EB-2010-0379

Ontario Energy Board

CONSULTATION

DEFINING AND MEASURING PERFORMANCE OF ELECTRICITY DISTRIBUTORS

COMMENTS OF
ENERGY PROBE RESEARCH FOUNDATION
(“ENERGY PROBE”)

September 25, 2013

EB-2010-0379

BOARD CONSULTATION

DEFINING AND MEASURING PERFORMANCE OF ELECTRICITY DISTRIBUTORS

Comments of Energy Probe Research Foundation

Background

In its letter of September 6, 2013, The Ontario Energy Board (the "Board") made provision for interested stakeholders to file written comments on the "Report of the Board on Empirical Research to Support Incentive Rate-setting for Ontario's Electricity Distributors" of even date (the "Draft Report") and on Pacific Economics Group's Update Report to the Board (the "September, 2013 Updated PEG Report") by September 25, 2012.

Energy Probe Research Foundation ("Energy Probe") has participated in all aspects of the Renewed Framework for Electricity and, in particular, attended the Stakeholder Conference for EB-2010-0379 on May 27-28, 2013. Further to the Board's letter of May 30, 2013, Energy Probe filed written comments on June 27 in response to the Board's non-exhaustive list of questions on the expert reports (its "June 27 comments").

On September 11, 2013, Energy Probe attended the Stakeholder Conference convened by the Board in its letter of August 23, 2013. This document provides Energy Probe's written comments on the Draft Report and on the September, 2013 Updated PEG Report.

1. Review of EP's June 27 Comments

Energy Probe notes that the Draft Report has endorsed the comments of Energy Probe and certain other stakeholders in the following areas:

a. Inflation factor

Energy Probe preferred an approach that did not contain a smoothing component. Rather, it favoured the use of the most up-to-date inflation indicator rather than a smoothed average of recent years' inflation rates. Energy Probe did not indicate a preference for either the "2-factor" IPI or the "3-factor" IPI, although it supported the use of a more Ontario-specific IPI. In addition, Energy Probe did not favour Professor Yatchew's suggested "banking" approach as it appeared to be incomplete.

The Draft Report indicates the Board's decision to use the year-over-year change in the GDP IPI FDD and the AWE-All Employees-Ontario to calculate the 2-factor IPI.

Energy Probe recognizes that undue volatility is problematic from a consumer's point of view, and it is satisfied that the intention to re-calculate the inflation factor annually addresses, if only in part, its concern.

b. X-factor components

Energy Probe supported the use of a total-factor productivity growth rate based on the entire industry and, in particular, it agreed with PEG's exclusion of Toronto Hydro and Hydro One from the sample in this regard. The Draft Report has now indicated that an industry productivity measure should not be materially impacted by only two distributors and Energy Probe continues to agree with this view.

Energy Probe had considerable difficulty with suggestions from various stakeholders that the productivity factor to be used was negative, and it accepts the recommendation in the September, 2013 Updated PEG Report that the productivity factor in the Price Cap regime be no less than zero. It further accepts the Draft Report's determination that the appropriate value for the productivity factor is zero.

c. Stretch factor

Energy Probe previously indicated its support for ranking distributors on the basis of efficiency using the econometric approach. It also supported the range of stretch factors from 0% to 0.6%, thus ruling out negative factors. The Draft Report proposes similarly and Energy Probe continues to agree.

d. Benchmarking

(no EP comment)

e. Productivity Factor Update

Energy Probe agrees with the Draft Report's plan to update the productivity factor every five years. It was concerned however that updated productivity factors be applied to individual distributors at the start of their respective IR terms. It notes that the Draft Report calls for implementing such changes for distributors under Price Cap IR in this way.

2. EP Comments on Cronin presentation

Energy Probe agrees with Dr. Cronin's recommendation that more research should be directed to understanding the reasons for the reported findings of negative productivity growth by all the experts in this consultation. As it noted in its June 27 comments,

> Energy Probe finds it strange that the industry-wide productivity trend could be negative, and is inclined to accept Professor Yatchew's conclusion that the negative productivity estimates are the result of measurement error. Moreover, the whole point of incentive regulation is to reward distributors for becoming more efficient, i.e. over those costs and decisions that are under the control of the distributor.
>
> To the extent that regulation and/or public policy may require distributors to undertake expenditures that are not associated with revenue increases, measured distributor productivity must decline. However, this negative finding does not preclude that distributors are being run more efficiently yet the greater efficiency is obscured by effects of regulatory and public policy.

Energy Probe notes that in his presentation, Dr. Cronin called attention to other factors that may bear some responsibility for the observed negative productivity growth, including treatment of line losses, previous incentive design, multiple rate-setting regimes, varying capital spending requirements, etc. The Draft Report also calls attention to the possible impact of IFRS.

Energy Probe strongly recommends that, while proceeding with IR reform as indicated in its Draft Report, the Board should devote sufficient resources to resolving the issue of the observed historical negative productivity growth. In Energy Probe's view, this research might well take more than six months of effort having regard to data issues and one-time investments (e.g. smart meters), inter alia. However, it would be time well-spent.

3. EP Comments on SEC's presentation

The presentation by School Energy Coalition emphasizes the link between the incentive-regulation regime and the incremental capital module and the implications for ratepayers.

SEC is concerned that the limits imposed on rate-setting by the new IR regime will not prevent significant rate increases (approximately 4%) that will be needed to finance large capital-spending programs via the incremental capital module in the coming five years.

SEC also questions whether the smaller utilities will be able to apply for the incremental capital module due to lack of resources. Accordingly, those smaller utilities will be subject only to the incentive-regulation formula.

Energy Probe considers that the incremental capital module was intended for the acquisition of extraordinary capital assets, i.e. that it not be used to support general capital spending when the amount thereof is unusually large.

In Energy Probe's view, the use of the incremental capital module to fund general capital spending has led to cost increases as such spending has proliferated. Energy Probe regards this trend as undesirable from the consumer perspective and recommends that the Board should revert to its original conception of the incremental capital module, which was to support extraordinary spending requirements.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

September 25, 2013

Lawrence P. Schwartz, Ph.D.
Consultant to Energy Probe