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August 12, 2013

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")
EB-2010-0379: Defining and Measuring Performance of Electricity Distributors

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THESL writes in respect of the above-noted matter.

On July 4, 2013, the Ontario Energy Board (the "OEB") released a report prepared by OEB Staff, entitled "Staff Report to the Board on Performance Measurement and Continuous Improvement for Electricity Distributors" ("Staff Report"). The Staff Report lays out a proposed framework for the implementation of the Distributor Scorecard and invites submissions from interested parties. THESL welcomes the opportunity to provide its views on this issue.

THESL is a signatory to the submissions of the Coalition of Large Distributors ("CLD"), and relies on those submissions as supplementary to these. As set out in those submissions, THESL is supportive of the use of metrics in the promotion of achieving outcomes that will benefit existing and future customers. All utilities currently collect and report information to the OEB and many use a variety of internal metrics to monitor progress. Along with the CLD, THESL suggests that the benefits of any new metrics that the OEB proposes should clearly outweigh the required work and cost related to collecting new information or data. Also along with the CLD, THESL would caution against considering using the Scorecard as a method of utility comparison. While the OEB would be able to measure each utility's performance against a common identified set of metrics and identify improvements against a utility's own past performance, different characteristics and operational realities would prevent a meaningful comparison across utilities.

THESL's supplementary submissions focus on the following areas:

- The overall intent of the Scorecard
- Proposed implementation timing
- Reporting on new measures
- Compatibility with LDC Corporate Scorecards
- System reliability measures
- System plan execution measure
- Public safety measures
- Overall cost performance measures
- Responses to the OEB's specific questions

The Overall Intent of the Scorecard

In the Report introducing the Distributor Scorecard,[1] the OEB notes that among the Scorecard's advantages is its ability to:

> *"... effectively organiz[e] performance information in a manner that facilitates evaluations and <u>meaningful comparisons</u>, which are critical to the Board's rate-setting approach under the renewed regulatory framework."* [2] (emphasis added).

THESL agrees that devising approaches to undertake meaningful cross-industry comparisons is an important objective. However, in THESL's observation, a number of measures proposed in the Staff Report explicitly illustrate the difficulty of deriving comparative insights by way of generic metrics that are not sensitive to the diversity of Ontario's distribution sector. The measures proposed under the "Overall Cost Performance" section of the Scorecard are particularly illustrative of this observation. Without a normalization methodology that accounts for differences in asset age, customer density and system configuration, comparisons of OM&A or Net Plant, unit costs between otherwise similar utilities are unlikely to be of value to the OEB or LDCs.

Furthermore, to the extent that the OEB seeks to use the Scorecard to drive utilities to achieve certain outcomes and improvements, THESL respectfully submits that an important consideration is that LDCs' ability to achieve outcomes is often tied to the funding they have available for a particular purpose. THESL believes that OEB Staff acknowledge this reality by recommending that "*any*

[1] October 18, 2012 Report of the OEB entitled "Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach" (the "RRFE Report")
[2] RRFE Report, p. 57

distributor-specific target(s), the achievement of which is funded through distribution rates, be included on the Scorecard."[3], and THESL supports OEB Staff's comments in this regard.

More generally, THESL submits that while the Scorecard can be valuable for the purposes of tracking individual LDCs' performance against a common set of performance outcomes, it is not well suited for comparative purposes between separate utilities. At its core, the Scorecard is based on a unique balance of objectives that reflect an individual LDC's makeup, operational circumstances and resource availability. As a result, THESL submits that the Scorecard is well-suited to be incorporated into a process of developing utility-specific target / metric customization during LDC rate hearings.

Proposed Implementation Timing

THESL echoes the concerns raised in the CLD submission with respect to OEB Staff's statement that the Scorecard will be implemented in Ontario starting in 2014, in light of the fact that a number of proposed measures and metrics will not be finalized until the end of that year. This is problematic for all utilities expected to undergo rebasing for the 2014 or the 2015 rate years, as their rate filings will need to be submitted ahead of the implied timeline for the Scorecard's finalization. Given the OEB's intent to use the Scorecard to monitor distributors' performance and apply corrective measures where it may be warranted, filing rate cases without a full understanding of the OEB's performance expectations would be unworkable and generally not provide those utilities a fair opportunity to understand the applicable standards prior to filing their rate applications. To that end, THESL supports the CLD's proposal for a "soft launch" of the Scorecard for a period of one calendar year after the time when all metrics have been finalized. THESL also submits that utilities filing for rebasing prior to the Scorecard's finalization should be permitted to seek customized Scorecard measures and targets through their rate application process – measures that would be applied during their rate setting term.

Reporting on New Measures

The draft Scorecard depicted in the Staff Report displays five most recent years of data for each measure. Since the Staff Report proposes to devise a number of new measures which distributors may not currently track, THESL requests that the OEB confirm that distributors will not be required to "back-cast" their performance on these new measures for the past five years once the Scorecard is finalized.

[3] July 4, 2013, OEB Staff Report entitled, "Report to the Board on Performance Measurement and Continuous Improvement for Electricity Distributors," EB-2010-0379, p.48.

Compatibility with LDC Corporate Scorecards

The Staff Report re-iterates the OEB's earlier statement that the proposed OEB Scorecard is not meant to replace the existing corporate scorecards currently used by distributors.[4]

In cases where the corporate scorecard differs from the OEB Scorecard, the presence of a Regulatory Scorecard will effectively expand an LDC's corporate scorecard (to encompass the areas where the two do not naturally overlap). THESL asks the OEB to clarify its expectations on the relationship between the corporate and regulatory scorecards.

System and Customer Reliability Measures

THESL endorses the OEB's plans to commence work on the establishment of regulated performance standards for the existing system reliability measures (SAIDI and SAIFI). In addition, THESL asks the OEB to consider exploring additional measures that could provide further insights into distributors' reliability performance. These could include such measures as energy not supplied, worst performing feeders, restoration during major storm days, among others. THESL would be pleased to participate in any consultations aimed at developing these or other measures.

Regarding the customer-specific reliability measures, THESL agrees that momentary interruptions should not be tracked on the OEB Scorecard due to the costs and complexity associated with their measurement. However, THESL is encouraged that the OEB plans to consider the issue of momentary interruptions during an upcoming consultation process. THESL agrees that momentary interruptions are a serious operational concern for any distributor hosting large industrial customers, but submits that the issue requires examination beyond measurement and reporting. To this end, THESL submits that the OEB may want to examine this issue in a broader context, including potential solutions for enabling distributors to improve their performance in this area. THESL would be pleased to participate in such a consultation, including any potential working groups.

System Plan Execution Measure

THESL echoes the suggestion made in the CLD submission that for the purposes of this measure the OEB should consider allowing the use of distributor-specific system plan execution measures identified in the LDCs' respective Distribution System Plans (DSP) in accordance with the requirements of the Section 5.2.3 of the *Filing Requirements for Electricity Distribution Rate Applications*. The Filing Requirements describe the measures that the OEB expects the distributors to identify and report on in their DSPs in the following manner:

> "*The Board understands that distributors often use certain qualitative assessments and/or quantitative metrics to monitor the quality of their planning process, the*

[4] RRFE Report, p. 57

efficiency with which their plans are implemented, and/or the extent to which their planning objectives are met. The Board expects that this information is used to improve continuously a distributor's asset management and capital expenditure planning processes."[5]

While the Staff Report does not provide a detailed description of the "System Plan Execution Measure" expected to be developed through subsequent consultation activities, there may be significant overlap in the purpose of the measures described in the DSP filing requirements and those referenced in the Staff Report. THESL requests that the OEB adopt distributor-specific measures / metrics advanced through the DSP submissions for the purposes of the Scorecard. THESL submits that utilities which are filing rebasing applications for the 2014 or 2015 rate years should be measured using distributor-specific metrics, as these applications will need to be submitted before the contemplated consultation deadline.

If the intent of the System Plan Execution measure contemplated in the Staff Report is different from the measures described in the DSP Filing Requirements, THESL requests that the OEB provide clarification and elaborate on these differences at its earliest convenience

Public Safety

THESL agrees with the CLD submission that it would likely be more efficient for the OEB to adopt and track a consistent and reliable metric for employee safety rather than public safety. Aside from the issues of consistency and measurability, THESL believes that employee safety is a crucial performance outcome that warrants tracking and recognition on its own merit.

However, if the OEB intends to follow OEB Staff's recommendation of including a measure of public safety into the Scorecard, THESL would also recommend that the OEB consider issuing guidance regarding the scope of public safety-related activities that it expects the LDCs to engage in, and for which it is prepared to allow the utilities appropriate funding. THESL understands that there are currently some differences among LDCs in the types of safety-related activities that they perform, or the frequency with which these activities are carried out (e.g., contact scans). Since these differences ultimately result in varying bill impacts across LDCs, in THESL's submission, it is important that utilities that go beyond the minimum level of safety do so in full awareness of the OEB's expectations and, where appropriate, receive recognition for doing so.

On a related matter, the OEB may wish to consider enabling distributers to seek funding specifically for Disaster Preparedness activities. Local power distribution is inherently exposed to severe weather conditions and regardless of how much investment is put into protecting or building stronger assets,

[5] July 17, 2013 Update to the OEB's, *Filing Requirements for Electricity Distribution Rate Applications*, Chapter 5, Updated p.37

power outages will happen. Recent disasters such as Hurricane Sandy (October 31, 2012), or the flash floods in Toronto (July 8, 2013) continually remind us that Ontario is not prepared for a serious disaster. Furthermore, ad hoc events such as the G20 (June 26-27, 2010) and Pan Am Games (July 2015) carry various disaster management and security requirements from provincial and municipal agencies that absorb months of work hours for planning, coordination and response.

THESL suggests that the OEB consider these issues in future processes as it finds appropriate, and THESL would be pleased to participate in any such discussions.

Overall Cost Performance Measures

With respect to the Total Cost Benchmarking measures proposed for inclusion into the LDC Scorecard, THESL relies on and reiterates its comments submitted on June 27, 2013 in response to the Expert Reports on productivity and benchmarking (appended to this submissions for easy reference). THESL continues to maintain its submissions that in order to properly assess THESL's relative cost efficiency, the benchmarking data set needs to be expanded to include a sample of US utilities, including those operating in large urban centres. Doing so helps ensure that THESL is not an outlier in the dataset in terms of its size, and enables inclusion of additional variables that are crucial to properly evaluate the company's cost performance. Most important of these variables is "large urban core," which cannot be accommodated by an Ontario-only dataset, where THESL is the only LDC operating in a dense metropolitan setting of its size.

Absent the above-referenced adjustments, the findings of the total cost benchmarking analysis contemplated by the OEB's expert consultant, Pacific Economics Group offer little insight into THESL's relative performance. Accordingly it is THESL's submission that these findings should not be displayed on the company's Regulatory Scorecard.

With regard to unit costs, THESL is unclear as to the insights that OEB Staff expect to gain from tracking distributors' Net Plant unit costs. Like many distribution systems in the province, THESL's system includes a large portion of assets that have been significantly or fully depreciated over time. As these assets are replaced, an LDC's Net Plant value will inevitably increase. Barring increases in outputs (e.g., customers, kilometres of line, kW) this would also lead to increases in the measured Net Plant unit costs. To the extent that the increasing unit costs signify deteriorating performance (as the common intuition may suggest), if the objective is to "improve" performance on this proposed metric, it follows that the LDCs would be best served by avoiding any capital investments altogether. At the same time, when viewed in isolation, this metric does not provide an entire picture of the distributor's asset management practices, since asset replacement is at times more cost-effective than deferring replacement due to the increased levels of maintenance that are typically required for ageing assets. For the above reasons it is unclear to THESL why OEB Staff propose to include the Net Plant unit cost measure on the Scorecard.

More generally, THESL questions OEB Staff's proposal of using simple unit cost metrics for the purposes of the Scorecard, given the array of inherent differences among the distributors' operational environments that such measures are often insensitive to. THESL notes that the OEB's consultant on performance measurement, the Pacific Economics Group (PEG) has in the past recommended that the OEB avoid using simple unit cost metrics:

> "*PEG recommends that, instead of simple unit cost metrics, the Board should use unit cost indexes with multidimensional output quantity treatments such as those that we have developed from our econometric work. The Board should also consider replacing or supplementing indexing with direct econometric cost benchmarking*".[6]

Notwithstanding THESL's methodological concerns referenced above, the company recognizes and commends the OEB for the work it has done to advance the use of econometric modelling since the time the above recommendation was made. THESL is uncertain about the incremental value that OEB Staff expect to derive from tracking the unit costs on the Regulatory Scorecard, and asks the OEB to specifically assess this issue prior to issuing its final guidance.

Responses to the OEB's Specific Questions.

For responses to the OEB's specific questions posed in the July 4th, 2013 Cover Letter please refer to the combined CLD submission.

Please do not hesitate to contact me if you have any questions.

Yours truly,

[original signed by]

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:AK/RB/DB

[6] March 20, 2008, Pacific Economics Group Report to the Board entitled "Benchmarking the Costs of Ontario Power Distributors p. VIII

Appendix A: THESL’s July 7, 2013 Written Comments on Experts’ Reports on Defining and Measuring Performance of Electricity Distributors
(5 pages)

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June 27, 2013

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Ms. Kirsten Walli
Board Secretary
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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

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

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[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

[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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