

Ontario's power trip: Priced out of the market

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Ontario is getting less and less electricity at higher and higher prices. It's only going to get worse

By Parker Gallant

As a former banker, I have no direct expertise in the electrical sector. I was simply curious as to why my electricity bill in Ontario went up when my consumption went down. What I found as I researched is a bewildering story of a province whose electrical sector is in trouble. Ontario is a high-price energy province and, under current policy, it is poised for a further escalation in prices. In short, Ontario is pricing itself out of the market and will not have the ability to attract any manufacturers or service sector companies that require significant energy in their daily processing.

Electricity is already priced 65% higher in Ontario when measured against neighbouring Quebec and Manitoba, and the gap is likely to get bigger. How Ontario got to this state is not totally clear, but as a banker I looked first to the institutions that make up Ontario's electricity sector and the numbers behind those institutions. The government entities involved in the electricity sector all present their public profile as open and informative and priced competitively. What's really going on is another matter. Finding financial information is often difficult. Finding ratepayer information is almost impossible.

What I did find is a complex, unproductive, costly and expanding beehive of corporate and institutional activity that produces less and less electricity at ever rising cost. There are now six key institutional players in the Ontario power market and one regulatory body. It's a giant megaplex of state control, each unit a part of the government power structure. How these entities came to be is an interesting story in itself, going back to the previous Conservative government's plans to privatize the industry and followed by significant changes in legislation governing the sector by the current Liberal government. But history is not the point now.

The six core players in the market, each controlled by the government, are Ontario Power Generation (OPG), which produces electricity; Hydro One, which manages the province-wide transmission and distribution grid; the Independent Electricity System Operator (IESO), which manages the hourly power needs and also operates a trading and pricing system; Ontario Electricity Financial Corporation (OEFC), which holds the stranded debt of the old Ontario Hydro and acts as a funding arm; the Ontario Energy Board (OEB), which regulates electricity; and the Ontario Power Authority (OPA), which acts as the government's policy execution vehicle.

The first four of these operations are pieces of the old Ontario Hydro, including OEFC, which was set up in 2000 to hold \$30-billion in stranded debt left over from the

province's past electricity management fiascos. The energy board (OEB) has been in place for decades as the independent regulator.

The current Liberal government under Premier Dalton McGuinty in 2004 set up the sixth entity, the OPA. The OPA functions as the official executor of government policy, and was recently given new powers under the province's Green Energy Act. The act removed the ability of any remonstrator from municipal, civic or public communities in the province. Via government directive from the McGuinty cabinet, the OPA dictates the course for how electricity is to be generated and distributed throughout the Province of Ontario for the next 20-plus years.

What is this conglomeration of government-controlled agencies doing? One thing is clear. They are doing much less for a lot more money than they used to. The three main companies that actually operate the power system (OPG, Hydro One and the IESO) are a great source of high-wage jobs and rising salaries, but their actual productive activity is declining. I have attempted to consolidate the results of OPG, Hydro One and IESO to try and compare the current year's results with those that existed in 2000 when the three entities were combined. The number story is simple: Less electricity, higher costs.

This is what has changed in the last decade.

Consolidated revenue grew by \$1.3-billion or 14.3% to \$10.5-billion, but gross revenue after fuel purchases were up by less than 1%. Expenses are another matter. Operations, maintenance and administration jumped by 44.9% to \$4-billion. This is likely mostly employment costs. Employment jumped from 15,800 to 18,000 permanent and 3,000 contract and non-regular (Hydro One's word) employees after allowing for the 5,000 jobs OPG and Hydro One outsourced between the years 2000 and 2003. Despite the addition of all those people, electricity sold and distribution dropped 33.8% and 5.5% respectively. Likewise available power capacity in megawatts fell from 25,800 to 21,729, a decline of 15.7%. Meanwhile, the cumulative debt as at December 31, 2010, had soared to \$11.1-billion, a gain of 31% or \$3-billion. This doesn't include the billions in debt held by the Ontario Electricity Financial Corporation.

Collectively the CEOs managing these provincially owned companies took home \$4.7 million in salaries in 2009. Each of the three operating entities tells the same story. At OPG, whose responsibility is the generation of electricity, revenue is down from their 2000 year-end by \$338-million or 5.5%. Net profit is nominally up by \$18-million, or 3%. But that number was the result of a \$683-million gain from appreciation in the value of the company's Nuclear Decommissioning Fund.

Since 2000, OPG's generating capacity has fallen 15.8% to 21,729 megawatts from 25,500. Actual electricity sold in 2009 was 92.5 terawatts, down 33.8% over the same period. One reason for OPG's declining sales: It is unable to sell power to the grid because the new green clean power from wind and solar gets first priority. OPG is forced to throttle down hydro generation when wind and solar are producing power. The most expensive power gets priority access to the power grid. The McGuinty Liberals have

turned the law of “supply and demand” on its head.

Hydro One’s responsibility is transmission and distribution of electricity directly to Ontario electricity users and indirectly via Municipal Electric Utilities (MEUs). The company’s distribution system, in terms of size and power carriage, barely changed through the decade, but it keeps growing costs and employment. In 2009, Hydro One distributed 7.7 terawatts less than it did in 2000, a decrease of slightly more than 5%. The distance covered by Hydro One’s transmission lines increased by only 424 kilometers or 1.5% since 2000.

But its employment numbers continue to skyrocket. Between 2000 and 2009, it took on 1,739 (after outsourcing 900 jobs in 2002 and granting early retirement to 1400 in the year 2000) employees, a gain of 52%. Almost half of its employees (5,032 in total for the year 2008) earned more than \$100,000 a year.

In keeping with the jump in employment, Hydro One’s debt increased by 48% or \$2.251-billion since March 31, 2003. Meanwhile, Hydro One’s rate increases for users continue to climb, by as much as 20% in 2009 alone. It has applied to the Ontario Energy Board for rate increases that could raise residential rates by over 20% in the next two years.

The third leg to the operating entities is the Independent Electrical System Operator (IESO), which has responsibility for management of the grid, projects daily usage to ensure adequate supplies of electricity.

IESO gives priority to the most unreliable and most expensive electricity generators; wind and solar ranging in price from 13.5 to 80.2 cents per KWh. When supply exceeds demand IESO throttles down the cheapest electricity, hydro and fossil (gas and coal). IESO also sets the “wholesale” and “spot” price through its trading activity. The “wholesale” price (when low) creates a “provincial benefit” which is added to electricity bills of all wholesale clients and to direct marketing retail distributors. It adds 3 to 4 cents per KWh to ratepayer’s bills. Excess power is sold or bought at a “spot” price from other distribution networks such as the New York Power Authority.

IESO is small by comparison to OPG or Hydro One in respect to employment, but a higher proportion — 65% of its 400+ employees — were paid in excess of \$100,000 in 2009. IESO obtains long-term credit from OEFC, the debt-management arm of Ontario’s electricity megaplex, and as of December 31, 2009, IESO owed OEFC \$78.2-million.

IESO lost \$14-million in 2009 and its CEO could have retired at the end of the year with an annual pension of \$263,000.

IESO will also be submitting an application to the OEB to recover the costs of managing McGuinty government directives to install “smart meters.” The costs of this project, not disclosed, will run to more than \$2-billion. Consumers will pay on individual consumer hydro bills. IESO’s website is loaded with information and seems to have better disclosure than the others (except for their annual financial report). I charted electricity consumption data from 2002 to get a feel on how demand is fueling the increase in

Ontario's electricity rates. It isn't. Even though I chose the two "highest demand" months of July and December, average hourly demand, lowest demand and peak demand are all down (anywhere from 6.4% to 23.5%). So if consumption is heading down, why are Ontario electricity bills going up?

What is exactly behind all this new activity and employment levels? While the private sector has to contend with increasing productivity, downsizing or moving production elsewhere, Ontario's government-owned energy sector employees just keep getting fatter under legislation that has forced this sector to accept expensive undertakings that have driven capital expenditures up and market share and revenue down, largely to subsidize the green energy agenda.

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Parker Gallant is a retired Canadian banker who looked at his Ontario electricity bills and didn't like what he saw.