



March 27, 2019

Ms. Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge St., Suite 2700  
Toronto, ON, M4P 1E4

**via RESS and Courier**

Dear Ms. Walli:

**Re: Staff Discussion Paper, Activity and Program Based Benchmarking (APB)  
Initiative  
BOARD FILE NO.: EB-2018-0278**

## **INTRODUCTION**

The Coalition of Large Distributors (“CLD”) appreciates the opportunity to provide comments on the Staff Discussion Paper (“Discussion Paper”) related to Activity and Program Based Benchmarking issued by the Ontario Energy Board (“OEB”) on February 25, 2018, and the expert reports authored by Pacific Economics Group Research LLC (“PEG” and the “PEG Report”) and Midgard Consulting Inc. (“Midgard” and the “Midgard Report”) that accompanied the Discussion Paper’s release.

The CLD consists of Alectra Utilities Corporation, Hydro One Networks Inc., Hydro Ottawa Limited, Toronto Hydro-Electric System Limited (“Toronto Hydro”), and Veridian Connections Inc. Collectively, CLD members:<sup>1</sup>

- Serve 68% of Ontario’s 5.1 million electricity customers
- Deliver 73% of the 131.5 TWh of electricity distributed in the Province
- Span 97% of Ontario LDC’s 991,000 km<sup>2</sup> of total service area

According to the OEB, “[it] has determined that it is time to introduce program/activity level benchmarking...” and that “the OEB has chosen to proceed with the electricity distribution sector first given the number of entities and the diversity of size and operations, as well as the significant experience at the OEB with benchmarking in the electricity distribution sector which provides the basis for an effective APB framework development.”

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<sup>1</sup> 2017 OEB Yearbook of Electricity Distributors (Published August 23, 2018)

On October 10, 2018, the OEB announced by letter the launch of the APB initiative with the formation of a Working Group, which included representatives from three CLD members. The Working Group met three times in Q4 2018, all prior to the release of the Discussion Paper.

Below are the comments of the CLD.

## **GENERAL COMMENTS**

As a matter of principle, the CLD submits that benchmarking can be a valuable exercise. It can generate actionable intelligence for utilities regarding specific aspects of utility operations. That intelligence can be leveraged to improve performance with respect to costs or other outcomes valued by customers, such as reliability, safety, customer service or environmental attributes. Benchmarking data, measured either at a point in time or over a period of study, can provide important information to assess indicators or trends, enabling a cycle of continuous improvement.

The CLD therefore agrees with OEB Staff that benchmarking at the activity/program level can be a beneficial exercise for utilities and customers, as identified in the Discussion Paper. CLD members are familiar with, and have often used, benchmarking for these purposes. Such examples include activity level benchmarking in the following areas (in alphabetical order):

- Compensation
- Distribution System Planning (planned versus actual)
- Distribution Station Refurbishment
- Equipment costs for major assets, including labour (e.g. switchgear, transformers, cable)
- Information Technology
- Labour utilization
- Pole Replacement
- Transformer Replacement
- Underground Cable Replacement
- Vegetation Management

The use of benchmarking for specific purposes clearly has value. The establishment of an entire framework dedicated to such standardized benchmarking should necessarily consider the potential to create costs, risks or unintended consequences that may undermine the value offered by such a framework. While the questions posed by OEB Staff are in part intended to address such issues, the Discussion Paper does not adequately consider this at the outset. Establishing a sector-wide APB framework within the general parameters proposed in the Discussion Paper is a significant undertaking and a material change in direction from the flexible, non-codified approach currently used. Costs, risk, and unintended consequences must continue to be a central consideration of the OEB throughout this consultation and prospective implementation.

The CLD recommends three courses of action that should be addressed at the outset.

## 1. *Defining the goal of the APB framework*

First, the CLD encourages the OEB to consider the Potential Uses of APB in Ontario Utility Regulation as a Critical Element of an APB Framework.<sup>2</sup> The Discussion Paper identifies four potential uses: monitoring performance, rate-making, performance incentives, and policy development. The CLD agrees that these could all be reasonable candidates, and that sharing best practices could also be added to that list.

However, the CLD submits that the optimal APB framework will vary depending on the specific focus and intent of APB that is ultimately adopted. For example, if the primary objective is to encourage the sharing of best practices, the CLD believes that a high degree of granularity paired with a technical forum adequately protected by safe harbor provisions could be both an effective and cost efficient approach to achieving many of the benefits articulated in the Discussion Paper. Alternatively, if the prospective APB framework is tied to performance incentives akin to the Total Cost Benchmarking framework, the CLD has a number of concerns as articulated in this submission.

**The CLD would welcome the opportunity to comment on a more detailed proposal or set of proposals for how this framework would be applied,** and incorporates this recommendation in its response to Q1 on the list of Critical Elements relevant to an APB framework.

## 2. *Take lessons from other APB frameworks*

Second, the CLD respectfully submits that a more robust review of the UK (Ofgem) and Australian (AER) APB frameworks is warranted. The Discussion Paper states that the jurisdictional review looked only at whether a framework existed and, if so, the context within which it was used.<sup>3</sup> The CLD is concerned that the potential for learning opportunities was not reviewed, assessed or considered. With respect to the commentary provided above, in the CLD's view, this context may be essential.

The CLD briefly reviewed both frameworks, and offers a few high-level observations for the OEB's consideration.

While the CLD agrees that benefits have been derived since the commencement of Ofgem's APB framework in 2005, it has not come free of charge.<sup>4</sup> UK utilities (Distribution Network Operators, or "DNOs") were forced to make significant changes to their internal data gathering and reporting

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<sup>2</sup> Section 2.5 of the Discussion Paper.

<sup>3</sup> Discussion paper, pg 8.

<sup>4</sup> Electricity Distribution Price Control Review: Price control cost reporting rules - cover letter, Ofgem, April 2005, <https://www.ofgem.gov.uk/sites/default/files/docs/2005/04/10708-13005a.pdf>

procedures to meet the requirements dictated by the framework. However, with approximately 65 utilities potentially regulated under Ontario’s regime, the CLD believes that this exercise will be costly and difficult to complete. Moreover, to achieve comparability in DNO benchmarking, Ofgem had to make considerable normalization adjustments to the reported data, including labour and contractor differences and consider urban and rural factors.<sup>5</sup> Finally, nearly a decade and a half after it was first used, Ofgem continues to refine its data and reporting requirements, and grow the asset categories it benchmarks – 103 categories for asset replacement alone at present.<sup>6</sup> As a response to some of these issues, Ofgem moved towards higher level benchmarking. It developed and placed a 50% weighting on total expenditure benchmarking as part of its RIIO-ED1 rate-making process.<sup>7,8</sup>

Whereas the Ofgem’s framework is highly granular, relatively mature and executed on a forecast basis, the AER’s APB framework is much less granular, exists at a comparably nascent stage and reviews historic costs. Despite these important differences, the AER has faced similar issues to Ofgem, specifically in the area of refining the accuracy of benchmarking models and obtaining consistent and comparable data from utilities.<sup>9</sup> Notably, its recent efforts include an extensive review of material operating environment factors driving differences in productivity and operating efficiency.<sup>10</sup> The Australian Energy Market Commission (AEMC), which establishes the National Electricity Market Rules including the overall approach to cost assessment and incentives which the AER then implements is also looking towards a more aggregated approach for benchmarking and cost incentives.<sup>11,12</sup>

The CLD respectfully submits that the experiences of the Ofgem and AER have the potential to be repeated in Ontario, and may even prove to be more complicated given the nature and number

<sup>5</sup> Table 4.2 of Ofgem’s RIIO-ED1 Final Determinations: Expenditure Assessment document showed that there were £639m of normalization adjustments applied to the data before carrying out the disaggregated cost benchmarking or as qualitative adjustments to the benchmarking.

<sup>6</sup> Proposed RIIO-ED1 Electricity Distribution Pack Reporting Templates – Version 5, Cost and Volumes Table CV7 – Asset Replacement, Ofgem, March 2019, <https://www.ofgem.gov.uk/publications-and-updates/notice-proposing-modifications-regulatory-instructions-and-guidance-rigs-riio-ed1-version-50>

<sup>7</sup> RIIO-ED1: Final determinations for the slow-track electricity distribution companies Business plan expenditure assessment, Ofgem, November 2014, paragraph 3.28, [https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1\\_final\\_determination\\_expenditure\\_assessment\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_expenditure_assessment_0.pdf)

<sup>8</sup> Handbook for implementing the RIIO model, Ofgem, October 2010, paragraphs 8.36 to 8.44, <https://www.ofgem.gov.uk/ofgem-publications/51871/riiohandbookpdf>

<sup>9</sup> Annual benchmarking report -Electricity Distribution Network Service Providers, November 2018, [https://www.aer.gov.au/system/files/AER%202018%20distribution%20network%20service%20provider%20benchmarking%20report%20\\_0.pdf](https://www.aer.gov.au/system/files/AER%202018%20distribution%20network%20service%20provider%20benchmarking%20report%20_0.pdf) , Executive Summary Section 6

<sup>10</sup> Annual benchmarking report -Electricity Distribution Network Service Providers, November 2018, [https://www.aer.gov.au/system/files/AER%202018%20distribution%20network%20service%20provider%20benchmarking%20report%20\\_0.pdf](https://www.aer.gov.au/system/files/AER%202018%20distribution%20network%20service%20provider%20benchmarking%20report%20_0.pdf) , Executive Summary Section 4.3

<sup>11</sup> Economic Regulatory Framework Review – Promoting Efficient Investment in the Grid of the Future, AEMC, July 2018, Summary Paragraph 5, section 7.2, <https://www.aemc.gov.au/sites/default/files/2018-07/Final%20Report.pdf>

<sup>12</sup> Total expenditure frameworks – A report Prepared for the Australian Energy Market Commission Economic Regulatory Framework Review Promoting Efficient Investment in the Grid of the Future, Frontier Economics, December 2017, section 5.1, <https://www.aemc.gov.au/sites/default/files/content/ae0d3fc5-4b9a-496a-a072-50886bc5c86f/2017-12-20-Totex-frameworks-Final-report-STC.pdf>

of utilities in this province. Whereas the UK and Australian energy regulators oversee 14 and 13 entities respectively, the number of rate-regulated LDCs in Ontario is approximately 4 to 5 times that amount. At Ofgem, the data requirements and approach to benchmarking have been developed in close discussion with the electricity distribution companies over a number of years.<sup>13</sup> This approach would be more difficult to achieve or would involve higher costs in Ontario given the relatively larger number of rate-regulated LDCs.

### *3. Proceed cautiously and deliberately*

The third action recommended by the CLD, based on the learnings from the UK and Australia and the need to more clearly define the intent of Ontario's APB framework, is that a deliberate and careful process is the best path forward. The CLD is generally concerned that the five year period within which the OEB expects to implement APB, beginning with distributors, could be too aggressive depending on the OEB's determination with respect to the Critical Elements of the framework. To the extent that compliance costs do emerge, CLD members encourage the OEB use phased approaches to APB implementation (see response to Q4) to reduce costs and maintain alignment with various utilities' rate cycles.

The jurisdictional evidence paints a challenging picture. The Discussion Paper concludes that, "[f]rom the jurisdictional review it can be inferred that there is perceived value in pursuing benchmarking at the program level."<sup>14</sup> As noted above, the CLD remains open to investigating the merits of an APB framework. However, it does not agree with the Discussion Paper that the jurisdictional review provides any conclusive evidence regarding any such merit. A deeper dive into the costs and benefits, uses and purposes of the APB in other jurisdictions is required. Furthermore, it could be informative to understand why other jurisdictions have not adopted rigorous APB frameworks such as that being proposed by OEB Staff.

While the CLD's comments and responses to the Discussion Questions are intended to convey preliminary support for the development of an APB framework, critical success factors such as the following should be considered before proceeding:

1. Maintaining flexibility in the framework, particularly as it relates to phasing-in its implementation.
2. Considering the value of designing a framework and mitigating the potential costs, risks, and unintended consequences.
3. Ensuring accuracy in cross-utility comparative benchmarking; this may require looking beyond Ontario for data or experience.
4. Prioritizing stakeholder confidence in the framework as an indicator of its success at each stage of its design and implementation.

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<sup>13</sup> Minutes of Cost Assessment Working Group, Ofgem, April-June 2012, <https://www.ofgem.gov.uk/network-regulation-riio-model/riio-forums-seminars-and-working-groups/riio-ed1-working-groups>

<sup>14</sup> Discussion Paper, pg 9.

## **ISSUES FOR STAKEHOLDER COMMENT**

### **Q1: What other elements, if any, should the OEB consider in its development of an APB framework?**

The elements proposed appear to be reasonable.

The CLD suggests that additional elements need to be considered as individual categories, or as critical subcomponents of the proposed group. They include:

- Confirming, with stakeholder input, how the APB framework will be used.
- Peer group considerations, particularly for utilities that have no natural comparators in Ontario.
- Output-based considerations in addition to business condition considerations.
- A continuous improvement model for the APB framework itself (e.g., a sunset clause).

### **Q2: What level of cost disaggregation is suitable for activities/programs benchmarking**

The appropriate level of cost disaggregation is dependent on a number of considerations, including the more precise specific uses for which the APB framework may be applied as noted in the above General comments. Phasing approaches, as the CLD recommends in Q4, could assist in this regard. If the APB framework ultimately proceeds to Level 4 (i.e. the most granular level) for some activities and some regulated entities, the CLD recommends that it be preceded by a detailed analysis of expected incremental benefits and costs. At a minimum, the CLD expects that activity-level benchmarking will require a review of the allocation methodologies used by regulated entities subject to that level of regulation, as these will vary among utilities. Additional guidance in the OEB's Accounting Procedures Handbook for Electricity Distributors will also be required.

### **Q3: Does the preliminary list provide a set of activities/programs for benchmarking that are meaningful in terms of utility operations and customer service?**

The CLD does not have any immediate objections to the list provided as it appears reasonable. To the extent that this has not already occurred, the CLD encourages OEB staff to review lessons learned from the Ofgem and AER experience for guidance as well.

### **Q4: Should the OEB pursue a phased approach for benchmarking activities and programs? Why?**

The CLD strongly supports a phased approach to APB and submits there are at least four ways in which phasing should be considered by the OEB in developing its framework.

A phased approach to data granularity is appropriate. More granular levels of benchmarking should not be pursued until higher level benchmarking results are reliably achieved (e.g., inconsistencies are mitigated, comparability is fair, and substitutions are controlled for). The value proposition (both benefits and costs) of more granular benchmarking should be clearly identified and significantly positive before being pursued.

A phased approach to the activities that are benchmarked is appropriate. Stakeholders may require time to implement and frequently refine APB. Selecting a few activities at the outset would help to simplify implementation at this nascent stage. The CLD recommends that the best candidates for initial inclusion would exhibit many or all of the following characteristics:

- No obvious substitution or set of substitutions exist.
- Clear and mature accounting guidance and practices exist.
- Is easily understood by customers.
- Can be readily normalized for relevant business conditions and output-based considerations.

A phased approach to the utilities that are subject to APB is appropriate. The CLD has highlighted the importance of identifying or controlling for appropriate peers, and the likelihood that this will require US data. This does not necessarily need to bear on establishing benchmarking for other utilities whose business conditions are less dissimilar. The CLD heard at the Stakeholder Forum that multiple methods could be adopted. We agree, and suggest that this could allow for benchmarking to proceed on an “as-ready” basis.

**Q5: What benchmarking method(s) should the OEB use to benchmark activities/programs? Why?**

The CLD does not believe there is a single “best” method for benchmarking. Different methods may be more appropriate than others depending on the purpose of the framework; its granularity, the utilities and activities that are benchmarked, and the data requirements that underpin it all. Nor does the CLD take the position that any methods should be ruled out at this stage either.

The CLD agrees with the comments by OEB Staff that each of the different methodologies should be judged in their capacity to deliver on the intended purpose of the APB framework, considering all of the costs, benefits, and risks in its construction.

The CLD further believes that capturing data or experience beyond Ontario’s LDCs will be necessary (though not necessarily sufficient) to attain a reliable APB framework. This applies to

all of the methods considered in the Discussion Paper. The CLD offers additional comment on these matters in Q8.

Finally, the CLD agrees with the Discussion Paper's conclusion that econometric benchmarking is less accessible to customers. Relative to unit cost (including cost-volume) approaches, econometric benchmarking is less helpful to utilities as the benchmarking outputs results are less readily translated into appropriate corrective actions.

**Q6: What is the preferred method that will be well understood by customers and other stakeholders?**

- See response to Q5

**Q7: 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?**

Building on the response to Q5, the CLD cautions against a one-size-fits-all approach to APB. Different methods may be more appropriate for benchmarking different activities and/or different utilities, for different purposes and in different circumstances. As a result, the development of the APB framework should be approached from an evolutionary perspective, with ample opportunity to test, discover, learn, and enhance the framework, as appropriate.

**Q8: What data considerations should the OEB take into account?**

The CLD has three general concerns with respect to data used to drive an APB framework. How these manifest is dependent on the method (or methods) that are ultimately chosen.

First, the CLD is not convinced that an Ontario-only data set will contain the necessary breadth to facilitate appropriate cross-utility benchmarking. For econometric benchmarking, this would require investigation into US datasets to assist in correctly identifying and calibrating the dependent variables included in the formulations. For unit-cost approaches, US utility comparators will be necessary to appropriately benchmark utilities that are outliers among the Ontario context, such as CLD members. In addition, even within the existing Ontario data, the OEB should investigate whether regional differences are relevant and require normalization.

Second, the CLD agrees with OEB Staff that there are gaps in the Ontario data. As noted under its General Comments, Ofgem is finding it must continue to refine the data it collects nearly 15 years after benchmarking was first implemented – and it has barely more than a dozen service territories to regulate. The CLD recommends that the selection of benchmarking granularity be



driven by the cost-benefit of attaining the data necessary to implement. These costs will likely require one-time and ongoing investments in IT and human resources.

Finally, with over 60 LDCs, the OEB is likely to find a significant range of data collection and reporting processes. The CLD concludes that while using existing data sets (and not adding new ones) is likely the lowest cost approach, it is not a no-cost approach. As reporting frameworks (RRR filings, USofA accounts) become more specific, the OEB should expect that utilities will bear compliance costs that will ultimately be recoverable through rates. Moreover, the CLD expects in-year variability for individual activity/program costs for reasons not captured in the model and outside of utility control (e.g., weather, individual project complexity, etc.). This places an emphasis on comparing trends in place of annual performance. The CLD notes that corrections to prior-year RRR filings can be challenging to have processed, and therefore, to the extent historical RRR data are relied upon to generate trend analysis or any other APB results, flexibility in this regard should be permitted.

The CLD further submits that the APB framework allow for qualitative analyses to supplement the quantitative approach. This practice is encouraged by the OEB in other contexts such utility scorecard's complementary MD&A. Specifically, the CLD believes that in many cases understanding the necessary context may be integral to a proper evaluation of the particular metric, whether it pertains to specific opportunities or challenges, or is a result of certain unique circumstances. In particular, it may be necessary to understand what drives the actions or choices undertaken by individual utilities rather than simply comparing quantitative analyses.

**Q9: Should the OEB undertake to start collecting new data now to support future benchmarking under the APB framework (e.g. data associated with tree trimming and asset sub-categories such as by type of poles or transformers)?**

The CLD submits that there are many other activities that are more determinative of a successful APB implementation than expanding data collection efforts. Any investments in expanding the depth of data collected should be done with a clearly articulated purpose in mind, and with a clear appreciation of the costs involved in doing so. Please see also the CLD's response to Q4 on phasing.

**Q10: What are the potential gaps in data gathering and what are the suggested mitigation solutions?**

Previous responses highlight the importance of ensuring comparability and consistency in the treatment and reporting of USofA accounts. This is a critical effort that will require considerable time and effort to establish or review. The CLD believes accompanying revisions to the Accounting Procedures Handbook may be required as part of an APB implementation, particularly at more granular Levels. This may require that data points across LDCs be validated via time

study or other study based on cost causality principles to substantiate allocations on a timely basis and to ensure arbitrary or invalid allocations are not being utilized.

### **Q11: What transitional issues need to be addressed?**

As the commentary above described, the CLD believes there are many items and issues to be addressed in developing an APB framework in Ontario. Among the critical elements to be addressed are the following:

- An understanding of the purpose and intent of APB
- An understanding of data availability and/or requirements
- An understanding for data comparability across the sector
- An understanding of necessary resourcing or transition costs

### **CONCLUSION**

The CLD appreciates the opportunity to provide comments at this early stage of the development of an APB framework.

If you have any questions with respect to the above, please contact the undersigned.

Sincerely,

*Original signed by Andrew J. Sasso*

Andrew J. Sasso  
Director, Regulatory Affairs  
Toronto Hydro-Electric System Limited

Indy J. Butany-DeSouza  
Alectra Utilities Corporation  
(905) 821-5727  
[indy.butany@alecrautilities.com](mailto:indy.butany@alecrautilities.com)

Andrew Sasso  
Toronto Hydro-Electric System Limited  
(416) 542-7834  
[asasso@torontohydro.com](mailto:asasso@torontohydro.com)



Gregory Van Dusen

Hydro Ottawa Limited

(613) 738-5499 x7472

[GregoryVanDusen@hydroottawa.com](mailto:GregoryVanDusen@hydroottawa.com)

George Armstrong

Veridian Connections Inc.

(905) 427-9870 x2202

[garmstrong@veridian.on.ca](mailto:garmstrong@veridian.on.ca)

Henry Andre

Hydro One Networks Inc.

(416) 345-5090

[henry.andre@HydroOne.com](mailto:henry.andre@HydroOne.com)