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August 14, 2014

To: All Licensed Electricity Distributors

**Re: Empirical Research in Support of Incentive Rate-Setting: 2013
Benchmarking Update for determination of Stretch Factor Assignments
for 2015 - Board File No.: EB-2010-0379**

In 2013, the Ontario Energy Board (the “Board”) issued a report titled “Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario’s Electricity Distributors” dated December 4, 2013 (the “Board Report”), in which the Board set forth the framework for setting rate adjustment formulas for local distribution companies. The use of stretch factors, as part of the Price Cap IR productivity factor, was approved by the Board and stated in the Board Report.

With the development of total cost benchmarking, and in light of continuing concerns with the use of peer group analysis, the Board determined that distributors will be assigned to one of five groups with stretch factors based on their efficiency as determined through econometric total cost benchmarking model. The Board also determined that the appropriate stretch factor values range from 0.0% to 0.6%. The Board set the lower-bound stretch factor value to zero to strengthen the efficiency incentives inherent in the rate-adjustment mechanism and in doing so reward the top performers.

The Board has continued the current stretch factor methodology with annual data updates for the duration of Price Cap IR. These stretch factor assignments are based on the results of a statistical cost benchmarking study designed to make inferences on individual distributors’ cost efficiency. The annual Price Cap IR applications from the electricity distributors require an update to stretch factors for preparation of the rates and tariff of charges.

The Board has recently received a study report that was prepared by Pacific Economics Group Research, LLC. (PEG) which includes updates to the stretch factor assignments for the Price Cap IR applications (the “2015 Benchmarking Report”). PEG developed total cost measures for 73 electricity distributors in Ontario using the Reporting and Record-Keeping Requirements (“RRR”) data that were reported by the distributors to the Board. In this report, which can be found

on the Board's website, PEG has followed the same methodology as for 2014 stretch factors and has ranked the distributors into five efficiency cohorts.

The 2015 Benchmarking Report presents the results of PEG's most recent Ontario benchmarking analysis, which identifies the 2015 rate year efficiency cohort groupings. The 2015 Benchmarking Report also describes the methodology used to identify the cohorts. These efficiency cohort groupings are used in the calibration of the Price Cap IR stretch factors for Ontario's electricity distributors i.e., the Price Cap Incentive Rate-setting and the Annual Incentive Rate-setting Index applications.

The Board has reviewed the 2015 Benchmarking Report relative to the groupings as published in the Board's report dated December 4, 2013. The table below contains nine distributors whose 2015 stretch factor assignments changed compared to their 2014 stretch factor assignments. Of those companies that have new stretch factors, four moved up to new cohorts (see Table 1) and five moved down in their respective groups (see Table 2). The Board notes that all other relative groupings remain the same.

Table 1 – The Electricity Distributors that Moved up to New Cohorts

| Company Name | 2014 Stretch factor ranking | 2015 Stretch factor ranking |
|--|------------------------------------|------------------------------------|
| GREATER SUDBURY HYDRO INC. | Cohort 3 (0.30) | Cohort 4 (0.45) |
| HORIZON UTILITIES CORPORATION | Cohort 2 (0.15) | Cohort 3 (0.30) |
| PUC DISTRIBUTION INC. | Cohort 3 (0.30) | Cohort 4 (0.45) |
| RIDEAU ST. LAWRENCE DISTRIBUTION INC. | Cohort 2 (0.15) | Cohort 3 (0.30) |
| WEST COAST HURON ENERGY INC. | Cohort 4 (0.45) | Cohort 5 (0.60) |

Table 2 – The Electricity Distributors that Moved down to New Cohorts

| Company Name | 2014 Stretch factor ranking | 2015 Stretch factor ranking |
|---|------------------------------------|------------------------------------|
| ERIE THAMES POWERLINES CORPORATION | Cohort 4 (0.45) | Cohort 3 (0.30) |
| FORT FRANCES POWER CORPORATION | Cohort 4 (0.45) | Cohort 3 (0.30) |
| LAKELAND POWER DISTRIBUTION LTD. | Cohort 3 (0.30) | Cohort 2 (0.15) |
| MILTON HYDRO DISTRIBUTION INC. | Cohort 3 (0.30) | Cohort 2 (0.15) |

All queries on the stretch factor rankings for 2015 should be directed to the Board's Industry Relations Enquiry at 416-440-7604 or IndustryRelations@ontarioenergyboard.ca.

Yours truly,

Original signed by

Kirsten Walli,
Board Secretary