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

Dear Ms. Walli,

**RE: EB-2018-0278 – Activity and Program Based Benchmarking For Electricity Distributors - London Property Management Association Response to Questions Raised in Staff Discussion Paper**

## **A. INTRODUCTION**

The London Property Management Association (“LPMA”) supports the greater use of benchmarking for electricity distributors. In particular, LPMA believes that the Activity and Program Based Benchmarking (“APB”) is an important initial step in expanding the use of benchmarking.

While benchmarking has been used by the Ontario Energy Board (“OEB”) for several years, the level of benchmarking was at a very high level. While this benchmarking was sufficient for sorting distributors into various efficiency cohorts for incentive rate making purposes, it did not provide any information as to why some electricity distributors were more efficient than others or why some electricity distributors lagged behind others in terms of efficiency.

LPMA believes that the use of APB at the more granular level of activity and programs should provide more insight into what makes a distributor efficient. APB may also provide information as to the width and depth of what makes a distributor efficient. For example, an efficiency distributor at the high level may have one or two activities and/or programs where it excels relative to others, which being average or even below average in other activities and/or programs.

APB will ensure that management of distributors that are lagging in overall efficiency will have access to greater information on where they lag other distributors and enable them to focus on the areas that will provide the most benefits to them and their customers. Management of efficient distributors will be provided information that may show them that in some areas there is still room for improvement, allowing them to become even more efficient and provide more value to customers.

LPMA has reviewed the Staff Discussion Paper (“Staff paper”) dated February 25, 2019 and believes it is a good initial step in the implementation of APB. Whether subsequent steps or refinements are required in the future will depend on the results of this first step.

## **B. GENERAL COMMENTS**

As noted in the Staff paper, APB provides the ability to compare utility cost performance in selected programs that are meaningful to utility operations and service to customers.

Customers have no more interest in better understanding their local distributor’s operations than they do in better understanding the operations of the cable provider or their internet provider. What matters to customers is cost, reliability and customer service. Customers expect that the regulation provided by the OEB and enhanced by the regulatory process that involves customer representatives will provide the appropriate outcomes with respect to these three matters that are of importance to customers.

Customers expect that their distributor will improve their cost performance in the activities and programs resulting in a combination of lower costs, better reliability and better customer service. Being able to compare the results between distributors will provide information to customers as to what is possible in terms of best practices. However, customers expect the distributors to improve their efficiency without requiring customers to understand the daily operations of the utility.

As is noted in some of the responses to the questions below that were posed in the Staff paper, LPMA sees the current consultation as the initial step in what could be a multi-step process of benchmarking numerous key activities and programs, beyond the initial preliminary list proposed by Staff.

## **C. RESPONSE TO QUESTIONS**

### **Question 1 – What other elements, if any, should the OEB consider in its development of an APB framework?**

In addition to the elements discussed in the Staff paper and illustrated in Figure 1, LPMA believes that an additional element should be included, that being enhanced audits at the required level of cost granularity.

As the OEB is aware, the output of either an econometric model, unit cost analysis or any other benchmarking method is only as good as the inputs into the methodology. The data used has to be accurate and consistent across all distributors. In the view of LPMA the probability of this being the current situation is low. The OEB has issued clarifications over the years to try and ensure that utilities are reporting their information consistently at an aggregate level. LPMA believes that now the OEB needs to extend this effort to a more granular level of data.

As Staff identify in their paper, increasing the granularity of data to measure at the activity or program level is likely to adversely affect the accuracy of the results due to inconsistency in the allocation of costs and reporting by the distributors. Instead of staying at a higher level of granularity to increase the accuracy of the results, LPMA believes there is merit in addressing the inconsistencies of the allocation of costs and reporting to increase the accuracy of the results and increasing the granularity of the data.

Just as moving to APB from total cost benchmarking is designed to provide more information on where distributors are efficient relative to one another or have room for improvement relative to one another, moving to a more granular APB in the future will provide additional information. In order to move to a more granular level in the future will require accurate and consistent historical data. Improving and verifying the accuracy of the data today will provide the database for such a review in the future.

**Question 2 – What level of cost disaggregation is suitable for activities/programs benchmarking?**

As noted above, LPMA believes that the level of cost disaggregation is dependent on the accuracy and consistency across utilities of the data currently available. Data at a more aggregate level is likely to be more accurate and consistent at this point in time. The greater the level of disaggregation, the more likely it is that there will be inconsistencies across utilities and a reduction in the level of accuracy at the sub-account level that is hidden by the aggregation of the sub-accounts to the account level.

Also as noted above, LPMA believes that the OEB should begin to address the issue of potential inconsistencies across utilities at a more granular level. This would make more activities and/or programs eligible for potential benchmarking in the future. The OEB should provide resources and guidance to utilities on the disaggregation of costs in a phased approach, concentrating on the activities and/or programs that provide the largest impact on costs, reliability and customer service.

**Question 3 – Does the preliminary list provide a set of activities/programs for benchmarking that are meaningful in terms of utility operations and customer service?**

LPMA submits that the preliminary list provided in the Staff paper provides a set of activities/programs for benchmarking that are meaningful in terms of utility operations and customer service.

In addition to those activities/programs included in the preliminary list, LPMA believes that the allowance for working capital should be benchmarked. In particular, the time to issue a bill and the average collection lag should be benchmarked.

These two components of a lead-lag study show the greatest variability across electricity distributors, as highlighted in Appendix A to the OEB's June 3, 2015 letter Re: Allowance for

Working Capital for Electricity Distribution Rate Applications, in which the default value of 7.5% was established.

As indicated in Appendix A, the billing lag was set at the median value of 17.5 days, and the observed range was 13 days to 19 days. Similarly, the collection lag was set at 22.0 days while the observed range was 21.8 days to 29.1 days.

As the OEB is aware, a change of a few days in either of these categories (or in the various other categories used in a lead-lag study) can have a significant impact on the percentage used for calculating the rate base associated with working capital. This working capital attracts the same return on capital as net capital assets, but unlike capital assets and additions, do not attract a capital cost allowance that reduces income tax.

The allowance for working capital is a significant portion of overall rate base and can vary significantly between distributors. As an example, based on the approved rate base in the EB-2016-0091 Decision and Rate Order dated March 23, 2017, the allowance for working capital was more than 11% of total rate base for London Hydro. Based on the EB-2015-0107 Decision and Rate Order dated March 24, 2016 for Wasaga Distribution, the allowance for working capital was more than 13.7% of total rate base.

Not only does the allowance for working capital have a significant impact on rate base and costs through the revenue requirement, but the time to issue a bill and the time to collect accounts are direct impacts on customer service.

Customers want their bills as soon as possible. This is becoming more important with the potential move to different billing determinants for some rate classes. The greater the time between consumption and receiving a bill undermines the ability of a customer to make changes in order to reduce or shift consumption.

**Question 4 – Should the OEB pursue a phased approach for benchmarking activities and programs? Why?**

LPMA submits that the OEB should pursue a phased approach for benchmarking activities and programs for the reasons noted on page 34 of the Staff paper.

LPMA believes that it is important for the OEB, utilities and customers to gain a good understanding of the benchmark results on activities and programs that have adequate and consistent data upon which to review the results. Following this step, and depending on the results obtained, parties can then determine what to do in a subsequent step of APB, such as collection of data needed for future use and improvement of data quality and consistency, although as noted above, LPMA believes that the OEB should start this now in order to be able to take the next APB step in a reasonable amount of time.

The initial benchmarking of activities and programs is likely to be at a high level of aggregation, based on the level of quality data currently available to the OEB. A review of the results of this benchmarking exercise may point to the need to further disaggregate these activities and programs in order to determine differences between utilities. This further disaggregation would be a second step in the use of APB. It may also be that no further disaggregation is warranted based on the results of the initial APB exercise, in which case instead of further disaggregation, the second phase of APB would be to look at other activities and programs.

The phased approach for APB should provide information and lessons learned that should assist with any second and subsequent phases for the implementation of APB.

**Question 5 – What benchmarking method(s) should the OEB use to benchmark activities/programs? Why?**

LPMA believes that at least initially, the OEB should use each of the three approaches to statistical benchmarking identified in the Staff paper, being: unit cost analysis, cost/volume analysis and econometric modelling.

At this point in time, it is not clear that any of the methods is superior to another in terms of providing information to the utilities, to customers and to the OEB. Arbitrarily picking one of the methods now, before any comprehensive results can be reviewed, would be counterproductive and possibly defeat the purpose of APB.

There is likely to be a trade off between simplicity of some of the methods and additional information provided by other methods. The OEB has already experienced this trade off with the use of an econometric approach to total cost benchmarking.

A simple comparison of average cost per customer or average cost per residential customer provides information to a utility over the course of time, where the average cost can be compared over time, adjusted for inflation. However, the comparison of the average cost from one utility to another is often very difficult and often meaningless. Even if the utilities are in the same peer group, utilities often have legitimate reasons as to why they are “unique” or different from other utilities. Even the definition of a peer group and who is in and who is out raises questions.

The use of the econometric approach to total cost benchmarking does not require peer groups, and it helps provide answers as to what factors affect some utilities and not others with respect to total costs. In other words, the econometric model “explains” some of the differences between the utilities.

LPMA believes that the econometric approach to APB would provide more information as to what factors account for the differences between utilities when it comes to the various activities and programs that are examined.

**Question 6 – What is the preferred method that will be well understood by customers and other stakeholders?**

LPMA believes the preferred method that would be well understood by customers and other stakeholders is the econometric model. As noted above, this method provides more information as to what the factors are that explain at least some of the variance in costs associated with activities and programs undertaken by the utilities.

LPMA submits that customers are more sophisticated than the OEB gives them credit for. While a simple cost per volume analysis for a given program is easy to understand, this method provides no information as to why the cost per volume of the customer's utility is different from a neighbouring utility or any other utility in the province. For example, if a customer is told that its utility has a billing cost per bill of \$1, this provides little information to the customer that is related to their cost, reliability or customer service. Another utility may have a cost of \$0.50 per bill. Without knowing why the cost for their utility is significantly higher than for the other utility, a customer cannot form a reliable opinion. For example, the more costly utility may get their bills out quicker to their customers and have less billing errors. One utility may have a greater turnover of customers (such as apartment customers) than another (that is predominantly single housing customers). These are factors that may be found to be statistically significant through the econometric modelling approach, "normalizing" the costs to account for whatever factors are influencing the cost per bill.

Customers do not need to know econometrics any more than they know how a transformer works. Customers care about the end results – costs, reliability and customer service.

If a utility has lower reliability because of transformer failures than another utility, customers do not care how a transformer works. They want to know why their transformers are less reliable than those of the other utility.

The econometric approach to APB would provide a comparison to other utilities and provide insights into why costs for an activity or program are different from other utilities, just as total cost benchmarking does for total costs. Reliance on a simple cost per volume methodology only gives customers half of the information. It tells them what the cost per volume is for their utility and they can find the information for other utilities. However, it does not provide any information that would explain the difference, other than their utility is different from everyone else.

**Question 7 – What benchmarking method(s) provides the best indication of performance efficiency to allow distributors to understand the results, and provides the opportunity to undertake the appropriate action to improve their performance? Why?**

Use of the cost per unit or unit cost analysis approach to benchmarking provides information that a utility can use to benchmark its own performance over time. A comparison to other utilities, is however, limited. No two utilities are the same and there will always be differences in costs

associated with activities and programs. These differences may be attributable to a number of drivers depending on the specific activity and/or program. The econometric approach is able to quantify the impact of these drivers, explaining at least part of the difference between utilities.

Consider the following example. A utility has a cost per activity that is 30% above the same cost per activity of a utility that is considered best in class in that particular activity. There does not appear to be any one or two drivers that could explain the difference. The higher cost utility spends time and effort to reduce its costs in an effort to become more efficient.

An econometric analysis identifies a number of drivers that indicate why the higher cost utility is justifiably higher. Individually, the drivers do not make a major difference, but in aggregate they explain 80% of the 30% differential in cost per activity. The question then becomes was the time and effort expended by the higher cost utility to reduce the 30% differential warranted, given that the normalized differential was only 6%? Had the higher cost utility had the information generated by the econometric methodology, it may have spent the time and effort on improving efficiency in another area where there was more justification for doing so.

#### **Question 8 – What data considerations should the OEB take into account?**

In order for APB to work and deliver the desired results, specific and detailed information is required. This data must be accurate and consistent across all utilities. The availability of this type of data is a prerequisite to being able to provide useful information, regardless of the benchmarking methodology used.

LPMA agrees with the Staff paper that there is a need for improvements to reporting and data quality to ensure reliable benchmarking in the longer term. As previously noted, data or reporting errors are more detrimental to APB as they directly affect the cost of the activity or program being benchmarked, while at an aggregate level, for total cost benchmarking, an error in one category would be offset by a corresponding error in another category, with no impact on the overall result.

Errors in the data used in any methodology can result in errors in the methodologies used for benchmarking and can lead to the wrong conclusions.

LPMA cannot emphasize enough that the correct application of accounting rules and reporting requirements are essential to ensure that the underlying data used in benchmarking will result in reliable, comparable and correct conclusions.

LPMA also notes that the benchmarking itself (regardless of the methodology used) could be used to identify outliers that may require further investigation into the quality, accuracy and consistency of the data used. This check would be similar to when a utility checks the accuracy of a meter when the reading appears to be abnormal.

**Question 9 – Should the OEB undertake to start collecting new data now to support future benchmarking under the APB framework (e.g. data associated tree trimming and asset sub-categories such as by type of poles or transformers)?**

Absolutely. Any of the benchmarking methodologies used require lots of accurate and consistent data. The more years of data for each of the utilities that is available, the better the benchmarking is likely to be. The sooner the OEB starts collecting new data, the sooner the benchmarking associated with that data can begin.

Delays in the accumulation of accurate and consistent data will delay the OEB's ability to benchmark the underlying activities and programs. This would be a disservice to both customers and to the utilities themselves. The sooner utilities can respond to the benchmarking to increase efficiencies the better of they will be and the better off their customers will be.

**Question 10 – What are the potential gaps in data gathering and what are the suggested mitigation solutions?**

While not a specific potential gap in data gathering, LPMA is concerned with the gathering of data that utilities gather but does not currently report to the OEB. Similarly, LPMA is concerned with the quality and consistency of any new data/information that may be needed to support the evolution/expansion of APB.

LPMA's concern in both cases is that there needs to be direction/guidance from the OEB to ensure that the data that utilities currently gather but does not report to the OEB or any new data that may be required from the utilities is accurate and consistent across all utilities. To this end, LPMA suggests that the OEB should schedule workshops across the province at which appropriate personnel can explain and provide examples of the data/information that it wants the utilities to start collecting. The workshop should be used to investigate how the utilities would obtain the data and ensure that there is consistency across utilities in how the data is defined and calculated.

**Question 11 – What transitional issues need to be addressed?**

LPMA does not support a quick implementation of the APB into the regulatory process. While the APB presents opportunities to incent lower costs for customers through continuous improvement, LPMA is concerned with the quality of data used in the benchmarking methodology.

LPMA believes that the OEB should concentrate on ensuring that the data used is accurate and consistent. This may involve audits of utilities that appear to be outliers with respect to cost per volume or an outlier in the econometric results. Any such data should be corrected, and the benchmarking redone.



In the meantime, LPMA believes that APB can be used as a screening tool. However, the value of this will depend on the initial results and the level of variance between utilities under the various benchmarking methodologies.

It is likely that over time and through ongoing reviews and refinements, APB can play a more significant role in reducing costs for customers, increasing reliability and improving customer service.

Yours very truly,

*Randy Aiken*

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