Horizon Utilities Corporation is the fourth-largest local electricity distribution company in Ontario and delivers electricity and related services to over 231,000 residential and commercial customers in Hamilton and St. Catharines. The company is committed to providing best value to its customers through the delivery of a safe and reliable supply of electricity in a cost effective manner. Horizon Utilities Corporation is owned by Hamilton Utilities Corporation and St. Catharines Hydro Inc. and operates out of facilities in Hamilton, Stoney Creek and St. Catharines.
Ontario’s LDC Sector: Setting the Direction Right

Max Cananzi, CEO, Horizon Utilities Corporation

Ontario Energy Network (OEN), October 15, 2007
It’s a real pleasure to be invited here today to share some of my views on this great industry of ours. Thanks to the OEN and in particular David Reid for providing this type of forum to share ideas within our industry. I also feel privileged to address you so soon on the heels of a provincial election. This recent campaign reminded me a little of the line by Kim Campbell back in 1993 when she so famously said, “An election is no time to discuss serious issues.”

So with the election over I want to talk about serious issues in our sector and get the policy train back on track and get on with the job of strengthening the distribution industry in this province - setting it on the right direction.
A new term of government
It’s at this fresh start that I want to target my comments today. As the Liberal majority government embarks on a new four-year term, we are all primed to work together with the Province to introduce unprecedented innovation and stability to our industry. As a distributor my hope is that we realize our full potential to be a driving force in the energy sector.

While Ontario has incrementally been rebuilding the foundations for a dynamic and rationalized industry, there are some important tasks left to accomplish. As we begin anew, let’s look at what we want in that picture to benefit the industry overall.

I want to emphasize, this is not a wish list. It is a To-Do list. We want to clear the way for rational progress to more market evolution and business drivers and less centralized and expensive intervention on the part of government.

I have three main points on my To-Do list, which I will address today:

NUMBER ONE. Let’s finish what we started. It’s time for Ontario to step up to the plate to finish the job of creating the conditions for a healthy industry that began with the Electricity Conservation and Supply Task Force.

NUMBER TWO. Distribution consolidation is essential. In the current environment we see policy and market distortions that are punitive for everyone. The province needs to continue to address issues of excessive fragmentation and insufficient scale in distribution.

NUMBER THREE. Rather than emphasizing what distributors cannot do, we need to create a strong policy environment where distributors can be important contributors in new ways to the health of the industry in Ontario.
Industry direction – we now have one
Starting with my first To-do item. Let’s finish what we started.

The industry has made significant progress over a relatively short period of time. The much-anticipated Integrated Power System Plan (IPSP) has been filed. Not only does it offer a detailed energy roadmap for the province, but it also provides a vision that should sustain us over the next two decades.

I want to extend my congratulations to Amir Shalaby’s team at the OPA for this key achievement. I would also like to recognize the impressive work of Paul Bradley and the work he did at OPA for getting new generation supply under contract, including the Bruce restart and the large volumes of renewable power in the Bruce and other areas. We’ve also seen Hydro One’s successful initiatives in getting the additional transmission from Bruce to Milton started and the focused efforts of the LDCs and OPA to develop a conservation strategy for the province.

All these pieces are working in concert to build confidence in our industry and in future conservation, supply, transmission and distribution.
Horizon – an LDC industry leader
As the CEO of one of Ontario’s largest local distribution companies, I can attest that these components working together, and working together effectively, are critical to our success.

We have a promising start. Momentum is gaining. Let’s make sure we keep it going. Horizon is doing its part as well.

With 230,000 customers, Horizon is the fourth-largest distributor. We’ve achieved the lowest controllable costs per customer of any municipal distributor in the Greater Golden Horseshoe area, at the same time ensuring we have among the lowest rates of any of these distributors. In total, this is a winning combination for customers and shareholders.
What has Horizon done so far?

- City of Hamilton
  - Hamilton Hydro: 100%
  - Dundas Hydro: 100%
  - Ancaster Hydro: 100%
  - Stoney Creek Hydro: 21%
  - Flamborough Hydro: 79%

- City of St. Catharines
  - Hamilton Utilities Corp.: 100%
  - St. Catharines Hydro Inc.: 21%

Horizon Utilities Corporation
We’ve built our success through a series of mergers since 2000. These consolidations have allowed us to build a platform that taps the strengths of merged distributors. They have let us drive economies of scale while at the same time improving customer satisfaction ratings and lowering rates. Horizon launched its existence in 2000 as the result of the regional merger of 5 utilities into an amalgamated Hamilton Hydro. In 2005, we completed a successful merger of Hamilton Hydro and St. Catharines Hydro to create Horizon.

Just this August, Horizon and Guelph Hydro announced a proposed merger, which we hope will be completed by the end of the year. With 290,000 customers, this will make us the third-largest distributor in Ontario after Hydro One Networks and Toronto Hydro.

And we are not stopping there.
Horizon mergers & growth objectives

Guelph

Hamilton

St. Catharines
Our strategy is to leverage our operational strengths in partnership with like-minded utilities primarily in the western Golden Horseshoe to reduce costs for the benefit of our ratepayers and shareholders. Our goal is to achieve a base of 600,000 to 1 (one) million customers, which will give Horizon a substantial advantage for economies of scale.

These mergers are only common sense. The bringing together of two exactly similar entities to serve a larger customer base will result in savings if executed with reasonable care. Smaller utilities, needing to perform the exact same business functions across a smaller customer base will, in general, cost more to run. While rooted in history and tradition, there’s a price to pay in higher rates and lower shareholder returns.

Here, I go back to the To-Do list. Item 2 Consolidation of the Distribution sector is vital.

The government made a promising start when it temporarily lifted the capital transfer tax on mergers and acquisitions until October 2008. However, there are still inconsistencies, impediments, and unintended consequences of policies that are hampering the growth and health of our industry. The larger industry rebuilding effort that has started will suffer if we do not move to create the necessary conditions for our continued evolution into larger LDCs with significant scale.

Let me give you some perspective on this.
Scale and fragmentation issues

The image shows a bar chart and a map of Ontario, Canada, highlighting the number of customers for different LDCs (Local Distribution Companies). The chart is labeled "LDCs - Largest to Smallest" and the map is titled "Electric Distribution Territory." The companies listed from largest to smallest number of customers are:

1. Hydro One Networks
2. Toronto Hydro
3. Hydro Ottawa
4. Horizon Utilities
5. PowerStream
6. Enersource
7. London Hydro
8. Newbury Power
Today there are 83 distributors in Ontario after a few recent mergers. They range in size from the largest, Hydro One Networks, at 1.2 million customers to the smallest, Newbury Power, at a mere 192 customers. The average size is 53,000 and the median 14,000 customers. This means that fully 41 distributors, or half of all distributors in the province are serving fewer than 14,000 customers.

Let me say this in another way: 41 distribution companies, in total, serve 250,000 customers. All 41 distributors, combined, serve a customer base not much larger than Horizon’s.

And while we have congratulated ourselves on having moved from over 300 distributors in the 1990s down to 83 today, many of these mergers have been non-contiguous. This means that there still, in effect, remains fragmentation of more than 200 distinct service territories.
Micro LDCs – is there a rationale?
Pictured here is a distribution utility - one of the smallest distributors. Names are not important to my point. This utility represents a kind of parallel universe to Horizon and larger distributors. It offers the same “product”, but the execution is on a miniature scale. It has only 1,600 customers, serves 4 square kilometres and 21 kilometres of line. And it’s not getting bigger any time soon. Because of its size, the controllable costs per customer per year are $296 - twice or 100% higher than Horizon’s costs. And where Horizon earned a full rate of return, and paid dividends and taxes, this utility had a 1% Return on Equity in 2006.

While this utility is in a small village in a rural area, there is no reason why its electricity users can’t be part of a larger utility where they could benefit from lower costs and a wider range of service possibilities.
Port Credit Hydro – would it be better off?
This slide shows a small distributor that looks similar to the former example. It is actually the former Port Credit Hydro office, which is now used as a distribution station for Enersource Hydro Mississauga. While Mississauga was established more than 30 years ago, the old Port Credit Hydro, if it still existed, would be a distribution utility about the same size as the utility in the former example.

Here’s my question to you. Do you think Port Credit customers would be better off in 2007 if they had still maintained their self-contained distribution utility with its tiny customer base? I think many, if not most of you, would share my view that they would not be.

I point out the contrast between Port Credit and the other un-named utility for an important reason. There are companies like Toronto Hydro and then there are entities like one I have mentioned.

As a result government is forced to establish a patchwork of measures to reinforce the weaker LDCs at the expense of the more robust. Any market reform that impacts the distribution sector must account for this reality.
## Provincial scale comparisons

<table>
<thead>
<tr>
<th>Province</th>
<th>LDCs #s</th>
<th>Largest LDC (Customers)</th>
<th>Next Largest LDCs (Customers)</th>
<th>Others/Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ontario</td>
<td>83</td>
<td>Hydro One (1.2m)</td>
<td>Toronto Hydro (670k)</td>
<td>Average = 53k Median = 14k</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hydro Ottawa (280k)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Horizon (230k)</td>
<td></td>
</tr>
<tr>
<td>British</td>
<td>13</td>
<td>BC Hydro (1.7m)</td>
<td>FortisBC (101k)</td>
<td>8 others = &lt; 70k</td>
</tr>
<tr>
<td>Columbia</td>
<td></td>
<td></td>
<td>New Westminster (29k)</td>
<td></td>
</tr>
<tr>
<td>Alberta</td>
<td>20</td>
<td>Epcor (620k)</td>
<td>Enmax (458k)</td>
<td>2 MEUs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>FortisAlbta (426k)</td>
<td>14 rural coops</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>ATCO (186k)</td>
<td></td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>3</td>
<td>SaskPower (441k)</td>
<td>Saskatoon MEU (57k)</td>
<td>Swift Current MEU</td>
</tr>
<tr>
<td>Manitoba</td>
<td>1</td>
<td>Man. Hydro (510k)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quebec</td>
<td>10</td>
<td>Hydro Quebec (3.8m)</td>
<td>Sherbrooke MEU</td>
<td>8 other MEUs</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>3</td>
<td>NB Power (370k)</td>
<td>St. John Energy (35k)</td>
<td>EDMUNSTON MEU</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>7</td>
<td>NS Power (460k)</td>
<td>Antigonish (3k)</td>
<td>5 other MEUs</td>
</tr>
<tr>
<td>PEI</td>
<td>1</td>
<td>Maritime Elec. (70k)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nfld. &amp; Lab.</td>
<td>2</td>
<td>Nfld. Power (227k)</td>
<td>Nfld. &amp; Lab. Hydro (35k)</td>
<td></td>
</tr>
</tbody>
</table>
As is seen on this next slide, no other province in Canada has so fractured a
distribution system as Ontario. In this province, the establishment of municipal
ownership of utilities came before vertical integration and provincial ownership of
transmission was established to support municipal distribution. Until 1998,
municipal and provincial ownership set the pattern and there was no external or
internal stimulus for consolidation for increased efficiency except from municipal
amalgamations like the one that occurred in Mississauga.

To be clear I am not advocating One Distribution Company for Ontario. What
makes Ontario different from other provinces is that it is too large and diverse for
that. In my view it needs a number of large distributors that can serve different
regional needs. The additional benefit is that benchmarking, as a form of
regulation and a proxy for competition, can thrive with a small number of large
distributors.

Any discussion, to reform the distribution sector, however, cannot occur without
Hydro One at the table in an active and participatory role.
Hydro One – divestment policy

Electric Distribution

Hydro One Networks Inc.
Distribution, Ratemaking Strategy

Determination/Reliability: Implementation – Process/Approach

Amortization Strategy

Hydro One will be seeking to acquire Utilities (Ontario) Distribution Companies (UOC) in Hydro One’s service territory. Deals will be subject to commercial, financial, and regulatory approval. Hydro One will also consider renewable energy opportunities in these areas. Hydro One will also consider commercial proposals to divest assets where there are no commercial or competitive benefits to retaining them. Deals must be voluntary and commercial in nature. Deals must be subject to Hydro One’s corporate governance and business criteria. Any deals will be subject to review by the appropriate body.

Directivity Strategy

Hydro One aligns its investments in the service territories where there are significant commercial or competitive benefits to retaining them. Deals must be voluntary and commercial in nature. Deals must be subject to Hydro One’s corporate governance and business criteria. Any deals will be subject to review by the appropriate body.

Municipal Solutions

Local load management to manage direct municipal relationships: management, rate, cost reduction

Local Operations

Municipal operations into Hydro One Networks, including billing, service delivery for local operations, and corporate management, with priority for operations in increased local presence and business benefits.

Treatement of Staff

Ambition: Ensure employee benefits and career development opportunities. In case of divestments, outplacement support.

Revenue Change

Revenue change will take into account the impact of changes to revenue models and operating and maintenance costs. Regular, timely, and transparent dialogue with stakeholders.

Ratios

Utilization (UOC) match as with Hydro One. Rates subject to OEB review and approval.

Horizon Utilities

Leading by Example

It is anticipated that this approach will lead to larger and more efficient UOCs with more relevant geographic boundaries. Given that the processes will be voluntary and that UOCs’ shareholders will be involved in the process, it is not expected to produce a negative impact.
Hydro One has a long legacy as a supplier of last resort. The former Ontario Hydro took on the role of serving rural areas where municipal utilities had not yet been established, but it always had to give way when new ones were created or existing ones expanded.

Since 1998, Hydro One has the same role as any other distributor, but its role in rationalization has not been clear - growth company … or … supplier of last resort.

In March of this year, the Minister approved a new acquisition and divestment policy for Hydro One, which supports fewer and larger distributors. In simple terms, Hydro One says it will sell where it is “embedded” in the area of urban distributors, such as in Hamilton and Niagara, and seeks to acquire where other distributors are embedded in its service territory, which generally means outside the Greater Golden Horseshoe.

We support this divestment policy, but with the proviso that the outcomes should favour larger contiguous distributors. It would be counter-productive and a wasted golden opportunity to have Hydro One divestment sustain the current fragmented structure by allowing it to sell to parties that do not have sufficient scale and that will not promote consolidations with larger incumbent distributors in the area. At all times the customer’s interests must prevail in these transactions and as we know the benefits to customers come from operational and back office synergies.

If there were a handful of large LDCs - rather than 83 LDCs with 200 service territories - wouldn’t Ontario be better off?
Could this vision of the sector be achieved without Hydro One ultimately being in a net divestment position?

Does Hydro One need to be in the distribution business at all?

A review of the distribution sector and possible reforms that would create further efficiencies in the sector is long overdue.

The Ministry of Energy issued a white paper in December of 2004 to review the transmission and distribution structure in Ontario. This paper was titled “Electricity Transmission and Distribution in Ontario - A Look Ahead”.

In this document Minister Duncan is quoted as having said, “Without a thorough examination of the network side of our electricity infrastructure, it will be impossible to bring about the changes needed to develop a safe, secure supply for Ontarians.” I couldn’t agree more.

It is unfortunate that due to other priorities the consultation process never really took off and the Ministry has yet to re-open the discussions.

I urge the government to bring this consultation forward again.

The fragmented nature of the distribution sector has resulted in too much government intervention.

This brings me to my third point - Building a strong policy environment for distributors to contribute towards the health of the energy sector.
Smart Meters and MDM / R

Customers by LDC (OEB 2006)

- 77 small LDCs = 40%
- 15% Toronto Hydro-Electric System Limited
- 25% Other Distributors
- 4% Horizon Utilities Corporation
- 4% EnerSource Hydro Mississauga Inc.
- 5% Hydro Ottawa Limited
- 4% PowerStream Inc.
- 4% Hydro One Networks Inc.

6 largest LDCs = 60%
Let me offer a vivid example of the problems of fragmentation and insufficient scale - the implementation of the smart meter program. At Horizon, we’re part of this innovative pilot project and have installed more than 25,000 smart meters to date. We support the policy direction of the government with regard to smart meter technology deployment.

We have also verified that with minor and inexpensive modifications to our billing system, and I want to emphasize minor and inexpensive, we can issue time of use bills directly to our smart meter customers.

In the current policy scheme we are not allowed to do this. Why must Horizon’s customers pay the higher cost of a more expensive Meter Data Management / Repository system when Horizon has a lower cost solution?

In this instance, we can deliver a responsive and innovative billing system for our customers. But, instead, insufficient scale and market fragmentation has dictated a flawed and expensive solution … and the government winds up in the smart meter billing business and involved in more unnecessary centralized government activity.

To date the government has not communicated a sound business plan that articulates the public good that is being served by a centralized MDM/R scheme or the value add for utilities to willingly want to outsource a portion of their most critical business process; the revenue billing process.

However, as directed by the Minister we are all complying with these requests.
Load Serving Entities – solving a problem

- GENERATORS/SUPPLIERS
- LSE
- LDC
- Regulated Price Customers

- ieso
  Power to Ontario. On Demand.

- Ontario Power Authority

- Ontario Energy Board
Another example is the situation of load-serving entities - LSEs. Today, the OPA has to be the contracting party for generation supply and conservation because no-one else can do it … in other words, there is effectively only one buyer in the province.

While OPA is valiantly seeking to move the LSE concept forward, the problem of scale and fragmentation in the industry means it is very difficult to break away from a structure of centralized government procurement - there simply aren’t enough LDCs of sufficient size to make the market work.

This important work however must move forward. In time as the market matures and the utility sector has sufficiently rationalized the issue of who has this obligation to serve regulated price customers can be revisited.
I want to make a few comments about the Arnett Panel, which is currently reviewing the roles of all these organizations. Without a doubt, there is some streamlining required that should take some of the pressure off organizations, such as the OPA. For example, in the area of conservation distributors have proven that they can design and deliver programs.

In May 2004 in response to the Minister’s request LDCs got to work to implement conservation programs without the aid or assistance of the OPA. As a result LDCs in 2006 achieved 500 million kWhs of energy savings or enough energy to power 42,000 home for a year.

While I certainly would not challenge the need for a central authority in the market to identify and co-ordinate the needs of conservation relative to the requirements of the IPSP, what is of concern is the highly centralized model that the OPA has opted to adopt.
The result has been a highly bureaucratic process that has created bottlenecks and has ground the conservation momentum created by LDCs to a crawl in the province.

As of this date most LDC funding for 2007 programs has been exhausted or will soon be exhausted. At this late stage in the year utilities have no funding or identified programs for 2008. Many utilities have begun to dismantle conservation teams and redeploy them back into other areas of the utility.

No business can simply have resources idle accumulating costs. This is not productive. This is not the way towards building sustainable capability for conservation in this province. This is not treating LDCs as partners in the quest towards building a conservation culture.

It is the view of Horizon that the OPA’s role should be to identify the multi-year conservation targets required, provide funding, contract with LDCs for regional solutions to meet targets, and provide measurement and verification of achievements. LDCs should be given complete freedom to design programs, propose strategies, and deliver results within the parameters of the contracts.

We are also interested in the Committee’s view of the role of Hydro One. From our perspective, Hydro One’s role in the long term should revert to being a transmission company and supplier of last resort for distribution.

LDC acquisitions by Hydro One of embedded service areas should only be an interim measure and part of a long-term consolidation plan with the end result being the eventual divestiture of distribution assets to facilitate the creation of 4 to 5 large LDCs in the province.
Adam Beck – what would he do?
I’m not sure what would be on Adam Beck’s To-Do list if he were standing here today looking at an industry on shaky legs and the prospect of a majority government for the next four years….but I’d like to take a stab at it.

First, on distribution he would understand that the first role of government would be to create the conditions necessary to facilitate an efficient distribution sector.

I think he would be in full support of reducing fragmentation and increasing scale because today it means lower costs along with greater service and efficiency for customers.

At Horizon, we have updated the notion of local ownership that Beck started. Our program targets, through mergers, the development of a large, contiguous LDC in the western Greater Golden Horseshoe area. The result is an LDC that continues to have municipal ownership, albeit multiple owners, who remain responsive to their communities.

I believe that Adam Beck would also ensure that the policy environment was adequate to support growth and health in the industry. He would advocate broad diffusion of the best technology to the greatest number of customers at the lowest cost. He would want to empower larger LDCs to exploit efficiencies and innovation for the best and lowest cost solutions rather hoping for large-scale central government involvement in operational issues.

… I don’t know if it’s just a coincidence, but his To-Do list looks a lot like mine.

Before I wrap up today, I want to summarize quickly that this industry is at a
critical juncture. And we are fortunate that the government has just been handed a new mandate to continue the job it started. Very simply, we want to serve our customers and shareholders better by ensuring we have the optimal conditions for a healthy industry. This means the right policies, the best conditions for distribution consolidation and the ability to unleash our innovation and technologies to save money and promote the overall vitality of the sector.

The benefits to everyone should be clear:

- Would we be discussing a centralized MDM/R billing system if we had only 4 or 5 utility billing systems in province?
- Would we be concerned about delivering Conservation and Demand Management Programs in accordance with the needs of the IPSP if we had 4 or 5 well resourced utilities serving the entire province?
- Would we be debating who has the obligation of supplier of last resort with regard to load serving entities if we had 4 or 5 well financed utilities in this province?
- Let’s get on with setting the direction right for the distribution sector.
- The benefits for the province are clear - lower overall costs for customers - less centralization, and - a more rationalized and streamlined distribution industry.

Thank you.
Vision:
• Our vision is to be the leader in providing innovative energy solutions to the communities we serve

Mission:
• Our employees create value for shareholders, customers and the communities we serve through the safe and reliable delivery of electricity and innovative energy solutions