EB-2010-0131

IN THE MATTER OF the *Ontario Energy Board Act, 1998,* being Schedule B to the *Energy Competition Act, 1998* S.O. 1998, c. 15;

AND IN THE MATTER OF an Application by Horizon Utilities Corporation to the Ontario Energy Board for an Order or Orders approving or fixing just and reasonable rates and other service charges for the distribution of electricity as of January 1, 2011.

HORIZON UTILITIES CORPORATION ("HORIZON UTILITIES")

RESPONSES TO ENERGY PROBE INTERROGATORIES

ON THE PRELIMINARY ISSUE

DELIVERED November 8, 2010

Question 1 a

Reference: Exhibit 1, Tab 1, Schedule 1, pages 6-10

Please provide all other pressures that have led Horizon Utilities to file a cost of service application for 2011 rather than waiting for 2012, other than the four items listed**.**

Response:

The response to this interrogatory has been filed confidentially.

Question 1 b

Has Horizon Utilities been unable obtain the necessary financing required to fund business investments in the period beginning in 2008 to the current time? If yes, please provide details.

Response:

No. However, any inferences from this answer must consider that, in management's opinion, the revenue and related cash flow shortfalls during this period, and the ongoing risks of such persisting in the absence of an advanced rebasing application, have resulted in past deferral of necessary investment ultimately required to support continuing high levels of customer service delivery. Horizon Utilities has been deferring capital and OM&A since 2008, as it is prudent to manage investments in relation to available income, cash flow, and corporate liquidity (Exhibit 1, Tab 2, Schedule 1, Page 6 of 17, L26-28). Additional and material deferrals will be necessary through 2011 in the absence of the advance re-basing application and such will elevate operational risks including those related to customer service delivery and as otherwise noted throughout the application.

Over the long-term, reduced cash flow and reduced income contributes to a direct reduction of equity, off of which the corporation is able to borrow. The amount of equity available to Horizon Utilities, and any LDC for that matter, is one very significant constraint on both its borrowing capacity and its cost of borrowing.

Horizon Utilities, like any local distribution company, seeks to balance operational and financial concerns to ensure that it would never find itself in a situation where it could not raise debt capital. This would be a very extreme and unfortunate situation. Horizon Utilities submits that the threshold test for demonstrating why and how a distributor cannot adequately manage its resources and financial needs during the remainder of its IRM plan period should be something less extreme than a past demonstration of failure to raise debt capital; effectively a liquidity event. Horizon Utilities respectfully suggests that threshold considerations on this point should include whether operational requirements can be addressed through available cash flow in a timely manner that continuously supports managing distributor risks and a high level of customer service. Horizon Utilities has submitted its advanced re-basing application on the basis that its past and anticipated levels of cash flow do not support these objectives.

Question 1 c

Has Horizon Utilities experienced any significant issues related to its cash flow in 2008 through to the current time? If yes, please provide details.

Response:

No. However, this response is to be considered in the context of the reasons and discussion provided in 1b).

Question 1 d

Please provide the number full equivalent employees (FTEE) of Horizon Utilities for each of 2007, 2008 and 2009, along with the forecast number for 2010 and 2011.

Response:

2007 - 367

2008 - 368

2009 - 386

2010 – 401

2011 – 428

Question 1 e

Please provide the most recent figure in 2010 of FTEE.

Response:

There are currently 378 FTEE's at Horizon Utilities. This figure is not consistent with Appendix 2-K - Total Number of Employees - as Horizon Utilities is currently actively recruiting to fill twenty-three (23) vacancies across the organization. The vacancy level reflects a stable percentage given the current rate of retirements and other reasons for turnover.

Question 1 f

Please provide the number of employees that retired in each of 2008 and 2009, along with the forecast number of retirements for 2010 and 2011.

Response:

In 2008, four (4) employees retired.

In 2009, thirteen (13) employees retired.

The total anticipated number of employee retirements for 2010 is nine (9).

The forecast for 2011 retirements is twenty-six (26). This includes eligible retirements for 2011 in addition to those employees that have been eligible since 2009.

Question 1 g

How many employees have retired year to date in 2010?

Response:

From January 1, 2010 to October 31, 2010 there have been seven (7) retirements.

Question 1 h

Please confirm that the Board approved return on equity for the 2008 test year in EB-2007-0697 was 8.57%.

Response:

Horizon Utilities confirms that the Board approved return on equity for the 2008 test year in EB-2007-0697 was 8.57%.

Question 2 a

Reference: Exhibit 1, Tab 1, Schedule 1, page 6 & Exhibit 3, Tab 2, Schedule 1, Tables 3-7, 3-19 & 3-23

How much of the revenue shortfall in 2008 was a result of the forecast error associated with energy usage per customer as compared to the Board approved figures shown in Table 3-7 of Exhibit 3, Tab 2, Schedule 1?

Response:

Horizon Utilities submits that the use of the term "forecast error" is inappropriate to describe the variance between the forecast energy usage per customer and the actual energy usage per customer. In the normal course, actual results will naturally differ from budget or forecasted results. The table below shows the calculation of the revenue shortfall related to each customer class that generates revenue based on kWh usage.

Revenue Shortfall re: Energy Usage per Customer

	Residential	General Service < 50 kW	Unmetered Scattered Load	Total
Energy Usage per Customer/Connection (kWh per customer/connection)				
2008 Actual	7,777	33,185	4,044	
2008 Board Approved	8,015	35,323	5,464	
Variance	**(238)**	**(2,138)**	**(1,420)**	
Rate (Rate Year) **	$ 0.0131	$ 0.0070	$ 0.0107	
Revenue Shortfall per Customer	-$ 3.13	-$ 15.04	-$ 15.15	
Board Approved # of Customers	211,942	17,927	3,338	
Total Revenue Shortfall	**$ (662,474)**	**$ (269,573)**	**$ (50,560)**	**$ (982,607)**

Questions 2 b

Please provide a calculation for each rate class shown in Table 3-7 with a kWh billing determinant that shows the difference in the average use between the actual 2008 and Board approved 2008 levels, multiplied by the actual number of customers in the rate class, multiplied by the appropriate approved variable rate for the rate class. As an example, consider the following calculation for the residential rate class**:**

(actual 2008 average use - Board approved 2008 average use) x actual 2008 customers x $0.0128/kWh = (7,777 - 8,015) x 211,092 x $0.0128 = ($643,071).

Response:

Revenue Shortfall re: Energy Usage per Customer

	Residential	General Service < 50 kW	Unmetered Scattered Load	Total
2008 Actual	7,777	33,185	4,044	
2008 Board Approved	8,015	35,323	5,464	
Variance	**(238)**	**(2,138)**	**(1,420)**	
Actual Number of Customers	211,092	18,037	3,205	
2008 Approved Variable Rate	$ 0.0128	$ 0.0072	$ 0.0148	
Total	**$ (643,071)**	**$ (277,654)**	**$ (67,356)**	**$ (988,081)**

Question 2 c

For each rate class in Tables 3-19 and 3-23 in Exhibit 3, Tab 2, Schedule 1, please provide the Board approved kW forecast for each rate class.

Response:

2008 Board Approved kW Forecast

	General Service 50 to 4,999 kW	Street Lighting	Sentinel Lighting	Large Use
2008 Board Approved kW Forecast	5,535,480	112,919	1,721	3,876,319

Question 2 d

Based on the response to part (c) above, please calculate the difference in the revenues due to the difference in the actual kW from the Board approved kW forecast in each applicable rate class, based on the Board approved rates for 2008.

Response:

The table below shows the calculation of the revenue shortfall related to each customer class that generates revenue based on kW usage.

Revenue Variance Board Approved Forecast vs. Actual kW Usage

		General Service 50 to 4,999 kW		Street Lighting		Sentinel Lighting		Large Use		Total
2008 Actual kW		5,496,894		110,018		1,664		3,299,915		
2008 Board Approved kW		5,535,480		112,919		1,721		3,876,319		
Variance		**(38,586)**		**(2,901)**		**(57)**		**(576,404)**		
Board Approved Variable Rate	$	1.7968	$	3.4026	$	7.9428		1.0218		
Variance in Revenue	**$**	**(69,331)**	**$**	**(9,871)**	**$**	**(453)**	**$**	**(588,970)**	**$**	**(668,625)**

Question 2 e

Please confirm that the Board did not make any adjustments to the kWh or kW forecasts for any rate classes in EB-2007-0697.

Response:

Horizon Utilities confirms that the Board did not make any adjustments to the kWh or kW forecasts for any rate classes in EB-2007-0697.

Question 3

Reference: Exhibit 1, Tab 2, Schedule 1, Pages 6-10 & Exhibit I, Tab 3, Schedule 4, Appendix 1-14

At page 10 of the Standard & Poor's Rating Agency Report dated July 8, 2010 it is stated that "We believe the LDC could also temporarily defer, for a year or so, a small portion (about C$5 million to C$7 million) of its maintenance capital expenditure without compromising service levels."

Has Horizon Utilities made any such temporary deferrals in its 2010 or 2011 forecast of capital expenditures?

Response:

Horizon Utilities respectfully submits that it is important to elaborate the context of the above quotation to frame a relevant response. Such is best understood by providing the full section within which this quotation was provided (same reference document and page as in the question):

“Supporting the utility's financial flexibility is HHI's access to a C$100 million bank credit facility maturing June 2013. In addition, HHI generates operating cash flow of about C$40 million per year from its distribution business.

HHI does not have access to equity markets and we have no expectation of direct equity investments in HHI from either Hamilton or St. Catharines. Nevertheless, HHI expects that it would have some flexibility to reduce dividends in times of **financial stress**. Cash dividends, based on 60% of net income, were C$8.1 million in 2009 (to be paid in 2010), with cash interest paid to HUC of C$9.2 million. We believe the LDC could also **temporarily defer**, for a year or so, a small portion (about C$5 million to C$7 million) of its maintenance capital expenditure without compromising service levels. **These two actions would be sufficient to cover about one year's interest expense.”** [Emphasis added]

One of the principal objectives of rating agency reports is to provide lenders with information regarding the borrower's ability to service debt obligations through payments of principle and interest as such become due. Rating agency reports generally include a description of management actions that may be undertaken in times of financial stress, to avoid liquidity events or events of default, in order to divert financial resources towards servicing debt obligations. The quotation provided in the question was offered by S&P in this context.

From a financial management perspective, Horizon Utilities may be able to make a decision to temporarily defer $5 million to $7 million of maintenance capital expenditures in order to avoid an event of default. However, the notion of deferring such expenditures simply because they do not immediately compromise service levels is not a prudent operational management strategy, and Horizon Utilities submits its view that this is an expectation of a rating agency. The principal purpose in making such expenditures on a timely basis in accordance with prudent asset management plans is to ensure that customer service levels are never compromised.

As documented in the Application, and as part of the evidence submitted in Horizon Utilities' Z-Factor Application (EB-2009-0332, Board Staff IR#5a), Horizon Utilities has deferred certain capital expenditures in 2009 and 2010, where such projects were considered lower risk and could be deferred without incurring any immediate risk to system reliability or customer safety. These deferrals were undertaken to balance overall expenditures with available income and cash flow and to balance financial and operational prudency.

For 2011, Horizon Utilities has not provided for any temporary deferrals in its capital expenditure program. As documented within the Application, there is an urgent need for increased investment in the renewal and maintenance of the electricity distribution system and related underlying enabling systems and processes that are beyond their productive life or no longer suitable to support business process that has evolved over the past several years. Such urgency for renewal capital and maintenance is based on asset condition data and an asset management plan elaborated upon in the Application, including related evidence offered in the studies and reports. As such, the approval of the 2011 Cost of Service Application provides the basis for making necessary capital investments to support customer service levels now and in the future.

In the event that the Board does not approve this Application, Horizon Utilities will need to revisit its 2011 budget to defer a material component of the OM&A and capital expenditures provided therein to address a resulting deficiency of income and cash flow otherwise required to provide for such expenditures.

Question 4 a

Reference: Exhibit 1, Tab 2, Schedule 1, Pages 6-10

Please provide all information provided to or received from the Horizon Utilities Board of Directors related to the proposal to file a cost of service application for 2011 rates rather waiting for 2012.

Response:

Horizon Utilities' Board of Directors ("Horizon Board") received regular updates on the status of the preparation of the 2011 Electricity Distribution Rates ("EDR") Cost of Service Application (the "Application") at its regular meetings on February 25, 2010, May 13, 2010, and August 12, 2010 within regular "Regulatory Update" reports. Complete excerpts from these reports related to the Application follow.

Excerpt from February 25, 2010 Regulatory Update Report

1 c) 2011 Cost of Service Application (OEB Reference File: EB-2010-XXXX)

On February 5, 2010, Horizon Utilities advised the OEB of its intention to file a Cost of Service application for the 2011 rate year ("2011EDR"). Such application is based on the 2011 budget for Horizon Utilities. The Horizon Utilities Board of Directors will receive the 2011 Budget and Three Year Plan along with the significant aspects of the 2011EDR in advance of its scheduled meeting on June 24, 2010. The 2011EDR application will be due to the OEB by mid-August, 2010.

Horizon Utilities management ("Management") will provide the Board with an update at its scheduled May meeting including elements of application and rate strategy.

Excerpt from May 13, 2010 Regulatory Update Report

1. *Electricity Distribution Rates, Applications, and Customer Bill Impacts*

Horizon Utilities Corporation ("Horizon Utilities") had two open rate applications during the first quarter of 2010. Decisions were recently received for both of these applications: the Z-factor application and the 2010 3rd Generation Incentive Regulation Mechanism ("3GIRM") application.

Horizon Utilities continues its preparation of the 2011 EDR Cost of Service Application ("COS") with a target completion and filing date in August 2010.

Excerpt from August 12, 2010 Regulatory Update Report

b) Horizon Utilities 2011EDR Cost of Service Application
OEB Reference File: EB-2010-0131

Horizon Utilities staff, in conjunction with its consultants and legal counsel, continues to prepare its 2011 CoS application. Management intends to file the CoS application on or before August 27, 2010.

Horizon Utilities provided the Board of Directors with an update on its CoS application at its meeting on July 14th, 2010. There have been no further developments to report, other than ongoing preparation of such, since that meeting.

Also included in the May 13, 2010 Horizon Board package was an Update on the 2011 Cost of Service Application. A copy of such Update is attached to this response as Appendix 1.

Finally, for the July 14, 2010 meeting of the Horizon Board, an update on the 2011 EDR Cost of Service Application was provided in the form of presentation material in advance of the meeting. A copy of such presentation is attached to this response as Appendix 2.

No further materials have been provided to the Horizon Board.

Question b

When did the Board of Directors give their approval to file a cost of service application for 2011 rates?

Response:

The approval of the Board of Directors of Horizon Utilities is not required with respect to applications to the OEB. Such authority is vested with the President and Chief Executive Officer.

However, as noted above, Horizon Utilities Management provided the Horizon Board with an update on the Application at its meeting on July 14, 2010. At the meeting held on July 28, 2010, the Horizon Utilities Board conditionally approved the 2011 Budget and Three Year Plan as presented, subject to the outcome of the 2011 EDR Cost of Service Application.

Question 5 a

Reference: Exhibit 1, Tab 2, Schedule 5 & Exhibit 1, Tab 2, Schedule 1, page 6
Exhibit 3, Tab 1, Schedule 2

Does the 2010 Bridge Actual column in the table on page 1 of Exhibit 1, Tab 2, Schedule 5 include any actual data for 2010 or is all of 2010 based on forecast information only?

Response:

The 2010 Bridge year data is based on forecast information only and does not include any actual data for 2010.

Question 5 b

Please calculate the return on equity for the 2010 bridge actual year based on the information in the table on page 1. Please compare this figure to the of 5.9% stated on page 6 of Exhibit 1, Tab 2, Schedule 1 and explain any difference in the two figures. In particular, please comment on the difference in the distribution revenue shown in the table on page 1 of Exhibit 1, Tab 2, Schedule 5 and that shown in Table 3-1 of Exhibit 3, Tab 1, Schedule 2.

Response:

See Table 1 provided as part of response to IR #5 (d) below. Please note that a revised "2010 Bridge Corrected" column has been provided in the response. The correction to the 2010 Bridge Year reflects an adjustment to the distribution revenue to remove $4,989,000 in revenue related to Smart Meters. This adjustment represents the imputed revenue and related return on investment to be recognized for Canadian GAAP purposes for Horizon Utilities' Smart Meter expenditures. Smart Meters have been excluded from all previously reported years. The 2010 Bridge Corrected distribution revenue in Table 1 agrees to the distribution revenue reflected in the Pro Forma 2010

Bridge Year Financial Statements (Exhibit 1, Tab 3, Schedule 2, Appendix 1-11, Page 2).

Based on the 2010 Bridge Corrected data provided in Table 1, the deemed return on equity for 2010 is 4.42%.

The distribution revenue figure for 2010 shown in Table 3-1 of Exhibit 3, Tab 1, Schedule 2 differs from the distribution revenue figure provided in Table 1 as it is based on actual distribution revenues to June 30, 2010 plus an estimate for distribution revenues for the balance of the year based on the load forecast. The 2010 Bridge Year distribution revenue was based on Horizon Utilities' original 2010 Budget.

Horizon Utilities' response to Board Staff IR #1(c) includes the computation used to derive the 5.9% ROE stated on page 6 of Exhibit 1, Tab 2, Schedule 1. As noted in Board Staff IR#1(a), computation is an estimate of calendar adjusted return on equity, including underlying assumptions with respect to deemed debt and equity values underlying the 2010 budget for Horizon Utilities. In addition, the ROE computation of 5.9% includes the imputed revenue and an estimated return on investment that Horizon Utilities would recognize for Canadian GAAP financial statement purposes for 2010 for its Smart Meter expenditures. Smart Meters are specifically excluded from the data provided as part of Table 1.

Question 5 c

Please recalculate the revenue deficiency using a return on equity of 8.57% as approved by the Board in EB-2007-0697 for 2008.

Response:

See Table 1 provided as part of response to IR#5(d). Assuming a return on equity of 8.57% for 2008, the computed revenue deficiency is $3,802,705.

Question 5 d

Please expand the table on page 1 of Exhibit 1, Tab 2, Schedule 5 to include actual figures for 2008 and 2009 using a return on equity for both years of 8.57%. Please also add a line that shows the actual return on deemed equity.

Response:

See Table 1 attached.

Horizon Utilities respectfully submits that the calculation of the % of return on deemed equity using the actual results provided for in Table 1 for 2008 and 2009 should not be used as a measure of ROE for purposes of this rate application.

Specifically, the actual results provided in Table 1 reflect actual interest expense recorded in the financial statements for fiscal 2008 and 2009, as opposed to the deemed interest allowance provided for as part of the deemed regulatory rate structure, as determined through Board rate-making policy. As noted in response to Board Staff IR#1(a), shareholders effectively support the debt requirement of the utility, to the extent that deemed debt exceeds actual debt, and are compensated for such by an after-tax deemed cost of debt capital, which approximates the same manner that a third party lender would be compensated. The deemed interest allowance, as provided, is the appropriate amount to be used for purposes of computing the ROE.

Question 5 e

Please explain any difference in the actual return on deemed equity calculated in (d) above with the figures of 7.2% for 2008 and 6.6% in 2009, respectively, as noted on page 6 of Exhibit 1, Tab 2, Schedule 1.

Response:

As noted in response to IR#5(d), the principal difference in the computations provided in Table 1 for 2008 and 2009 compared to the ROE computations provided in Exhibit 1, Tab 2, Schedule 1, page 6 is with respect to the amount of interest expense used in the computation (actual interest versus deemed interest). As noted in IR#5(d) above, Horizon Utilities respectfully submits that the computation provided in Table 1 does not reflect the ROE in accordance with the rate structure.

Table 1

DESCRIPTION		Notes		2008 Actual	2009 Actual	2010 Bridge Corrected	2010 Bridge As Filed	2011 Test Existing Rates	2011 Test Year Revenue Requirement
						(Note 1)			
Revenue				$000's					
	Revenue Deficiency								$19,560,006
	Distribution Revenue			$83,081	$83,903	$85,937	$90,834,824	$83,665,964	$83,665,964
	Other Operating Revenue (net)			$6,641	$5,360	$5,603	$5,602,995	$5,481,969	$5,481,969
Total Revenue				$89,722	$89,263	$91,540	$96,437,819	$89,147,933	$108,707,939
Costs and Expenses									
	Operation & Maintenance			$41,153	$40,008	$40,907	$40,907,367	$47,875,239	$47,875,239
	Depreciation& Amortization			$22,177	$23,295	$25,937	$25,936,572	$27,371,137	$27,371,137
	Actual Interest (2008/2009)/Deemed Interest (2010-2011)	(3)		$9,133	$9,901	$12,399	$12,399,500	$12,553,453	$12,553,453
Total Costs and Expenses				$72,463	$73,204	$79,243	$79,243,439	$87,799,829	$87,799,829
Utility Income Before Income Taxes				$17,259	$16,059	$12,297	$17,194,380	$1,348,104	$20,908,110
Income Taxes									
	Corporate Income Taxes			$6,225	$5,496	$5,776	$5,775,951	$532,942	$6,058,643
Total Income Taxes				$6,225	$5,496	$5,776	$5,775,951	$532,942	$6,058,643
Utility Net Income				$11,034	$10,563	$6,521	$11,418,429	$815,162	$14,849,467
Actual/Deemed Return on Rate Base									
	Rate Base			$341,312,648	$351,172,774	$369,164,571	$369,164,571	$376,890,026	$376,890,026
	Interest Expense			$9,133,000	$9,901,000	$12,399,000	$12,399,500	$12,553,453	$12,553,453
	Net Income			$11,034,000	$10,563,000	$6,521,000.00	$11,418,429	$815,163	$14,849,467
Total Actual Return on Rate Base			(A)	$20,167,000	$20,464,000	$18,920,000	$23,817,929	$13,368,616	$27,402,920
Actual Return on Rate Base				5.91%	5.83%	5.13%	6.45%	3.55%	7.27%
Deemed Return on Rate Base									
	Rate Base			$341,312,648	$351,172,774	$369,164,571	$369,164,571	$376,890,026	$376,890,026
Return Rates									
	Return on Debt (Weighted)			3.59%	3.59%	5.60%	5.60%	5.55%	5.55%
	Return on Equity	(2)		8.57%	8.57%	9.85%	9.85%	9.85%	9.85%
	Deemed Interest Expense			$12,269,507	$12,623,959	$12,399,500	$12,399,500	$12,553,453	$12,553,453
	Return on Equity			$11,700,198	$12,038,203	$14,545,084	$14,545,084	$14,849,467	$14,849,467
Total Return			(B)	$23,969,705	$24,662,162	$26,944,584	$26,944,584	$27,402,920	$27,402,920
Expected Return on Rate Base				7.02%	7.02%	7.30%	7.30%	7.27%	7.27%
Revenue Deficiency Before Tax			(B) - (A)	$3,802,705	$4,198,162	$8,024,584	$3,126,655	$14,034,304	$0
Revenue Deficiency After Tax				$5,718,353	$6,313,025	$12,067,044	$4,531,385	$19,560,006	$0
Net Income, as above				$11,034,000	$10,563,000	$6,521,000	$11,418,429	$815,162	$14,849,467
Deemed Equity (40%)				$136,525,059	$140,469,110	$147,665,828	$147,665,828	$150,756,010	$150,756,010
% Return on Deemed Equity				8.08%	7.52%	4.42%	7.73%	0.54%	9.85%

Notes:

(1) 2010 Bridge Year Distribution Revenue adjusted from GAAP Financial Statements to Regulatory of $4,989,000. This adjustments represents the imputed revenue and related return on investment that Horizon Utilities would recognize for Canadian GAAP financial statement purposes for 2010 for its smart meter expenditures. Smart meters was excluded for all other years.

(2) The above table provides the calculation of the revenue deficiency using a return on equity of 8.57% for 2008 and 2009. The Distribution Revenues for 2008 and 2009 have been adjusted to indicate revenue from rates only, excluding items that do not relate to that year's distribution revenue. The adjustments to Operating Revenue are explained in detail in Exhibit 3, Tab 1, Schedule 2, Pages 3 and 4, Table 3-2. The adjustments relate to the one time recovery of OMERS, the 2005/2006, 2007/2008 LRAM/SSM recovery and the regulatory adjustment to GAAP Financials related to smart meter expenditures.

(3) Actual, not deemed, interest expenses for 2008 and 2009 have been used in the table for the respective years. ROE calculations for regulatory purposes are based on deemed interest and not actual interest, in accordance with the OEB's approach in the Revenue Requirement Work Form Exhibit 6, Tab 1, Schedule 2, Appendix 6-1 and page 8 of 11.

QUESTION 6

Reference: Exhibit 1, Tab 2, Schedule 5 & Exhibit 4, Tab 2, Schedule 1

Please reconcile the OM&A cost of $19,583,024 + $21,324,343 shown in the table on page 1 of Exhibit 1, Tab 2, Schedule 5 with the figure of $40,066,077 shown in the table on page 2 of Exhibit 4, Tab 2, Schedule 1 for 2010.

Response:

The OM&A costs shown in the table on page 1 of Exhibit 1, Tab 2, Schedule 5 include property and capital tax. These costs are not included in the figure of $40,066,077 shown in the table on page 2 of Exhibit 4, Tab 2, Schedule 1 for 2010.

	2010 Bridge Year
Exhibit 1, Tab 2, Schedule 5	
Operations & Maintenance	19,583,024
Billing, Collecting, Admin & General	21,324,343
	40,907,367
Exhibit 4, Tab 2, Schedule 1	
Total OM&A	40,066,077
Property Tax	575,666
Capital Tax	265,623
Total	**40,907,366**

Question 7

Reference: Exhibit 1, Tab 2, Schedule 1, page 7

Please provide all assumptions and calculations used to estimate the adjusted return on regulated investments for 2011 of between 2.0% and 5.0%.

Response:

Please refer to Horizon Utilities' response to VECC interrogatory 1(e).

Question 8

Reference: Exhibit 1, Tab 2, Schedule 1, page 10

If Horizon Utilities believes that the Board does not contemplate the nature of the capital expenditures proposed by Horizon Utilities as being urgent requirements in 2011 that would trigger use of the capital module and that such renewal expenditures are common and to be expected in the ordinary course of the business of maintaining an electricity distribution system, please explain why it believes that these same circumstances are justification for an early cost of service rebasing application.

Response:

For clarity, Horizon Utilities has not requested, nor does it intend to request the use of, the incremental capital module.

The circumstances Horizon Utilities has offered as its justification for an early cost of service rebasing application are broader than capital expenditures. The incremental capital module narrowly addresses capital expenditures.

Horizon Utilities has submitted at Exhibit 1, Tab 2, Schedule 1, page 6, of its 2011 EDR Cost of Service Application evidence and reasons regarding the need for such Application, summarized as follows:

1. Material and persisting shortfalls in revenue, relative to the Board approved Base Revenue Requirement, which is adversely affecting Horizon Utilities' ability to finance its required business investments

2. A requirement to address the deferrals noted in item 1, and an urgent need for increased investment in the renewal and maintenance of the electricity distribution system and related underlying enabling systems and processes that are beyond their productive life. Horizon Utilities has submitted its Asset Management Plan ("AMP") as Appendix 2-1 in Exhibit 2, Tab 2, Schedule 2 as part of the Application. The AMP, along with the

studies in the accompanying appendices, further elaborates the need for capital investment.

3. An urgent requirement to renew and increase skilled trades positions within the workforce and other administrative functions in support of the growth and change in electricity distribution business.

4. A requirement for a reasonable rate of return on regulated investments in order to provide necessary and stable cash flow to support the delivery of customer service and distribution system on a sustainable basis in a manner that protects public and employee safety. Absent the relief requested in this Application and as referenced in Horizon Utilities' response to VECC interrogatory 1e), Horizon Utilities continues to anticipate that its ROE in 2011 will 2%, based on a 1% IRM adjustment.

Question 9 a

Reference: Exhibit 1, Tab 2, Schedule 1, pages 9-10

Please provide a table for 2008 through 2011 that shows the distribution system capital expenditures for each year, along with a separate line that shows all of the remaining non-distribution system capital expenditures for these years, along with the total capital expenditures being closed to rate base in each year.

Response:

Horizon Utilities categorizes its capital expenditures being closed to rate base in each year as follows:

2008-2011 Rate Base Asset Additions

Source: E2/T2/S2

	2008	2009	2010	2011
Distribution Plant Additions - Gross	$28,635,025	$37,716,502	$34,066,886	$36,827,393
Contributions and Grants	($3,908,587)	($5,675,309)	($2,262,647)	($2,044,172)
Distribution Plant Additions - Net	$24,726,438	$32,041,193	$31,804,239	$34,783,221
General Plant Additions	$9,722,610	$5,443,230	$5,788,761	$9,208,878
Total Rate Base Additions	**$34,449,049**	**$37,484,423**	**$37,593,000**	**$43,992,099**
Smart Meter Investments	$10,547,660	$6,043,663	$701,000	$1,578,275

General Plant Additions, which are fully described and substantiated in the Application by individual project (see Exhibit 2, Tab 3, Schedule 1), relate to investments that are necessary in order to support effective utility operations, in accordance with Horizon Utilities' Asset Management Plan (Exhibit 2, Tab 3, Schedule 2). General Plant investments are an integral part of this Plan, whose fundamental basis is summarized in the Application as follows:

> In order to balance distribution system risks and customer bill impacts, Horizon Utilities' capital plan provides for managing investments in the distribution system over a 20 year period, which will increase Horizon Utilities' annual capital expenditure, particularly in the area of end of life asset investment, by approximately $11.5 million per year. Even at this increased rate of investment, the ratio of assets beyond end of life to total assets is expected to increase until 2014, but Horizon Utilities considers this both necessary and reasonable to manage customer cost increases at a graduated pace. The balance of this Exhibit contains Horizon Utilities' evidence with respect to the work it has undertaken since 2008 to determine the condition of its

assets and with respect to its plans, including long-term renewal and conversion strategies, to address the results of those determinations. Discussions of Horizon Utilities' capital expenditures for the 2011 Test Year are set out in Table 2-33 below.

Horizon Utilities entered a phase of sustained renewal capital growth commencing in 2008. Its distribution capital investment needs will be increasing from $22MM, as approved in 2008 EDR COS Application to $45MM by 2015.[1]

Question 9 b

Does the distribution system capital expenditures noted on page 9 include the reduction associated with contributions and grants?

Response:

The distribution system capital expenditures noted on page 9 do include the reduction associated with capital contributions. There are no grants to consider.

Question 9 c

Please calculate the materiality threshold for the 3rd GIRM capital module. Please show all calculations and assumptions used

Response:

Horizon Utilities has calculated the materiality threshold for the 3rd GIRM capital module to be $44, 027, 009. The audited RRR billing determinants were used with the rebased rates to calculate the ICM Billing Determinants for Growth – Numerator 2009 Audited RRR in the Threshold Parameters calculation.

The following tables illustrate the calculations:

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[1] Exhibit 2, Tab 1, Schedule 3, pages 5-6

ICM Billing Determinants for Growth – Numerator

Name of LDC: **Horizon Utilities Corporation**
File Number: **EB-2009-0228**
Effective Date: **May 1, 2010**
Detailed Re-Based Revenue From Rates

Applicants Rate Base			**Last Rate Re-based Amount**	
Average Net Fixed Assets				
Gross Fixed Assets - Re-based Opening	$ 554,953,895	A		
Add: CWIP Re-based Opening	$ 8,021,582	B		
Re-based Capital Additions	$ 29,169,380	C		
Re-based Capital Disposals	-$ 3,369,664	D		
Re-based Capital Retirements		E		
Deduct: CWIP Re-based Closing	-$ 4,210,582	F		
Gross Fixed Assets - Re-based Closing	$ 584,564,611	G		
Average Gross Fixed Assets			$ 569,759,253	H = (A + G) / 2
Accumulated Depreciation - Re-based Opening	$ 278,581,415	I		
Re-based Depreciation Expense	$ 24,059,797	J		
Re-based Disposals	-$ 3,369,664	K		
Re-based Retirements		L		
Accumulated Depreciation - Re-based Closing	$ 299,271,547	M		
Average Accumulated Depreciation			$ 288,926,481	N = (I + M) / 2
Average Net Fixed Assets			**$ 280,832,772**	O = H - N
Working Capital Allowance				
Working Capital Allowance Base	$ 437,249,681	P		
Working Capital Allowance Rate	15.0%	Q		
Working Capital Allowance			**$ 65,587,452**	R = P * Q
Rate Base			**$ 346,420,224**	S = O + R
Return on Rate Base				
Deemed ShortTerm Debt %	4.00%	T	$ 13,856,809	W = S * T
Deemed Long Term Debt %	56.00%	U	$ 193,995,326	X = S * U
Deemed Equity %	40.00%	V	$ 138,568,090	Y = S * V
Short Term Interest	4.47%	Z	$ 619,399	AC = W * Z
Long Term Interest	6.10%	AA	$ 11,833,715	AD = X * AA
Return on Equity	8.57%	AB	$ 11,875,285	AE = Y * AB
Return on Rate Base			**$ 24,328,400**	AF = AC + AD + AE
Distribution Expenses				
OM&A Expenses	$ 39,695,645	AG		
Amortization	$ 22,840,885	AH		
Ontario Capital Tax (F1.1 Z-Factor Tax Changes)	$ 745,696	AI		
Grossed Up PILs (F1.1 Z-Factor Tax Changes)	$ 5,825,105	AJ		
Low Voltage	$ 196,399	AK		
Transformer Allowance	$ 1,778,591	AL		
	$ -	AM		
	$ -	AN		
	$ -	AO		
			$ 71,082,321	AP = SUM (AG : AO)
Revenue Offsets				
Specific Service Charges	-$ 2,958,823	AQ		
Late Payment Charges	-$ 720,000	AR		
Other Distribution Income	-$ 979,204	AS		
Other Income and Deductions	-$ 2,116,454	AT	**-$ 6,774,481**	AU = SUM (AQ : AT)
Revenue Requirement from Distribution Rates			**$ 88,636,239**	AV = AF + AP + AU
Rate Classes Revenue				
Rate Classes Revenue - Total (B1.1 Re-based Revenue - Gen)			$ 88,513,524	AW
Difference			$ 122,716	AZ = AV - AW
Difference (Percentage - should be less than 1%)			0.14%	BA = AZ / AW

ICM Billing Determinants for Growth – Denominator

Rate Class	Fixed Metric	Vol Metric	Billed Customers or Connections	Billed kWh	Billed kW	Base Service Charge	Base Distribution Volumetric Rate kWh	Base Distribution Volumetric Rate kW	Service Charge Revenue	Distribution Volumetric Rate Revenue kWh	Distribution Volumetric Rate Revenue kW	Total Revenue by Rate Class
			A	B	C	D	E	F	G = A * D * 12	H = B * E	I = C * F	J = G + H + I
Residential	Customer	kWh	212,580	1,597,158,130	0	$12.66	$0.0128	$0.0000	$32,295,154	$20,443,624	$0	$52,738,778
General Service Less Than 50 kW	Customer	kWh	17,979	577,556,075	0	$27.08	$0.0072	$0.0000	$5,842,456	$4,158,404	$0	$10,000,860
General Service 50 to 4,999 kW	Customer	kW	2,216	1,815,472,173	5,231,608	$246.97	$0.0000	$1.7848	$6,567,426	$0	$9,337,374	$15,904,800
Large Use	Customer	kW	12	1,236,169,244	2,474,130	$11,001.46	$0.0000	$1.0080	$1,584,210	$0	$2,493,923	$4,078,133
Unmetered Scattered Load	Connection	kWh	3,208	12,770,029		$9.46	$0.0148	$0.0000	$364,172	$188,996	$0	$553,169
Street Lighting	Connection	kW	52,281	39,460,323	110,133	$1.25	$0.0000	$3.3932	$784,215	$0	$373,703	$1,157,918
Sentinel Lighting	Connection	kW	502	534,109	1,542	$2.85	$0.0000	$7.9332	$17,168	$0	$12,233	$29,401
Stand-By	Connection	kW			242,220	$0.00	$0.0000	$2.0358	$0	$0	$493,111	$493,111
									$47,454,801	**$24,791,024**	**$12,710,345**	**$84,956,170**

Threshold Test

Threshold Test			
Year		2008	
Status		Re-Basing	
Price Cap Index		**0.18%**	**A**
Growth		**4.19%**	**B**
Dead Band		**20%**	**C**
Average Net Fixed Assets			
Gross Fixed Assets Opening		$ 554,953,895	
Add: CWIP Opening		$ 8,021,582	
Capital Additions		$ 29,169,380	
Capital Disposals		-$ 3,369,664	
Capital Retirements		$ -	
Deduct: CWIP Closing		-$ 4,210,582	
Gross Fixed Assets - Closing		$ 584,564,611	
Average Gross Fixed Assets		$ 569,759,253	
Accumulated Depreciation - Opening		$ 278,581,415	
Depreciation Expense		$ 24,059,797	**D**
Disposals		-$ 3,369,664	
Retirements		$ -	
Accumulated Depreciation - Closing		$ 299,271,547	
Average Accumulated Depreciation		$ 288,926,481	
Average Net Fixed Assets		$ 280,832,772	**E**
Working Capital Allowance			
Working Capital Allowance Base		$ 437,249,681	
Working Capital Allowance Rate		15%	
Working Capital Allowance		$ 65,587,452	**F**
Rate Base		**$ 346,420,224**	**G = E + F**
Depreciation	**D**	**$ 24,059,797**	**H**
Threshold Test		**182.99%**	**I = 1 + (G / H) * (B + A * (1 + B)) + C**
Threshold CAPEX		**$ 44,027,009**	**J = H *I**

Threshold Parameters

Threshold Parameters			
Price Cap Index			
Price Escalator (GDP -IPI)	1.30%		
Less Productivity Factor	-0.72%		
Less Stretch Factor	-0.40%		
Price Cap Index		**0.18%**	
Growth			
ICM Billing Determinants for Growth - Numerator :		$ 88,513,524	A
ICM Billing Determinants for Growth - Denominator :		$ 84,956,170	B
Growth		**4.19%**	C

Question 9 d

With reference to Hydro One's 2009 EDR Application, please provide a summary of what the Board allowed Hydro One to recover through the capital module.

Response:

The Hydro One 2009 EDR Application to which the Intervenor refers is a 3rd Generation Incentive Rate Mechanism (IRM) Application which includes relief sought through the Incremental Capital Module. Horizon Utilities is not applying under the framework of the Incremental Capital Module. As stated in its response to part 9e) below, the capital expenditures in 2011 as submitted in the Application are not in excess of the threshold for the ICM. Horizon Utilities respectfully refers the Intervenor to the OEB website where the aforementioned decision is available on the public record for additional information.

Question 9 e

Based on the response to part (b) above, what capital expenditure amount for 2011 could qualify for the capital module and what is a high level estimate of the amount that would be recovered from rate payers assuming the Board allowed the recovery as requested by Horizon Utilities?

Response:

Horizon Utilities has applied the methodology in the Supplemental Report of the Board on the 3rd Generation Incentive Regulation Mechanism and, specifically, the Incremental Capital Module. Horizon Utilities threshold CAPEX using the Incremental Capital Model is $44,027,009 and Horizon Utilities' 2011 net capital additions are $43,992,099. While the result is that the threshold is not met, Horizon Utilities submits that need for increased capital spending, as supported in its Application, is only one of several critical factors contributing to the need for early rebasing. Please see Horizon Utilities' response to Board staff interrogatory 4a) for further discussion of this matter.

Appendix 1

Report to:	Board of Directors	**Submitted by:**	John G. Basilio
Date:	May 13, 2010	**Prepared by:**	Indy J. Butany-DeSouza

Subject:	Agenda Item 7.2 Update – 2011 Cost of Service Application

INFORMATION	✓	APPROVAL	

The COS process is well underway, including the preparation of 2011 business and financial plans. Additionally, significant studies are required to support the application including: a depreciation study to support depreciable lives of distribution property; a lead/ lag study in support of the working capital component of rate base; asset management plans; distribution system plans; and load and revenue forecasts.

In January 2010, the OEB commenced a generic proceeding on the merits of the alignment of rate year and fiscal year (EB-2009-0423). The principal benefit of such alignment is a proper matching of regulated cashflow to underlying approved financial plans in COS applications. Through the CLD, Horizon Utilities submitted its views on: (i) the benefits that will arise from the alignment; (ii) the impact on ratepayers; (iii) the preferred timing for the alignment to take place and, (iv) any transitional matters and complexities concerning financial and regulatory reporting requirements. The OEB concluded such proceeding on April 15, 2010. While the OEB had set a generic proceeding for this process, it provided that the merits of an alignment of the rate year with the fiscal year for a distributor would be evaluated on a case-by-case basis through the next scheduled COS application. The OEB has encouraged LDCs that seek a January 1, 2011 effective date for rates to file their COS application "as early as possible".

Management expects that the filing deadline for 2011 COS applications will be late August 2010. As part of its COS application strategy, Horizon Utilities will seek a January 1, 2011 effective date for rates and will therefore file the application as early as possible.

The process and potential timelines for disposition and defense of the COS application are as follows:

- Late September – Issuance from the OEB of the Notice of Application to be published in the local papers in Hamilton and St Catharines
- Late October - Interrogatories and responses
- Late November/ Early December – Settlement conference
- December/ Early January – Outstanding issues heard through oral hearing
- Late January – Undertakings and Argument-in-Chief
- February – Final intervenor submissions and Final Horizon Reply Argument
- March – Decision and Draft Rate Order
- Late March/ Early April – Final Rate Order

While the above-noted process and timeline contemplates the implementation of rates for May 1, 2010, Management expects the potential of a rider for rates effective January 1, 2010, during this transition year.

Appendix 2

horizon UTILITIES Looking beyond

2011 EDR Cost of Service Application

Horizon Utilities Board of Directors Meeting

July 14, 2010

2011 Budget and Implications for COS Application

- 2011 Budget provides significant increases in operating and capital programs to support sustainable investment in distribution system and customer service;
- Government mandated initiatives will add costs
  - elements of *Green Energy Act* and achievement of conservation and demand management ("CDM") targets;

RESULT

- Necessary increase in revenue requirement
  - Horizon Utilities' 2008 revenue requirement was $93.6 MM; 2011 revenue requirement is $111.4 MM (a Cumulative Average Growth Rate of 5.97%)

horizon UTILITIES Looking beyond

Customer Bill Impacts

Bill Impacts	Distribution Impacts		Total Bill Impacts	
Customer Class	% Impact	$ Impact	% Impact	$ Impact
Residential, 800 kWh	21.24%	$4.79	2.37%	$5.41
General Service <50, 2,000 kWh	33.45%	$12.85	5.54%	$14.52
General Service >50, 100,000 kWh/ 350 kW	71.86%	$382.05	3.90%	$431.71
Large User, 2,800,000 kWh/6,500 kW	115.33%	$15,438.80	5.86%	$17,445.84
Street Lighting, 2,400,000 kWh/6,800 kW	65.93%	$28,408.62	11.21%	$32,101.74

Typical Horizon Utilities residential customer 680 kWh/mo:

- Distribution increase of 21.05% or $4.49/mo;
- Total bill impact is an increase of 2.59% or $5.07/mo.

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Beyond Distribution Rates

Customer bill also impacted by riders

Pre- January 1/2011

- Smart meter funding adder: currently $1.56/ mo/ customer
- MEI Cost Assessment : $.00375 per kWh ($2.55/ mo)
- HST = 8% increase

Post January 1/2011

- Smart Meter Entity charge: $0.48/ mo/ customer
- Late Payment Charge: $.0024 per kWh ($1.60/ mo/ cust)
- IFRS costs

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Key Considerations in the Cost of Service Application

- Address revenue volatility:
  - Load forecast
  - Cost allocation – revenue to cost ratios
  - Rate Design

- Changes since 2008:
  - Growth in Capital and Operating requirements
    - Process improvement requirements
  - Rate year/ fiscal year alignment
  - Working capital requirements (Lead/ lag study)

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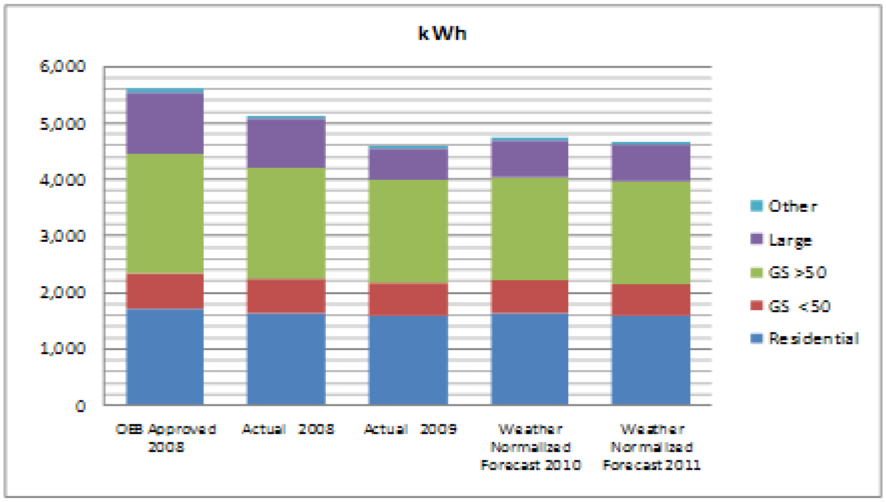
horizon UTILITIES Looking beyond

Revenue Volatility - Consumption History and Forecast (All Customer Classes - kWh)



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Revenue Volatility - Load Forecast

- Actual load forecast was materially less than load forecast in 2008 COS;
  - 2008 COS used typical and accepted approach to load forecasting;
- 2011 COS load forecast is more sophisticated based on multiple regression analysis (for all classes except large user) incorporating:
  - Heating degree days
  - Cooling degree days
  - # of days in a month
  - Shoulder month impacts
  - Ontario real GDP %
- Risks addressed in load forecast:
  - achievement and impacts of anticipated CDM targets;
  - holding large user load forecast to 2009 actuals

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Revenue Volatility – Revenue to Cost Ratios

Customer Class	Low	High	2008 Approved	2009 and 2010 Actual	2011 Cost Allocation	2011 Proposed	Planned for Next Rebasing
Residential	85.0%	115.0%	111.6%	106.4%	110.6%	104.0%	100.0%
General Service < 50	80.0%	120.0%	92.5%	88.1%	102.6%	102.6%	100.0%
General Service > 50	80.0%	180.0%	86.3%	98.0%	85.1%	91.6%	100.0%
Large Use	85.0%	115.0%	92.1%	95.2%	66.3%	91.6%	100.0%
Street Lighting	70.0%	120.0%	43.0%	70.0%	75.5%	91.6%	100.0%
Sentinel	70.0%	120.0%	70.0%	72.3%	62.2%	91.6%	100.0%
Unmetered Scattered Load	80.0%	120.0%	80.0%	62.0%	129.0%	104.0%	100.0%
Standby Power	n/a	n/a	65.8%	65.8%	89.0%	91.6%	100.0%

- Purpose of cost allocation is to determine the costs associated with serving each customer class;
- Objective to recover costs from appropriate customer class

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Revenue Volatility - Rate Design

Customer Class	Current Volumetric Split	Current Fixed Charge Split
Residential	37.96%	62.04%
General Service < 50	40.50%	59.50%
General Service > 50	50.90%	49.10%
Large Use	64.42%	35.58%
Sentinel Lights	39.34%	60.66%
Street Lighting	32.09%	67.91%
Unmetered Scattered Load	33.32%	66.68%
Standby Power	100.00%	0.00%

- Revenue variability should reflect underlying cost structure i.e., fixed vs. variable components
- LDC costs are largely fixed
- Plan to increase fixed portion of rates – particularly for larger commercial customers

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Need for Advanced COS Application – OEB Letter

- 2009-2011 ROEs very low;
- Material decreases in load and commercial revenue since last rebasing;
- Risk inherent in continued deferral of costs to balance earnings and cashflow; and
- Material increases in renewal capital requirements and operating costs over next several years

If the COS Application is not accepted:

- Unable to provide for 2011 Budget;
- Unable to take the business forward in 2011; and
- Increased risk to the distribution utility

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Resourcing

- Resources to support Horizon Utilities through the development and defense of the Cost of Service Application
  - Corporate Counsel: Borden Ladner Gervais LLP;
  - Consulting support
  - Regulatory Affairs group and broader Horizon Utilities organization

Plan:

- Leverage as much experience as practical to assist us in communicating our “story” in support of required regulated investments

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Process and Next Steps

- Potential preliminary step: Review of the application in respect of the off ramp test
- Submission of the application at the end of August, with a request for rates effective January 1st, 2011
- **Sept/Oct 2010:** Notice of Application; initial disposition of the application through written hearing (1-2 rounds of interrogatories)
- **Dec 2010/ Jan 2011:** Settlement Conference for full settlement or, if only partial/ no settlement, then next step - oral hearing
- **Late Jan 2011:** Oral hearing for outstanding issues
- **Feb 2011:** Argument-in-Chief; Intervenor Reply Argument; Horizon Utilities final written submission
- **Mar/ Apr 2011:** Decision and Order

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