The threat to Ontario's at-cost power system

by W.J. Fisher, P.Eng.

In this increasingly complex and wired world, engineers have inherent social responsibilities to voice reasoned opinions on public policy initiatives, based on technical knowledge and professional experience, which the public often has inadequate knowledge to question. This is only too obvious in the debate on the privatization of Ontario Hydro, in which the government's claims have been virtually unchallenged says this 30-year public utilities veteran. Here's what he thinks engineers should be saying.

In my visits to Queen's Park to discuss this matter with some of our political representatives, I have found that even at this level, many do not fully grasp the technical and financial implications of this issue. The local media, who have been very generous in the publication of dissenting opinion, have also expressed a certain feeling of mystification. I therefore consider it a professional duty to contest a policy that my experience leads me to believe will have disastrous consequences for the electrical power consumers and the economy of this province.

At the beginning of the last century, Sir Adam Beck introduced a publicly owned and operated power system designed to provide electrical energy at cost to the residents, businesses and industries of Ontario. His rationale was that cheap abundant power was the most important factor in the future growth and prosperity of the province. His vision was correct and remains just as true today as it did then. However, for the past seven years this concept has been under attack and the people of Ontario are facing legislation that could usher in energy costs similar to those paid by consumers in the investor-owned regimes in the U.S.

The fate of Ontario's at-cost power system was sealed the moment the Tory government was elected in 1995. In that year, according to the chair and president of the Ontario Energy Association, representing private sector energy companies, Government, industry and independent experts began cooperation on the design of a competitive electricity market and regulatory regime appropriate to Ontario's particular circumstances and needs. As a result of these stated aims, it is reasonable to assume that the findings of the McDonald Commission and of the white paper published in 1997 were foregone conclusions.

In 1995, Hydro's debt was reduced by $1.7 billion to $33 billion under Maurice Strong, who had put Hydro's house in order by eliminating the divisions responsible for the debt. The Tories were elected in June, and soon after Strong was replaced by Bill Farlinger, formerly of Ernst and Young, and an advocate of privatization. In his 1996 financial report, the president and CEO Alan Kupsis projected that the debt would be reduced to $27.8 billion by the end of 1999. He also departed soon after and Farlinger assumed his duties until the appointment of Ron Osborne in 1998.

In 1997-1998, the rate of debt reduction slowed considerably, averaging only $300

Year	Total revenue	Operating cost (including debt servicing)	Debt retirement	New, fixed and other assets	Program funding (Nuclear, etc.)
	[$ million]	[$million]	[$million]	[$million]	[$million]
1995	8996	8368	1731	881	0
1996	8886	8314	1163	844	0
1997	8925	8670	677	883	1550*
1998	8979	8035	(93)	865	1486
1999 3 months	2594	2150	587	149	379

*A deficit balance of $4.5 billion was incurred this year for nuclear upgrading in the sum of $5.6 billion and $490 billion related to future labour relations costs, to be funded between 1998 and 2001 from current revenue, a decision designed to benefit only the successor companies. From January 1997 to March 31, 1999, more than $3 billion, which could have been used for debt reduction, was placed in this fund. The financial statements of the successor generating company do not show any information about this fund but do record substantial sums for unspecified investment "activities," no doubt financed by the cash flow from the more than $1.5 billion of depreciation recorded for 2000-2001.

million a year, compared to $1.4 billion a year in 1995-1996, and producing a debt of $30.5 billion on March 31, 1999. However, from 1995-1999, large investments in new fixed assets and present/future nuclear recovery programs in excess of $7 billion occurred, with the obvious intention of making the asset base more profitable for future privatization.

The financial summary for the period is listed in the table (p. 27). The figures are taken from Ontario Hydro financial reports.

The other arm of the power-at-cost system was removed by legislation in 1998 with the rescinding of the *Public Utilities Act*, which specifically mandated non-profit local distribution of power. Municipalities are now required to set up their own distribution companies, the profits of which are subject to corporate tax laws. In order to hand over as many municipal systems as possible to the private sector, Hydro One has been using public funds to purchase the assets of small utilities that did not have the expertise to set up the required corporate structures, thereby committing the local consumers to higher rates.

The "stranded debt" that became the consumers' burden on April 1, 1999, contains two substantial elements totalling $6.8 billion. Almost $4.3 billion is assigned to a series of contracts arranged in about 1990 by Ontario Hydro, or power delivery from non-utility generators, which extend to 2048. Without a shred of published evidence to support its claim, the government has stated that on a discounted cash flow basis, the contracts are a liability of $4.3 billion. If indeed they are a liability, consumers will in any event carry the cost of these contracts in their rates. With the "stranded debt," they are in effect paying twice. The remainder of the $6.8 billion is assigned to used nuclear fuel storage and disposal. These duties are now the responsibility of the successor company and as the storage facilities are already in place and the disposal will probably take place long after the "stranded debt" has been paid, the consumers are likely to bear the cost once again in their rates.

On March 31, 1999, the combined depreciated generation, heavy water, transmission and distribution assets of Ontario Hydro were recorded as $33 billion. The next day, the Tory government handed over these assets to Hydro One and Ontario Power Generation (OPG) for their assumption of $17 billion of the real Hydro debt of $30.5 billion.

To carry out the creative accounting necessary to justify this gift to the successor companies, the government formed the Ontario Electricity Financial Corporation (OEFC) to choreograph the steps necessary to achieve this end. The details are too complex to describe in this small space, but one item provides for the acquisition by the government of equity shares in the new companies by the assumption of $8.9 billion of the $17.1 billion mentioned above. It is rather like a landlord offering cash incentives to entice future tenants. When the companies are sold, the purchase price is passed to the government to compensate for its equity holding. Since the legislation creating OEFC contains a provision for its termination at the government's discretion, it is conceivable that such proceeds could disappear into the maw of the finance ministry.

From the time of their formation, Hydro One and OPG had executives with privatization backgrounds from the British power system, the chair of Hydro One and the chief operating officer of OPG being two. Debt levels for both companies fell by $1.1 billion in total to the end of 2001, while their new assets grew by more than $2 billion, including municipal utility assets acquired by Hydro One.

Preparation for the planned deregulation was made in May 2001 when the Bruce nuclear facility was leased to British Energy, a contract that could probably net the British company close to $10 billion over the next 18 years, even assuming that

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generation revenues remain at present levels. The chances that revenues will be fixed are, however, quite slim, given that British Energy is now in competition with OPG and can take advantage of the spot market ratcheting system. This system, which was put in place by a government elected to protect the best interests of the electorate, is a classic example of the benefits flowing from a competitive generating system. It's unfortunate that in this case the flow is from the consumer to the supplier. To quote from the Nesbitt Burns, January 2000 blueprint for restructuring the Ontario electrical industry: "A spot market will be operated by the Independent Market Operator (IMO), which will dispatch required electricity beginning with the lowest bid price. Each generator whose bid is accepted for a time period will be dispatched to supply electricity during that time period and will receive a price equal to the last highest bid that was accepted by the IMO."

We are now in the deregulation phase and it is still not too late to stop this process. The government's desire to privatize is not about producing a better power system, but simply about the huge profits that can be made by a few corporations and the government itself (by virtue of increased corporate taxes), from the biggest utility revenue source in Canada. We had and still have, given the political will to repossess it, a viable non-profit public system that supplies power at cost, with no profit except to the consumer, and that can be debt-free within a few years if the surcharge imposed by the government to pay the "stranded debt" remains. Following debt elimination, consumers could all look forward to a large rate decrease rather than a future of increases and the associated huge drain on Ontario's economic health. Sir Adam Beck, who was as confirmed an entrepreneur as anyone living today, was absolutely correct in his philosophy of power at cost.

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