

2006 December 8

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P. O. Box 2319
2300 Yonge St
Toronto, ON M4P 1E4

Dear Ms. Walli:

RE: PowerStream Initial Comments on Distributor Cost Comparisons EB-2006-0268

The purpose of this letter is to provide the Ontario Energy Board (the Board) with PowerStream Inc.'s initial comments on Board staff's proposals for the comparison of distributor costs (November 24, 2006). PowerStream understands that the Board consultant's initial report will be published for comment in mid-December, and plans to provide further comments in response to that document. Given the time constraint for responses, we are not in a position to undertake an in-depth analysis of the Board's proposals including the dataset provided in the excel spreadsheet at this time. We feel that such an analysis is required.

However, we would like to take this opportunity to provide comments on the philosophy of the Board's approach, methodology and data comparisons issues and to provide PowerStream's proposal to address a number of our concerns.

During the course of its project PowerStream would respectfully submit that the Board consult extensively with stakeholders on issues including:

- data definitions;
- model specification; and
- factors in the operating environments of the distributors that may impact on performance.

General Comments

PowerStream appreciates the Board's consultation initiative on the dataset provided in the November 24th 2006 excel spreadsheet. An initial review of the data reveals significant limitations in what Board has done to date that require comment and further analysis before stakeholders and the Board can consider it a suitable base for regulation. PowerStream is however very concerned with the amount of time the Board has given for comment. When datasets and draft documents are issued by the Board for comment, stakeholders need to be afforded the time to understand the material, coordinate a corporate position with relevant staff in order to issue a well thought-out response submission. The dataset provided and this "early opportunity" to comment should be viewed as a very preliminary stage for developing methodologies for measuring performance in the electricity distribution sector.

The current consultation process focuses on data issues and does not discuss possible methodologies. From the distribution sector perspective, further consultation on possible methodologies is required. The choice of methodology can ultimately influence the data requirements in terms of variables, level of aggregation, or data composition. Further we would suggest that there remains work to be done in ensuring the accuracy, relevance and comparability before the Board retains a consultant to explore and develop a suitable methodology (ies). PowerStream would welcome the opportunity to work with the Board to make subsequent versions of this analysis more useful as part of the overall development of incentive regulation.

Responses to Specific Questions

1. Are the “cost centre” groupings of cost sufficiently useful for the purposes of comparing distributors? (Cost centres)

Studies in other jurisdictions have demonstrated that the definition of cost and input data can significantly influence results and subsequent conclusions. Given the uncertainties regarding the accounting treatment of the cost data, PowerStream would recommend that the Board undertake a consultation on and review of the Uniform System of Accounts **prior** to using the data in the November 24th excel spreadsheet to develop a methodology for grouping distributors to compare performance. This is discussed further below under the heading “integrity of data”.

Partial indicator measures are widely used as they are easy to calculate, however, they need to be interpreted with caution. Obviously, no single partial indicator can provide a complete measure of overall performance. A significant amount of the discussion in the November 24th letter relates to operating costs. Yet, various comparative performance studies have shown that in other regulatory regimes that consideration of the asset strategies of each company is also key and any efficiency comparison should take into account a measure of capital asset inputs (in both physical and financial terms) as well as operating costs. By concentrating on the productivity of one particular input (say operating cost per customer) a misleading impression of overall performance may result. Companies adopt different capitalization programs and use different degrees of operating and capital expenditures. For example, an improvement in say labour cost per customer could reflect a substitution of capital for labour or a move to contracting out a labour intensive function. Partial analysis of ratios (e.g. labour productivity and capital productivity ratios) will not take into account the different mixes of operating expenditures and capital expenditures that companies will adopt. This will ultimately skew efficiency comparison results. If a **range** of partial indicators were considered, they could provide a general impression of performance levels.

The Board's interest should be in the **overall** performance of distribution companies. The Board should not attempt to examine the actions of distribution company managers in the conduct of their business nor identify where in the organization savings can be made.

The OEB suggests including labour costs separately for comparison. However there are several other factors such as environmental or structural factors that are beyond the control of management but help drive the performance of the distributor. Labour costs are likely to be but one of these factors. We discuss this in more detail in the section “cost drivers”.

2. Are the divisors used to unitize the costs reasonable? (Cost drivers)

The divisors considered are consistent with those used in studies in other jurisdictions. However, we would submit that the **range** of divisors is limited at present. The work conducted on cost allocation revealed that there are several inconsistencies in how distributors report data such as kilometers (km) of line; some distributors report circuit km of line whereas other distributors report physical km of line. Using km of line as a divisor therefore can yield significantly different results. In addition, some distributors might view km of line as an input (physical measure of capital) while other might view it as an output.

The Board should review other variables used in making electricity distribution efficiency comparisons such as:

- Labour costs: variations in labour costs can impact the relative performance of network operators.
- Customer mix: the type of customers varies between distributors. A distributor focused on industrial clients could potentially have a different underlying efficiency than a distributor focused more on residential customers.
- Connection (or population) density: connection density is frequently cited as an important environmental factor. It is important to analyze the influence of this factor on the relative efficiency scores. Two opposing effects can occur. On the one hand increasing connection density will decrease per unit costs as more customers are connected to the same physical network. However, on the other hand, urbanization or clustering will tend to increase per unit costs in cities.
- Topography: rolling terrain versus flatter areas will have an impact on the size of the distribution network, choice of technology or ease of maintenance, for example.
- Climate: different elements of climate can influence the operation and performance of a network. For example, colder areas tend to have higher load factors than milder areas. Alternatively, precipitation or snowfall can impact the performance.
- Age of assets and system configuration: The system configuration, type of technology and age of the assets can impact the relative position of a distributor.

We strongly recommend that the Board does not use partial indicators in isolation when trying to determine a company’s overall performance. As mentioned above, it is the overall performance that should be of interest to regulators.

3. What are the matters/features useful to consider in establishing sub-groups of suitably similar distributors for purposes of comparing cost behaviors (Grouping)

Distributors use a wide range of inputs to provide services to customers. While the use of inputs is broadly similar across distributors some distributors may use proportionally more of some inputs and less of others. It is possible to operate at equal efficiency while substituting between inputs and supplying different outputs.

The main features are comparability of cost drivers but also include management practices and operating environment, as well as public policy objectives both at the municipal and provincial levels. These drivers should be taken into account and evaluated.

4. Are there additional data that should be acquired from distributors to improve the comparison process (Other)

In making decisions regarding the level of detail for data to be collected, and also the amount of data, we feel it is necessary for the OEB to consider the principles of “regulatory proportionality” and the relative costs and benefits of more detailed data collection. Therefore further data collection should be based on data for which there is a direct need and a clear demonstration of how it will be used in the analysis. This is discussed further in the section entitled “regulatory proportionality”.

5. Are the proposed aggregations or alternatively the 2006 EDR groups appropriate?

As the consistency of the comparator data improves, it will be possible to define more narrow comparators to focus on specific distribution functions such as billing and collection. However, until then only high level aggregations should be investigated since disaggregated data has been shown to be inconsistently reported.

6. Should average labor costs be reported separately for comparison?

At present we are not convinced of the value in publishing average labor costs for comparison purposes unless the drivers of the differences in average labor costs are also well understood. This involves investigating:

- Management practices and staff structure for each utility
- Adjusting for any regional differences in average labor rates
- The extent to which full time labor versus contracted out labor is used.

Given that valid labor cost comparisons will need to adequately address each of these issues recognized/taken into account this may represent an excessive regulatory data collection burden of little perceived value.

7. Given the difficulty of data comparability below cost centre level for O&M should a lower level of granularity be considered?

See the answer to 4 above.

8. Are the four cost drivers the appropriate ones?

There is a wide range of accepted cost drivers for electricity distribution, some of those have been adopted by Board but others include customer density, customer mix, temperature variations, ownership, and public service obligations (PSO)¹ etc. PowerStream would require further time to consider each of these and advise the Board accordingly regarding which should be considered as part of this analysis.

9. What other drivers should be considered?

PowerStream would need more time to investigate this (see response to 8 above.)

10. Should different cost drivers be used for different cost centres?

PowerStream would need more time to investigate this (see response to 8 above.)

11. Are grouping factors proposed by staff appropriate?

We have reservations about the grouping approach, in particular the decisions as to where the boundaries lie. Given the comment regarding cost drivers above, PowerStream would submit that there is a considerable amount of further work required to be undertaken prior to determining whether the grouping factors are appropriate. The grouping factors should be determined once the data has been refined, a technique for measuring the comparators is agreed and the cost drivers are finalized.

12. Are there additional characteristics that should be considered for grouping distributors?

See the answer to 11 above.

13. Should external benchmarks be established in other jurisdictions?

The merits of this approach needs to be considered before engaging in a cross province or international data collection exercise. Distributors will need to feel comfortable that

¹ A PSO is an obligation placed by a municipal or provincial government on a distributor to provide a service or to engage in an activity where it is not commercially attractive to do so, but which the government considers to be in the public interest.

comparability is maintained as moving to different jurisdictions can reduce comparability for reasons of changes in: exchange rates, regulatory regime, ownership structures, multi-utility structures etc., all of which can affect a comparator exercise and yield misleading conclusions.

The test of regulatory proportionality and cost benefit analysis should also be considered in this context to determine whether it is really necessary to go outside of Ontario.

Review of regulatory proportionality

The Board's standard notice and comment period for the electricity distribution sector is 2 weeks regardless of complexity of the issues and with no regard to coordinating them with the parallel regulatory processes that affect our business.

PowerStream would strongly recommend that the Board review the burden and timeliness of regulatory processes, information provided by the distribution companies and other regulated entities, used in regulation and disseminated to customers and others.

Companies have consistently indicated that the information required by the Board and the timelines provided for notice and comment are too great a burden. PowerStream would recommend that the Board assess the data collected from companies to eliminate any redundant data collection and the priorities of the regulatory agenda. This process should include consultation with interested parties.

Integrity of Data

All performance measures require accurate data to be used. Regulators need to recognize the difficulties in obtaining consistent and comparable data and acknowledge the consequences of this difficulty in relation to regulating a particular sector.

Before proceeding, one has to ask:

- Are the data comparable?
- Are the data reliable?
- Were there any exceptional circumstances in the years being considered?
- Have there been any programs which would materially impact the data (e.g. a restructuring that will significantly improve efficiency the year after the comparison was made)
- As an industry distributors would want to spend time going through the data ourselves to check the consistency of data.
- Are the rules for tracking costs against accounts clear and strictly enforced?

- Are the data for previous years changed as a result of financial restatements or other corrections?
- There is no data “scrubbing” process that is typical in performance management and benchmarking studies
- How sensitive is the analysis to the data used?

Board staff states that it found data recording inconsistencies when more granular data sets were analyzed. Bad debts and amortization were removed and isolated in separate cost categories to reduce data anomalies in O&M and administration. PowerStream would suggest that this may imply a need to review distributors reporting requirements before the Board draws conclusions on the given data set that may substantially affect distributors' bottom line.

The data collected and reported might be valid for an individual company and its use in developing just and reasonable 2006 distribution rates. However it would be incorrect to draw comparisons between companies. PowerStream's own experience shows that bringing together four trial balances was a formidable task as each former utility used different assumptions for recording its data. The discussions that surrounded the measurement of km of line during the cost allocation workgroup process (i.e. some distributors measured circuit km of line whereas other distributors measure physical km of line; some distributors included secondary services while others did not) can also attest to the difficulty in obtaining consistently measured data.

As mentioned above, PowerStream would recommend that the board undertake a consultation and review of the Uniform System of Accounts **prior** to using the data in the November 24th excel spreadsheet and developing a methodology for grouping distributors to compare performance.

PowerStream would suggest that the Board consider the approach used by the Office of Water Services (Ofwat) to measure performance across water companies in the UK. Ofwat requires water companies to appoint independent professionals (reporters and auditors) to examine and test information that is submitted and to provide Ofwat with their opinions on that information.

The Reporters act as professional commentators and certifiers on the regulated activities of individual water companies in the UK. All water companies have to provide Ofwat with a range of regulatory information annually (similar to our RRR reporting). Ofwat approves each appointment.

Reporters and auditors examine the financial and non-financial elements of the information that companies submit to the regulator.

As well as scrutinizing individual companies' data, reporters help Ofwat to ensure that information from different companies is comparable. Ofwat provides the reporters with guidance on the information that has the most impact on its regulatory decision making. As a result, Ofwat is able to compare company information to regulate the industry and to establish robust assumptions about relative efficiencies and service to customers.

Reporters have two major roles: scrutinizing the historical data presented in companies' annual returns, and the forecast data presented in their submissions for periodic reviews of price limits.

Conclusion

PowerStream believes that a significant amount of critical analysis and further investigation needs to be completed prior to using the data published in the November 24th letter before a methodology is developed.

When draft documents are issued by the Board for comment, stakeholders need to be given sufficient time to understand the material, conduct their own analysis and coordinate a corporate position with relevant staff in order to issue a well thought-out submission. Work needs to be prioritized in conjunction with other projects. This becomes an increasingly difficult task when consultation processes are initiated without significant warning. While the Board did announce its intention to continue this work earlier this year and perhaps has been working on developing the data spreadsheets for some time, it was impossible for distributors to predict the timing of, and prepare for the November 24th letter. This deadline also coincides with our work on the Cost of Capital and Incentive Regulation draft report, commencing cost allocation modeling, and compiles our smart meter implementation plans for filing etc. All these consultations also have a material impact on PowerStream's "bottom line".

PowerStream further requests that the Board provide clarity on how this analysis will be factored into the incentive based regulation regime, the time frames over which the approach will be refined and finally the points at which the industry will be consulted on developments in data, analysis and conclusions.

PowerStream would welcome the opportunity to work with the Board to make subsequent versions of this analysis more effective as part of the overall development of incentive regulation.

If you have any further questions, please do not hesitate to contact me.

Yours truly,

(original signed by) PAULA CONBOY

Paula Conboy
Director of Regulatory and Government Affairs