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

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

WIREBURY INTERROGATORY #1

Reference: 1:10-12

Please provide a copy of the paper Yatchew jointly authored with Stephen Littlechild.

Response

A copy of the paper is being sent to parties electronically. It is also available at

http://www.economics.utoronto.ca/yatchew/

WIREBURY INTERROGATORY #2

Reference: Appendix B

Preamble: The conclusion of the Yatchew paper (p. 203) states.

> *The results of our study suggest that horizontal mergers between distributors are not likely to produce substantial scale economies in the operation of their usual wires business. There are likely to be substantial economies in power procurement, a function that has not been previously performed by most Ontario distributors because the preponderance of electricity has been supplied on an 'as required' basis by Ontario Hydro, the main generator. (emphasis in original)*

Please confirm that economies of scale in power procurement can be achieved through joint procurement by non-contiguous distributors.

Response

There are likely to be substantial scale economies in joint power procurement by contiguous or non-contiguous retailers in a competitive market for supply. However, in the current setting, Ontario distributors do not procure power.

WIREBURY INTERROGATORY #3 There was no Interrogatory #3. We have not renumbered interrogatories.

WIREBURY INTERROGATORY #4

Please refer to the attached table setting out Hydro One Networks total retail costs that appear in its 1999 cost allocation study. (RP-2000-0023, Ex. D, Tab 2, Sched. 1, App. A, Sheet 3, updated 2000-06-07) which functionalizes Hydro One Network's expenses.

a) Please identify any significant differences in terms of the relationship between functionalized costs and total costs shown in this table and that which you would expect to see for a typical LDC.

b) Please identify each function, for each expense item (i.e., each cell in the table), that in your view would be higher for a non-contiguous distributor than it would be for a contiguous distributor of a comparable scale.

c) For each functionalized expense item identified in b, above, indicate identify:

- *the specific expenses within the item that would be higher for a non-contiguous distributor*
- *your best estimate of the proportion of the functionalized expense item that would be higher for a non-contiguous distributor, and*
- *your best estimate of maximum differential that could be attributed to a distributor being non-contiguous.*

d) Based on the detailed analysis of the cost differentials for non-contiguous versus contiguous distributors in c above, please provide your estimate of the maximum potential impact on the total revenue requirement of a distributor caused by it being non-contiguous, as compared to a contiguous distributor of similar scale.

e) Please identify each function, for each expense item (i.e., each cell in the table), that in your view would affect the rates or capital contribution that a non-incumbent distributor would recover from new customers that it connects and serves.

f) Please identify all functionalized expense items for which there would be no incentive for distributors to minimize if there were robust competition for connecting new customers.

g) If it is your view that competition for connecting customers would not discipline distributors to control any functionalized expense items, please explain why competitive forces will be impotent in this situation.

Response

I have not performed an analysis of Hydro One's cost allocation study or compared their study to those of local distribution companies.

Nevertheless, a "non-contiguous distributor" would generally have higher O&M and capital costs in comparison to a utility serving the same number of customers and having similar vintage infrastructure in a contiguous service area. The increased costs would result from discontiguity or density effects and failure to achieve economies of scale. The specific impacts on costs would depend on how the spatial pattern of discontiguities evolves.

Moreover, the increased costs would not be limited to the discontiguous distributor. Dilution of density of host utilities could increase their costs as well. For further discussion please see responses to Board Staff Interrogatories #1, #5 and #8.

While there may be some competitive forces operating with respect to "new potential" customers, those competitive pressures would essentially disappear upon connection. In particular, if connected customers cannot exit and are uncontestable, distributors will not be able to compete for their business.

WIREBURY INTERROGATORY #5

Reference Page 3 Line 19-20 "…Ontario government policy documents which have recognized the natural monopoly character of distribution".

Do you consider electricity distribution to be a natural monopoly and if so, how do you define natural monopoly.

Response

Electricity distribution is widely considered to be a "natural monopoly". For example, the Macdonald Committee stated in its report that it "...views the wires portion of the distribution system as a natural monopoly." (page 105). I concur with this view. A "natural monopoly" occurs when a defined market can be served at lower cost by a single firm than by a multiple firm industry structure.

WIREBURY INTERROGATORY #6

Reference Page 5 Line 7 "Discontiguities should not be created except in exceptional cases."

Please describe in your view what would constitute a discontiguous service area.

Response

The Wirebury model–which is the main focus of the testimony-provides an example of a utility which would have multiple discontiguous service areas.

Moreover, individually, the service areas are unlikely to achieve minimum efficient scale, particularly as Wirebury sees itself operating "…as an embedded distributor in respect of multi-unit condominiums and rental buildings and for new sub-divisions." (Evidence of Wirebury Connections Inc., Paragraph 4.)

The discontiguities that would be created under the Wirebury model would not be justified because its targeted customers would in most cases be contiguous to (or at least in close proximity to) areas of moderate to high customer density which are serviced by conventional distributing utilities.

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