

Getting the Jump on Competition

Notes for Remarks by
William A. Farlinger
Chairman, Ontario Hydro

The Canadian Club of Toronto

Toronto, Ontario

March 18 1996

Subject to change upon delivery

I am delighted to be here to talk to you about one of Ontario's favourite topics:
Ontario Hydro.

As a recent hire - a rare occurrence these days - I have had a chance to unearth the goods on what is taking place at Hydro and I'm here to give you some insider knowledge.

So here's the scoop:

- Niagara Falls is not for sale. Hydro doesn't even own it.
- Competition in the electricity industry is already here, and gaining momentum.
- Privatization in the UK power sector has been a success, proving competition can work in your favour.
- And, probably the best news of all, Ontario Hydro has a plan that will make Ontario's electric industry a winning participant in an open, competitive North American marketplace.

This shouldn't come as a surprise to anyone. Ontario Hydro has been one of the world's leading electric utilities since its founding 90 years ago. Over that span, our number one mission has been to provide service and power at the lowest possible cost. Sir Adam Beck's vision was that low electricity rates would give our industries an edge on the competition beyond our borders. That vision remains unchanged.

Since its establishment by the government in 1906, Hydro has helped Ontario become the leading economic force in Canada. Indeed, we have played a significant and successful role in the broader North American economic scene.

Contrary to any notions you may hear, we have no intention of wavering in our resolve to make Ontario's economy even stronger and more competitive in the next century.

Resistance to change is sparked by fear of the unknown. And the larger the change the greater the resistance. So it is not surprising that we have conflicting views on the future of Ontario Hydro when we are on the verge of a tremendous revolution within the electric industry.

Ontario Hydro's management has seen the writing on the wall and I would like to share the message with you today. Simply put, it is this: competition is coming fast and furiously to the electric industry. Everyone seems to agree that competition is good for our customers. But some vested interests want to hold on to the status quo in order to protect their own interests.

How and when we restructure our industry to accommodate and promote competition is critical to the future of the province. We cannot wait for the wave of change to hit our shores. We must manage the change to ensure that Ontario

continues to enjoy the benefits that its electric industry have brought us during the 20th Century.

Competition makes us more efficient. It forces us to seek better ways of doing business. Competition brings out the best in us. That's why you have more than one runner in the 100-meter dash.

Some would argue that we can be just as effective continuing as a publicly-owned monopoly. As you are aware, the Power Workers Union - and the Toronto Star - differ sharply with us on the privatization issue. The Star's motivation is beyond my comprehension, but the resistance from the union is not unexpected. Indeed, unions all across North America are opposed to the changes in the electric industry that will end regional monopolies.

But the weight of opinion goes against maintaining the status quo. The government appointed Donald Macdonald to report on the future of the electric industry in Ontario. Almost all of the 200 submissions to that committee agree that the days of Hydro's monopoly are numbered..

Why has competition become the holy grail of the electricity sector? There are two major contributing factors. One is a surplus of generating capacity throughout the industry in North America. The second is the availability of economic alternatives to our centralized generation.

Neither was a factor during much of this century when utilities, enjoying monopoly status, were only faced with the task of building large-scale generating stations to keep up with demand that grew at an annual rate of 7 per cent.

Ontario Hydro did it better than most. No. We were the best. First we harnessed hydroelectric sites throughout the province as we brought electricity to the far reaches of the land.

As we started running out of good hydroelectric sites, we turned to fossil generation and then became world leaders in the practical application of nuclear power. Right up to the end of the 1980s we were focusing our energies on planning for expansion of our generating capacity in order to meet future demand.

But that demand turned out to be a mirage. A fundamental change in the electricity industry has been taking place over the past two decades in North America. The oil crisis of the early 1970s signalled the end of that traditional growth rate.

Customers - business and residential alike - were beginning to control their appetite for electricity. In fact, demand actually decreased in the recessions of the early 1980s and the early 1990s.

All of a sudden utilities were sitting on surplus capacity. And there were still big new generating stations like Darlington coming into production. Suddenly, large generating stations which were the bread and butter of our industry were no longer

attractive. In fact, small, low-cost and highly efficient gas turbines are now proving they can meet or beat our price.

This wasn't unique to Ontario. Just about every major utility in North America was in the same boat. Many were sitting atop surplus generating capacity at a time when global competition was having a dramatic impact on their industrial customers.

With a continent-wide system of transmission and distribution lines, it would appear logical that you should pitch your product to any buyer that is connected to power lines. But lining up sales with customers beyond our neighbouring utilities is very difficult under the century-old system that is in place today. You have to go through the intermediary utilities to carry the power to your new customer - we call it wheeling in the trade.

At the same time, of course, competing utilities who can better your price are going to want to sell their product in your own back yard. Fair is fair.

So there is a major push, especially in the U.S. to open the way for competition by deregulating the industry and introducing open markets. Once achieved it is inconceivable in an era of free-trade that we could go on protecting the Ontario market from U.S. competition.

And why would we want to? We are sitting atop a healthy surplus and have a very competitive price. We are higher priced than Quebec and Manitoba, but we are low compared to Michigan and New York state. Our generators in Ontario can compete and earn significant revenues for the provincial economy.

We have made significant changes and improvements to Ontario Hydro over the past three years. We have cut costs and staff levels, although we still have 700 identified surplus employees because of the job security clauses in our labour contract.

We have also announced a freeze on customer rates for the remainder of the decade and have created opportunities for some customers to enjoy even more favourable rates. Our immediate objective has been to retain our customer base, and we have accomplished that.

Some would argue that the turn-around in Hydro's fortunes means we should leave well enough alone. That would be a serious mistake. The new reality of open markets will mean that customers can shop around for the best rates, even if it means dealing with a utility or generator several states away. But we can play that game as well, by competing in those traditionally-closed markets.

Opportunity is knocking, and Ontario Hydro has developed a plan of action to set up the Ontario electricity industry to be a competitive player in the new marketplace. In our final submission which we sent to the Macdonald Committee this past Friday, we reiterated our strong belief in the creation of an open marketplace. We see the need for competition at the generation level, which the municipal utilities like. But we also want to see open competition at the customer level, which the municipal utilities don't like.

The idea of opening the retail market up to competition has most of the province's 306 municipal utilities scrambling to protect their individual monopolies. I can't help but think they are putting their own interests ahead of their customers. Last week at their annual meeting, I brought this contradiction to their attention. Why, I asked, is competition good for Ontario Hydro in generation, but not good for the municipal utilities in distribution?

Customers want choice. In the past decade, they have seen the benefits of competition in the telecommunications, natural gas and transportation industries. Ten years ago, few of us could foresee how competition in telephone service would produce the array of products and services that are available to us today.

It is hard to imagine the choices we will have in electricity in ten years. But I can guarantee that you will be able to buy our product at a very competitive price. Competition guarantees it. And it will be a price that is better than our present monopoly would be able to match.

There will also be competition at the local level in service, maintenance and consumer products. Someone still has to make those trouble calls when the squirrels chew through your wires. However, these services can be provided by any number of suppliers. Your local utility has no lock on expertise to do these jobs.

I noticed recently that Consumers Gas and the Scarborough electric utility were jointly calling for proposals for reading gas, water and electric meters. Imagine. Just one meter reader to annoy you or your dog. It makes so much common sense you have to wonder why it wasn't done long ago. It is cheaper, more efficient and better for the customer. And it will be even easier when your meter can be read over the phone or cable-TV lines.

Competition in generation is essential and there are any number of proposals on how to accomplish it. One calls for the creation of four or five separate generating companies through a redistribution of Hydro's existing generating stations. That would be appropriate if we are aiming solely to ensure competition within Ontario.

But we won't have the luxury of an exclusive market. Therefore, as an alternative we could retain one or two large generating companies that could compete as major players in the larger North American market. Under either option, new competitors would also be allowed entry into the supply business to ensure competition.

We feel that privatization will speed up the competitive process and bring about the changes needed to create real competition in the new marketplace.

Before I joined Ontario Hydro, my predecessor Maurice Strong talked to me about what he called "the handcuffs" which restrict the operation of a government-owned company. After six months on the job, I really appreciate the constraints of public ownership. I understand much better how it can affect the decision-making ability of management.

Government bureaucracy, as well as criticism from special interests and the media, force delays in management decisions. I have seen it lead to indecision on even routine matters which private enterprise would simply put on the fast track.

Let me give you one recent example. About a year ago, Ontario Hydro's research and technology wing, Ontario Hydro Technologies, developed an innovative solar energy product called EN-R-PAK. This stand-alone power source can be used at cottages or other remote facilities.

In our view, EN-R-PAK would help the overall development of the industry by promoting the practical uses of solar power, and produce some revenues to lower customer rates. However, we have run into consistent opposition from a small segment of the industry for the past year, because they feel we are intruding into their business. This has resulted in needless delays as we spend time explaining and defending our position to them. All this for a technology and product that is unique and one we are making available to the public through solar industry distributors as well as other retail dealers.

So which type of company do **you** think will survive and thrive in a competitive market? One that labours under government handcuffs, or one that is free to compete aggressively? These are questions our union leaders and employees should be asking. In fact, there are a number of employees who have proposed employee participation in future ownership. I hope there will be many more.

The question on everyone's mind, of course, is: will it work? For the answer we could go to Britain where deregulation and privatization of its public electricity system has taken place on a scale never before attempted. I'm sure you have heard a great deal about that experience, and some of it is not positive.

We were getting conflicting messages too, so we commissioned an independent study to find out just what was taking place there.

Since the UK was the first to deregulate, it is not surprising that some mistakes were made. The major one was undervaluing the assets of the utilities. They were sold too cheaply. The other mistake was substantially underestimating the amount of efficiency that could be achieved through privatization. That led to some people making a lot of money when the real value of the business became evident.

In spite of this, the study shows that customers have come out ahead. This year, residential electricity customers will have enjoyed a 13 per cent decrease in real prices since 1989. Savings for industrial customers have ranged from 11 per cent to as high as 17 per cent.

But there is more to it than just price. Service levels to customers have improved dramatically. Now standards exist where none did previously, and service providers must report on the quality of service they provide. There is even a system of fines for poor customer service.

Better rates have also allowed Britain's industry to maintain a significant edge over electricity rates in most other European countries. That is a critical factor to keep in mind since we too are trying to return that competitive edge to Ontario industries and manufacturers competing in world markets.

So we must give the British transition at least a passing grade. It can work. And armed with the information on what pitfalls to avoid, Hydro feels confident that competition and privatization can benefit Ontario's electricity customers. Our solution of a combination of competition and privatization is not unique. It is happening all over the world.

We are anxious to get on with it and have urged the Macdonald Committee to set a transition date for the restructuring of the industry. For example, we would like to see open retail access introduced by the year 2000. Equipped with a firm transition date, our customers can get on with the running of their businesses. Uncertainty creates instability and inactivity, which are not welcome assets in a dynamic and competitive marketplace.

The final say on Ontario Hydro's future will be the government's. But no matter how drastic the changes ahead, one thing remains constant - a competitive electricity industry is critical to the economic vibrancy of this province. We must have competitive rates in order to attract and keep industry and ensure jobs for our children. And the best guarantee for job security is a competitive and efficient industry.

Low cost power was the key element in Sir Adam Beck's vision. It is just as valid today, but the means of achieving it have changed.

Thank you very much for your kind attention. If you are so kind as to ask me, I would look forward to returning at some future date to report on our progress.

Thank you.