

September 25, 2013

Ms. Kirsten Walli  
Ontario Energy Board  
PO Box 2319  
27<sup>th</sup> Floor, 2300 Yonge Street  
Toronto, Ontario M4P 1E4

**Re: Consultation re: Measuring Performance of Electricity Distributors (EB-2010-0379)**

Dear Ms. Walli,

On September 6, 2013, the Board released its “Draft Report of the Board on Empirical Research to Support Incentive Rate-setting for Ontario’s Electricity Distributors” (the “Draft Report”). A consultation was subsequently held at the Board’s office on September 11, 2013.

Entegrus Powerlines Inc. (“Entegrus”) has been an active participant throughout this proceeding<sup>1</sup> and appreciated the opportunity to attend this latest consultation.

At this time, Entegrus wishes to offer additional commentary and recommendations, organized under the following sections by topic:

- Section 1: The Productivity Factor
- Section 2: The Stretch Factors & The Quintile Approach
- Section 3: 1998-2002 Capital Additions Data Issue

### **Section 1: The Productivity Factor**

Entegrus supports the determination in the Board’s Draft Report that the productivity factor be set at nil. Entegrus notes that this determination is based on empirical study of distributor data by expert consultants.

Dr. Kaufman (the PEG expert consultant) estimates the negative industry productivity experience to be -0.3%. Similarly, the EDA’s expert consultant, Professor Adonis Yatchew, estimates negative industry productivity of between -0.7% and -0.8%<sup>2</sup>. Mr. Steven Fenrick, expert consultant for the Coalition of Large Distributors (“CLD”), summarizes the empirical findings as follows:

*“... the 2002 through 2012 TFP has been measured to be negative. All four experts appear to agree that over this time period it has been negative.”<sup>3</sup>*

<sup>1</sup> See Ontario Energy Board website / RRFE / Entegrus submissions dated: June 27, 2013; June 24, 2013; May 31, 2013

<sup>2</sup> See Ontario Energy Board website / RRFE / Presentation of Professor Adonis Yatchew of September 11, 2013: page 3

<sup>3</sup> See Ontario Energy Board website / RRFE / Transcript of consultation of September 11, 2013: page 67 ( lines 22-25)

While the data-based analysis shows a negative productivity factor, Entegrus supports the Board's determination to set the productivity factor at nil, rather than a negative value. Entegrus takes this view due to the undesirable implicit message to consumers and other stakeholders that would otherwise result.

Nonetheless, at the September 11 consultation, some participants advocated that the negative industry TFP trend should be studied in more detail<sup>4</sup>, or alternatively that a "forensic TFP examination"<sup>5</sup> of IRM3 should be conducted. There was further discussion that indicated an additional six months might be required to facilitate such study.

Entegrus notes that the current consultation process commenced May 3 with the release of PEG's preliminary draft report. Since that time, there have been a total of four days of consultation and numerous commentary submissions from a cross-section of stakeholders, including extensive empirical analysis by the above-noted four expert consultants.

From a distributor perspective, the negative industry TFP trend is not a revelation. Rather, the trend is a function of industry change and numerous associated directives that distributors have responded to over the past 10 years. As noted by Professor Yatchew:

*"Additional responsibilities undertaken by distributors as a result of the Green Energy Act, FIT programs, smart meters and other initiatives have also contributed to cost increases without increases in measured outputs."*<sup>6</sup>

In a follow-up report, Professor Yatchew further describes major Ontario policy and legislation changes that have affected the industry, notably those that have occurred over the period from 2002-2010.<sup>7</sup>

Accordingly, Entegrus submits that the drivers of the negative industry TFP trend are readily apparent and do not require further study. Entegrus believes that there has been sufficient time to dissect, discuss and corroborate the trend over the past five months of consultation. Additional study would come at the expense of "paralysis through analysis".

Entegrus asserts that it is critical to expedite the remainder of the empirical research phase of the RRFE process in order that price cap parameters are in place for 2014 distribution rates.

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<sup>4</sup> See Ontario Energy Board website / RRFE / Transcript of consultation of September 11, 2013: page 40 (lines 15-28), and page 41 (lines 1-12)

<sup>5</sup> See Ontario Energy Board website / RRFE / Transcript of consultation of September 11, 2013: page 122 (lines 14-28), and page 123 (lines 1-9)

<sup>6</sup> See Ontario Energy Board website / RRFE / Presentation of Professor Adonis Yatchew of May 24, 2013: page 10

<sup>7</sup> See Ontario Energy Board website / RRFE / Electrical Distributor Association comments of June 27, 2013: pages 2-5

## Section 2: The Stretch Factors & The Quintile Approach

In its Draft Report, the Board has determined that distributors will be assigned to one of five cohorts, with different stretch factors for each cohort based on its efficiency as determined via PEG's econometric cost performance rankings.

PEG further describes the segmentation of the five cohorts as follows:

*"Distributors whose actual costs are at least 20% below the costs predicted by PEG's cost model will be in the first cohort and assigned a stretch factor of zero. Distributors whose actual costs are between 15% and 20% below the costs predicted by PEG's cost model will be in the second cohort and assigned a stretch factor of 0.15%. Distributors whose actual costs are between 0 and 15% below the costs predicted by PEG's cost model will be in the third cohort and assigned a stretch factor of 0.3%. Distributors whose actual costs are between 0 and 15% above the costs predicted by PEG's cost model will be in the fourth cohort and assigned a stretch factor of 0.45%. Distributors whose actual costs are more than 15% above the costs predicted by PEG's cost model will be in the fifth cohort and assigned a stretch factor of 0.6%."*<sup>8</sup>

This non-symmetrical approach to cohort segmentation is shown in the updated PEG Report of September 6, 2013, as well as PEG's associated Excel file entitled "Tables in 2012 PEG Report". Entegrus has summarized the resultant distribution in Table 1 below:

**Table 1: Summary of PEG September 6, 2013 Tranche Distribution**

| Group | Scoring Range                 | Stretch Factor | Distribution of Distributors |     |              |
|-------|-------------------------------|----------------|------------------------------|-----|--------------|
|       | (Actual Minus Predicted Cost) |                | #                            | %   | Cumulative % |
| 1     | <= -0.20                      | 0.00%          | 5                            | 7%  | 7%           |
| 2     | -0.20 to -0.15                | -0.15%         | 7                            | 10% | 17%          |
| 3     | -0.15 to -0.00                | -0.30%         | 18                           | 24% | 41%          |
| 4     | 0.00 to 0.15                  | -0.45%         | 26                           | 36% | 77%          |
| 5     | > 0.15                        | -0.60%         | 17                           | 23% | 100%         |

As shown above, the outcome of this scoring range distribution is that: 17% of distributors land into the top 2 cohorts, 41% of distributors land in the middle cohort and the remaining 59% of distributors fall into the bottom 2 cohorts. As noted by PEG, the result of this distribution is that, *"the average stretch factor for the industry will be [-] 0.37%".*<sup>9 10</sup>

Entegrus cannot locate details in the report to show how these static scoring ranges were determined.

Entegrus submits that the distribution of distributors should be symmetrical, broken down into quintiles. Under this approach, the cohorts and the associated stretch factor distribution would be relative to other distributors. This would make the model less susceptible to data migration

<sup>8</sup> See Ontario Energy Board website / RRFE / 2012 PEG Report of September 2013: pages 20-21

<sup>9</sup> Ibid: page 21

<sup>10</sup> **Note:** Entegrus believes that the resultant stretch factor based on this distribution actually calculates to -0.39%

volatility that might otherwise occur over time due to the use of static scoring ranges, while still encouraging continuous improvement on a relative basis.

Further, the resultant relative cohort outcomes would be more understandable for stakeholders. Comparatively, explaining the meaning of cohort outcomes from a static scoring range perspective would be complex and confusing for stakeholders.

Entegrus acknowledges that the utilization of a quintile approach may appear to foment a competitive approach amongst distributors, akin to benchmarking. However, Entegrus feels that this is appropriate because the foundation of PEG's predictive econometric model is the data of other distributors. Accordingly, Entegrus views that this process is already inherently competitive, and thereby takes no issue with extending that approach to the segmentation of the cohorts.

Entegrus acknowledges that the proposed quintile approach would result in additional distributors moving into the top two tranches, since each tranche would have 14-15 distributors. In turn, this would equate to more distributors having lower stretch factors – the average IRM4 stretch factor would migrate to -0.30%. By comparison, the average 2013 stretch factor under IRM3 was -0.40%.

Customarily, stretch factors and productivity factors are considered in isolation. However, Entegrus notes that the determination to set the productivity factor at nil implicitly results in a stretch factor of between -0.3% to -0.8% (see Section 1 above). Accordingly, Entegrus submits that a decrease in the average stretch factor by 0.10% due to the adoption of a quintile approach would not be unreasonable.

### **Section 3: 1998-2002 Capital Additions Data Issue**

On May 31, 2013, Entegrus submitted a letter of commentary to the Board noting the importance of using accurate historical capital data in PEG's total cost benchmarking calculations. Entegrus specifically raised concerns regarding the reasonability of certain capital asset addition figures determined by PEG through the use of estimation. A copy of this letter has been included as Attachment A.

On June 19, 2013, Entegrus received a response in this matter from PEG via Board Staff. PEG explained that two different estimate methods ("Method 1" or "Method 2") were applied on a case-by-case basis for each distributor in order to estimate figures for the period where industry capital additions data were not available. PEG further acknowledged that *"Entegrus was one company for which neither method generated highly plausible estimates of additions."* A copy of this response has been included as Attachment B.

In response, on June 24, 2013, Entegrus submitted a letter recommending that since the estimated data attributed to Entegrus was not plausible, another approach should be employed. Entegrus requested that the Board direct PEG to utilize a simple average of existing actual capital data to derive an estimate for Entegrus 1998-2002 capital asset additions as a means by which to more accurately represent historical capital additions. A copy of this letter has been included as Attachment C.

On September 6, 2013, the Board released the latest iteration of the 2012 PEG Report, along with

PEG's associated spreadsheet models. In the spreadsheet entitled "TFP and BM Database Calculations 2012 WP", under the tab marked "Capital Calculations for BM" in cells T351 thru T355, the Entegrus 1998-2002 capital asset additions have been appropriately updated by PEG to values that closely approximate the figures recommended by Entegrus in its letter of June 24, 2013. In cells U351 thru U353 of the same spreadsheet tab, there is an explanatory note, which indicates, *"Simple Linear Interpolation was used in place of Method 1 or Method 2"*. Entegrus agrees with these adjustments and appreciates the assistance of the Board and PEG in this regard.

While the "Capital Calculations for BM" worksheet has been updated, this same adjustment to Entegrus 1998-2002 capital asset additions has not been flowed through to the "Capital Calculations for TFP" worksheet. Specifically, in the same spreadsheet entitled "TFP and BM Database Calculations 2012 WP", under the tab marked "Capital Calculations for TFP" in cells V354 thru V358, the previous PEG "Method 2" is still being applied to derive Entegrus data. This results in estimated capital additions for Entegrus for 1998-2002 of \$9,406,434 annually. As further described in Entegrus' previous correspondence (see Attachment C), this estimate is not plausible, given that Entegrus' actual 1997 additions were \$3,740,567 and 2003 additions were \$3,512,014. When "simple linear interpolation" is applied in the same manner as described in the previous paragraph above, the capital additions become \$3,626,291. Entegrus believes this result to be more plausible, and consistent with the previous adjustment already made by PEG to the "Capital Calculations for BM" worksheet. Further, it is the understanding of Entegrus that such an adjustment would affect the econometric model's "actual versus predicted costs" outcome for Entegrus.

Accordingly, Entegrus respectfully requests that the Board direct PEG to update the tab marked "Capital Calculations for TFP" in cells V354 thru V358 to reflect capital additions of \$3,626,291, and consequently update the model results.

If you have any questions, please do not hesitate to contact me.

All of which is respectfully submitted,

*[Original Signed By]*

David Ferguson  
Director of Regulatory & Administration  
Phone: (519) 352-6300 Ext. 558  
Email: [regulatory@entegrus.com](mailto:regulatory@entegrus.com)

cc: Lisa Brickenden, Ontario Energy Board  
Dave Hovde, Pacific Economics Group  
Jim Hogan, CEO – Entegrus Inc.  
Dan Charron, President – Entegrus Powerlines Inc.  
Chris Cowell, Chief Financial & Regulatory Officer  
Ryan Diotte, Senior Regulatory Analyst

## **Attachment A**

May 31, 2013

Ms. Kirsten Walli  
Ontario Energy Board  
PO Box 2319  
27<sup>th</sup> Floor, 2300 Yonge Street  
Toronto, Ontario M4P 1E4

**Re: May 27 & 28, 2013 Stakeholder Consultation re: Measuring Performance of Electricity Distributors (EB-2010-0379)**

Dear Ms. Walli,

Entegrus Powerlines Inc. ("Entegrus") is appreciative of having had the opportunity to attend the above-noted stakeholder consultations earlier this week.

These latest stakeholder sessions reiterated to Entegrus the importance of accurate historical capital data. These data are critical to the proposed distributor total cost benchmarking methodology developed by the Board consultant, the Pacific Economic Groups ("PEG"). The PEG Report details how this historical capital data was utilized to derive a capital benchmark (1989) and subsequent year data was utilized to develop a TFP growth trend against the benchmark<sup>1</sup>. The PEG Report further notes that the dataset for 1989 thru 2011 capital additions was incomplete. The incomplete dataset required that PEG create an estimation process to fill in data for missing years, as explained in the PEG Report:

*"MUDBANK data are available for all municipal distributors through 1997 and for some municipal distributors through 1998. RRR data are available from 2002 to the present for all distributors. Because there was a data "gap" between these data sources between 1997 and 2002, PEG had to interpolate capital additions data between 1997 and 2002."*<sup>2</sup>

The available capital data from PEG's TFP & BM Database for three selected distributors (Entegrus, Distributor 9 and Distributor 13) is shown as **Attachment A** to this letter. The attachment clearly demonstrates the period for which the dataset is incomplete.

The PEG Report indicates that in most cases, capital additions for the incomplete period could be inferred based on the difference between gross asset values between 1997 and 2002. For the purposes of this letter, this PEG inference method will be referred to as "Methodology 1".

However, the PEG Report further explains that in certain exception cases another inference method was employed:

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<sup>1</sup> Report of the Pacific Economics Group Research, LLC, pages 31-34

<sup>2</sup> *ibid*, page 32

*“In some cases, however, PEG noticed precipitous drops in gross assets between 1997 and 2002. These drops did not appear to be plausible. Discussions with PBR Working Group revealed that, in some mergers over the 1997-2002 period, the gross capital stocks reported in 2002 for the merged company were in fact equal to net asset values in those years. The actual gross stocks were accordingly higher than what was reported by these distributors in 2002.”<sup>3</sup>*

The PEG Report proceeds to provide a detailed algorithm developed to infer capital additions in cases where “precipitous drops in gross assets between 1997 and 2002”<sup>4</sup> were observed. For the purposes of this letter, this inference methodology will be referred to as “Methodology 2”.

**Attachment B** to this letter shows the capital data for the three selected distributors, inclusive of the PEG inferences for 1998-2002 capital additions. Based on review of PEG’s TFP and BM database calculations, in all three cases the inference methodology employed was Methodology 2. However, Entegrus notes that none of the three selected distributors appear to meet the Methodology 2 criteria of having shown “precipitous drops in gross assets between 1997 and 2002”.

Further, in the opinion of Entegrus, the 1998-2002 capital additions produced by Methodology 2 do not appear reasonable. Specifically, in the case of Entegrus as shown in **Attachment B**:

- a) the inferred 1998-2002 capital additions are 305% higher than the average actual 1990-1997 Entegrus capital additions, and;
- b) the inferred 2003-2011 capital additions are 165% higher than the average actual 2003-2011 Entegrus capital additions.

Entegrus made similar observations with respect to Distributor 9 and Distributor 13.

Based on this analysis, it is the conclusion of Entegrus that the 1998-2002 capital additions are overstated for the three selected distributors. Entegrus believes that this overstatement has a material impact on the statistical models and TFP calculations and negative consequence to the affected distributors. Entegrus puts forth for the Board’s consideration that in these three cases, Methodology 1 or an alternative methodology should be employed. In the event that an alternative methodology is developed, Entegrus seeks the opportunity to review the detailed calculations and provide commentary.

Please note that Entegrus may have additional comments in advance of the June 27, 2013 stakeholder commentary deadline established in the Board’s letter of May 30, 2013.

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<sup>3</sup> *ibid*, page 33

<sup>4</sup> *ibid*, page 33



In the meantime, if you have any questions, please do not hesitate to contact me.

All of which is respectfully submitted,

*[Original Signed By]*

Chris Cowell  
Chief Financial and Regulatory Officer  
Phone: (519) 352-6300 Ext. 283  
Email: [regulatory@entegrus.com](mailto:regulatory@entegrus.com)

cc: Lisa Brickenden, Ontario Energy Board  
Dan Charron, President  
David Ferguson, Director of Regulatory & Administration  
Ryan Diotte, Senior Regulatory Analyst

## Attachment A

### Capital Data by Year

**Data Source:** Pacific Economics Group: Report to the Board (TFP and BM database calculations 2.xlsx)

**Ref Tab:** Capital Calculations for BM

| Year | Entegrus Powerlines             |                                 | Distributor 9                   |                                 | Distributor 13                  |                                 |
|------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|      | Gross Capital                   | Gross Capital Additions         | Gross Capital                   | Gross Capital Additions         | Gross Capital                   | Gross Capital Additions         |
| 1989 | 37,493,506                      | -                               | 12,917,032                      | -                               | 81,912,076                      | -                               |
| 1990 | 41,725,464                      | 4,231,958                       | 14,042,437                      | 1,125,405                       | 92,734,057                      | 10,821,981                      |
| 1991 | 42,872,828                      | 1,147,364                       | 14,416,882                      | 374,445                         | 95,268,129                      | 2,534,072                       |
| 1992 | 44,906,811                      | 2,033,983                       | 15,063,217                      | 646,335                         | 101,602,879                     | 6,334,750                       |
| 1993 | 46,513,128                      | 1,606,317                       | 15,710,962                      | 647,745                         | 106,050,589                     | 4,447,710                       |
| 1994 | 48,850,746                      | 2,337,618                       | 16,337,649                      | 626,687                         | 118,167,577                     | 12,116,988                      |
| 1995 | 52,500,748                      | 3,650,002                       | 17,481,990                      | 1,144,341                       | 121,528,811                     | 3,361,234                       |
| 1996 | 56,756,822                      | 4,256,074                       | 18,422,793                      | 940,803                         | 126,988,623                     | 5,459,812                       |
| 1997 | 60,685,188                      | 3,928,366                       | 19,274,578                      | 851,785                         | 133,953,628                     | 6,965,005                       |
| 1998 | Data incomplete for this period | Data incomplete for this period | Data incomplete for this period | Data incomplete for this period | Data incomplete for this period | Data incomplete for this period |
| 1999 |                                 |                                 |                                 |                                 |                                 |                                 |
| 2000 |                                 |                                 |                                 |                                 |                                 |                                 |
| 2001 |                                 |                                 |                                 |                                 |                                 |                                 |
| 2002 | 62,409,035                      |                                 | 20,367,757                      |                                 | 135,229,482                     |                                 |
| 2003 | 66,602,176                      | 4,193,141                       | 22,333,454                      | 1,965,697                       | 142,945,891                     | 7,716,409                       |
| 2004 | 71,243,595                      | 4,641,419                       | 24,442,192                      | 2,108,738                       | 151,427,068                     | 8,481,177                       |
| 2005 | 73,792,006                      | 2,548,411                       | 26,039,920                      | 1,597,728                       | 134,715,886                     | (16,711,182)                    |
| 2006 | 80,045,540                      | 6,253,534                       | 28,241,965                      | 2,202,045                       | 146,718,043                     | 12,002,157                      |
| 2007 | 86,769,390                      | 6,723,850                       | 30,946,706                      | 2,704,741                       | 159,584,472                     | 12,866,429                      |
| 2008 | 93,295,204                      | 6,525,814                       | 36,045,408                      | 5,098,702                       | 178,599,796                     | 19,015,324                      |
| 2009 | 99,104,240                      | 5,809,036                       | 39,134,819                      | 3,089,411                       | 202,210,227                     | 23,610,431                      |
| 2010 | 105,983,310                     | 6,879,070                       | 42,668,454                      | 3,533,635                       | 217,907,103                     | 15,696,876                      |
| 2011 | 110,693,490                     | 4,710,180                       | 47,355,942                      | 4,687,488                       | 237,422,405                     | 19,515,302                      |

**Attachment B**  
**Capital Data per Year, Inclusive of PEG 1998-2002 Capital Addition Inferences**

**Data Source:** Pacific Economics Group: Report to the Board (TFP and BM database calculations 2.xlsx)

**Ref Tab:** Capital Calculations for BM

| Year | Entegrus Powerlines |                         |                   | Distributor 9 |                         |                   | Distributor 13 |                         |                   |
|------|---------------------|-------------------------|-------------------|---------------|-------------------------|-------------------|----------------|-------------------------|-------------------|
|      | Gross Capital       | Gross Capital Additions | Average Additions | Gross Capital | Gross Capital Additions | Average Additions | Gross Capital  | Gross Capital Additions | Average Additions |
| 1989 | 37,493,506          |                         |                   | 12,917,032    |                         |                   | 81,912,076     |                         |                   |
| 1990 | 41,725,464          | 4,231,958               |                   | 14,042,437    | 1,125,405               |                   | 92,734,057     | 10,821,981              |                   |
| 1991 | 42,872,828          | 1,147,364               |                   | 14,416,882    | 374,445                 |                   | 95,268,129     | 2,534,072               |                   |
| 1992 | 44,906,811          | 2,033,983               |                   | 15,063,217    | 646,335                 |                   | 101,602,879    | 6,334,750               |                   |
| 1993 | 46,513,128          | 1,606,317               |                   | 15,710,962    | 647,745                 |                   | 106,050,589    | 4,447,710               |                   |
| 1994 | 48,850,746          | 2,337,618               |                   | 16,337,649    | 626,687                 |                   | 118,167,577    | 12,116,988              |                   |
| 1995 | 52,500,748          | 3,650,002               |                   | 17,481,990    | 1,144,341               |                   | 121,528,811    | 3,361,234               |                   |
| 1996 | 56,756,822          | 4,256,074               |                   | 18,422,793    | 940,803                 |                   | 126,988,623    | 5,459,812               |                   |
| 1997 | 60,685,188          | 3,928,366               |                   | 19,274,578    | 851,785                 |                   | 133,953,628    | 6,965,005               |                   |
| 1998 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 1999 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2000 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2001 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2002 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2003 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2004 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2005 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2006 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2007 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2008 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2009 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2010 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |
| 2011 |                     | 8,829,919               |                   |               | 7,908,887               |                   |                | 16,550,789              |                   |

| Entegrus Notations & Observations:   |  |
|--|--|
| Yellow highlights: The numbers highlighted represent PEG capital addition inferences for the period 1998 thru 2002.                      |  |
| Blue highlights: In all 3 cases, comparing the 2002 gross capital numbers to the 1997 numbers does not demonstrate a "precipitous drop". |  |

## **Attachment B**

## Andrya Eagen

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**From:** RRF <RRF@ontarioenergyboard.ca>  
**Sent:** June-19-13 1:49 PM  
**To:** David Ferguson  
**Cc:** RRF  
**Subject:** FW: Method 1 vs. Method 2 for Entegrus

Good Afternoon, Dave

Below, please see a response from PEG's to your May 31<sup>st</sup> e-mail and letter.

Cheers,

Lisa

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**From:** Dave Hovde [mailto:hovde@earthlink.net]  
**Sent:** June-18-13 2:15 PM  
**To:** RRF; Larry Kaufmann  
**Subject:** Method 1 vs. Method 2 for Entegrus

We looked into the issues Entegrus raised regarding our choice of method for estimating missing plant additions data. Entegrus was one company for which neither method generated highly plausible estimates of additions. As noted in the working papers on the Capital Calculations for BM spreadsheet, we noted the drop in accumulated amortization as evidence that method 2 was superior despite a small increase in gross plant from 97-02. In addition, the use of method 1 would result in a 90% drop vs. typical levels of additions which we see as more implausible than the increase generated by method 2.

Here are the results using method 1 which can be obtained by entering a 1 in the place of 2 in cell L337:

| 2011 Company Name   | Year | Gross Additions |
|---------------------|------|-----------------|
| Entegrus Powerlines | 1989 |                 |
| Entegrus Powerlines | 1990 | 4,419,426       |
| Entegrus Powerlines | 1991 | 1,355,991       |
| Entegrus Powerlines | 1992 | 2,248,347       |
| Entegrus Powerlines | 1993 | 1,830,851       |
| Entegrus Powerlines | 1994 | 2,570,184       |
| Entegrus Powerlines | 1995 | 3,894,256       |
| Entegrus Powerlines | 1996 | 4,518,578       |
| Entegrus Powerlines | 1997 | 4,212,150       |
| Entegrus Powerlines | 1998 | 405,455         |
| Entegrus Powerlines | 1999 | 405,455         |
| Entegrus Powerlines | 2000 | 405,455         |
| Entegrus Powerlines | 2001 | 405,455         |

|                     |      |           |
|---------------------|------|-----------|
| Entegrus Powerlines | 2002 | 405,455   |
| Entegrus Powerlines | 2003 | 4,505,186 |
| Entegrus Powerlines | 2004 | 4,974,430 |
| Entegrus Powerlines | 2005 | 2,904,629 |
| Entegrus Powerlines | 2006 | 6,622,494 |
| Entegrus Powerlines | 2007 | 7,124,078 |
| Entegrus Powerlines | 2008 | 6,959,661 |
| Entegrus Powerlines | 2009 | 6,275,512 |
| Entegrus Powerlines | 2010 | 7,374,591 |
| Entegrus Powerlines | 2011 | 5,240,097 |

Dave Hovde  
Vice President  
Pacific Economics Group Research  
22 E. Mifflin Street  
Suite 302  
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**From:** David Ferguson [<mailto:David.Ferguson@entegrus.com>]  
**Sent:** May-31-13 1:43 PM  
**To:** BoardSec  
**Cc:** Lisa Brickenden; Dan Charron; Chris Cowell; Ryan Diotte  
**Subject:** May 27 & 28 Stakeholder Consultation EB-2010-0379: Letter of Comment

Good afternoon,

Please see the attached letter of comment from Entegrus Powerlines, as relating to the Stakeholder Consultation held at the Ontario Energy Board earlier this week.

Should you have any questions, please do not hesitate to contact us.

Best regards,  
Dave

David Ferguson, CPA, CA, MBA  
Director of Regulatory & Administration  
Entegrus  
320 Queen Street, P.O. Box 70  
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## **Attachment C**



June 24, 2013

Ms. Kirsten Walli  
Ontario Energy Board  
PO Box 2319  
27<sup>th</sup> Floor, 2300 Yonge Street  
Toronto, Ontario M4P 1E4

**Re: Consultation re: Measuring Performance of Electricity Distributors (EB-2010-0379)**

Dear Ms. Walli,

On May 31, 2013, Entegrus Powerlines Inc. ("Entegrus") submitted a letter of commentary to the Board in respect of the above-noted consultation. In the letter, Entegrus raised concerns regarding the reasonability of certain 1997-2002 industry capital asset addition figures determined by the Pacific Economic Group ("PEG") Report by way of estimate. A copy of this letter has been included as Attachment A (See previous Attachment A).

On June 19, 2013, Entegrus received a response in this matter from PEG via Board Staff. PEG explained that two different estimate methods were applied for each distributor on a case-by-case basis to estimate figures for the period of 1997-2002 where industry capital additions data were not available. PEG further acknowledged that *"Entegrus was one company for which neither method generated highly plausible estimates of additions."* A copy of the PEG response has been included as Attachment B (See previous Attachment B).

In the PEG Report, it was noted that for some distributors, "a precipitous drop in gross assets between 1997 and 2002"<sup>1</sup> was observed. PEG further explains that "discussions with the PBR Working Group revealed that, in some mergers over the 1997-2002 period, the gross capital stocks reported in 2002 for the merged company were in fact equal to *net* asset values in those years."<sup>2</sup> This reasoning was cited as support for PEG applying an alternative estimation methodology ("Methodology 2") to infer 1997-2002 capital asset additions for a handful of distributors who were deemed to have experienced a "precipitous drop in gross assets". However, as demonstrated under Scenario A of Exhibit A attached, in the case of Entegrus there was in fact no drop in gross capital assets between 1997 and 2002 – *gross capital actually increased*. Yet, PEG employed Methodology 2 for Entegrus with the result that implausible capital addition estimates were generated. These Methodology 2 estimates are equally improbable as those which would have been generated had PEG elected to use Methodology 1 (see Exhibit A, Scenario B), which was applied to the majority of other distributors.

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<sup>1</sup> Report of the Pacific Economics Group Research, LLC, pages 31

<sup>2</sup> Ibid, page 31

Methodology 2, designed by PEG to account from the information taken from the PBR Working Group discussions, in effect assumes that the total distributor assets were reported on a net asset basis. Entegrus submits that PEG should consider a more plausible and financially reasonable explanation: In many cases assets which were fully depreciated were not added to the books of the combined entity at the time of Market Opening because the net book value was \$Nil. The end result is a net book value which is correct, but also an apparent drop in gross asset value and accumulated depreciation which is the case for the identified handful of distributors. The incorrect interpretation of the cause for the apparent decline in gross assets has lead PEG to create a methodology which renders an implausible result.

Entegrus submits that, given the importance of this initiative and the consequence to distributors, it is inappropriate to utilize an estimate methodology that generates implausible results. As previously noted by Entegrus in the letter of May 31, 2013, the methodology applied by PEG results in estimated 1998-2002 capital additions are 305% higher than the average actual 1990-1997 Entegrus capital additions, and 165% higher than the average actual 2003-2011 Entegrus capital additions. The result is that Entegrus is disadvantaged in the efficiency rankings for levels of capital expenditure that never actually occurred. This issue also impact a handful of other distributors where Methodology 2 was employed, despite the fact that their gross capital assets also increased between 1997 and 2002.

Entegrus recommends that in cases where neither Methodology 1 nor Methodology 2 generates a reasonable estimate of additions for 1997-2002, a third approach be utilized. In this regard, please see Exhibit A for a comparison of the following different alternatives utilizing Entegrus data:

- Scenario I – PEG Inference Method 2 (as currently utilized in PEG Report);
- Scenario II – PEG Inference Method 1;
- Scenario III – Average of Capital Additions for: (i) 1989-1996 (Average I); (ii) 1989-2011 - excluding the missing 1997-2002 period (Average II), and (iii) 2003-2011 (Average III); and,
- Scenario IV – Actual Capital Additions for 1997-2002 (based on internal company records)

Entegrus understands that at this stage of the consultation process, it may be impractical to collect 1997-2002 internal data from each distributor to support actual 1997-2002 capital asset additions. However, as shown by the calculation captioned “Average II” in Scenario C of Exhibit A, the use of an average based on existing data can closely approximate actual capital additions for the 1997-2002 period (comparatively, see Scenario D of Exhibit A). Specifically, in the case of Entegrus, the average generates an estimate of \$4,204,479 versus an actual average of \$4,818,347.

Accordingly, Entegrus requests that the Board direct PEG to use an average based on existing actual data to derive a plausible estimate result for Entegrus 1997-2002 capital asset additions for the purposes of the PEG Report. Entegrus recommends that this average be calculated as detailed by the caption “Average II” in Scenario C of Exhibit A.

If you have any questions, please do not hesitate to contact me.

All of which is respectfully submitted,

*[Original Signed By]*

Chris Cowell

Chief Financial and Regulatory Officer

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cc: Lisa Brickenden, Ontario Energy Board  
Dave Hovde, Pacific Economics Group  
Jim Hogan, CEO – Entegrus Inc.  
Dan Charron, President – Entegrus Powerlines Inc.  
David Ferguson, Director of Regulatory & Administration  
Ryan Diotte, Senior Regulatory Analyst

**Exhibit A**  
**Entegrus Powerlines Capital Data Under Alternative Scenarios**

**Data Source:** Pacific Economics Group: Report to the Board (TFP and BM database calculations 2.xlsx)

**Ref Tab:** Capital Calculation: for BM

| Year | Scenario A: PEG Current                                  |                         | Scenario B: PEG Alternative                    |                         | Scenario C: Averages  |   | Scenario D: Actuals                                 |                         |
|------|--|-------------------------|--|-------------------------|---|---|---|-------------------------|
|      | Gross Capital  | Gross Capital Additions | Gross Capital                                  | Gross Capital Additions | Gross Capital   | Gross Capital Additions                                     | Gross Capital                                       | Gross Capital Additions |
| 1989 | 37,493,506   | -                       | 37,493,506                                     | -                       | 37,493,506  |   | 37,493,506  | -                       |
| 1990 | 41,725,464   | 4,231,958               | 41,725,464                                     | 4,231,958               | 41,725,464  |   | 41,725,464  | 4,231,958               |
| 1991 | 42,872,828   | 1,147,364               | 42,872,828                                     | 1,147,364               | 42,872,828  |   | 42,872,828  | 1,147,364               |
| 1992 | 44,906,811   | 2,033,983               | 44,906,811                                     | 2,033,983               | 44,906,811  | <b>2,898,960</b><br>(Average I)<br>(1990-1997)              | 44,906,811  | 2,033,983               |
| 1993 | 46,513,128   | 1,606,317               | 46,513,128                                     | 1,606,317               | 46,513,128  |   | 46,513,128  | 1,606,317               |
| 1994 | 48,850,746   | 2,337,618               | 48,850,746                                     | 2,337,618               | 48,850,746  |   | 48,850,746  | 2,337,618               |
| 1995 | 52,500,748   | 3,650,002               | 52,500,748                                     | 3,650,002               | 52,500,748  |   | 52,500,748  | 3,650,002               |
| 1996 | 56,756,822   | 4,256,074               | 56,756,822                                     | 4,256,074               | 56,756,822  |   | 56,756,822  | 4,256,074               |
| 1997 | 60,685,188   | 3,928,366               | 60,685,188                                     | 3,928,366               | 60,685,188  |   | 60,685,188  | 3,928,366               |
| 1998 | Additions as currently estimated under PEG Methodology 2 | 8,829,919               | Additions as estimated under PEG Methodology 1 | 405,455                 | Additions based on the average of 1990-1997 & 2002-2011 actuals | <b>4,204,479</b><br>(Average II)<br>(1990-1997 & 2003-2011) | Actual additions based on Entegrus internal records | 3,796,413               |
| 1999 |  | 8,829,919               |  | 405,455                 |   |   |   | 4,249,786               |
| 2000 |  | 8,829,919               |  | 405,455                 |   |   |   | 8,835,845               |
| 2001 |  | 8,829,919               |  | 405,455                 |   |   |   | 3,212,753               |
| 2002 | 62,409,035   | 8,829,919               | 62,409,035                                     | 405,455                 | 62,409,035  | <b>5,364,939</b><br>(Average III)<br>(2003-2011)            | 62,409,035  | 3,996,938               |
| 2003 | 66,602,176   | 4,193,141               | 66,602,176                                     | 4,193,141               | 66,602,176  |   | 66,602,176  | 4,193,141               |
| 2004 | 71,243,595   | 4,641,419               | 71,243,595                                     | 4,641,419               | 71,243,595  |   | 71,243,595  | 4,641,419               |
| 2005 | 73,792,006   | 2,548,411               | 73,792,006                                     | 2,548,411               | 73,792,006  |   | 73,792,006  | 2,548,411               |
| 2006 | 80,045,540   | 6,253,534               | 80,045,540                                     | 6,253,534               | 80,045,540  |   | 80,045,540  | 6,253,534               |
| 2007 | 86,769,390   | 6,723,850               | 86,769,390                                     | 6,723,850               | 86,769,390  |   | 86,769,390  | 6,723,850               |
| 2008 | 93,295,204   | 6,525,814               | 93,295,204                                     | 6,525,814               | 93,295,204  |   | 93,295,204  | 6,525,814               |
| 2009 | 99,104,240   | 5,809,036               | 99,104,240                                     | 5,809,036               | 99,104,240  |   | 99,104,240  | 5,809,036               |
| 2010 | 105,983,310  | 6,879,070               | 105,983,310                                    | 6,879,070               | 105,983,310   |   | 105,983,310   | 6,879,070               |
| 2011 | 110,693,490  | 4,710,180               | 110,693,490                                    | 4,710,180               | 110,693,490   |   | 110,693,490   | 4,710,180               |

**\*\* 4,818,347**  
(average actual)

\*\* Entegrus capital asset additions in 2000 were significantly higher than other years due to building construction to accommodate the merger of operations of the 11 former Chatham-Kent utilities that came together as a result of Municipal amalgamation.