Comparators and Cohorts Workgroup

Update to OEB

November 2004

Presentation Outline

- ***Questions of Scope and Function***
- ***Mandate of the C&C Workgroup***
- ***Assumptions and Definitions***
- ***Progress to Date***
- ***Conceptual Approach***
- ***Limitations and Concerns***
- ***Alternatives to the Use of Comparators and Cohorts***
- ***Summary***

Question of Scope

- Will the use of C&C in the 2006 rates process be limited to screening applications to determine what further information is needed, rather than for directly setting rates?

Questions of Function

- Can Comparators and Cohorts help to identify applications that require filing of further information?
- Can Comparators and Cohorts assist in rationalizing apparent differences in cost levels between utilities?

Mandate of the C&C Workgroup

- Produce report for the Board on the use of C&C in assessing prudence of proposed 2006 costs
  - Propose an approach to establishing a set of C&C to assist in the consideration of 2006 rate applications
  - Produce draft sections of DRH2 & filing requirements for 2006
- Provide input and information for use by the Board's consultant

Working Assumptions

- Any use of C&C in connection with 2006 rates is limited to screening applications, rather than setting rates - <u>This assumption needs to be confirmed by the Board</u>
- Did not assume C&C would be workable, but attempting to find out if it could be
- Made no assumption as to future use of C&C

Working Definitions

Cost Driver: an external condition, requirement, or environmental characteristic that has a material and direct influence on utility cost levels

Input Cost Drivers refer to factors affecting costs incurred to produce service

Output Cost Drivers refer to required levels of performance – e.g., reliability

Working Definitions cont'd

Comparator: a measurable indicator of utility costs or operations that can be compared across utilities

Cohort: a grouping of utilities based on similar values for cost drivers (not comparators!)

Progress to Date

- A conceptual framework has been developed
- Preliminary lists of cost drivers and comparators have been identified
- An initial assessment of data availability and quality has been done
- Concerns regarding data and methodology have been identified
- No final conclusions have been reached

Defining the Conceptual Model

- Basic purpose is to find a valid, meaningful method of comparing results across utilities
- Simple comparisons of costs across utilities can be misleading for at least three reasons, since they fail to account for:
  - differences in input cost drivers
  - differences in the way costs are reported
  - differences in output cost drivers – i.e., service quality and reliability

Conceptual Model cont'd

1. Identify Input Cost Drivers and Link to Comparators
2. Define Cohort Groups Based on Cost Driver Similarities
3. Validate Reported Comparator Values to Ensure Same Reporting Basis
4. Analyze Validated Comparator Values

Step 1 Concerns

- What level of granularity is appropriate for comparators?
  - High level comparators may have several cost drivers and may be too general to address specific concerns
  - Low level comparators may exhibit data and comparability problems
- How can tradeoffs between CAPEX and OPEX be dealt with?

Step 2 Concerns

- There is a relative lack of data on cost drivers
- Across a spectrum of cost driver values, definition of cohort ranges may be arbitrary
- How many utilities are required to form a robust cohort? Would cohort assignment be driven by population requirements instead of cost driver values?
- Utilities with outlier cost driver values should not be forced into cohorts

Step 3 Concerns

- Reported comparator data will be affected by differences in accounting and business practices, and adjustment to a common basis may be difficult
  - Costs for the same function may be classified differently among utilities, depending on outsourcing and/or accounting practices

Step 4 Concerns

- Have important input cost drivers been omitted from the analysis? If so, how can they be accounted for?
- How can important output cost drivers be incorporated into the analysis? Is there a way to quantify the cost consequences of differing service levels?
- What additional filing requirements, if any, would be necessary?

Alternatives to C&C

- Alternative approaches would be required if:
  - Reliable data cannot be assembled in time
  - Cohorts for a given comparator or set of comparators could not be defined for one or more utilities
- Only alternative identified to date is analysis of historical trends in cost and service levels within a given utility

Summary

- There appears to be acceptance of the conceptual model
- There are serious concerns around data quality, availability, and comparability
- Much work has been done, but there is much left to do
- Views differ on how helpful C&C may be, qualitatively or quantitatively