The Future for LDCs: Queen's Park Policy Direction?

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The Imminent "Death Spiral"

– "Death spiral" of a century old business model based on a "natural monopoly".
– Driven by rapid technological change and diffusion.
– **But** the fate of the LDCs (and Ontario's economy) also depends on how world oil and natural gas prices evolve and more.

It’s More Complicated

- Increasing density of Ontario’s population into fewer and larger urban concentrations (with electrified public transit).
    - LDC franchises serving the mega-urban cores remain highly viable and highly prized assets. Private equity interest.
  - Other “peripheral” distribution franchises experience continued loss of load (aftershocks from deindustrialization, real price increases and decentralizing new technologies, etc).
- *As of now, this Alternate Scenario more probable.*

Larger Policy Context: Many Moving Parts

- Also depends on other policies at Queen's Park (QP):
  - Nuclear refurbishment (large centralized facilities producing 75twh in 2032) – 30 year commitment (taking us well into 2050's).
  - Most hydro-electric facilities (42 twh in 2032) should be competitive for many years to come, especially with **carbon pricing** for natural gas.
  - If the radical technology change applies, then more than just LDC assets will be "stranded". Nuclear generation particularly at risk.

Larger Policy Context

- Liberal balanced budget by 2017: payments in lieu of taxes (PILs) and the value of Hydro One and OPG.

- LDCs are an important component of municipal finance ($350 million).

- Large pools of private capital (eg pension funds) want to acquire "public infrastructure", including LDCs.
  - Very powerful lobby at QP.
  - Ed Clark's report: an important signal of future Liberal government intentions.

My Advice: Go Back to Basic Policy Objectives

– Security of supply;
– Environmental and safety standards;
– Lowest possible financial cost;
– Fairness to consumers and low income (low volume) customers in particular;
– Fairness to investors with respect to "stranded assets"; and,
– Transparency in all things.

My Advice on Monopoly

- Never act to preserve a monopoly under assault from superior technology.
  - The policy direction should be an orderly retreat from monopoly, where that model no longer serves.

My Advice on “Duty to Serve”

- The **“duty to serve”** exists only in monopoly or near monopoly.

- However, the government’s “duty” with respect to an essential commodity is more complicated.
  - This is a political (ie. redistributive) issue/duty.

My Advice on “Duty to Serve”

- *Nonetheless,* it is important to end formally, by legislation, the “duty to serve” by any distribution utility, except one (Hydro One).
- Reason: The “duty to serve” is also the legal pretext for full recovery of “stranded assets”.
- The future risk of “stranding” should ***no longer*** be with customers.

My Advice on Stranded Assets

- Should consider immediately a regulatory process for determining when and whether an asset has been “stranded”.
- Should also consider how to recover any debt associated with that asset.
  - Recovery from ratepayers of yet another “stranded debt” merely exacerbates the “death spiral” problem.

My Advice on Stranded Assets

- QP should take unto itself all potentially stranded assets as well as any residual "duty to serve".
  - Hydro One (H-1) should stand ready as buyer of last resort to acquire all "at risk" LDC's.
- Reason: Amalgamating all such redistributive issues into Hydro One makes for transparency of subsidy and QP has "deeper pockets".
  - Recovery of any stranded debt through general taxation (accepting a lower rate of return on Hydro One assets or an explicit transfer/subsidy to H-1).

My Advice on LDC Consolidation and Private Ownership

- No convincing evidence of significant economies of scale beyond the very smallest;
- Private monopolies **not** likely to be more efficient than public monopolies;
- Efficiency depends on the regulatory regime, not ownership (unless competition prevails).
- There is a significant and **known** cost to the provincial treasury to allow private ownership of the biggest LDCs. Therefore:
  - Private ownership ***should not be facilitated, unless it is contractually guaranteed*** that reduced prices to customers more than offset the loss of revenue to QP.

Summary

- Most likely scenario confronting Queen's Park is more complicated than the "death spiral" scenario.
- But QP must act to:
  - Protect the electricity consumer ***and*** the Ontario taxpayer;
  - While accepting its responsibility for an "essential" commodity .
- How?
  - Reduce risk of stranded assets falling on customers or taxpayers;
- How?
  - Eliminate the "duty to serve", for all except QP itself.
  - Make all subsidies transparent