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via electronic mail to boardsec@oeb.gov.on.ca – original to follow by mail

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

Dear Ms. Walli:

**RE: Toronto Hydro Initial Comments on Distributor Cost Comparisons
OEB File No. EB-2006-0268**

By way of its letter of November 24, the Board has invited initial comments on its proposals for the comparison of distributor costs. This letter provides the initial comments of Toronto Hydro-Electric System Limited (Toronto Hydro). Toronto Hydro 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.

General Comments

Toronto Hydro makes the following general observations:

1. A substantial amount of work directly relevant to the questions posed by the Board in the November 24 letter was carried out by the Comparators and Cohorts sub-group in the generic 2006 EDR process. To what degree has Board Staff or the Board consultant made use of that work (for example, in identifying cost drivers for various comparators)? Toronto Hydro suggests that that work would be a useful starting point for many of the issues addressed in the November letter.

2. Toronto Hydro acknowledges that Board Staff and utilities have devoted substantial effort and have made corresponding progress in validating and correcting data filed under the RRR process. Nevertheless, has the data published by the Board along with the November letter been thoroughly checked for correctness? In its own case, Toronto Hydro observes that its apparent 2005 billed total distribution revenue is less than \$2.5 million. This appears to be an isolated error, but it underscores the need for ensuring that the subject data is correct (at least with respect to its definition) for the purpose of analysis.
3. In its November letter, the Board states “The [Board consultant’s] 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.” However, it is not clear specifically how the comparisons will assist the Board in either purpose, and whether the assistance will be in the form of providing general contextual information or whether the analysis will go directly to findings of prudence and revenue requirement. Therefore, Toronto Hydro awaits further information on the Board’s intentions to address issues around the specific purpose to which the comparative analysis will be put. However, in principle Toronto Hydro submits that the use of comparative analysis to support substantive findings rather than ‘screening’ demands high standards of data integrity, consistency and accuracy, and an equally reliable analytic approach. Toronto Hydro understands that Board Staff do not assert that these standards have been achieved.
4. Toronto Hydro submits that there are at least three major stages of analysis that remain to be completed. The first is the definition of consistent, functionally-oriented data categories and the resolution of (correct) data into those categories, which then would serve as comparators. The second is the development of a database of cost drivers which could plausibly be correlated to individual comparators. The third is the development of statistical equations which relate comparator values for individual utilities to the set of cost driver values for those utilities which are jointly found to be statistically significant in explaining the comparator values. Prior to this level of analysis taking place, simple comparisons of unitized utility data are likely to be of very limited value, and may in fact be misleading and prejudicial.

Responses to Specific Questions

Themes

Are the “cost centre” groupings of cost sufficiently useful for purposes of comparing distributors?

For the purpose of contextual comparisons only, O&M, Administration, and Amortization are reasonable comparator (i.e., ‘cost centre’) categories. The segregation of bad debt shows the need to define or refine functional comparator categories on a consistent basis.

Toronto Hydro submits that the unitization of most comparator values should be on a per customer basis, since ultimately it is customers that pay utility bills. However, this approach does not at all preclude the use of other variables such as kilometers of line, customer density, and megawatt deliveries as cost drivers. Furthermore, Toronto Hydro submits that the total cost modeling approach taken by Christensen and Associates was unreasonable and unhelpful, since what is relevant to the Board and customers is not total distribution costs but distribution costs per customer.

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?

Please see remarks above. Toronto Hydro urges that a clear distinction be maintained between comparators (e.g., O&M/customer) and cost drivers such as kilometers of line.

What are the matters/features useful to consider in establishing sub-groups of sufficiently similar distributors for purposes of comparing cost behaviours?

Toronto Hydro does not support the approach of forming cohort groups per se, since it is unnecessary and possibly misleading in the analysis of cost drivers and comparators. What is relevant is not that *utilities* (somehow) be considered similar, but that the cost drivers pertinent to each comparator be properly measured and analyzed for each distributor.

Under the cohort approach, a single distributor may be a member of several different cohorts depending on the comparator in question, since different comparators will have different cost drivers. For example, billing and collections as a comparator may not be significantly affected by customer density, whereas operations and maintenance could be. Therefore if cohorts are to be used at all, they should be defined with respect to similarities in cost driver values for particular comparators, *not* similarities in comparator values. However, since a given comparator could be significantly driven by several different cost drivers, a question arises as to how to determine cohorts if different utilities have different values for multiple cost drivers. The clustering methodology used by Christensen was opaque and detracted from the analysis in the 2006 EDR process.

Fortunately, using the comparator/cost driver equation approach, resolution of cohorts is unnecessary and irrelevant. Instead, the equations would be estimated using comparator and cost driver values from all utilities, and a fitted or predicted value for each utility would be determined using the cost driver values for that utility. This statistical approach automatically accounts for multiple cost drivers and the specific values for each cost driver for each utility.

Are there additional data that should be acquired from distributors in order to improve the comparison process?

As indicated above in point four, the Board should consult the results from the Comparator and Cohort sub-group and obtain information on the cost drivers identified there. Further information on comparators is likely of limited value at this stage, especially given the inconsistency of the data.

Potential Cost Centres

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

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

Should average labour costs be reported separately for comparison?

This question is not specific enough to comment on precisely. What form of labour cost is referred to (i.e., capitalized labour, uncapitalized labour, labour rates)? Generally, Toronto Hydro submits that the focus should be on the final cost of the services delivered by utilities, rather than on input costs. In any case, labour rates are not a proper comparator, but instead are a cost driver.

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.

Please see the answer above re groupings.

Potential Cost Drivers

Are the four cost drivers above the appropriate ones?

Cost drivers are specific and appropriate to individual comparators. The listed cost drivers may be relevant to certain comparators, but not every cost driver is relevant to every comparator. For example, it is unlikely that megawatt-hours are significantly associated with administration cost per customer.

In addition, Toronto Hydro submits that many other cost drivers are worthy of consideration.

What other cost drivers should be considered?

Please refer to the 2006 EDR Comparators and Cohorts results.

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

Different cost drivers should certainly be used for different comparators. Please refer to the 2006 EDR Comparators and Cohorts results.

Possible Grouping Characteristics

Are the grouping factors proposed by staff appropriate?

Please see the remarks above regarding cohorts.

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

Please see the remarks above regarding cohorts. No plausible clustering methodology has been proposed, and it is unlikely that one can be developed.

In addition, Toronto Hydro submits that “The degree of outsourcing and cost particulars” is irrelevant to the exercise and would be extremely difficult to measure consistently in any case.

Other Questions for Consideration by Interested Parties

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

Benchmarks established in other jurisdictions would be subject to the same concerns around the comparability (and relevance) of the underlying data as now exist regarding the Ontario utilities. At most, extra-jurisdictional benchmarks could serve as contextual points of reference.

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

Toronto Hydro is not aware that service quality levels have been considered as explicit cost drivers at all. Over the objections of several stakeholders, they were omitted from the Christensen analysis. However, Toronto Hydro supports the further investigation of how to bring service quality and reliability into the comparative exercise. Toronto Hydro notes that service quality and reliability could be modeled either as outputs (i.e., comparators), or as cost drivers.

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

Toronto Hydro submits that after meaningful and thorough consultation with the industry, the Board should define a clear, functionally-oriented, and consistent set of cost reporting categories that would be invariant to existing, legitimate variations in accounting policies between different utilities.

In addition, the Board should obtain, from utilities or other sources, cost driver data on factors which are plausibly thought to significantly explain comparator values. Although some cost driver data is currently available through RRR filings, it is likely that other variables will have material explanatory power. For example, adverse terrain is a factor that could at least be represented as a 'dummy variable'.

Yours truly,



Colin McLorg, Manager
Regulatory Affairs