Consultation.

The PWU represents a large portion of the employees (over 15,000) working in all sectors of Ontario's electricity industry (attached is a list of PWU employers) and has been a key participant in Ontario's energy policy discussions for over 70 years.

The PWU's intent in making this submission is to provide the Minister of Finance input that will enhance the robustness of the 2015 Budget and priorities while minimizing the risk to the affordability, adequacy, reliability and safety of Ontario's power system and ensuring the development of a budget that is growth-oriented and fair to Ontario's electricity customers and taxpayers.

To this end, please find the PWU's submission on the 2015 Pre-Budget Consultation.

We hope you will find the PWU's comments useful.

Yours truly,

Don MacKinnon
President

List of PWU Employers

Algoma Power
AMEC Nuclear Safety Solutions
Atlantic Power Corporation - Calstock Power Plant
Atlantic Power Corporation - Kapuskasing Power Plant
Atlantic Power Corporation - Nipigon Power Plant
Atlantic Power Corporation - Tunis Power Plant
Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power Wind Operations
Brookfield Renewable Power - Mississagi Power Trust
Bruce Power Inc.
Compass Group Corporation of the County of Brant
Covanta Durham York Renewable Energy Ltd.
Entegrus
Erie Thames Powerlines
Erth Corporation
ES Fox
Great Lakes Power
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
Lake Superior Power Inc. (A Brookfield Company)
London Hydro Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Waste Management Organization
Nuvia Canada
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Rogers Communications (Kincardine Cable TV Ltd.)
Sioux Lookout Hydro Inc.
SouthWestern Energy
The Electrical Safety Authority
TransAlta Generation Partnership O.H.S.C.
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

Power Workers' Union

2015 Pre-Budget Submission
to the
Standing Committee on Finance and Economic Affairs
Government of Ontario

January 26, 2015

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Power Workers' Union

2015 Pre-Budget Submission to the Standing Committee on Finance and Economic Affairs, Government of Ontario

1. INTRODUCTION

The Power Workers' Union ("PWU") appreciates the opportunity to offer the following submission on Ontario's 2015 Pre-Budget Consultation as invited by the Minister of Finance.[1]

The PWU has been a key participant in Ontario's energy policy discussions for over 70 years. The PWU represents a large portion of the employees working in Ontario's electricity industry and our members work in all sectors of the Ontario electricity industry. Our submission stems from our energy strategy and policy statement:

> **Reliable, secure, safe, environmentally sustainable and reasonably priced electricity supply and service, supported by a financially viable energy industry and skilled labour force is essential for the continued prosperity and social welfare of the people of Ontario. In minimizing environmental impacts, due consideration must be given to economic impacts and the efficiency and sustainability of all energy sources and existing assets. A stable business environment and predictable and fair regulatory framework will promote investment in technical innovation that results in efficiency gains.**

In this submission, the PWU specifically comments on the recommendation of the Premier's Advisory Council ("Council") on Government Assets to separate Hydro One into two companies - transmission and distribution - and to sell a majority share in the resulting distribution company to the private sector. The PWU believes that its comments will provide the Minister input that will enhance the robustness of the 2015 Budget and priorities while minimizing the risk to the affordability, adequacy, reliability and safety of Ontario's power system. These comments are also aimed at ensuring the development of a budget that is growth-oriented, fair to Ontario's electricity customers and taxpayers, and respectful of the legally protected rights of hundreds of thousands of employees working in Government Business Enterprises

[1] http://www.fin.gov.on.ca/en/consultations/prebud/

("GBEs") including the more than 15,000 members of the PWU who are working hard every day to keep the lights on for Ontarians.

1.1 Executive Summary of Submission

1. *The PWU supports the objectives of maximizing the value of Ontario's publicly owned assets for the benefit of the people of Ontario, and the voluntary consolidation of the distribution sector in Ontario.*

2. *However, the recommendation by the Council to split Hydro One into two separate companies - distribution and transmission - and to subsequently sell a majority stake in the distribution company to a private owner is ill-conceived and if implemented would be harmful to the province's finances and to electricity rate payers in Ontario. Specifically, implementation of the Council's recommendation would:*

   a. significantly decrease the Government's revenue stream – due to loss of net income and tax leakage to the federal government

   b. result in the loss of existing valuable synergies at Hydro One; impose inefficiency and cost of operations at both companies thereby increasing the cost of electricity for ratepayers

   c. result in significant transition and transaction costs

   d. result in deterioration of service quality and reliability

   e. require a complex and costly regulatory approval process.

3. *The Council's Recommendations are not consistent with:*

   a. Recommendation 17-1 of the 2012 report of the Commission on the Reform of Ontario's Public Services ("Commission") which advised the Government to "not partially or fully divest any or all of the province's government business enterprises … unless the net, long-term benefit to Ontario is considerable and can be clearly demonstrated through comprehensive analysis",[2]

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[2] Commission on the Reform of Ontario's Public Services: Public Services for Ontarians: A Path to Sustainability and Excellence; 2012, page 407.

   b. *The Government's instruction to the Council that preference be given "to the continued government ownership of all core strategic assets."*[3]

   c. *The 2014 Annual Report of the Office of the Auditor General of Ontario which identified 'the higher cost of private-sector financing' as a factor why public-private partnerships have often cost Ontario taxpayers more than if the Government had undertaken projects itself.*[4]

4. *The Government should reject the assumption that private capital always holds the key to improved efficiency. GBEs such as Hydro One and the Ontario Power Generation ("OPG"), in addition to their role as providers of low cost electricity to Ontarians, can be used to fuel economic growth, create more jobs and return more revenue to the Government through ongoing and new efficiency measures and the pursuit of business opportunities both locally and abroad while under full public ownership. As the guardian of the public assets owned by Ontarians, it is incumbent on the government to ensure that Ontarians are not losing a reliable revenue stream and face the risk of higher electricity cost and reduced service quality.*

5. *There are better ways to maximize the value of Hydro One and the OPG:*

   a. *encourage Hydro One and OPG to keep on looking for more efficiency improvement opportunities and pursue strategic partnerships and business opportunities;*

   b. *amend legislation and regulations to allow distributors such as Hydro One to directly provide multiple products and services and enjoy economies of scope;*

   c. *sell idle properties that are not generating revenue and have limited potential to do so; pursue new strategic partnerships/arrangements that focus on developing idle properties e.g. conversion of Nanticoke and Lambton Generating Stations to dual fuel; and*

[3] Ontario Budget: 2014: Building Opportunity, Securing Our Future, page 164
[4] Office of the Auditor General of Ontario: 2014 Annual Report, page 7

d. Monetize and take advantage of OPG's and other Ontario low carbon electricity generation by creating a carbon credits system that can be traded in the Western Climate Initiative.

6. *The PWU recognizes the fiscal challenges facing the province as well as the need to provide affordable, safe and reliable electricity to Ontarians. Moreover, as the Council indicates in its Report, 'almost none of the potential improvements or restructuring at Hydro One or OPG will be possible without consulting and negotiating with the Power Workers' Union and the Society of Energy Professionals.'[5] Therefore, to the extent that the Province needs to address new and existing challenges, there should be an open dialogue between government, industry and labour based on fairness and mutual respect. Transparent and fair negotiations based on respect for legally protected collective bargaining rights with respect to such matters as working conditions, wages and pensions would enhance friendly labour environment, ensure long-term and sustainable delivery of service, and are essential ingredients for maximizing the value of Hydro One and OPG assets.*

2. THE PWU's COMMENT ON THE COUNCIL'S RECOMMENDATIONS REGARDING HYDRO ONE

In April, 2014, the Government of Ontario established the Premier's Advisory Council ("Council") on Government Assets including the Ontario Power Generation ("OPG"), Hydro One and the Liquor Control Board of Ontario ("LCBO") to recommend ways to improve their efficiency and optimize the full value of the assets.

On November 13, 2014, the Council released its Initial Report titled: *Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers* ("the Report"). With respect to Hydro One, the Council recommends, among other things, that:

i. The transmission and distribution businesses of Hydro One Networks should be separated into two entities: transmission and distribution.

[5] Premier's Advisory Council on Government Assets: Initial Report, Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers, page 11

ii. The Province should dilute its interest in the resulting distribution company to a minority interest (40 per cent to 45 per cent) by bringing in private capital.

iii. The Hydro One distribution assets should be used as a catalyst to encourage consolidation of the electricity distribution system.

iv. The Province should dilute its interest in Hydro One Brampton and, like Hydro One Distribution, use its assets as a catalyst to encourage consolidation.

2.1 The Recommendation to Split Hydro One into two Companies

From an outcome perspective, the PWU submits, there are many reasons discussed later in this submission that demonstrate why the Council's recommendation to divide Hydro One and to sell a majority share in the resulting distribution company to the private sector should be rejected.

It would be helpful, however, to first identify some fundamental limitations and deficiencies of the Council's review of Hydro One and its recommendations in light of the Council's mandate, consistency with the Government's instructions and the standard approach to conducting a transparent, comprehensive and verifiable study. The following are but some of these limitations:

2.1.1 Absence of Cost-Benefit Analysis of Options; Lack of Logic, Rationale, and Relevance to Hydro One's Circumstances

Built into the recommendations with respect to Hydro One are three measures:

a) Separate Hydro One Transmission and Distribution

b) Sell a majority share of the resulting Distribution company (bring in private capital)

c) Consolidation – use Hydro One Distribution (and Hydro One Brampton) as a catalyst for consolidation and improved efficiency in the distribution sector

The causal relationships among these three measures and how each is relevant to or useful in the context of the specific circumstances of Hydro One Distribution are not clear at all. In other words, neither the justification for breaking Hydro One nor the call for private capital in the context of Hydro One, are clearly explained.

The Council states in its Report that, in its assessment, 'the transmission business is a well-run part of Hydro One with some opportunities to deliver savings ….we believe Hydro One transmission should remain in public hands as a core asset at this time.'[6]

With respect to distribution, however, the Council states:

> **We view the distribution business differently. There are huge challenges in Ontario's local electricity distribution system. There are too many entities, some of them inefficient, that lack the capability and capital to modernize and adapt to the changing environment… Ontario needs a more consolidated and efficient electrical distribution system. The system needs more capital, which is unlikely to be available from the public sector owners given other pressing needs.**[7]

It is clear that the Council's call for consolidation and private capital emanates from the assessment of Ontario's electricity distribution sector at large which has 'too many, small' distributors that need to consolidate and grow in size. The rationale does not apply to Hydro One. Hydro One Distribution is not only the largest distributor in the province but also has been consolidating other smaller utilities, most recently Norfolk (April 2013), Haldimand County Hydro (June 2014), Woodstock (2014) and is still looking for more opportunities to consolidate. Moreover, there is no evidence that Hydro One has difficulty in accessing capital for the purpose of acquiring other smaller distributors.

In this regard, it is not clear why the Council considers the separation of Hydro One into transmission and distribution and the sale of Hydro One's Distribution assets to the private sector necessary to 'catalyze consolidation' in the distribution sector. Put differently, the Council does not tell us why Hydro One, as it is presently configured, cannot be used in the "catalyst for consolidation" role that the Council envisages for the "distribution only" Hydro One successor company. Voluntary consolidation is happening especially within the publicly owned utilities and Hydro One is the most active participant in that regard.

[6] Premier's Advisory Council on Government Assets: Initial Report, Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers, page 7

[7] Ibid.

It is not apparent that there are significant efficiency gains available to be obtained within Hydro One's distribution business. However, even assuming that such a potential existed, there is no evidence that the PWU is aware of that the separation of the distribution from transmission business is essential, or even helpful, in the realization of such efficiency gains. The combined operation of transmission and distribution remains the typical structure for wires companies across Canada, North America and most of the world. There simply is no trend towards such separations nor empirical evidence of benefits being derived from doing so.

There is indication in the Report which suggests that the Council proposes to split Hydro One on the ground that it is a necessary requirement for selling public assets to the private sector:

> **We researched and reviewed significant activity in the global electricity transmission and distribution markets, where transactions have occurred recently in North America, Europe and Australasia. There has been an increasing focus globally on the vertical unbundling of assets to ensure that wholesale (i.e., transmission) and retail (i.e., distribution) businesses are separated from their parent companies before any transaction.**[8]

The Council appears to have first determined, based on some unexplained reason, that Hydro One Distribution's assets needed to be sold to the private sector and only then found the break-up of Hydro One a necessary requirement to complete the transaction. In other words, the Council's recommendation is not based on a transparent, professional and independently validated comparison of options, setting out costs and benefits to the public of each, as required by its mandate. Such options could involve for example:

a) encouraging efficiencies and consolidation in the transmission/distribution segment of the electricity industry in Ontario without mandating a break-up of Hydro One

b) to mandate the break-up as the Council has suggested.

Unfortunately, nowhere in the Report does the Council provide such analysis.

[8] Ibid. page 60

2.1.2 Internal Contradiction and Inconsistency

There is a serious internal contradiction in the Council's recommendations. On the one hand, the Council identifies the need for consolidation in the Ontario distribution sector as a priority. There are two primary sources of potential savings arising from consolidation. The first is the elimination of duplicate functions. Merged utilities may need only one head office, one executive suite, one billing and IT system, one system control centre, one customer care centre, etc. The second is economies of scale. The cost of centralized functions and fixed assets can be spread over a larger customer base, reducing unit costs.

However, the Council simultaneously recommends the splitting of Hydro One into two companies. It does this without any acknowledgment that, by doing so, it would be creating the duplication, and eliminating the economies of scale that it recognizes as benefits of mergers– the very antithesis of the goals of distribution section reforms it is pursuing.

Compounding this irony is the fact that the government has, effective January 1, 2015, completed the merger of its two agencies in the electricity sector – the Ontario Power Authority and the Independent Electricity System Operator. The identified objectives for this combination are clearly explained in a recent news release from the IESO:

> **Amalgamation will achieve efficiencies going forward by reducing overlap, reducing costs and streamlining electricity sector planning.[9]**

2.1.3 Disregard of Relevant Canadian Experience

The Council states that it has 'researched and reviewed significant activity in the global electricity transmission and distribution markets where there has been an increasing focus globally on the vertical unbundling of assets.'[10] The PWU submits that the overwhelming number of cases of vertical unbundling of assets in the electricity market involved the separation of transmission and distribution from generation and none of them are relevant to the specific circumstances of Hydro One.

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[9] http://www.ieso.ca/Pages/Media/Release.aspx?releaseID=6946

[10] Premier's Advisory Council on Government Assets: Initial Report, Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers, page 60

The PWU finds it curious that the Council chose not to mention the experience of other Canadian jurisdictions wherein attempts at disintegration of utilities along the lines of the Council's recommendations have failed.

New Brunswick and British Columbia, for example, represent cases wherein policies of disintegration of distribution and transmission failed miserably and were reversed as a result. Not only did the experiments cost millions of dollars, they also failed to produce the hoped-for benefits. To the contrary, they increased the cost of electricity and decreased efficiency.

In New Brunswick, NB Power was disintegrated in 2004 creating five separate companies. In October of 2013, the government of NB reintegrated NB Power in order to 'increase efficiency and to keep energy prices low and stable.'[11] The Government also noted that disintegration provided little value and resulted in electric utility structure, market structure and rules that were overly complex.

In British Columbia, the B.C. Transmission Corporation (BCTC) was separated from B.C. Hydro which was left with generation and distribution - two of its traditional areas of operation. Some calculations suggested that over $65M was wasted as a result of the "failed experiment" due to duplication of, for example, offices and officers, following the separation. In 2010, British Columbia passed the *Clean Energy Act* which reintegrated BC Hydro and the BCTC into one utility.[12] [13]

The single "made in Ontario" case study involves the former Great Lakes Power Ltd ("GLP"). Before 2008 GLP operated as a vertically integrated generation, transmission and distribution utility. Through a series of transactions in 2008 and 2009 the distribution business was spun into a separate company, and then the transmission business was spun into a separate company. The evidence reveals that after the separation, the two businesses collectively had more employees and higher costs than when they operated as a single company. Moreover, the successor companies have higher rates and their combined net income was only very slightly higher than earned

[11] http://www2.gnb.ca/content/gnb/en/news/news_release.2013.10.0956.html
[12] http://greenpolicyprof.org/wordpress/?p=427
[13] http://thetyee.ca/Opinion/2010/05/03/LiberalsOweApology/

while a single company. Notably, this is in the context of a separation on a much smaller scale than the one the Council proposes and in respect of a company where, unlike Hydro One, the transmission and distribution operations were not closely integrated with each other.

It is reasonable, therefore, to conclude that the proposal to break Hydro One in to two businesses and to sell a majority stake in Hydro One Distribution to the private sector lacks logic and is not supported by relevant experience and sound cost-benefit analysis.

2.2 Consequences of Splitting Hydro One Transmission and Distribution and Selling Hydro One Distribution

2.2.1 Loss of Valuable Synergies Resulting in Higher Costs for both new Companies

Splitting Hydro One into transmission and distribution and the creation of two head offices, two executive suites, two billing and IT systems, two legal departments and duplicate work centres, material and equipment staging centres, etc., will inevitably increase the aggregate costs of the two new companies relative to the single existing company, permanently and year after year. The same can be said about lost economies of scale. The inevitable costs arising from duplication and the loss of economies of scale are likely to wipe out any potential savings that the companies might gain from other measures of operational efficiency.

Hydro One describes the benefits of its use of a consolidated workforce in the following terms:

> **Hydro One has an integrated workforce for its transmission and distribution businesses. This allows Hydro One to take advantage of economies of scale and efficiencies that would not be available through separate transmission and distribution operations. Examples would include a centralized control centre, centralized fleet operations, and an integrated asset management strategy.**[14]

Hydro One has never operated transmission and distribution as two separate businesses under a single corporate roof. They have always been operated as a single integrated operation. As indicated earlier, Hydro One's operations take place in a vast, thinly populated service territory. It is only economic to have a certain number of staff,

[14] EB-2013-0416, Exhibit C1, Tab 3, Schedule 1, p. 4

plant and equipment within any given area. Hydro One deploys many of the same human and physical resources in the operations and maintenance of both its transmission and distribution systems within any given area.

Separating the two operations, therefore, would increase the cost of operations and would only leave the new companies with two stark choices: maintain service levels by doubling up on resources and associated costs or drastically reduce coverage levels, thereby drastically reducing service levels.[15]

2.2.2 Very Large and Non-Recoverable Transition and Transaction Costs

Hydro One is a large and complex company. The structural separation of Hydro One into two distinct companies would be neither an easy nor an inexpensive task. In some respects it will be a more challenging undertaking than the separation of the old Ontario Hydro into five new companies in 1999.[16]

This is not a case of formally dividing two businesses that have been operating separately, but in parallel, under a single corporate roof. On the contrary, transmission and distribution functions have always been carried out on a fully integrated basis at Hydro One and, before that, throughout Ontario Hydro's history. These operations are not undertaken as two separate divisions within one company. Thousands of employees divide their time, sometimes on a daily basis, between the two functions. Similarly, all manner of plant and equipment is routinely and continuously employed in furtherance of the operations of both businesses. The same can be said for accounting, technology, and any number of corporate support and administrative functions.

Moreover, the staffing and overall infrastructure of Hydro One has been scaled to be cost effective in relation to the size of the overall corporate operation. Quite apart from the inevitable need for duplication of resources, it is not apparent that existing resources

[15] Potentially, there is a third alternative – the employees and facilities would remain in the hands of one of the two companies, and the other company would contract in the required services from the other. The result would be, at best, net neutral, ignoring the inevitable transaction costs such an arrangement would entail.

[16] Note that the combined transmission and distribution function within the old Ontario Hydro was much more closely integrated with one another, than either part of it was connected to the Ontario Hydro generation business. Thus the separation of OPG from Hydro One was in many respects much more straightforward than will be the separation of the two integrated parts of Hydro One.

(e.g. Cornerstone[17]) can simply be divided into two separate systems, or operated on a cost effective basis within the confines of two much smaller enterprises.

The PWU submits that the transaction costs, be it the one-time internal or external (investment bankers, financial and legal advisors, etc.), needed to accomplish the separation would be significant. The PWU assumes that the ultimate total will be in the hundreds of millions of dollars. In this context, it is passing strange that there was not the least mention of these costs in the Council's interim report. Transparency requires a full accounting of such costs up front, together with a detailed justification for the incursion of the costs.

These costs would be a dead loss to the province. The new companies will have to recoup all of these considerable transition and transaction costs before the province, as shareholder, can see a dime of net financial benefit from the transaction. Unless the companies can do so within a relatively narrow window of time, the province will suffer an irretrievable net loss from the transaction. The Council has not even suggested that these costs can be recovered, let alone set out a roadmap for doing so. Given the significance of these costs, it is incumbent on the Council to deal with the issue of how such costs can be justified in comparison to the provable savings, if any, to be gained by the Council's proposal, and to explain how such costs can be recovered.

2.2.3 It will Require Regulatory Approval Which will be Difficult to Obtain

Pursuant to s. 86 of the *Ontario Energy Board Act, 1998*, the separation of Hydro One into two distinct companies (even if both remain wholly owned by the province), requires regulatory approval from the OEB. The test applied by the Board in considering such applications is the "no harm" test. Of particular concern to the Board is whether customers will be exposed to a higher cost structure utility if the proposed transaction proceeds.

As noted above, the OEB will not permit a utility to pass transaction costs on to customers through rate increases.

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[17] Cornerstone is an SAP based enterprise IT system on which Hydro One manages its accounting, billing, customer service, customer information and other functions, for both its transmission and distribution businesses. Hydro One has invested more than $500 million in Cornerstone in the 2006-14 period - see: EB-2013-0416, Exhibit I, Tab 4.02 Schedule 1, Staff 62, p. 2

The fundamental problem is that, for the reasons discussed above, each of the two new companies will almost certainly have a higher cost structure than Hydro One has today. That will leave the province with only two alternatives. First, it could seek to permanently insulate its customers from the impact of this higher cost structure. That could only be achieved by offsetting these costs against its dividends. Needless to say, this will have a negative impact on provincial finances. Second, it could run the risk of having the OEB disallow the transaction on the basis that it does not pass the "no harm" test.

2.2.4 Sale of Equity will Result in Decreased Revenue Stream which Cannot be Offset by Increased Earnings Through Efficiency Gains

As the Council points out, from a fiscal perspective, Hydro One's net income, in addition to payments in lieu of taxes (PILS), counts as revenue to the Province.[18] In this regard, it is worth pointing out that in the last 10 years, Hydro One (both Transmission and Distribution) has paid close to $3 billion to the government in the form of dividends and has generated close to $7 billion in net income over the period 2000-2013.[19]

Hydro One Distribution alone has generated over $2 billion in government revenue in the form of net income and PILS in the 2005-2013 period:[20] that is an average of $170M and $52M per year in net income and PILS, respectively:

[18] Premier's Advisory Council on Government Assets: Ibid., page 52

[19] Hydro One Annual Reports

[20] The PWU acknowledges that Hydro One's actual dividend to the province may be more than, or less than its actual net income in any given year. That is a matter in the discretion of Hydro One and the province, as its shareholder. However, the net income determines the amount that is theoretically available to be dividended in any given year.

Table 1: Hydro One Distribution Net Income & Payment in Lieu of Taxes[21]

	Net Income ($M)	PILS ($M)
2005	95.8	71.7
2006	125.6	63.0
2007	88.1	93.0
2008	115.6	76.1
2009	160.4	28.2
2010	194.0	8.0
2011	236.2	66.1
2012	258.5	43.6
2013	258.3	24.0
Total	$1,532.5M	$473.5
Average/year	$170M	$52.6M

The Council estimates that between $2 billion and $3 billion, 'depending on market conditions at the time', can be realized, by reducing government ownership in the electrical distribution systems (the PWU understands this to mean Hydro One Distribution and Hydro One Brampton), and invested in Ontario's transit and transportation infrastructure.[22]

The Council at the same time recognizes that a smaller equity position means lower government income from these companies in downstream years. The problem is that the Council assumes that potential efficiency gains in entities that will remain publicly owned will more than offset the lost income:

> **While the provincial government would get less ongoing income directly from these companies, the investments in economic growth will help mitigate this shortfall over time. In addition, this lost income would be more than covered from the savings generated by the improvements we are proposing for the entities we believe should remain publicly owned, including the LCBO.[23]**

There are three fundamental problems with the Council's justification of the loss of government income resulting from the sale of majority share in Hydro One distribution:

[21] Ontario Energy Board:2005-2013 Yearbooks of Ontario Distributors
[22] Premier's Advisory Council on Government Assets: Ibid., page 12
[23] Ibid.

First, nowhere in the Report does the Council provide analysis that demonstrates Ontarians would be better off with a one-time $2-3 billion proceed from the sale of equity than with a reliable and long-term revenue stream; neither does the Council consider whether seeking the capital for the stated investment in infrastructure from other sources is a better or more viable option.

Secondly, the Council strangely argues that the lost government revenue resulting from the sale of equity in Hydro One can be more than covered from efficiency gains that the Council proposes for the entities it believes should remain publicly owned – i.e. the OPG, LCBO, and presumably Hydro One Transmission and a portion of Hydro One Distribution. This however begs the question as to whether the province would be better off capturing those savings without an equity sale in Hydro One. In such a case, the combined additional revenue to the province would unquestionably be larger. Considering that the Council is asked to find ways of maximizing the asset values of Hydro One, OPG and LCBO, it is not clear how potential savings at OPG and LCBO provide the basis for decisions affecting the revenue that Hydro One generates for the Province.

Last but not least, the Council has grossly overestimated the quantum of potential efficiency gains from consolidation and the infusion of private capital. This is particularly the case with respect to Hydro One Distribution. The PWU notes the Council's observation that annual OM&A costs on a per customer basis at Hydro One Distribution are higher than other distributors such as Hydro Ottawa, Toronto Hydro and Hydro One Brampton and that Hydro One Distribution 'has experienced lower historical economic performance when compared to the transmission business…the distribution segment has performed below the deemed return on equity set by OEB in each of the past four years.[24]

The fact of the matter is that while there is always room for improving efficiency, it is important to recognize that operational efficiency at Hydro One Distribution is by and large a reflection of the nature of its service which is in no way comparable to those distributors the Council identified in its Report:

[24] Ibid., page 56

Table 2: Ontario Distribution Sector (2013)[25]

				Industry - All 73 Distributors	Hydro One Distribution	Hydro One Distribution's Share
Total Customers				4,944,488	1,220,101	25%
Total Service Area (sq. km)				681,502	650,000	95%
	Rural Service Area (sq. km)			675,001	650,000	96%
	Urban Service Area (sq. km)			6,501	- *	0% *
Total KM of Line				197,808	119,516	60%

*** Since this table was produced Hydro One has either acquired or is in the process of acquiring Norfolk, Haldimand and Woodstock LDCs which have a combined total of 209 square kilometres of urban service territory.**

About 99 per cent of the distribution service area in Ontario is rural. Hydro One Distribution serves 25 per cent of the province's total distribution customers but accounts for more than 96 per cent of the total rural service area in the province. Similarly, Hydro One Distribution accounts for over 60 per cent of the total KM of Line in the Province and as a consequence of that accounts for about 1/3rd of the total distribution loss in the province. The result is that Hydro One not only accounts for a third of the total number of employees to serve a fifth of total customers but also incurs higher costs by way of overtime and significant level of line losses due to the nature of its service. It is in spite of such high cost operation that Hydro One Distribution continues to generate net income year after year including the $258 million in 2013.

The Council does not explain how potential efficiency savings can replace, for example, the $258 million net income in 2013 which we will use for demonstration. Assume that a 60 per cent stake is sold to a private equity purchaser. Holding all else equal, this would mean that the government's revenue would decrease by $155 million per year. The question is how much cutting in OM&A, over which the company has some control, would be required to generate this amount of savings?

Hydro One's distribution business presently requires $1,414.9 million in rate revenue. These funds are dedicated to four broad uses:

[25] Ontario Energy Board: 2013 Yearbook of Electricity Distributors

Return on Capital:	$442.7 million[26]
Depreciation and Amortization:	$355.4 million[27]
Payments in lieu of Taxes:	$52.5 million[28]
Operations, Maintenance and Administration:	$564.3 million[29]

The $155 million in desired savings represents a decrease of the overall OM&A budget by more than 27 per cent. Leaving aside the fact that most of the company's expenses are "locked-in" by a range of legally binding contracts, cuts of this magnitude are unprecedented, essentially impossible, and certainly unsustainable, given that Hydro One is under regulatory obligations to maintain service and reliability standards.

Moreover, the Council has ignored the many demands that any consolidation or efficiency savings would be expected to fulfil, in addition to increased dividends to the shareholders:

a. The first call on any such savings is to recoup any premium paid to an acquired entity, together with all of the one-time transaction costs needed to plan and execute the transaction;

b. While utilities are encouraged by the Ontario Energy Board (OEB) to seek and obtain efficiency savings, the OEB insists that customers share in any such savings through (relatively) lower rates. Every several years, a utility's rates are "rebased". On rebasing, customers gain the full benefit of any reduced cost structure that the utility has been able to implement during the interim period. Any additional earnings above the prescribed rate of return

[26] The company has no ability to control this number, and has no interest in reducing the return on equity (in fact, the converse is true).

[27] This is an accounting expense which reflects the value of all of the capital investments that the company has made over time. Changes in the capital expenditures made in any given year in the future have only a very small impact on the total D and A expense.

[28] The province, as recipient, has no interest in reducing this amount.

[29] All numbers from EB-2013-0416 Exhibit E1, Tab 1, Schedule 1, p. 1 (updated May 30, 2014)

can only be obtained through the introduction of wholly new expenditure reductions.[30]

The simple reality is that the province cannot "have its cake and eat it too". An equity sale will inevitably result in a serious and permanent loss of income. The Council should not pretend otherwise.[31] Moreover, it is very difficult to conceive of any operational improvements which could only be realized if Hydro One is split into two companies. To the extent that improvements can be achieved without splitting the company, of course, there is no reason to split the company and incur unnecessary but significant legal and financial expenses associated with the split.

2.2.5 Sale of Equity will Result in Permanent and Significant Loss of Provincial Revenues due to "Tax Leakage" to the Federal Government

Hydro One pays PILs, rather than actual corporate taxes, because it is wholly owned by the province, and thus exempt from both provincial and federal corporate taxes.[32]

With respect to provincial corporate taxes, the province is obviously indifferent as to whether it receives these funds as actual taxes or as PILs. The same is not the case for federal corporate taxes. Because Hydro One pays PILs, the province (not the federal government) receives the amount that Hydro One would have paid as federal corporate taxes, if it had been a taxable entity.

While there is no legislative prohibition on the province or a municipality selling more than 10 per cent of the equity owned by it to a private purchaser, the province is aware of the "tax leakage" to the federal government that would result from such a transaction. As a result, the province has embedded in the s. 94 of the *Electricity Act,*[33] an onerous transfer tax on such transactions which seeks to capture, as a one-time payment, the value of the lost stream of federal tax payments that would result from such a transaction. The transfer tax is sufficiently onerous that no transactions that would

[30] Essentially all of the same restrictions would be applicable in respect of TxCo, with respect to the replacement of the other half of the annual revenue shortfall.
[31] The PWU invites the Council to make public any financial modelling it may have done.
[32] Under s. 149(1)(d) of the *Income Tax Act* ("ITA") an entity which is 90+% owned by a province or a municipality is exempt from federal tax.
[33] S.O. 1998, c. 15, Schedule A

trigger the payment of the transfer tax have been undertaken in the 16 years since the regime was put into place.

As can be seen from Table 1 above, Hydro One's distribution business paid on average $52 million per year to the province in PILS in the 2005-2013 period. In the event that more than 10 per cent of the equity was sold to a private purchaser, a significant portion of this amount would be irretrievably lost to the province. This is a significant "dead loss" to the province's fiscal situation, particularly considering that the province has no unilateral ability to resolve this issue and that the federal government has no interest to provide relief to the province of Ontario, when the Income Tax Act ("ITA") deals with this issue in a uniform manner for all provinces.

The PWU invites the Council to share with the public its insights on the matter and what, if any, assurances it has received from the federal government that the current ITA rules will be changed. Needless to say, in the absence of actual change to the ITA to eliminate the dead loss to the province resulting from the type of transaction proposed by the Council, the undertaking of such a transaction, by virtue of this loss alone, would be improvident and contrary to the public interest.

2.3 Hydro One Brampton

The Council correctly identifies that given its location, Hydro One Brampton has the potential to be a vehicle for the consolidation of LDC operations in the western and north west GTA.

With regard to the Council's proposal that the government sell some of its interest in the company to private owners, however, the PWU submits that it would give rise to the same tax leakage and other issues as described above. As a result, the PWU suggests that voluntary merger activity with municipally owned LDCs is by far the most attractive and viable route to give effect to this consolidation activity.

3. RECOMMENDATIONS FOR MAXIMIZING THE VALUE OF HYDRO ONE AND OPG

- Retain joint ownership of Hydro One's transmission and distribution operations.

- Retain full government ownership of Hydro One while encouraging the company to pursue efficiency improvement opportunities; besides the substantial inherent monetary value of the physical assets of Hydro One, recent and ongoing capital investments represent significant current and future annual revenue streams and net income for both the shareholder and electricity ratepayers.
- Retain the current policy of voluntary consolidation; amend legislation and regulation such as the Affiliate Relationship Code to allow distributors to directly provide multiple products and services and enjoy economies of scope.
- Encourage Hydro One and OPG to:
    - pursue opportunities for strategic partnership with distributors, transmitters and generators in business ventures such as development and construction projects in other jurisdictions
    - sell and export products and services outside of Ontario
    - monetize OPG's and other Ontario low carbon electricity generation by creating a carbon credits system that can be traded in the Western Climate Initiative
    - sell idle properties that are not generating revenue and have limited potential to do so i.e. no attractive rental opportunities
    - pursue new strategic partnerships/arrangements that focus on developing idle properties e.g. conversion of Nanticoke and Lambton Generating Stations to duel fuel
    - incent Hydro One to pursue opportunities for voluntary and commercially viable consolidation of embedded utilities
- Engage in transparent and fair negotiations between government, industry, and labour, based on respect for legally protected collective bargaining rights of workers with respect to working conditions, wages, and pension

All of which is respectfully submitted.