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**By electronic filing**

June 28, 2013

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
2300 Yonge Street  
27<sup>th</sup> floor  
Toronto, ON M4P 1E4

Dear Ms. Walli

**Defining and Measuring Performance of Electricity Distributors**

**Board File No.:** EB-2010-0379

**Our File No.:** 339583-000098

**Introduction**

Pursuant to the Board's May 30, 2013 letter to interested stakeholders, we are submitting these brief comments on behalf of Canadian Manufacturers & Exporters ("CME"). These comments relate to the expert reports which have been submitted by Board Staff, the Coalition of Large Distributors ("CLD"), the Electricity Distributors Association ("EDA"), and the Power Workers Union ("PWU").

The opinions expressed in these reports are intended to assist the Board in determining the parameters of its 4<sup>th</sup> Generation Incentive Regulation Mechanism ("4<sup>th</sup> Gen IRM"), being one of the rate setting methods identified by the Board in its October 18, 2012 report entitled "Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach" (the "RRFE Report").

We have relied on the expertise of others, including counsel for the School Energy Coalition ("SEC"), to scrutinize the technical aspects of the differences in approaches followed by the authors of each of the expert reports. Counsel for SEC provided us with a preview of his submissions and comments, and we also received a preview of comments to be made by the Consumers Council of Canada ("CCC").

CME supports and adopts SEC's thorough analysis of the expert evidence presented by Board Staff, CLD, EDA and PWU, including its description of the extent to which the opinions of the experts differ on a number of topics. In large measure, we support SEC's recommendations which flow from its analysis with respect to the 5 topics listed in Appendix B to the Board's May 30, 2013 letter, namely:

1. The Inflation Factor,
2. The Productivity Factor,
3. Total Cost Benchmarking,

4. Efficiency Cohorts/Rankings & Stretch Factors, and
5. Implementation Considerations.

We also support, in large measure, the conclusions which the CCC expresses in its comments.

### **Conceptual Considerations**

At a conceptual level, there are certain issues which we urge the Board to take into account before determining its next steps with respect to establishing the parameters for formulaic ratemaking under the auspices of 4<sup>th</sup> Gen IRM.

#### Resolving Disputes Between the Experts

In our view, the ability of the Board to make any definitive determinations with respect to material matters within the ambit of the various expert reports which are in dispute is constrained when none of the reports have been subject to scrutiny and testing in a public hearing process. In these circumstances, we urge the Board to be very wary of basing any determinations on the contents of a disputed matter within the ambit of an expert report which has not yet been appropriately tested. In this connection, we support the further process suggestions which CCC makes in its comments.

#### Negative Productivity is Incompatible with Incentive Ratemaking

Our support, at a conceptual level, for the submissions and comments presented by SEC and CCC is influenced by our belief that most ratepayers perceive an incentive rate mechanism to be one which provides them with upfront benefits in consideration for the utility being permitted to operate under the auspices of a formulaic ratemaking framework.

Under the Board's incentive approach to ratemaking for electricity distributors, these benefits are to be reflected in an X-factor which, to us, includes both productivity and a stretch factor. The X-factor is a deduction from the Inflation Factor to produce an escalation factor which is then applied to increase rates. In our submission, for a ratemaking methodology to qualify as an IRM, the X-factor, including whatever stretch factor is determined to be appropriate, should not be a negative number. We submit that a negative allowance for an X-factor cannot reasonably be and should not be approved as a component part of an incentive rate mechanism. The X-factor in the formula must not be negative.

This is not to suggest that a formulaic approach to ratemaking cannot accommodate rate increases which exceed the rate of inflation. Such an outcome can and should be the consequence of ratemaking components in the formula approach other than a negative X-factor. Such components include deferral and variance accounts for pass through or Y-factor items; mechanisms which accommodate additional recoveries for certain expenditures such as the Incremental Capital Module ("ICM") and mechanisms which accommodate government-imposed initiatives such as the Smart Meter Adder. Put another way, the factors giving rise to formulaic rates which exceed the rate of inflation should be separately identified and measured and not bundled within the ambit of a negative X-factor.

Our point is that "negative productivity" is a concept which ratepayers regard as being incompatible with incentive regulation and, as a result, the Board should refrain from approving any formulaic approach to ratemaking which appears to set prices for regulated services by countenancing and approving negative productivity.

## Responses to the Board's Questions

### 1. The Inflation Factor

#### *Q1. Expert's Recommended Approaches*

We support and adopt counsel for SEC's analysis of the reports of the experts which demonstrates the extent to which the industry-specific Inflation Factor, which the RRFE Report adopts, is materially more volatile than the GDP IPI FDD Inflation Factor measure used in the Board's 3<sup>rd</sup> Gen IRM.

#### *Q2. CME's Preferred Approach*

CME supports the proposal that the GDP IPI FDD measure of inflation be used in 4<sup>th</sup> Gen IRM.

### 2. The Productivity Factor

#### *Q3. Expert's Recommended Approaches*

We rely upon and support counsel for SEC's analysis of the strengths and weaknesses of the total Factor Productivity ("TFP") approaches followed by the different experts. For the reasons described above, we urge the Board to refrain from adopting an approach to formulaic ratemaking which appears to countenance and approve negative productivity.

#### *Q4. Appropriate Ontario TFP*

Subject to the caveat that the Board should refrain from approving a Productivity Factor in an incentive regulation ratemaking formula which is negative, we support SEC's proposed approach which is to calculate productivity in a manner which excludes the poorest productivity performers from the calculation.

### 3. Total Cost Benchmarking

#### *Q5. Expert's Recommended Approaches*

We support and adopt SEC's analysis of the expert evidence on this topic.

#### *Q6. CME's Preferred Approach*

While we support SEC's proposal that reliance be placed on unit cost comparisons to the median rather than to the average of the appropriate peer group, we also agree with CCC's suggestion that this is a topic on which the divergent expert evidence needs to be tested before the Board finalizes its position with respect to the benchmarking issue.

#### *Q7. Unit Cost/Peer Group Model*

SEC's proposal seems reasonable and we support it, recognizing that this, again, is an area where the expert evidence diverges materially. Such evidence needs to be carefully scrutinized and tested before the Board finalizes its position on the matter.

*Q8 & 9. HV and LV Services Data*

We support the comments made by SEC on these points.

4. Efficiency Cohorts/Rankings & Stretch Factors

*Q10. Expert's Recommended Approaches*

We accept that a range between 0% and 0.5% is reasonable and support SEC's proposal that a utility-specific Stretch Factor within that range be derived on the basis of a methodology that is relatively simple and easy to apply.

*Q11. Appropriate Stretch Factors*

At a conceptual level, we support the utility-specific Stretch Factor approach proposed by SEC and urge the Board to adopt it.

5. Implementation Considerations

We agree with SEC and CCC that the ICM rules need to be updated and clarified.

Costs

CME requests that it be awarded its reasonably incurred costs of participating in this process.

Yours very truly



Peter C.P. Thompson, Q.C.

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c. Interested Parties  
Paul Clipsham

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