

**RP-2003-0044 – ONTARIO ENERGY BOARD COMBINED SERVICE AREA  
AMENDMENT PROCEEDING**

**TORONTO HYDRO-ELECTRIC SYSTEM AND LDC COALITION RESPONSES TO  
VERIDIAN CONNECTIONS INC. INTERROGATORIES ON THE REPORT OF DR.  
ADONIS YATCHEW FILED ON NOVEMBER 27, 2003**

**VERIDIAN INTERROGATORY #1**

*Ref. Pg 3, Lines 6-8*

*Reference is made to “sub-optimal capital investment decisions”. In the context of Veridian’s amendment application we propose to connect new customers in developing areas that are contiguous to our existing service area boundaries. Can you provide examples, situations, or conditions under which where sub-optimal capital investments could be made?*

**Response**

Suppose that a prospective customer is near the border between two utilities and that for regulatory reasons or as a result of density effects and cost averaging, the two utilities will charge substantially different rates to this customer. Suppose further that the customer is physically closer to the lines of the distributor with the higher rates. The customer may prefer to be connected to the distributor with the lower rates even though the lines are more distant. However, from the system point of view, the more cost-effective connection may be to the distributor with higher rates.

Moreover, if service area amendments along boundaries become common, utilities may engage in capital expenditures in order to protect their territory. For example, utilities may seek to preempt incursions by neighbors by developing facilities near the border even if they are not immediately necessary.

## **VERIDIAN INTERROGATORY #2**

*Ref. Pg 5, Lines 1-3*

*What are the economic criteria or parameters that need to be considered on an equivalency basis from utility to utility to help determine whether one utility or another could economically service the area under consideration? Who should make this determination, the customer or the regulator?*

### **Response**

Among the key economic criteria would be the incremental fixed and variable costs associated with servicing the area for each of the two utilities. The regulator should ultimately determine the appropriateness of a service area amendment.

### **VERIDIAN INTERROGATORY #3**

*Ref. Pg 5, Lines 16-17*

*Please explain what is meant by “stable and predictable changes” in industry structure.*

#### **Response**

In order to reduce capital planning uncertainty and its effects on financial costs for utilities, structural changes in the industry should be predictable as far as possible. For example, if the Wirebury model were approved and if this should result in substantial changes in service area boundaries, the resulting instability would have a detrimental impact on the industry and its customers with little compensating benefit.

## **VERIDIAN INTERROGATORY #4**

*Ref. Pg 6, Lines 12-15*

*Would you consider corporate policies, structure, ownership, size, debt load, etc., to be other relevant factors that influence and affect distribution network planning and distribution costs?*

### **Response**

It would seem that the most important drivers of distribution network planning are the growth in customer base and its spatial distribution. Corporate policies, corporate structure, size, debt load and system expansion can all affect distribution costs. In addition, the regulatory regime combined with the nature of ownership can influence costs.

## **VERIDIAN INTERROGATORY #5**

*Ref. Pg 10, Lines 18-21*

*When considering the issue of density effects, is it typically in the interest of a large diverse distribution utility with a less dense customer base to strive to increase its customer base? If the answer is yes, is there an economic point in time for the utility where customer additions no longer benefit (e.g. a rise in per customer cost) existing customers? Please explain.*

### **Response**

In general, all utilities – whether they have a sparse or dense customer base --prefer to see more business and more customers. There is some evidence in the Ontario and Norwegian data that large utilities may display some diseconomies of scale, though the evidence is not as persuasive as the evidence on scale economies, particularly since the New Zealand and Swiss studies do not show diseconomies of scale.

## **VERIDIAN INTERROGATORY #6**

*Ref. Pg 11, Lines 7-10*

*The statistical data for Ontario's old public utility commissions referred to throughout your evidence appears to be dated. If you were to undertake a new study using 2003 utility data, for example, would you expect that the minimum efficient threshold of 20,000 customers for distribution utilities has increased, decreased or remained the same in Ontario? Please explain.*

### **Response**

I have not undertaken such a study, nor have I had access to more recent data. On balance, it would seem that minimum efficient scale may have increased given the additional responsibilities in the current electricity market.

Please also see response to VECC Interrogatory #9.

## **VERIDIAN INTERROGATORY #7**

*Ref. Pg 16, Lines 7-19*

*In posing the four questions, would it be fair to say that you are highlighting a significant deficiency in the overarching public policy issue concerning electricity restructuring, as it currently exists in Ontario? If so, is it a structural issue that rests in the hands of the Ontario government and not with the regulator? Please explain.*

### **Response**

It may very well be a structural issue that requires direction from the Province. On the other hand, as indicated in the response to Veridian Interrogatory 11 below, the regulator is in a better position to know the preferred direction for distribution sector evolution and restructuring and as such may advise the Government of the need for a restatement of policy and possible changes in legislation.

## VERIDIAN INTERROGATORY #8

*Ref. Pg 18, Lines 17-24; Pg 19, Lines 1-5*

*If your statements are true in a general sense, is there not some degree of competitiveness or contestability for customers that can arise in new growth areas at the boundaries of expanding utilities, especially where existing distribution networks can drive their own technological and economic efficiency gains for the benefit of new customers? Please explain.*

### **Response**

It is reasonable to expect some degree of competitiveness at the outset, but the beneficial competitive effects are likely to be short-lived and limited to the customers which are being contested. Moreover, these potential gains need to be weighed against the potential for regulatory uncertainty and the potential for inefficient capital expenditures. For example, utilities may employ strategies (e.g., “fencing in their territory”) that would “protect” their service areas even though such strategies may not be efficient from the point of view of the system as a whole.

It should be kept in mind that even in economic settings, “protection of territory and borders” can be costly. Indeed, in competitive markets, firms expend considerable resources protecting their market share, but these costs are dominated by the benefits of competition. On the other hand, collegial relationships where both parties have an interest in cooperation, lend themselves to leaving borders unprotected.



## **VERIDIAN INTERROGATORY #9**

*Ref. Pg 25, Line 24-26; Pg 26, Lines 1-3*

*The suggestion is made that embedded distributors will want host distributors to invest in upgrading their facilities for the benefit of the embedded distributors. If the “user pays” principle applies, the embedded distributor would be required to pay the appropriate up-stream infrastructure costs. Under what conditions would the host distributor upgrade its network to accommodate an embedded distributor without compensation?*

### **Response**

For upstream upgrades which are exclusively dedicated to the embedded distributor, then the “user pay” principle would be dispositive. However, it is often – perhaps typically – the case in networks that multiple parties benefit from upgrades, enhancements and expansions. As a result there may be substantial differences of opinion between the host and the embedded utility as to the nature, location and timing of capital investments. This in turn may require regulatory adjudication that would not be required in the absence of creation of new embedded distribution.

## **VERIDIAN INTERROGATORY #10**

*Ref. Pg 29, Lines 3-5*

*Please identify and explain the “subtle set of issues” being referred to in this instance.*

### **Response**

These issues are more subtle than those relating to the Wirebury proposal because they are not premised on the creation of non-conventional utilities serving multiple discontinuous areas. Thus, a determination as to the appropriateness of the applications cannot be made as easily. There are arguments on both sides.

The regulator, in making decisions on these matters would need to consider economic efficiency, the potential for creating regulatory uncertainty and the longer term evolution of the distribution system.

## **VERIDIAN INTERROGATORY #11**

*Ref. Pg 30, Lines 18-23*

*In your opinion, whose role is it to promote further rationalization of the electricity distribution sector in Ontario, the provincial government in its role in developing provincial policy and related legislation or the energy regulator?*

### **Response**

It would appear that major restructuring of distribution would require Provincial direction and perhaps enabling legislation. However, the Ontario Energy Board, as a leading repository of expertise on Provincial energy matters may see it appropriate to advise the Province of improvements in distribution structure that are desirable but that cannot be achieved given the incentive and regulatory instruments currently available to it.

## VERIDIAN INTERROGATORY #12

*Ref. Pg 35, Lines 6-11*

*In several sections of your evidence reference is made to the words “direct competition”. In your view how would you define the meaning of “direct competition” versus say “indirect competition” within the context of service area amendments at the borders of existing distributors?*

### **Response**

The term “direct competition” is used in the evidence to denote conventional competition for customers. As has been noted, if customers cannot switch, direct competition is not sustainable amongst distributors.

However, as indicated at page 32, lines 15-24, distributors compete against each other in capital and labour markets. Moreover, distributors may compete in regulatory and political arenas. These other forms of competition may also be considered to be “indirect competition”.

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