4TH Generation Incentive Regulation of Ontario's Electricity Distributors

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ELECTRICITY DISTRIBUTORS ASSOCIATION

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Inflation Factor

In present circumstances broader measures of inflation are reasonable

Primarily because they are less volatile.

They are also likely to be better understood and accepted by electricity consumers.

Productivity Trends

In our earlier report we estimated the productivity factor using two methodologies – an index based approach, and a cost based approach.

The estimates were approximately -0.7% and -0.8% respectively, indicating significant upward cost pressures in the industry.

Our preliminary analysis of the updated data which includes the year 2012 suggests estimates slightly more negative.

Productivity Trends

We remain of the view that the econometric approach has characteristics superior to the pure index based approach.

An econometric model is needed whether one is going to calculate productivity trends via the index approach or via the econometric approach.

It permits the identification of the components of productivity changes.

Productivity Trends

The PEG Report excludes the two largest distributors on the basis that they are “outliers”, thus excluding them from productivity trend, but includes in other utilities with wide size disparities.

There are appropriate methodologies for including these data-points and we believe that they are informative.

Peer Group Analysis

We support the Board's decision to set aside the use of Peer Group analysis at the present time.

Peer Group Analysis, in its proposed form, is contentious and unlikely to contribute productively to the assignment of distributors to efficiency cohorts.

Relative Efficiency

Estimation of relative efficiencies is difficult and subject to considerable risk of misclassification. Even minor model variations can lead to migration of distributors from one efficiency cohort to another.

Among the available alternatives, the cost model provides the better indicator of relative efficiency, though even this model can lead to anomalous results for some distributors.

Stretch Factors

We support the Board's decision to assign distributors to five groups based on their relative efficiency, as determined by the benchmarking model. We have put forth arguments that the stretch factors should be centered at zero with negative values assigned to relatively efficient utilities. The Board does not believe negative stretch factors to be appropriate.

We are considering whether resetting the dividing lines between stretch factor groups may be appropriate. Rather disparate utilities are included in the 'least efficient' group.

We appreciate the Board's willingness to give future consideration to incentive schemes based not only on relative performance but also on relative improvement.

The Numbers – Draft Report of the Board

Inflation Factor – 1.6%*

Productivity Factor – 0.0%

Stretch Factors – Range from 0.0% to 0.6%

Efficiency Cohort	Stretch Factor
I	0.0%
II	0.15%
III	0.3%
IV	0.45%
V	0.6%

*Page 15 of the Draft Report of the Board provides staff estimates for the inflation measure in 2013 and 2014 of between 1.6% and 1.9%.

The Numbers – Draft Report of the Board

Applying these components to the incentive regulation formula

$$\text{Allowable Rate Increase} = \text{Inflation Factor} - \text{X Factor} - \text{Stretch Factor}$$

one obtains nominal rate increases ranging from 1.0% to 1.6%.

For example, the 'median' utility would receive a rate increase of

1.6% - 0.0% - 0.3% = 1.3%.