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March 26, 2012

**Via Courier and RESS**

Ms. Kirsten Walli  
Ontario Energy Board  
Box 2319  
2300 Yonge Street  
Suite 2700  
Toronto ON M4P 1E4

Our reference  
280138

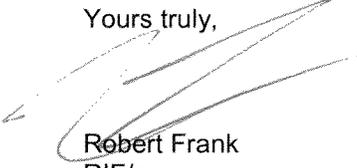
Email  
robert.frank@nortonrose.com

Dear Ms. Walli:

**Electrical Contractors Association of Ontario (ECAO)  
Stakeholder Conference, March 28-30, 2012  
Renewed Regulatory Framework for Electricity: EB-2010-0377/0378/0379,  
EB-2011-0043/0004**

We are counsel to the ECAO in this matter. Pursuant to the Board's letter dated February 22, 2012, please find enclosed two hard copies of the ECAO presentation in respect of the Stakeholder Conference scheduled for March 28 - 30, 2012.

Yours truly,

  
Robert Frank  
RIF/ss

Enclosure

Copy to: Eryl Roberts, Electrical Contractors Association of Ontario (via email)

**Electrical Contractors Association of Ontario:  
Talking points on Capital Construction Input Costs**

**Stakeholders Conference, March 28-30, 2012  
Renewed Regulatory Framework for Electricity  
EB-2010-0377; EB-2010-0379**

*"[T]he inextricable link between electricity prices and economic performance requires us to review possible avenues to reduce long-term costs to electricity consumers. We believe evidence-based policies that drive efficiencies and improve effectiveness would prove beneficial over time."*

***The Drummond Report: "Public Services for Ontarians: A Path to Sustainability and Excellence", Commission on the Reform of Ontario's Public Services, 2012***

**Capital Construction Costs Must be Evaluated for Economic Efficiency**

1. The renewed regulatory framework for electricity must include an evaluation of capital construction input costs as part of the rate-setting process.
2. Appropriate incentives must be put in place for economically efficient planning and construction of capital assets, irrespective of the type of investment (i.e. whether for connection assets, expansions, enhancements and renewable enabling improvements).
3. While the comments herein are made in respect of capital construction costs, they apply equally to O&M costs.

**Strong Electrical Contracting Industry Ensures Economic Efficiency of Capital Costs**

4. As noted in the April 2011 PEG report to the Board, "[i]t is widely believed that effective utility regulation should replicate the operation and outcomes of competitive markets. One reason is that competitive market forces create maximum incentives to operate efficiently."<sup>1</sup>
5. The current regulatory scheme in Ontario does not incent economic efficiency in respect of capital construction costs. In particular, project input costs are not evaluated against competitive market prices. As a result, there is a hugely disproportionate amount of capital construction in Ontario that is performed in-house, in an inefficient manner and at inflated costs.

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<sup>1</sup> "DEFINING, MEASURING AND EVALUATING THE PERFORMANCE OF ONTARIO ELECTRICITY NETWORKS: A CONCEPT PAPER", PACIFIC ECONOMICS GROUP RESEARCH LLC, April 2011 (the "PEG Concept Paper") at p. 58.

6. Procurement processes employed by transmitters and distributors in Ontario should be compared to those used in other jurisdictions where contracting out and public tendering are commonplace and significant aspects of capital construction projects.
7. In Ontario, the lack of contracting out has come at a substantial financial cost to ratepayers, and it fosters other inefficiencies. Incentivizing market-based procurement processes would lead to greater effectiveness and efficiency in the Ontario electrical contracting industry (both in terms of cost and timeliness), particularly at times when significant capital construction projects are required (such as in the current environment).
8. In the renewed regulatory framework, proper incentives must be put in place to ensure that appropriate performance metrics are used to assess how effectively companies manage their capital construction costs. Productivity and cost efficiency benchmarks and other evaluation mechanisms must be used to serve this purpose. In all cases, capital construction costs must be assessed for value.
9. Where services are contracted out, they should be procured using a competitive model, such as public tendering. Where projects are not contracted out, transmitters and distributors should be required to demonstrate the economic efficiency of project costs. Where capital construction services are performed in-house (or through an affiliate), the costs for those services must be assessed for reasonableness against competitive market prices.
10. Longer term investment planning will allow industry participants to understand the anticipated needs for capital construction and make informed decisions about investment in plant, equipment and personnel.

### **Evaluation Mechanisms**

11. Evaluation metrics which assess capital construction costs against competitive market costs will incent economically efficient behaviour and foster a stronger electrical contracting industry in Ontario that more effectively and efficiently serves the needs of all stakeholders. Appropriate evaluation mechanisms in respect of capital spending can include benchmarking and prudence reviews.
12. Benchmarking of capital spending could be based on past performance, peer performance, or sector performance. Ideally, Ontario data would be applied where available.

13. As noted in the PEG Concept Paper, in addition to incentive mechanisms, the Board can use discretion and judgment as a means of creating incentives for networks to achieve regulatory objectives. One example is the use of prudence reviews in cost of service proceedings where certain performance measures fail to conform with established standards.<sup>2</sup>
14. ECAO submits that, as part of a prudence review, the Board should consider whether the regulated entity has employed “best practices” by demonstrating:
  - (a) procurement processes based on the competitive marketplace;
  - (b) control of administration costs in respect of capital construction such that they are consistent with those found in private markets;
  - (c) accurate measurement of costs;
  - (d) efficient use and tracking of equipment and inventory related to project construction; and
  - (e) safety and quality in construction.

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<sup>2</sup> PEG Concept paper, at p. 58.

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