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June 28, 2007

VIA EMAIL & COURIER

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge St, Suite 2701  
Toronto ON M4P 1E4

Dear Ms. Walli:

**Board File No. EB-2006-0268 Comparison of Distributor Costs  
Pacific Economics Group Report  
Comments of Energy Probe**

Pursuant to the Ontario Energy Board's letter dated April 27, 2007, attached please find the Comments of Energy Probe Research Foundation (Energy Probe) in respect of the Pacific Economics Group Report entitled *Benchmarking the Costs of Ontario Power Distributors*. An electronic version of Energy Probe's Comments will be provided in PDF format.

Energy Probe wishes to note to the Board that a power outage at our offices on June 26<sup>th</sup> due to a storm added to our difficulties in providing our Comments on that date.

Should you have any questions or require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh  
Case Manager

cc: Tom Adams (By email)

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# Ontario Energy Board

## BENCHMARKING THE COSTS OF ONTARIO POWER DISTRIBUTORS

**Pacific Economics Group**  
25 April 2007

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**COMMENTS OF  
ENERGY PROBE RESEARCH FOUNDATION  
("ENERGY PROBE")**

**June 28, 2007**

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# **BENCHMARKING THE COSTS OF ONTARIO POWER DISTRIBUTORS**

**Comments of Energy Probe Research Foundation**

**EB-2006-0268**

## **Background**

**In the 2006 rate-setting process, a comparators and cohorts mechanism was used to assist Board staff in screening the 2006 distributor rate filings. The comparative analysis techniques are currently under further development; the Board has not yet indicated the uses that might aptly be made of the techniques.**

**The Pacific Economics Group (PEG), was retained by the Board to assist in developing a methodology for comparing electricity distributor costs, using more recent data gathered from Ontario local electricity distributors under the Board's Reporting and Record-keeping Requirements for the years from 2002 to 2005.**

**Subsequently, by letter dated April 27, 2007, interested parties were invited to provide written comments on the PEG Report entitled *Benchmarking the Costs of Ontario Power Distributors*.**

## **Comments of Energy Probe**

### **Suitability and Application of Benchmarking To Rate Setting**

**Energy Probe strongly supports the use of benchmarking in the rate setting process and compliments Board staff for its initiative in bringing Pacific Economics Group, a highly respected expert group in this field, to provide input on critiquing benchmarking options, proposing suitable approaches, presenting various analytical methods, and commenting on limitations imposed by data limitations.**

**The PEG report on electric LDC productivity benchmarking builds on a rich regulatory literature at the OEB in gas LDC benchmarking and previous work of Board Staff in electric LDC benchmarking. The Board staff work on benchmarking was preceded by evidence presented to the Board by Energy Probe in RP 2004-0117 (and associated cases) advocating the use of benchmarking for regulatory purpose and introducing a simple normalized cost per customer ranking to assist in the review of regulatory assets amassed by electric LDC.**

**Energy Probe specifically endorses the following:**

- The immediate use of O&M benchmarking using indexes and econometric methods, employing PEG's work and any other analysis that can be brought to bear as a screening tool to determine LDCs with apparently poor productivity so that they can be examined in greater detail for the purposes of rate determination;**
- The development over the next year of next generation benchmarking tools using more complete data sets so that the Board has the option of evolving regulatory oversight toward a quantitatively defined efficiency frontier; and,**
- The use of benchmarking analysis to apply less challenging cost control objectives on efficient utilities and more challenging objectives for utilities demonstrating inferior performance.**

## **Noteworthy Insights of the PEG Report**

**The PEG findings identified “appreciable” economies of scale in Ontario power distribution. This finding supports the view that long term consumer benefits can be achieved through efficiency driven consolidation. Energy Probe supports Board policies and decisions that move in this direction. For example, the decision to withdraw the higher ROE for small utilities removes a regulatory barrier to efficiency gains through consolidation.**

**The PEG findings indicate that the *total* cost of power distribution is on balance *lower* in a younger power distribution system. This finding is particularly encouraging in light of the substantial capital demands that appear on the horizon for many of Ontario’s LDCs. This finding supports the LDCs moving forward with needed capital enhancements.**

## **Questions Raised by the PEG Report**

**Perhaps due to an incomplete understanding of the PEG analysis, but there are some points of clarification that Energy Probe suggests might be useful.**

**The R Squared statistic of 98% that PEG provides (p. 53) appears the result of a statistical test of a model of total cost. In a total cost model, we would expect to see a relatively high statistical performance for the single variable of customer numbers. It would be helpful to see similar descriptive statistics for the cost model where the model is normalized to provide cost per customer.**

**PEG did not have access to data on power deliveries to embedded LDCs. It is unclear why this data could not be accurately measured by subtracting the receipt amounts of embedded utilities.**

**PEG claims that capital cost records are not deep enough to support Total Factor Productivity studies. Instead, PEG uses a ratio of gross plant value to a construction cost index. Energy Probe suggests that additional explanation for the use of this information would be of assistance.**

**It is unclear as to the regulatory treatment of the non-compliant. Oshawa PUC did not provide retail volume data, a factor that impaired PEG's analysis.**

## **Recommendations**

**Energy Probe believes that benchmarking is an excellent tool to apply to understanding labour costs and labour cost trends on a going forward basis. To gain a complete understanding of labour cost, it is essential that pension liabilities be fully laid out. Energy Probe was extremely disappointed to discover that the recent Agency Review Panel did not examine pension costs, “Because we could not determine the cost (in particular) of pensions, we could not determine Total Compensation for senior executives at the Institutions.”<sup>1</sup> It appears that direct labour costs were not used in the PEG study (p.46, 47). It also appears that pension costs for current employees were not included (p.45). Instead Statscan data for locational education ranked employment cost is used as a proxy. Energy Probe is concerned that this proxy is likely to be too low an estimator of the real cost. Energy Probe therefore recommends that the Board pursue specific labour cost benchmarking**

**Energy Probe supports the development of the use of service quality data for benchmarking purposes.**

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<sup>1</sup> Ontario Provincially-Owned Electricity Agency “Agency Review” Panel Phase 1 Report, released June 27, 2007, p. 19.

**As identified above in our specific endorsements, Energy Probe urges the development of a quantitatively defined efficiency frontier.**

**Due to data constraints, the PEG report does not tackle the issues surrounding capital cost efficiencies. Given the scope and importance to consumers of capital cost issues, Energy Probe suggests that the Board might consider supplementing econometric work with a direct engineering analysis of some elements of the LDC business. Issues that Energy Probe suggestions might be considered as potential candidates for independent engineering input into the regulatory process include line loss efficiency improvement options, and Toronto Hydro's decision to upgrade 4.4 kV systems to 13.8 kV rather than the more modern 27.6 kV alternative.**

**Respectfully submitted at Toronto, Ontario this 28<sup>th</sup> day of June, 2007.**

**Tom Adams  
Energy Probe Research Foundation**