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***via RESS e-filing – signed original to follow by courier***

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street, 27th floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Toronto Hydro-Electric System Limited ("THESL")**
**Written Comments on Experts' Reports on Defining and Measuring Performance of Electricity Distributors**
**OEB File No. EB-2010-0379**

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THESL writes in respect of the above-noted matter.

The following are the comments of Toronto Hydro Electric System Limited ("THESL") in respect of the Board's RRFE Productivity and Benchmarking consultation (EB-2010-0379) and the various consultants' reports filed with the Board on May 31, 2013. THESL welcomes the opportunity to provide its views on the issues that are under consideration before the Board. While THESL has provided its substantive comments as part of separate submissions filed by the Coalition of Large Distributors ("CLD"), it is providing these separate comments on issues more specific to THESL.

THESL is always supportive of Board initiatives to streamline the regulatory processes, provide incentives for LDCs to continue to be efficient and effective in the delivery of distribution services to their customers, and to provide customers with transparent information on rates they pay for these services. THESL feels strongly that the processes the Board determines should equally consider all stakeholders – the regulator, customers, and the LDC – in arriving at rate setting policies for the future.

**PEG Report**

THESL submits that there are three serious flaws in the report and recommendations reached by PEG.

The first is PEG's arbitrary exclusion of THESL and Hydro One Networks, Inc. ("HONI") from its productivity estimates and recommendations. The second is PEG's unwillingness to acknowledge the results of its own analysis – namely that the measured total factor productivity for Ontario's LDCs has been negative over the past decade. The third is PEG's unjustified insistence on using a peer grouping methodology in addition to econometric benchmarking. While THESL has other concerns with PEG's analysis which are addressed in detail in the CLD Submissions, these are issues that THESL submits are especially problematic.

***Exclusion of THESL and HONI***

In the Board's RRFE Report of October 18, 2012 ("RRFE Report"), the Board indicated that it would like to have an industry specific analysis as the foundation for the development of the 4th Generation IRM framework ("4GIRM").[1] Clearly, excluding two LDCs who serve almost 40% of customers[2] in the province from the analysis materially undermines the Report's findings. PEG's rationale for excluding THESL and HONI is that "including these companies would lead to a distorted estimate of the industry trend for 4th Gen IR".[3] The fact is that excluding any 40% of the industry would distort the industry trend. There is no question that THESL and HONI are part of the industry, and therefore should be included in estimating the "industry trend" to be used under 4GIRM. If their data is not to be included, then the natural consequence of that must be explicitly recognized: the PEG approach does not work for these utilities, and some other methodology must be adopted to measure and give effect to their results.

PEG's supplemental analysis filed on June 14, 2013 (the "Supplementary Empirical Analysis") further demonstrates that excluding THESL and HONI is erroneous. In their submissions, PEG's analysis demonstrates, using an "average" measure of TFP growth (which averages each LDC's measured TFP, as opposed to aggregating LDC inputs and outputs and then measuring an aggregate TFP) that there is no need to exclude the two large utilities. The measured industry productivity using this approach, whether THESL and HONI are included or excluded, yields a similar result.[4]

THESL submits that the correct approach to determining a productivity benchmark to apply to the industry for the term of 4GIRM is to include the entire industry in the analysis. To do otherwise would effectively amount to "cherry-picking", by selectively including utility data strictly based on desired outputs. Dr. Kaufmann acknowledged that had the THESL and HONI data not affected the TFP trend, he would have included their respective data.[5] While PEG has attempted to provide statistical theories to justify why these two companies should be excluded[6], nowhere is there any evidence indicating that

[1] RRFE Report, October 18, 2012, page 17
[2] Source: OEB 2011 Yearbook of Distributors.
[3] PEG Report, Page 69.
[4] PEG Supplementary Empirical Analysis, Page 2, Summary Table
[5] Trancript Volume 2, Page 65
[6] PEG Report, Page 56

PEG looked at any other LDCs to determine whether, based on statistical analysis, they too should be excluded. THESL submits that PEG's observation has nothing to do with the data of specific utilities, but simply the large percentage of total industry data that is being proposed for exclusion. It is all but certain that the removal of data from any collection of LDCs equalling as much as 40% of the industry (or even a smaller amount) would similarly have a corresponding statistical impact on the benchmarking results.

In the alternative, however, should the Board accept PEG's approach of excluding THESL and HONI data from the industry TFP analysis, THESL submits that the results of such an analysis should then, logically, not be applicable to those two utilities. That is, if a productivity estimate applied in a 4GIRM framework excludes THESL and HONI data, then THESL and HONI cannot be fairly expected to use that productivity estimate in subsequent rate settings.

Dr. Kaufmann in fact appears to support the above conclusion. During the stakeholder conference, in a discussion about the applicability of the full sample productivity estimate relative to the estimate without THESL and HONI, Dr. Kaufmann supported the use of the reduced sample to "set a productivity factor that is appropriate for most distributors in the province"[7]. In Dr. Kaufmann's view, excluding THESL and HONI is "the right approach that gives you the right result for what it is we are trying to do, something that's appropriate for **most** companies" (emphasis added). He goes on to acknowledge, however, that applying the reduced sample productivity estimate to THESL and HONI may not be appropriate.[8]

THESL notes that while the exercise to determine an appropriate productivity estimate can seem academic (as evidenced by the "competing" estimates and methodologies employed by the experts in this consultation), the application of the results has a very "real-world" consequence insofar as it affects the revenues LDCs receive to carry out their distribution activities in a safe and effective manner. As such, THESL urges the Board to carefully consider the instances where application of empirically derived TFP estimates may warrant exceptions based on specific limitations of the underlying analysis.

***Evidence on Productivity Factor***

On the issue of PEG's recommended productivity factor being contrary to the actual results obtained by PEG in their analysis, THESL directs the Board's attention to the table produced on page 2 of PEG's Supplemental Empirical Analysis. In that table, of the ten different estimates of productivity provided based on different methodologies and on different samples of LDCs, eight show a negative productivity estimate. While PEG provides its rationale for why it discounts all estimates other than the methodology and sample that supports their recommendation, THESL is unclear on the rationale provided on page 3 for why the "average" methodology results in an "aggregation bias", where it seems that the aggregation method favoured by PEG is the method that would most likely result in "aggregation bias". More generally, THESL submits that PEG's recommendation of a 0.1% productivity factor is ignoring the preponderance of empirical evidence provided during this consultation, including its own.

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[7] Transcript Volume 2, page 61.

Negative industry productivity trends are also estimated by both Dr. Yatchew, and by Mr. Fenrick (who used PEG's own econometric models, correcting for the exclusion of a key component of costs, namely OM&A). THESL believes the volume of evidence in this consultation clearly shows that the Ontario distribution sector productivity over the past ten years has been slightly negative. While THESL understands that a negative productivity trend may seem counter to initial expectations, it is demonstrably what the evidence shows. It is not in the interest of customers or the industry to ignore this evidence and impose a productivity factor during the term of the 4GIRM which is not supported by the factual evidence.

***Issues with Peer Groups***

PEG's proposed methodology in developing a benchmarking framework for the application of varying stretch factors builds upon the methodology developed for the 3GIRM framework. In THESL's view, this methodology is needlessly complex and arbitrary.

The development of the peer groups is based on a constructed output index (aggregating customer numbers, system peak demand, kWh deliveries and circuit km of lines), service area, percent of underground lines, and customer growth. This grouping results in 12 peer groups, which PEG somewhat arbitrarily further reduces to six groups to eliminate groups with only zero to four members. PEG asserts that they "endeavoured to make the process for winnowing the groups to the six that are recommended as transparent as possible"[9]. While the rationale is explained in the PEG Report, THESL believes it is far too arbitrary to be relied upon. The placement of one company in a particular peer group will impact the rankings of other LDCs within that peer group against the group's average, and hence the overall efficiency ranking of all LDCs. Even intuitively, the comparison of utilities like THESL with Enwin Utilities (which is a fraction of its size and operates in a notably different environment) in one peer group demonstrates that there are an insufficient number of comparable peers for the effective creation of peer groups for all utilities, and that the variables being used, on their own, are insufficient to account for all the differences between the utilities currently in the proposed groupings. THESL submits that peer grouping is not a robust method of benchmarking.

In THESL's view, Dr. Yatchew's and Mr. Fenrick's recommendations that benchmarking be based solely on econometric cost models is a much more transparent and appropriate approach for 4GIRM. These models are in alignment in showing that the rankings amongst LDCs produce significantly different outcomes than those under PEG's methodology. THESL believes that the econometric models are more strongly underpinned by statistical analysis, produce results that are a lot more intuitive, and are generally less subjective and arbitrary than the approach advanced by PEG.

**PSE Report – The Benefits of an Expanded Dataset**

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[8] Transcript Volume 2, page 61.
[9] PEG Report, page 84.

Section 4.3 and the Appendix of the PSE Report discuss limitations of using an Ontario-only dataset for evaluating cost efficiency of utilities whose unique operating circumstances (e.g., size or customer density) may lead to unique cost drivers, making them outliers in the context of Ontario. As indicated by PSE, for evaluating cost efficiency among peers, the sample group needs to include "true" peers, whose cost drivers are representative and inclusive of other members of the sample group.

THESL agrees with PSE, and submits that in order to properly assess THESL's relative cost efficiency, the benchmarking data set needs to include other large utilities operating in large urban cores and exposed to similar operating constraints and cost pressures as THESL. Given the lack of such peers in the context of Ontario (as confirmed by the PSE report), it follows that assessing THESL's relative cost efficiency must necessarily involve comparisons to large metropolitan utilities outside of Ontario.

PSE has provided in their report the results of such an analysis in which PSE extended the dataset to include a sample of US utilities, including many operating in large urban centres. In contrast to THESL benchmarking efforts using the limited Ontario dataset, when the sample includes true peer data THESL's actual costs compare relatively well to both the model benchmark cost value (PSE Report, Figure 6, page 50), as well as in comparison with other utilities in the full sample (PSE Report, Figure 8, page 52).

In THESL's view, this highlights a shortcoming of benchmarking THESL – and consequently applying an inappropriate stretch factor under the 4GIRM framework – against an Ontario-only sample of LDCs. THESL submits that the Board should consider the use of PSE's expanded dataset (of combined US and Ontario comparators) for use in any benchmarking analysis of THESL, as well as any other utilities in Ontario that it may consider to be outliers within the confines of the Ontario dataset.

Please address all your comments and questions to my attention.

Yours truly,

*[original signed by]*

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