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BY COURIER

December 8, 2006

Ms. Kirsten Walli
Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street
P.O. Box 2319
Toronto, ON.
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Dear Ms. Walli:

EB-2006-0268 - Comparison of Electricity Distributor Costs – Hydro One Networks' Comments

Hydro One is pleased to offer comments and responses to questions posed by the Board in its November 24, 2006 letter which describes the details of the first stage of the Board's consultation on comparison of distributor costs. Hydro One welcomes the opportunity to provide responses and notes that at this time its responses are preliminary in nature because the issues have not been examined in sufficient detail given the short period of time to do so. The matter of cost comparisons requires careful consideration and adequate time to examine and resolve the underlying issues.

Hydro One appreciates the opportunity to provide comments at this time and would like to be involved in future proceedings that address this matter, to assist in the development of options and furthering the understanding of this important matter.

General Comments

- In some respect a lot of the discussion that is being addressed in the Board's current letter has already taken place as part of the Board's Comparator and Cohort analysis under proceeding RP-2004-0188, in which Hydro One participated extensively and provided substantial comments and evidence.
- Hydro One understands the Board's undertaking to develop a better understanding of LDCs' costs and to develop a meaningful cost comparison methodology. The principle of comparability is clearly important as an aid to assist the Board in its regulatory oversight of the electricity distribution sector in Ontario. The exposure to cost comparisons provides an opportunity for LDCs to

benchmark their cost levels and in so doing creates accountability for LDCs to ensure that costs are reported in an accurate, rigorous and consistent manner.

- However, having said that, Hydro One is of the view that given the diversity of the LDCs in Ontario in respect of their scope of operation, infrastructure, customer density, geography, climate, and vegetation it is unlikely that simple comparators can be developed for detailed comparison of utilities costs. Therefore, Hydro One would recommend a more cautious approach to the development of such comparators and their application. Given the significant differences between utilities perhaps, at most, one could envisage the use of cost comparators as a screening guide to allow the Board to see at a quick glance the distribution of costs.
- If the Board's aim is to move forward and develop more appropriate cost comparators then it will be necessary to gather data that would help establish the impact of LDC characteristics on the cost metrics chosen. For example, a rural power outage is different from an urban power outage, i.e. travel time can be significantly longer and weather is often an issue when responding to rural outages. In the case of an urban outage this can present its own complexities with respect to traffic and access to sites. The impact of such differences must be quantified to allow for analysis of comparators along with measuring the impact on the customers. In this way the adjustments would create a set of more comparable metrics.
- As noted above Hydro One has been actively engaged in the Board's previous proceedings that dealt with Comparators and Cohorts, and in so doing provided extensive evidence regarding the need for rigour, accuracy and consistency in respect of data collection and the development of suitable benchmarks¹. However, given the different nature of issues that impact Hydro One compared to the other utilities the Board's consultant excluded Hydro One from the report on Comparators and Cohorts².
- With these comments in mind Hydro One is pleased to provide responses to the questions posed in the Board's November 24, 2006 memorandum.

Questions for Consideration by Interested Parties – Potential Cost Centres

1. Are the proposed aggregations, or alternatively the 2006 EDR groupings, appropriate?

- The use of aggregations and groupings may be appropriate if the basis of such an approach is data that has been validated and tested for accuracy, validity and reliability. However the consistency and quality of the data that is currently available is questionable due to different interpretations and possible errors in collection, reporting and application.
- As noted in other proceedings Hydro One cautions that it is difficult to make a meaningful comparison of its costs with other LDCs in Ontario. The costing structure, unique business characteristics, size of the service area and the impact of embedded LDCs are some of the reasons why including Hydro One in this comparison endeavour could lead to inaccurate comparisons³.

¹ RP-2004-0188 OEB Process for Establishing 2006 Distribution Rates

² The **CA Energy Consulting Phase II Report**, dated October 2005 noted, that Hydro One Networks was “*excluded from the C&C analysis at the outset of the study*”[Page 6].

³ Ibid; The report goes on to state, “*Hydro One Networks has acquired, by our count, 87 of Ontario’s LDCs, and has developed an umbrella of activities and functions that have assumed some of the business functionality that would otherwise*

- Due to inter-LDC differences in the categorization of “O”, “M” and “A”, it is more meaningful if these three components are taken on a combined basis.

2. *Should average labour costs be reported separately for comparison?*

- No. Any labour cost comparisons must be made with care. Hydro One’s concerns with respect to labour rate comparisons include a) “like for like” skill sets being compared, b) base labour rates vs. fully burdened rates being compared, c) composition of standard labour rates due to internal cost accounting practices, d) the nature of the work being performed and e) service territory characteristics (e.g. urban/rural) and f) legacy collective agreements. In addition, comparing labour costs on a stand-alone basis may not be meaningful as some utilities may have substituted technology for labour and others may have contracted out certain services, thus substituting a “purchased service” for a labour cost.
- As noted above the issue is quality of data and consistent definitions. Also with contracting out, labour costs and management costs become more of an issue than just labour costs.

3. *Given difficulties with data comparability below the cost centre level of O&M and administration, should a lower level of granularity be considered? For example, billing separated from collection? Please suggest the lowest level of granularity based on the USoA that would be most useful*

- Caution must be exercised between what would be useful to have i.e. micro comparisons and the present reality of using data that may not have been appropriately validated for consistency, accuracy and reliability. If errors in result reporting are made in comparisons at the onset, all credibility and belief in the process will be lost.
- As noted in the response to Question 1 above, Hydro One has concerns with the comparability of the underlying data and the consistency in reporting at the USofA level amongst LDCs. In order to maximize the quality of any comparisons, Hydro One believes a higher (not lower) level of granularity should be used. Total OM&A, (as defined in response to Question 1 above) would be the most useful level of granularity.

Questions for Consideration by Interested Parties – Potential Cost Drivers

4. *Are the four cost drivers above the appropriate ones?*

- No. As presented, the four cost drivers are too broad to provide valid comparisons. At a glance it would appear that as presented the cost drivers suggest uniformity of application across the distribution sector. But that is not the case.
- It is well known that not only are all distributors not equal but neither are all customers served by the same distributor equal. A utility may serve a combination of residential, commercial industrial and

be carried out by the LDCs as individual entities. This business arrangement would appear to set Hydro One Networks apart from other LDCs in terms of cost behaviour and, potentially, the range of service options that can be provided to electricity consumers” [Page 6].

farm customers, all of whom have different characteristics in terms of pattern and level of consumption of energy and types of distribution equipment that is used to serve them. Another example may be that not all feeders are equal. A distributor may employ a variety of distribution feeders that operate at different voltages, that are located in different terrain (dense vegetation, urban, rural), that use different structures (overhead, underground, submerged), and the list goes on.

- In support of the matter of cost drivers Hydro One considers that before one can embark on the development of appropriate cost drivers the major goal should be the development of appropriate processes that ensure the quality of the data, its collection and analysis for groupings of costs.
- The issue of which data should be collected and what costs would be incurred in collecting such data must be addressed. Also, the ability to measure the data on a consistent basis is an issue that has to be dealt with. All utilities have to be consistent in how they measure and report the required data. Without this the mere collection of data is meaningless. Only then can one start developing the cost drivers that might be useful for comparison purposes. A thorough analysis of the cost driver metrics would then be required before a decision is made on the selection of appropriate metrics.

5. *What other cost drivers should be considered?*

- In and of themselves the four cost drivers noted in the Board's letter do not capture the differences that exist between utilities in Ontario. For example, the major issues of (i) geography as applied to location, and (ii) rural versus urban are not addressed, even though the Board's consultant agrees these are key points.
- Other cost drivers that may be worth considering may include the following:
 - Maximum demand
 - Transformer capacity
 - Breakdown of km of lines into (i) overhead, (ii) underground etc
 - Voltage based
- There may be other cost drivers that Hydro One has not yet had an opportunity to identify.
- It should also be noted here that performance quality comparisons can lead to reliance on more complex cost drivers.

6. *Should different cost drivers be used for different cost centres? If so, which cost driver do you view as appropriate for which cost centre?*

- Yes, it may be possible to use different cost drivers for different cost centres. However, this is likely to add to the complexity. Also, there is the issue of data accuracy and ability to gather the necessary data. In this respect more time is required to develop and implement such concepts.
- At this time Hydro One has not developed any ideas along these lines.

Questions for Consideration by Interested Parties – Possible Grouping Characteristics

7. Are the grouping factors proposed by staff appropriate?

- Hydro One views the proposed groupings factors as a valid start. The groupings in and of themselves do not tell the full story. These have to be accompanied by supporting analysis that identifies and quantifies all of the impacts, e.g. what is the percentage difference in northern versus southern LDCs (There may be differences but how significant are these differences?). Without this analysis groupings may not yield useful information.

8. Are there additional characteristics of utilities that should be considered for grouping distributors?

- It is possible that other characteristics could be used to group utilities. In consideration of performance and costs there are likely any number of characteristics that could be selected provided that they can be measured on a consistent and meaningful basis. Hydro One has not determined what those might be but one could envisage that grouping utilities could be done by:
 - age and asset type
 - predominant use of a specific voltage level
 - geographic location
 - similar number of customers in groups, e.g. comparable residential or commercial, industrial customers
 - similar proportions of customers, e.g. ratio of residential/commercial-industrial customers
- Needless to say extensive studies and analyses would be required to develop the basis for the groupings to ensure that the resulting groupings were comparable

Other Questions for Consideration by Interested Parties

9. Should external benchmarks established in other jurisdictions be considered in setting rates for Ontario distributors?

- Hydro One is of the view that there may be some merit in giving consideration to the use of external benchmarks. Provided that sufficient care and concern is exercised to establish the basis for comparison, and that this is done on a like-for-like basis, external benchmarking processes can be helpful to the Board and the utilities because these extend the scope and available data for comparisons. In this way external benchmarks provide supplementary data for use in Ontario.
- Such benchmarks may be particularly useful in circumstances where it is difficult to find any suitable benchmarks within the province because of the significant differences between incumbent utilities.

10. *Some SQI data is currently collected. How could consideration of service quality as a driver of O&M cost be improved?*

- One of the major issues associated with the use of SQIs is the validity of the measurement and the expectation of future performance, i.e. the impact of the time lag between measurement and the outcome of investment to improve performance. Obviously more time and effort is needed to examine this issue.
- There needs to be clear definition of what is expected of an SQI, i.e. what it is intended to be measured. For example, given the aging of the distribution infrastructure in Ontario it may be prudent to examine whether the existing SQIs are the appropriate metrics to measure performance.
- Another consideration in the establishment of SQIs is whether these reflect customer values. It is important to know what aspects of performance customers' value, and what level of performance customers are prepared to pay for.

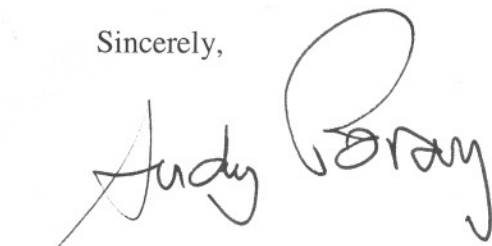
11. *In order to further the development of utility comparisons, what additional data should be collected from distributors, and why?*

- At this time Hydro One is not aware of any additional data that should be collected from utilities.

Comments on Hydro One's Spreadsheet Data

- The data which Hydro One provides to the OEB under the RRR filing requirements is accurate but it is incomplete. For example, the RRR filing requirements make no provision for reporting the energy consumption of the embedded Market Participants. Thus in Hydro One's case the RRR filings underestimate the amount of delivered energy to Hydro One's distribution customers. Therefore, if the Board were to use energy as a comparator, the result would skew Hydro One's performance. As a result there is potential for misuse of the data contained in the RRR filings. Hydro One would be pleased to meet with Board staff to discuss how best to address the issues with the data contained in RRR filings.
- Hydro One notes that in the Board prepared spreadsheet it was classified as an "urban" utility, whereas it is for the most part a "rural" utility.

Sincerely,



for Susan Frank