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BY EMAIL

February 10, 2010

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

Dear Ms. Walli:

Re: Board Staff Submission on Horizon Utilities Corporation 2010 Electricity Distribution Rates Application Board File Number EB-2009-0228

Please see attached Board staff's submission for the above proceeding. Please forward the attached to Horizon Utilities Corporation and any intervenors in this proceeding.

Horizon Utilities Corporation reply to submissions is due February 26, 2010.

Yours truly,

Original Signed by

Martin Benum
Advisor, Applications and Regulatory Audit

Ontario

ONTARIO ENERGY BOARD

STAFF SUBMISSION

2010 ELECTRICITY DISTRIBUTION RATES

Horizon Utilities Corporation

EB-2009-0228

February 10, 2010

Board Staff Submission
Horizon Utilities Corporation
2010 IRM3 Rate Application
EB-2009-0228

Introduction

Horizon Utilities Corporation ("Horizon") filed an application with the Ontario Energy Board (the "Board"), received on November 4, 2009, under section 78 of the Ontario Energy Board Act, 1998, seeking approval for changes to the distribution rates that Horizon charges for electricity distribution, to be effective May 1, 2010. The application is based on the 2010 3rd Generation Incentive Regulation Mechanism.

The purpose of this document is to provide the Board with the submissions of Board staff based on its review of the evidence submitted by Horizon.

Board staff makes submissions on the following matters:

- Disposition of Deferral and Variance Accounts as per the Electricity Distributors' Deferral and Variance Account Review Report (the "EDDVAR Report");
- Adjustments to the Retail Transmission Service Rates; and
- Accounting for the implementation of the Harmonized Sales Tax ("HST".)

DISPOSITION OF DEFERRAL AND VARIANCE ACCOUNTS AS PER THE EDDVAR REPORT

General Background

For purposes of 2010 IRM applications, the EDDVAR Report requires a distributor to determine the value of its December 31, 2008 Group 1 Deferral and Variance account balance and determine whether the balance exceeded the preset disposition threshold of $0.001 per kWh using the 2008 annual kWh consumption reported to the Board. When the preset disposition threshold is exceeded, a distributor is required to file a proposal for the disposition of Group 1 account balances (including carrying charges) and include the associated rate riders in its 2010 IRM Rate Generator for the disposition of the balances in these accounts. The onus is on the distributor to justify why any account balance in excess of the threshold should not be cleared.

Any distributor exceeding the preset disposition threshold was required to file a Deferral and Variance Account Workform.

Horizon Specific Background

Annual Disposition

While the Board's preset disposition threshold for Group 1 accounts was exceeded, Horizon did not request to dispose of its Group 1 account balance at this time. In support of its position, Horizon stated that:

> "Horizon Utilities has analyzed its December 31, 2008 Deferral and Variance account balances of $(19,466,721) and has extrapolated the account balances to April 30, 2010, December 31, 2010 and April 30, 2011. Those balances are projected to be $(9,211,210), $(5,238,841) and $(1,100,783) respectively.
>
> The extrapolation of balances for all accounts with the exception of the RSVA Transmission Network and Connection accounts to April 30, 2010 is based on the change in the variance accounts using wholesale quantities at the wholesale rates less retail quantities at retail rates. Further, the extrapolation of the RSVA Transmission and Connection accounts for the periods December 30, 2010 and April 30, 2011 is based on the average monthly change in these two variance accounts from September 30, 2009 to April 30, 2010.
>
> The Deferral and Variance account (liability) balances are expected to decline from the December 31 2008, balance of ($19,466,721) to ($1,100,783) by April 30, 2011 on the basis of the extrapolation noted in the preceding paragraph. The disposition of the Group 1 Account balances as part of this 2010 3rd Generation IRM Application would, effectively, be redundant with the current trend of disposition based on current related rates.
>
> Based on the current trend of disposition of net balances noted in above, Horizon Utilities will have to refinance such net balances with an equal and offsetting amount of debt of approximately, $18.3 MM by 2011. An additional and redundant disposition of these balances will have the following implications:

(a) Unnecessary and duplicate financing requirement, and related interest charges, of $18.3MM for a total of $36.6MM;

(b) A potential requirement to recover $18.3MM from customers, as of April 30, 2011, related to a trend that would result in a net Group 1 Accounts receivable of the same amount as of such date.

For the above reason, Horizon Utilities submits that the present trend of disposition of the Group 1 Accounts based on (existing related rates) is sufficient to meet the objectives of the EDDVAR Report. The addition of a redundant layer of disposition as a result of this Application would not be in the best interests of Horizon Utilities, which would be required to unnecessarily incur significant additional debt and related interest charges, or customers, who would continue to be exposed to rate volatility related to Group 1 Accounts."

Board staff interrogatory # 5a requested that Horizon complete and submit an updated version 4 of the Deferral Variance Account Workform. Horizon has complied with this request.

Global Adjustment

In response to Board staff interrogatory # 2a Horizon stated it had reviewed the Regulatory Audit & Accounting Bulletin 200901 and confirmed that it had accounted for its Account 1588 RSVA Power and Global Adjustment sub-account in accordance with this Bulletin. In response to Board staff interrogatory # 2b, Horizon confirmed that had not made adjustments subsequent to its initial application to comply with the Regulatory Audit & Accounting Bulletin 200901 with respect to account 1588 and the global adjustment sub-account.

In response to Board staff interrogatory # 3a, Horizon agreed that a separate rate rider be prospectively applied to non-RPP customers to dispose of the global adjustment sub-account balance would be appropriate on the basis of cost causality. Horizon however noted there may be exceptions pertaining to the cases in which RPP status of a customer changed between the period during which the balance accumulated and the time at which the rider would take effect.

In response to Board staff interrogatory # 3b, Horizon stated that it did currently have the billing capability to have a separate rate rider applicable to non-RPP customers to dispose of the global adjustment sub-account balance. Horizon however indicated it would not be capable to address cases in which RPP status of a customer changed between the period during which the balance accumulated and the time at which the rider would take effect.

As of November 1, 2009 the MUSH sector (Municipalities, Universities, Schools and Hospitals) and other designated institutional customers that remained as RPP customers were required to switch to non-RPP customer status as per O. Reg. 95/05 of the Ontario Energy Board Act, 1998. In response to Board staff interrogatory # 4d, Horizon indicated that the rate rider should not apply to RPP customers, and should exclude customers in the MUSH sector. Horizon further indicated that its billing system could not readily exclude customers in the MUSH sector.

Horizon has not requested that the Board review and approve the disposition of the December 31, 2008 balances of other Group 1 Deferral and Variance accounts as defined by the EDDVAR Report. The total balance of the Group 1 accounts, excluding the 1588 Global Adjustment sub-account is a credit of $20,274,313. The balance in the 1588 Global Adjustment sub-account is a debit of $1,185,010. Horizon has included interest, using the Board's prescribed interest rates, on these account balances up to April 30, 2010. Debit balances are amounts recoverable from customers.

Submission

While the Board's preset disposition threshold of $0.001 per kWh was exceeded, Horizon indicated that the disposition of its Group 1 account balance at this time would not be appropriate since Horizon expects that the credit balance will be largely reduced by April 30, 2011. Board staff notes from the projections provided by Horizon that the main driver for this change is Horizon's forecast increase in the global adjustment sub-account balance (debit position). Horizon used a linear extrapolation based on the historical change in the balance of the global adjustment sub-account over the December 31, 2008 and September 30, 2009 period.

While Board staff acknowledges that some distributors have experienced an unprecedented growth in the global adjustment sub-account in the first nine months of

2009, Board staff notes that the method upon which Horizon established its forecast assumes that the balance will continue to grow at the same pace as it did over the December 31, 2008 and September 30, 2009 period. This may or may not be true. Board staff observes that the EDDVAR Report provides a framework for the review and disposition of account 1588 on a quarterly basis. Board staff suggests that if Horizon is concerned about the increase in the global adjustment sub-account, Horizon can make an application to the Board to dispose of the actual account balance if the preset disposition threshold of $0.01 per kWh is exceeded for two consecutive quarters.

Board staff submits that the Board may wish to consider ordering Horizon to dispose of its Group 1 account balances. Were the Board to elect to do so, Board staff suggests that the Board may wish to consider establishing a separate rate rider for the disposition of the Global Adjustment sub-account balance. Considering the capability of Horizon's billing system, Board staff suggests that the rate rider could be applied prospectively to non-RPP customers. Board staff submits that recovering the Global Adjustment sub-account balance solely from non-RPP customers would be more reflective of cost causality since it was that group of customers that were undercharged by the distributor in the first place.

However, the Board may wish to consider, as an alternative, to recover the allocated Global Adjustment sub-account balance from all customers in each class. This approach would recognize the customer migration that might occur both away from the non-RPP customer group and into the non-RPP customer group.

In addition to the decision on whether a separate rate rider should be established for the disposition of the global adjustment sub-account, the Board must decide on the time period over which the rate riders should apply. As previously noted, customer migration might occur in the low volume group. For this group of customers, there would be a benefit to dispose of the global adjustment sub-account balance over a relatively short period of time in order to reduce inter-generational inequities. Board staff submits that a disposition period no longer than one year would be appropriate. These balances have been accumulating over the last four year period and to delay immediate action is not in the customer's best interest. Board staff recognizes that some volatility in electricity bills may result. That aside, Board staff believes that a one year disposition period would be in the interest of all parties.

In order to reduce inter-generational inequities, Board staff submits that the disposition period for all Group 1 accounts should not exceed one year.

Board staff notes that the final proposed balances for disposition may no longer reconcile with previously audited balances nor with Horizon's RRR filings. Board staff has reviewed the balances and notes that the changes do not result in material differences. Board staff notes that Horizon stated in response to staff's interrogatory # 5d that Horizon has complied with the Board's accounting policies and procedures. Board staff is mindful of the importance of a timely disposition of deferral and variance account balances and does not believe that the disposition should be delayed. Board staff suggests that the Board consider approving the proposed deferral and variance account balance disposition rate riders on a final basis.

ADJUSTMENTS TO THE RETAIL TRANSMISSION SERVICE RATES (RTSR)

General Background

Electricity transmitters in Ontario charge Uniform Transmission Rates (UTR) to their transmission connected customers. These UTRs are charges for network, line connection and transformation connection services. Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, the new UTRs effective July 1, 2009 were as follows:

- Network Service Rate was increased from $2.57 to $2.66 per kW per month, a 3.5% increase;
- Line Connection Service Rate remained unchanged at $0.70 per kW per month; and
- Transformation Connection Service Rate was decreased from $1.62 to $1.57 per kW per month, for a combined Line and Transformation Connection Service Rates reduction of 2.2%.

On July 22, 2009 the Board issued an amended "Guideline for *Electricity Distribution Retail Transmission Service Rates*" ("RTSR Guideline"), which provided electricity distributors with instructions on the evidence needed, and the process to be used, to adjust Retail Transmission Service Rates ("RTSRs") to reflect the changes in the UTRs effective July 1, 2009. The Board set as a proxy at that time an increase of 3.5% for the

Network Service Rate and reduction of 2.2% for the combined Line and Transformation Connection Service Rates. The Board also noted that there would be further changes to the UTRs in January 2010.

Based on the Decision and Rate Order of the Board in the EB-2008-0272 proceeding, a Rate Order issued January 21, 2010 revised the UTRs effective January 1, 2010 as follows:

- Network Service Rate has increased from $2.66 to $2.97 per kW per month, an 11.7% increase over the July 1, 2009 level or 15.6% over the rate in effect prior to July 1, 2009;
- Line Connection Service Rate has increased from $0.70 to $0.73 per kW per month; and
- Transformation Connection Service Rate has increased from $1.57 to $1.71 per kW per month, for a combined Line and Transformation Connection Service Rates increase of 7.5% over the July 1, 2009 level or 5.2% over the rate in effect prior to July 1, 2009.

Horizon Specific Background

Horizon has applied for an adjustment to its RTSR rates based on a comparison of RTS revenue under existing rates and adjusted wholesale transmission costs. Horizon is requesting an increase of 7.942% for it's Network Service Rate and an decrease of 4.760% for its Line and Transformation Connection Service Rate. In Board staff's view, Horizon has provided a reasonable analysis and explanation as part of its original application.

Submission

Board staff notes that very few distributors, including Horizon, included in their 2009 rates the July 1, 2009 level of UTRs since for most of them, distribution rates would have been implemented on May 1, 2009. Therefore, in accordance with the July 22, 2009 RTSR Guideline, Board staff submits that the revisions to the RTSRs ought to reflect the changes from the current level to the January 1, 2010 level, that is an increase of about 15.6% to the RTSR Network Service rate, and an increase of about 5.2% to the RTSR Line and Transformation Connection Service Rate.

Board staff has reviewed the evidence provided by the applicant and submits that the proposal by Horizon may no longer be reasonable, based on the January 1, 2010 level of the UTRs. Board staff asks Horizon to clarify if it wishes to continue its original proposal or will include as part of its reply submission updated calculations to reflect the January 1, 2010 UTR adjustments.

ACCOUNTING FOR THE IMPLEMENTATION OF THE HARMONIZED SALES TAX

General Background

The Ontario provincial sales tax ("PST") (currently at 8%) and the Federal goods and services tax ("GST") (currently at 5%) will be harmonized effective July 1, 2010, at 13%, pursuant to Ontario Bill 218 which received Royal Assent on December 15, 2009.

The PST is currently an incremental cost applied to the price of goods purchased by an electricity distributor and is included in a distributor's OM&A expenses and capital expenditures. The PST is therefore included in the distributor's revenue requirement and is recovered from ratepayers through the application of distribution rates.

When the PST and GST are harmonized, distributors will pay the HST on purchased goods and service but will now claim an input tax credit for the PST portion. The mechanics of HST as a value added tax means that the distributor will no longer incur that portion of the tax that was formerly applied as PST (i.e. the 8%) on goods purchased. However, the current rates as applied will continue to effect cost recovery as if the PST was still in place. If no action is taken, the distributor will realize a savings in the cost of goods purchased while applying rates which do not reflect those savings.

Horizon Specific Background

In response to Board staff interrogatory # 7a which asked if Horizon agrees that a deferral account should be established to capture the reductions in OM&A and capital expenditures, Horizon stated that:

> "In principle Horizon Utilities accepts the use of deferral accounts to protect both consumers and utilities in cases of changes to external items such as tax rates. However, while in other cases such as changes in income tax rates the effects

> are readily determinable, the cost impact on Horizon Utilities of the switch from PST to HST is unknown at this time and may never be accurately determined.
>
> The cost impact will consist of the (effective) removal of an 8% tax component on both capital goods and other operating supplies and services, offset by the fact that depending on market conditions for each of those goods and services, prices will increase as suppliers fail to pass through the full tax reduction in prices. Information on the degree to which prices fail to reflect the full tax change will necessarily be speculative and in all probability could not form the basis for accounting entries. Therefore, Horizon Utilities does not accept that accurate entries could be made in such a deferral account if it were established."

Horizon further stated that an adjustment to rates to reflect the change from PST to HST should not be made until the distributor submits its next rebased cost of service application at which time the distributor can fully evaluate the impact of the change in its forecasted costs for the test year.

Submission

Board staff notes that many distributors' comments on the administrative burden and costs of sales tax harmonization are at odds with the provincial and Federal governments' pronouncements regarding the stimulative and competitive results of harmonization. Because the costs and savings are not clear at this point, Board staff submits that tracking of these is warranted at this point to quantify, per government pronouncements, that the potential savings for corporations like Horizon could be significant. Accordingly, Board staff submits that the Board may wish to consider establishing a deferral account to record the amounts, after July 1, 2010 and until Horizon's next cost-of-service rebasing application, that were formerly incorporated as the 8% PST on capital expenditures and expenses incurred, but which will now be eligible for an HST Input Tax Credit ("ITC"). The intention of this account would be to track the incremental change due to the introduction of the HST that incorporates an ITC from the 5% to the 13% level. To qualify for this treatment, the cost of the subject items must be in the category of distribution revenue requirement. Tracking of these amounts would continue in the deferral account until Horizon's next cost of service application is determined by the Board or until the Board provides guidance on this matter, whichever occurs first.

Horizon would apply to clear the balance in the account as a credit to customers at the next opportunity for a rate change after the account balance information becomes available and is supported by audited financial statements.

All of which is respectfully submitted