June 26, 2007

Kirsten Walli, Board Secretary
Ontario Energy Board
PO Box 2319
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Toronto, Ontario, M4P 1E4

Re: Comparison of Distributor Costs Consultation on Consultant's Report
Board File No.: EB-2006-0268

Benchmarking to be used as a rate setting tool has repeatedly arisen as an area of interest in the Ontario Electric Industry and every time the general conclusion, by both the industry participants and the contracted subject matter experts, is that the current data structure and reporting guidelines do not lend to detailed comparison, either between differing LDCs and/or year to year comparisons of the same LDC. To quote the PEG report,

"Provided that staff moves, at a minimum, to upgrade its unit cost approach in the ways that we have recommended, we believe that benchmarking can and should play a role in the upcoming rate applications. Benchmarking should be used to appraise bridge year and test year costs in addition to recent historical costs. That said, it must be emphasized that none of the methods developed are good enough yet to provide the basis for mechanistic adjustments to initial rates and rate adjustment mechanisms. We are particularly concerned about the inability of current methods to control for differences in capital usage, system age, and the mix of services provided."[1]

And on page ii) paragraph 3 of the executive summary,

"A fundamental result of benchmarking science is that differences between costs of utilities depend in large measure on differences in external business conditions. The cost performance of a company is thus a matter of the cost that it incurs given the business conditions that it faces. Benchmarks should accurately reflect these conditions." [2]

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[1] Mark Newton Lowry, Lullit Getachew, Steve Fenrick. *Benchmarking the Costs of Ontario Power Distributors* PEG Report (Wisconsin, April 2007) page 68.
[2] Mark Newton Lowry, Lullit Getachew, Steve Fenrick. *Benchmarking the Costs of Ontario Power Distributors* PEG Report (Wisconsin, April 2007) page ii.

The above quoted sections of the PEG report ask the questions, is it premature to perform the comparisons at this stage of the deregulated Ontario electricity market? Do benchmarks accurately reflect business conditions and cost drivers?

To bring this point out in more detail the PEG report continues to say *"The accuracy of the indexing approach to benchmarking hinges on the degree to which the cost pressures faced by the peer group resemble those faced by the subject utility."* [3]

The authors discuss the concern with the inability of the current benchmarking approach to isolate these business conditions, which is a fundamental requirement for the indexing approach utilized in some of the reported outputs. Is it fair to any LDC, whether categorized as a high cost or low cost utility to utilize the non-adjusted data for benchmark comparisons?

The PEG report also highlights some recommended reforms to the current Ontario Data tables, namely:

- Better guidelines for, and public reporting of, the share of salaries and wages in net OM&A expenses;
- Greater consistency in the assignment of labour costs to the major categories of distributor activities;
- Standardized, publicly available data on plant additions.

The question then arises, if there is not consistent application of APH and USoA guidelines, how comparable are LDCs and what level of accuracy are the benchmarking indices giving?

From our experience and knowledge there are significant differences amongst utilities in the accounting treatment used to deal with the allocation of indirect costs and administrative overheads.

In the process of setting distribution rates (for future test year applications) all revenue and expense data will be normalized, if this is deemed necessary for rate setting, should it not follow that proper benchmarking should also be based on normalized data? Along with normalization, the trial balance data should be adjusted to match the approved rate base and revenue requirement of the LDC. Assets excluded for rate base calculations and expenses that are deemed not recoverable in distribution rates should not be included in any benchmarking study. Again these points allude to the fact that benchmarking may be premature in the Ontario market, and the publicized data may not be accurate and fair, which are both guiding regulatory principles.

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[3] Mark Newton Lowry, Lullit Getachew, Steve Fenrick. *Benchmarking the Costs of Ontario Power Distributors* PEG Report (Wisconsin, April 2007) page iii.

Again, from our knowledge and experience some utilities incurred significant one-time historical expenditures that were never included in rates. These costs were included in the RRR filings and were part of the determination of average costs.

The PEG report also indicates that "*Benchmarking is also complicated by the unavailability of important data. One major problem is the unavailability of good capital data.*"[4] It then seems unreasonable to compare OM&A costs from one LDC to another, without considering the capital side of the equation. It is widely agreed upon that as capital expenditures increase the OM&A costs decrease. A LDC with high OM&A indices may be offset by low capital expenditure (and vice versa), which may be a reasonable result depending on various business and geographical conditions.

The PEG report did not explore the SQI data filed by all LDCs to the OEB on an annual basis. Some utilities may be over performing in the reliability indicators which would provide an explanation of why some LDCs costs are higher than others. Granted this explanation would not deem these costs appropriate, however it would provide some insight as to the cause of the higher servicing costs.

RDI has discovered some inconsistencies with the peer group data utilized by the authors of the report.

- Southwestern Midsize
  - Customer Max = 34,736 (Bluewater Power Distribution)
  - Customer Min = 6,829 (Middlesex Power Distribution)
- Southwestern Small
  - Customer Max = 19,873 (Halton Hills)
  - Customer Min = 586 (Dutton Hydro)

Another area of concern is the handling of amalgamated utilities. The southwest contains many amalgamated utilities including ELK, Essex, Erie Thames, Westario and Horizon. It is not understood how these utilities were assigned to peer groups. While these LDCs have an accurate count on service territory (square Kms) and customers served, it is not known if the geographical layout of these amalgamated utilities has properly been considered and accounted for in the output of the PEG report. As an example both Westario Power and Erie Thames Powerlines have been classified as "Southwestern Midsize" while they both serve approximately 15,000-20,000 customers they each have 7 or more municipalities in which this population base is located and may be more accurately classified as "Southwestern Small". The above also impacts on customer density, yet another identified cost driver.

There are other differences with amalgamated utilities that can potentially skew the results of the benchmarking study. One example is the contiguous vs. non-contiguous service areas driving different cost requirements. The report did not provide an indication of which LDCs were categorized as contiguous or not. A second example is the potential

[4] Mark Newton Lowry, Lullit Getachew, Steve Fenrick. *Benchmarking the Costs of Ontario Power Distributors* PEG Report (Wisconsin, April 2007) page 32.

requirement for multiple transmission and distribution stations (compared to similarly sized LDCs) which will drive up OM&A costs as well as capital expenditures. Yet a third difference is the need to manage multiple operation centres to ensure regulated response times and other SQI indices are met across the entire service territory. The PEG report does not comment on these issues and does not seem to account for these distinctions in the reported comparator indices.

It is commonly known that customer mix impacts the revenue streams and revenue potential of utilities and it can be extrapolated that customer classes have different cost levels to service. Using such wide peer groups ensures that the customer mixes will not be consistent and again lowers the accuracy of comparison data.
All of the above points are additional issues that bring into question the results and timing of any benchmarking study in the Ontario market.

A higher level aspect of achieving good cost performance involves the concept of asset management.

Benchmarking costs looks at the financial after the fact results of decisions made by utility staff. Decisions are the result of the decision making processes utilized within the utility. A series of informal and formal business processes are involved in reaching the final decisions. These processes may or may not include accepted "best practices."

The achievement of good cost performance is to a large extent driven by these decision making processes. The use of Asset Management practices are widely utilized by utilities in other regulatory jurisdictions. Asset Management involves the use of managed business processes leading to optimal decision making.

Asset Management leads to optimal spending in Operations and Maintenance as well as capital within an acceptable reliability envelope.

LDC owners benefit by ensuring that they are not over or under invested given an acceptable reliability standard.

The financial returns to the owners are maximized. Customers benefit by having an acceptable level of reliability with a lower cost structure to support it.

The regulator benefits because best business practices are being utilized, costs are lower, and reliability is maintained.

It is our belief that it is too early to utilize benchmarking as part of the regulatory process. The data deficiencies identified in the PEG report should be remedied and good data collected for a series of years before benchmarking should be seriously considered as part of the Ontario regulatory framework.

It is also our belief that an Asset Management culture should be incorporated as part of the regulatory framework in Ontario as a precursor to the achievement of good cost performance for LDCs.

If you require any further information, please contact me directly.

Sincerely,

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