EDA
The Voice Of Ontario's Electricity Distributors

December 15, 2008

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
Suite 2700
Toronto, ON M4P 1E4

Via RESS and by courier

Dear Ms. Walli:

Re: EB-2007-0673 OEB Further Consultation on Stretch Factor Rankings for 3rd Generation Incentive Regulation for Electricity Distributors

The Electricity Distributors Association (EDA) is the voice of Ontario's electricity distributors.

The EDA is pleased to provide the attached comments regarding the model used to assign stretch factors and approaches to improve the grouping approach in order to reduce potential misclassification in the two OM&A benchmarking evaluations**.** The EDA has consulted with its members on these issues through a Regulatory Council meeting on December 9th, where discussions centered on issues that should be taken into consideration in the benchmarking analysis. The following comments summarize the consensus reached at the Regulatory Council.

Yours truly,

"original signed"

Richard Zebrowski
Vice President, Policy & Corporate Affairs

Attach.

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EDA Comments on Further Consultation on Stretch Factor Rankings for 3rd Generation Incentive Regulation for Electricity Distributors

The EDA supports the principles of Incentive Rate Making (IRM) and believes that the benchmarking work to-date has been worthwhile; however, we believe that it is an evolutionary process that requires continued efforts to improve as we learn more and obtain better information.

As a recognition of the evolutionary process of IRM, and the time and resources required in developing Stretch Factor Rankings, the EDA submits the following summary of issues (which are detailed further below) for consideration:

Summary of Issues	
2009 Rate Year	**2010 Rate Year (commence investigation in 2009)**
Low Voltage Costs (existing data)	Low Voltage Costs (additional data)
High Voltage Transformer Costs (existing data)	High Voltage Transformer Costs (additional data)
Canadian Shield attribution	Inclusion of Capital (Total Costs)
	Data Inconsistencies
	Review Peer Group Composition
	Embedded Wholesale Market Participants (2010)

Recognition of Capital in Benchmarking

The EDA submits that there is a need to address capital in order to compare total costs, which will provide a more fair and equitable comparison between distributors. The EDA is aware of many situations which would lead to incomparability between distributors. The sole use of OM&A data does not account for existing differences, examples which include, expensing of distributor lease facilities that are normally treated as capital by other distributors, capitalization policies and the impact of lifecycle/age of assets. The best approach to address these differences is to compare total costs.

The EDA recognizes that the investigation and collection of total cost data is extensive and would not be available for rates effective May 1, 2009. EDA recommends that the Board commence total cost methodologies for the stretch factor rankings for rates effective in 2010.

Treatment of Low Voltage Costs

The EDA supports the idea that embedded distributors should have the O&M component of the Low Voltage (LV) charge included in their costs to be benchmarked, and the hosts' costs should be reduced by the same amount (assumed to be recovered from the embedded distributors). However, the costs should include not only O&M but also the Administrative cost component as well. There are administrative costs associated with owning LV assets, such as insurance costs, property taxes and allocated costs of administration.

The EDA recommends developing a proxy administration cost for the embedded LDCs assuming the LV transformation is done by them.

OEB Staff have determined that the revenue to cost ratio for Hydro One's LV customers is 2.35. The EDA understands that the revenue to cost ratio for ST class customers became 2.35 only after adding the "Industrial Commercial Sub-Transmission" customers to the ST class. The "Industrial Commercial Sub-Transmission" customers pay much higher rates than LV customers and other ST class customers. 2.35 is Hydro One's cost ratio for its whole ST class of customers, which includes LV customers. In response to the interrogatories in the case of Hydro One 2007 rate case (where the ST class revenue-to-cost of 2.35 was disclosed), Hydro One estimated that current revenues at current rates from embedded LDCs were $23.5 million and that revenues required from embedded LDCs based on a revenue cost ratio equal to one were $18 million. This indicates that the revenue to cost ratio for embedded LDCs is only 1.3.

Therefore using the ST class revenue to cost ratio of 2.35 to LV customers is not appropriate. The difference between a cost ratio of 2.354 and 1.3 is material. The EDA believes that the estimate for the LV OM&A costs should be recalculated using the 1.3 revenue to cost ratio. This updated LV cost should be used for the 2009 rate year.

Pooling of LV Costs

Pooling is a prominent feature of Hydro One's LV arrangements. The fact that pooling per se does not affect the issue of whether LV costs should be attributed to embedded distributors when LV facilities substitute for those that would normally be provided by the distributor. However, pooling has a bearing on how good a proxy for those distribution costs the billed LV charges would be. Distributors with only short spans of LV within their systems could find that the attributed LV costs exceed what their own would be; conversely, attributed LV costs could understate LDC costs in cases where there were long line lengths.

This pooling issue should be further considered in 2009 to potentially further refine the approach for addressing LV costs in 2010 in order to better compare distributors.

<u>High Voltage Transformation Costs</u>

The EDA submits that OM&A Transformation Station (TS) Costs should be removed from OM&A initially and total TS costs in the future in order to fairly compare costs between distributors. Distributors that own and operate their own transformation stations have these costs reflected in their OM&A and distribution rates, while distributors that do not own their own transformation stations have these costs reflected in their retail transmission rates and the RSVA Connection Deferral Account # 1586.

The EDA understands that not all HV costs are separately identified in a distributor's Trial Balance Filing (RRR 2.1.7), however, we believe that those costs which are readily identifiable should be removed for the benchmarking used for the 2009 year. The readily identifiable OM&A accounts are # 5014 Transformer Station Equipment – Operation Labour, # 5015

Transformer Station Equipment – Operation Supplies and Expenses and # 5112 Maintenance of Transformer Station Equipment.

The EDA recommends that further USoA accounts be created in order to allow distributors to fully capture the costs of owning and operating their transformer stations.

The EDA believes the exclusion of these high-voltage transformation costs does not necessarily level the playing field among the LDCs. There are a number of embedded utilities that have significant OM&A expense related to municipal substations that their host utilities do not incur. Host utilities supplied from their own transformation stations often do not own municipal stations. Distribution structure alternatives are dictated by the supply voltage which drives municipal substation requirements. We believe further studies in this area are required to better understand different distribution structures and the resulting cost drivers.

Treatment of Canadian Shield

The northern binary variable was specifically added to the econometric benchmarking to compensate for the higher costs of operating where a "majority" of a distributor's service territory is on the Canadian Shield. The binary variable was also used to determine those distributors in "northern" peer groups.

This Canadian Shield recognition is meant to be a compensating variable because the OM&A expenses are expected to be higher for distributors on the Shield. It is therefore somewhat surprising that when the "Shield" benefit is removed, Renfrew Hydro's ranking improved by 5 places, i.e., moving from 11th to 6th rank. It is counter intuitive to see Renfrew benchmarked better when the compensating benefit is removed. In this case it appears that the Shield binary variable is a compensating burden rather than a compensating advantage for northern distributors. The EDA recommends further examination of this observed anomaly and further work to verify whether the northern and other econometric variables in the econometric model are working as expected.

In addition, the EDA recommends that in cases where additional information reveals that a distributor may have been misclassified with respect to the Canadian Shield, then the benchmarking should be revised and the distributor should be properly classified.

Embedded Wholesale Market Participants

A distributor does not bill for the energy used by the Embedded Wholesale Market Participants (EWMP), whether consuming or generating energy, and for "behind-the-meter" generation customers.

The IESO does not include the energy consumption of the EWMP customers, which are connected to the distribution system, in the "wholesale" bill it charges the LDCs. The RRR instructions (by the OEB) to distributors do not specify the inclusion of consumption by EWMPs. The consequence of this is that the RRR wholesale and retail kWh numbers used for benchmarking purposes may not reflect all kWh throughputs.

The EDA believes that benchmarking requires that the throughput data used in IRM benchmarking be collected with sufficient rigor to address all the permutations and system configurations for energy used or generated by wholesale market participants. Energy throughput is an important measure which should include the consumption data by EWMP customers. Further work on this issue should be carried out in 2009 to update throughput values for the 2010 rate year.

Data Quality and Rigor

In view of continued concerns about data comparability affecting the outcome of distributor benchmarking, the EDA recommends improving data quality by reviewing data filing instructions and performing data sensitivity tests to ensure a higher level of data quality and rigor.

It has been recognized for some time that more effort is required to ensure consistency in data reporting. This data quality issue has even more relevance given that it may impact benchmarking results. In particular, greater emphasis should be placed on consistent measurements of kilometers of distribution line as this is seen as an important cost driver. The EDA believes that improving data consistency should be a project for 2009. Some of this work could be incorporated in the planned IFRS review.

Peer Groups

The EDA has received input from members on approaches they would like to see considered by the OEB in its approach to grouping distributors for the unit cost analysis. Members believe that the unit cost analysis should consider density and service area size. These two issues were raised in the EDA's April 28, 2008 letter on Comparison of Ontario Electricity Distributors Costs (EB-2006-0268) where the EDA stated that "peer groups should be further delineated by including density and service area size". In addition the Board recognized Circuit Kilometres of Line and Service Area Kilometres as Cost Drivers in its Comparison of Ontario Electricity Distributors Costs (EB-2006-0268 issued November 24, 2006) in which it compared distributors' 2002 – 2005 costs based on various cost drivers.

Further work carried out by some members has found that density (customers/km) is a relevant cost driver for the unit cost analysis. The EDA believes that the unit cost analysis should incorporate density as one of the criteria for the peer groupings. Having high and low density distributors in the same peer group appears to be distorting the peer comparisons. In particular one distributor with very low density and associated higher costs per customer can distort the results significantly.

Line density alone may not adequately reflect a distributor's costs, thus, Service Area (Square) Kilometres should also be incorporated. A distributor with a large rural service area has its costs driven, not only by circuit kilometres installed, but by its costs that are also incurred by the distance and time which it must travel to provide reliable distribution assets and service to all of its customers.

The EDA believes further work should be carried out in 2009 on the peer groupings. Density and service territory should be reviewed and the other existing peer criteria should be revisited. Consideration should also be given to distribution structures which are impacted by the supply voltage and drive municipal substation requirements.

In addition further work in 2009 should include a review of the industry labour index and an update to the econometric model. This review should result in a revised peer analysis for the 2010 rate year.