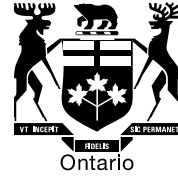


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BY E-MAIL AND WEB POSTING

November 24, 2006

To: All Licensed Electricity Distributors
All Participants in Proceedings EB-2006-0088 and EB-2006-0089
All Other Interested Parties

Re: Comparison of Distributor Costs
Board File No.: EB-2006-0268

Board staff is undertaking a two-stage consultation process on comparison of distributor costs. This letter describes the details of the first stage of the consultation, encourages input from interested parties and provides an outline in “Next Steps” of the more formal consultation that will occur later.

Background

The Board began its work of comparing distributor costs in the 2006 EDR process. The Board hired Christensen Associates Energy Consulting LLC to provide a report on comparators and cohorts. The use of comparator and cohort data was considered during the 2006 EDR proceeding as follows:

The Board reminds parties that its decision in RP-2004-0188 was to develop and use comparators and cohorts data exclusively as a screening tool and not as a mechanism for the direct setting of rates for 2006. Although an analysis may identify an average level of spending, it would be incorrect to draw the conclusion that any particular level represented, in itself, an efficient level of spending.

As part of its multi-year Rate Plan for electricity distributors, the Board announced earlier this year that it would continue its work on methods and techniques to compare distributor costs. Board staff is continuing this work and is providing interested parties with an early opportunity to participate in the development of the methodology.

To help the Board develop a sound methodology for comparing distributors, Board staff is hiring a consultant who will use the data in the accompanying Excel workbook to further develop the comparison methodology. The consultant’s report will be issued for review and comment by interested parties later this year.

The report and its findings will assist the Board in the 2008-2010 rebasing proceedings and in the development of the 3rd generation incentive regulation mechanism.

Distributor Aggregated Data Now on Board Website

Board staff has prepared an Excel workbook that contains distributor cost and operating data for review and comment by interested parties. The link is provided on the Board's website under "What's New". Access to the relevant data is considered an important first step in order for interested parties to provide informed input in the next stage of the consultation.

Matters for Consideration by Interested Parties

You will find below a description of potential cost centres, cost drivers, and grouping characteristics that reflect staff's views on how utilities might eventually be grouped to compare performance. You will also find some questions pertaining to these categories. Your submissions will be provided to staff's consultant.

Broadly stated, Board staff questions below are posed in order to explore four themes:

1. Are the "cost centre" groupings of cost sufficiently useful for purposes of comparing distributors?
2. Are the divisors used to unitize the costs (i.e., the physical quantities) reasonable drivers/determinants of cost behaviour for purposes of comparing distributor costs?
3. What are the matters/features useful to consider in establishing sub-groups of sufficiently similar distributors for purposes of comparing cost behaviours?
4. Are there additional data that should be acquired from distributors in order to improve the comparison process?

Potential Cost Centres

The cost centre information used on the summary sheet of the workbook is an aggregation of accounts from the Trial Balance (section 2.1.7 of the Electricity Reporting and Record-keeping Requirements - RRR) and is presented in the Excel worksheets as follows:

- Operations and Maintenance (O&M)
- Administration
- Bad Debt Expense
- Amortization Expense

The underlying data used to populate the unitized spreadsheets in the model are also provided in the Excel workbook. The ratios were calculated by dividing the cost centre information by the drivers described below (an example of a ratio would be the above administration expense divided by the total number of customers of the distributor).

Board staff has chosen this level of detail due to some data recording inconsistencies apparent when more granular data sets are analyzed. For example, some distributors have included administrative customer service costs in general administration costs. Bad debts and amortization were removed and isolated in separate cost categories to reduce data anomalies in O&M and administration.

Both the confirmed, unadjusted, 2006 EDR groupings from the Trial Balance, as well as

the 2005 Trial Balance aggregated using the 2006 EDR level of aggregation, have been provided. Service Quality Indicators (SQI) data for the years 2002 to 2005, as reported by the utilities, are also provided.

Questions for Consideration by Interested Parties:

- 1) *Are the proposed aggregations, or alternatively the 2006 EDR groupings, appropriate?*
- 2) *Should average labour costs be reported separately for comparison?*
- 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 Uniform System of Accounts (USoA) that would be the most useful.*

Potential Cost Drivers

The Christensen Associates Energy Consulting LLC study, conducted for the 2006 EDR process, indicated that geography and the number of customers were the key drivers of operating and maintenance costs. The same study indicated that administration costs were driven by the number of customers served by a utility.

In the accompanying Excel worksheets, staff has analyzed the cost data based on the following drivers.

- Number of customers
- Megawatt hours
- Kilometres of line
- Square kilometres of service area

The worksheet allows users to view the data using any one of these drivers by means of a drop-down menu for each cost centre (Summary Sheet, Row 8, right side of box).

Other potential drivers, such as the ratio of overhead line to underground line, were not selected, but these data have been provided within the Excel worksheets for completeness.

Questions for Consideration by Interested Parties:

- 4) *Are the four cost drivers above the appropriate ones?*
- 5) *What other cost drivers should be considered?*
- 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?*

Possible Grouping Characteristics

There may be certain characteristics that would allow distributors to be compared with each other. Staff is considering the following characteristics as a basis for grouping utilities that reflect similar attributes:

- Geographical location
- Customers per kilometre of line

- Total number of customers
- The degree of outsourcing and cost particulars
- Service quality performance

Questions for Consideration by Interested Parties:

- 7) *Are the grouping factors proposed by staff appropriate?*
- 8) *Are there additional characteristics of utilities that should be considered for grouping distributors?*

Other Questions for Consideration by Interested Parties

Please consider the following additional questions:

- 9) *Should external benchmarks established in other jurisdictions be considered in setting rates for Ontario distributors?*
- 10) *Some SQI data is currently collected. How could consideration of service quality as a driver of O&M cost be improved?*
- 11) *In order to further the development of utility comparisons, what additional data should be collected from distributors, and why?*

Key Features of the Excel Workbook

The key features of the workbook on the Board website are:

- The sources of the data in the workbook are filings under RRR section 2.1.4, Service Quality Indicators; section 2.1.5, Statistical Information; and an aggregation of the data provided under section 2.1.7, Trial Balance.
- Data is provided for the years 2002 to 2005 inclusive.
- The data appears at the level of aggregation that was used in the 2006 EDR applications, or at a more summarized level. There are approximately 400 prescribed accounts listed in the Trial Balance, RRR section 2.1.7. The summary level used in 2006 EDR and this analysis aggregates these accounts to about 40 line items (provided in the detail pages of the workbook).
- For distributors that have been created recently through mergers and/or acquisitions, a “consolidated LDC” for the year(s) preceding the re-organization has been created by summing the data provided to the Board by the predecessor distributors. For example, for the years 2002 to 2004, the data for Horizon Utilities was compiled by summing the corresponding data points for Hamilton Hydro and St. Catharines Hydro as submitted for those same years.
- In the Summary section of the workbook, Board staff has unitized the cost information. Workbook users can select any one of four attributes as the divisor in studying the unitization. The attributes used are discussed in the “Potential Cost Drivers” section above. The workbook allows the user to select the different divisors from a dropdown list provided at the top of the data column.

How to Provide Comments

Parties wishing to provide written responses to the questions identified in this letter should send three paper copies and an electronic version of the comments in searchable Adobe Acrobat (PDF) and Word to the Board Secretary by **4:30 pm on December 8th, 2006**. Electronic copies may be sent by e-mail to boardsec@oeb.gov.on.ca. Please name your electronic copy: "Your Organization Name_ EB-2006-0268". Written comments should quote file number EB-2006-0268 and include a contact name, postal address and telephone number and, if available, e-mail address and fax number.

This letter, the Excel workbook, and all written comments received by the Board in response to this letter will be available for public inspection on the Board's website at www.oeb.gov.on.ca and at the Board's office during normal business hours.

Next Steps

Board staff expects to issue the consultant's initial report for comment by mid-December. Written comments will be due by mid-January, 2007. Your comments at that time will be considered in the completion of the final report on comparison of distributor data to the Board. The report will assist the Board in the 2008-2010 rebasing proceedings and in the development of the 3rd generation incentive regulation mechanism.

Cost Awards

It is not intended that costs will be awarded at this initial stage of the consultation. However, future stages of this project may include provision for cost awards.

Any questions relating to this consultation should be directed to Duncan Skinner at 416-440-8127, or Wade Frost at 416-440-7678, or by e-mail to EDR@oeb.gov.on.ca. The Board's toll-free number is 1-888-632-6273, and the Market Operations Hotline is 416-440-7604.

Yours truly,

Original Signed By

Peter O'Dell
Assistant Board Secretary