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 ONTARIO ENERGY BOARD STAFF INTERROGATORIES ON THE PRELIMINARY ISSUE

DELIVERED NOVEMBER 8, 2010

Question 1

Reference: E1/T2/S1/page 6/ll. 27-28

Horizon Utilities Corporation ("Horizon") states that its adjusted Return on Equity ("ROE") on its regulated investments was 7.2% in 2008 and 6.6% in 2009, and is forecast to be 5.9% for 2010.

Question 1 a

Is the actual or forecasted adjusted ROE documented in this exhibit an accounting return or a regulatory return? Please explain your response.

Response:

The actual or forecasted adjusted ROE documented in E1/T2/S1/page 6/II.27-28 is a "calendar year adjusted return on equity" ("CAROE") and is determined on the following bases:

1. CAROE is computed based on calendar year financial results, which correspond to the fiscal year of Horizon Utilities;
2. CAROE reduces net income for any regulatory recoveries that relate to prior

years. Specifically, with respect to 2008 and 2009, net income has been adjusted to reflect regulatory recoveries for OMERS and LRAM/SSM adjustments that relate to prior fiscal years (i.e. OMERS adjustment in 2008 related to fiscal years 2005 and 2006; LRAM/SSM adjustments in 2008 related to fiscal years 2005 and 2006; and LRAM/SSM adjustment in 2009 related to fiscal years 2007 and 2008;

3. The Equity base in the calculation is determined by computing an estimate of rate base for the related calendar year, based on Board rate-making principles, and applying the deemed capital structure (i.e., Rate Base multiplied by 40% = Deemed Equity);

4. Actual interest is adjusted to an estimated amount that would correspond to a deemed allowance on the estimated rate base computed in 3. The net income used in the CAROE is adjusted for the difference between actual interest and the estimated allowance.

This calculation is appropriate as it provides an estimate of actual ROE on the same basis as such is determined through Board rate-making policy. In doing so, this clarifies the amount of return on equity actually accruing to shareholders on the amount of equity that the Board allows a return to be earned through regulated revenue. The adjustment in 4 supports this result as shareholders effectively support the debt requirement of the utility, to the extent that deemed debt exceeds actual debt. They 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.

Question 1 b

What adjustments have been made in the derivation of the actual ROEs for 2008 and 2009 and the forecasted ROE for the 2010 bridge year shown in this exhibit?

Response:

The adjustments to net income in 2008 and 2009 include the following items, which were summarized in Exhibit 3, Tab 1, Schedule 2, Page 3 of 6:

2008:

One-time recovery of OMERS	($1,371,359)
2005/2006 LRAM/SSM	(868,076)
PILs adjustment	750,211
	($1,489,224)

2009:

2007/2008 LRAM/SSM	(854,904)
PILs adjustment	282,118
	($572,791)

There were no adjustments to net income in 2010.

In addition to the above, interest expense as reported for accounting purposes was also adjusted for 2008, 2009 and 2010 to reflect an estimate of interest expense computed on the deemed regulatory debt structure versus the actual debt structure. Interest on the long-term promissory note has been adjusted to the approved interest rate of 6.1%, versus the actual interest rate on the promissory note of 7%.

Question 1 c

Please provide a detailed derivation of the 5.9% ROE forecasted for 2010.

Response:

The following table provides the estimated ROE forecasted for 2010 based on the 2010 Bridge Year as filed:

$000's	**2010B**	
Base Distribution Revenue - Fiscal Year Basis	$ 85,966	
Smart Meter Revenue	4,869	
Other regulated charges and other income	5,020	
Total Revenue Budget	$ 95,855	
Operating costs (including Capital Taxes)	(41,987)	
Depreciation	(27,822)	
Interest	(10,385)	
Income before taxes	15,661	
Income taxes	(4,462)	
Financial Statement Net Income	**$ 11,199**	A
Estimated adjustment to interest expense - net increase in interest expense		
To adjust to deemed debt structure and 6.1% interest rate on long-term debt	(2,778)	
PILs effect (2008 - 33.5% / 2009 - 33% / 2010 - 31%)	861	
	(1,917)	C
Adjusted Regulatory Net Income	**$ 9,282**	D=A-B-C
Regulated Rate Base (Estimate) - including Smart Meters	391,970	
Regulated Deemed Equity (40%)	156,788	E
Return on Deemed Equity	5.9%	=D/E

Note: 2010 figures above include Smart Meters (Revenue, OM&A and Estimated Rate Base).

Question 1 d

Please provide information on Horizon's achieved return to date for 2010 (e.g. to September 30, 2010). Please provide any update available on what Horizon expects to earn to December 31, 2010.

Response:

As at September 30, 2010, Horizon Utilities' achieved estimated annualized ROE for 2010 is estimated at 7.9%.

Based upon Horizon Utilities latest forecast, prepared as part of its third quarter financial results as at September 30, 2010, the estimated 2010 ROE forecast is approximately 7.2%, as follows:.

$000's		**2010F**
Base Distribution Revenue - Fiscal Year Basis		$ 85,716
Smart Meter Revenue		4,869
Other regulated charges and other income		5,345
Total Revenue Budget		$ 95,930
Operating costs (including Capital Taxes)		(40,393)
Depreciation		(27,522)
Interest		(9,468)
Income before taxes		18,547
Income taxes		(5,267)
Financial Statement Net Income	A	**$ 13,280**
Estimated adjustment to interest expense - net increase in interest expense		
To adjust to deemed debt structure and 6.1% interest rate on long-term debt		(2,778)
PILs effect (2008 - 33.5% / 2009 - 33% / 2010 - 31%)		861
	C	**(1,917)**
Adjusted Regulatory Net Income	D=A-B-C	**$ 11,363**
Regulated Rate Base (Estimate) - including Smart Meters		391,970
Regulated Deemed Equity (40%)	E	156,788
Return on Deemed Equity	=D/E	7.2%

The following is a summary of the significant factors contributing to a difference in the original estimated ROE of 5.9% to the most recent ROE forecast of 7.2%:

- A very hot summer, resulting in an increase in consumption and higher than anticipated distribution revenues, principally in the residential class. Approximately $0.6M in distribution revenue was realized in excess of that which would otherwise be expected using weather normalized consumption. Excluding the $0.6M in distribution revenue results in a revised ROE of approximately 7.0%.
- Lower than anticipated wages and benefits related to current vacant positions. As at September 30, 2010, Horizon Utilities has approximately 23 vacant positions as a result of employee turnover, retirements, and new planned positions for 2010 that have not yet been filled. The lower wages and benefits reflect only a temporary timing difference that will not continue into 2011.
- Lower than anticipated tree trimming expenditures of approximately $0.5MM as a result of lower contracted costs. These lower costs are reflected in the budget underlying the Application.
- Non-recurring savings achieved with respect to favourable experience in the employee group insurance program, and property tax savings related to prior year's assessments.

The estimated annualized ROE as at December 31, 2010 is expected to be lower than the estimated achieved annualized ROE as at September 30, 2010 reflecting:

- Lower distribution revenue in the fourth quarter reflecting a decline in commercial load as a result of the shut-down of a large use customer and lower than anticipated distribution rates under IRM than originally anticipated;
- OM&A expenditures planned in the fourth quarter vary from those experienced in the first three quarters of the year. In addition, some temporary timing differences of such expenditures, experienced up to September 30, 2010, are expected to reverse in the fourth quarter;

As noted in the response to Board Staff IR 2a), the computation of an estimated ROE is based on a number of assumptions and factors. A change in any one of the underlying assumptions will result in a variance to ROE.

It is important to note that the actual ROE as at December 31, 2010 may also differ significantly from the estimate provided herein due to the following:

- Uncertainty with respect to the recovery through rates of the settlement under the Late Payment Class Action (“LPCA”). Horizon Utilities portion of the LPCA settlement is approximately $1.1M. As such settlement reflects a legal obligation of Horizon Utilities, a liability will be recorded in the year-end financial statements. In the absence of a decision prior to year-end on the ability of Horizon Utilities to recover such settlement costs through future rates, Horizon Utilities would be required to record this expense through income, resulting in an after-tax loss of approximately $0.8M. This would have the effect of reducing the estimated ROE by approximately 0.5%.
- Uncertainty regarding the potential impact of the implementation of the Board’s new Customer Standardization and Arrears Management requirements. Specifically, these new requirements increase credit risk including potential adverse impact to bad debt expense and working capital costs through a material extension to the collections cycle and an impairment to the ability of Horizon Utilities to continue securing against known and unacceptable levels of customer credit risk.

Question 2

Reference: E1/T2/S1 and Response to Board staff IR # 5 in Horizon's Z-factor Application

Board staff has attached a copy of the redacted version of the response to Board staff interrogatory # 5 from Horizon's Z-factor application dealt with under File No. EB-2009-0332. In response to Board staff IR # 5 d) in that proceeding, Horizon forecasted an adjusted ROE of 6.29% for 2009 and 6.19% for 2010. Elsewhere in that interrogatory response, Horizon explained the drivers for expected underearning of its ROE.

On page 6 of E1/T2/S1 in this application, Horizon has documented an actual 2009 ROE of 6.6% and a forecasted 2010 ROE of 5.9%.

Question 2 a

Please explain what factors lead to actual 2009 earnings being 31 basis points higher than was forecast in the Z-factor case.

Response:

The response to Board staff interrogatory #5 from Horizon Utilities Z-factor application was prepared prior to the end of Horizon Utilities' fiscal year end, December 31, 2009. At the time the response was prepared, Horizon Utilities estimated the ROE based on the best information available to it at that time, including the year-end forecast that was prepared as part of its third quarter reporting in September 2009. Such estimate provided for an ROE of 6.29%.

An estimate of forecast ROE is based on many assumptions including but not limited to electricity consumption, the level of OM&A expenditures expected for the balance of the year (including that related to emergency and other reactive maintenance), the estimated level of rate base (including the determination of the amount of capital expenditures transferred from work in progress to capital, estimates on working capital allowance.).

Subsequent to the filing of the responses to the Z-factor interrogatories, Horizon Utilities completed the preparation of its year-end financial statements, which resulted in an actual ROE computation of 6.6%.

Horizon Utilities respectfully submits that a 31 basis point difference on the ROE estimate equates to a net income variance from estimate of approximately $0.5MM.

Question 2 b

Please explain what factors are contributing to a further decline in the forecasted ROE for 2010.

Response:

Horizon Utilities had provided a forecast ROE for 2010 of 6.19% as part of the interrogatory responses in November 2009. Such forecast was based on assumptions and information available at that time. Horizon Utilities has revised its forecasted 2010 ROE at 7.2%, based on information available as at the end of its 3rd quarter ending September 30, 2010. Please refer to Horizon Utilities' response to Board Staff interrogatory 1d) for further detail on this calculation.

Question 3

Reference: E1/T2/S1/page 6/ll. 27-28, E5/T1/S1/page 2 and E5/T1/S2/Appendix 5-1

In Appendix 5-1, Horizon provides a copy of the Promissory Note dated February 28, 2005 due to Hamilton Utilities Corporation ("HUC"). This Promissory Note attracts a rate of 7.0% on a principal of $116 million and matures on July 30, 2012. This Promissory Note was considered in Horizon's 2008 Cost of Service application under File No. EB-2007-0697, and the Board determined that a debt rate of 6.1% would be allowed for this debt based on the timing and Board's policy and practice on cost of capital, based on market conditions and the timing of the 2005 updated note.

In its application, Horizon states: "Horizon Utilities requests a debt rate of 6.1% with respect to the $116MM HUC Note. Such rate was approved for such note in the 2008 EDR COS Application Decision. There have been no changes to the terms of such note since such decision."

Question 3 a

Please confirm whether Horizon is paying interest to HUC on the rate of 7.0% as documented in the executed Promissory Note.

Response:

Horizon Utilities confirms that it is paying interest to HUC at a rate of 7.0% as documented in the executed Promissory Note.

Question 3 b

Please confirm that Horizon's distribution rates as approved by the Board in the application considered under File No. EB-2007-0697 and in distribution rates subsequently approved through IRM rate adjustments for 2009 and 2010 would reflect recovery of interest on the $116MM Promissory Note at a rate of 6.1%.

Response:

Horizon Utilities confirms that its distribution rates as approved reflect recovery of interest on the $116MM Promissory Note at a rate of 6.1%.

Question 3 c

Please confirm whether or not Horizon earns a lower net income and hence return on equity as a result of Horizon paying interest on the Promissory Note at a rate of 7.0%, higher than the 6.1% approved by the Board for recovery in Horizon Utilities' revenue requirement. Please explain your response.

Response:

The payment of interest at a rate of 7% on the Promissory Note versus the 6.1% approved by the Board results in lower actual net income and therefore a lower actual ROE, when ROE is computed on a simple accounting basis by taking the quotient of actual net income and actual shareholders equity. However, as noted in response to VECC IR #1(b-c), the ROE figures computed for 2008, 2009 and 2010 are based on adjustments provided and described in those responses. Such adjustments provide an adjusted ROE based on actual performance that is more directly comparable with results that would be expected under Board rate-making policy.

Question 3 d

If possible, please estimate the impact that paying a 7.0% interest rate on the $116M Promissory Note rather than the 6.1% allowed for rate-setting would have on the actual ROEs of 7.2% in 2008, 6.6% in 2009 and forecasted to be 5.9% in 2010.

Response:

The ROEs provided in the question are computed on the basis provided in response to VECC IR#1 (b-c) and reflect interest expense on the $116MM Promissory Note at a rate of 6.1%. The impact to such ROEs of an interest rate of 7.0% on the $116MM Promissory Note would be a further reduction of approximately 0.5% in each year

Question 4

Reference: E1/T2/S1 and the Board's Decision on Hydro Ottawa Limited's 2011 Cost of Service Application (Board File No. EB-2010-0133)

On October 27, 2010, the Board issued its Decision on the Preliminary Issue of early rebasing with respect to Hydro Ottawa Limited's 2011 Cost of Service application, considered under File No. EB-2010-0133. In that Decision, the Board discussed the evidence and its findings on specific issues and criteria that would justify a distributor filing for early rebasing in reference to the Board's letter of April 20, 2010.

In E1/T2/S1 of Horizon's current cost of service application, and specifically on pages 6 and 7, Horizon lists in some detail four criteria in support of its proposed early rebasing.

Question 4 a

With reference to the Board's Findings documented on pages 9-11 of the Hydro Ottawa Decision, please identify how the criteria documented in E1/T2/S1 (and in any other areas of Horizon's application) justify an early rebasing.

Response:

In its Decision on Hydro Ottawa's application for an early rebasing, the Board organized its comments and findings under the following sections: i) the Incentive Rate Mechanism ("IRM") Policy Framework; ii) the Implementation of Board Policy Determinants; and iii) Hydro Ottawa's specific circumstances.

The Board addressed these three areas in its Decision. Horizon Utilities submits that its Application is justified in the context of these three criteria as follows.

- IRM

The Board has indicated its expectation that LDCs "manage" resources in the context of the IRM unless circumstances would cause it to request the off-ramp relief. Such off-ramp is the ROE dead band of +/- 300 basis points. Horizon Utilities has not and does not anticipate earning the allowable ROE of 9.85%, the current fair return standard, as updated by the OEB in February 2010, or the present ROE of 8.57% underlying its current rates. Horizon Utilities calendar year adjusted return on equity related to regulated investments was 7.2% in 2008; 6.6% in 2009 and the revised forecast for 2010 is 7.2%[1]. The estimate of deemed ROE for the 2011 Test Year is 2%[2]. Horizon Utilities does not meet the off-ramp for its 2010 Bridge Year but it certainly meets the off-ramp for its 2011 Test Year. Further, in the Hydro Ottawa Decision, the Board specifically evaluated Hydro Ottawa's projected ROE for 2011, in consideration of whether Hydro Ottawa would, based on such projection or the adjusted projection provided by Energy Probe, approach the off-ramp. As stated above, Horizon Utilities not only satisfies the off-ramp of 300 basis points at the current fair return standard but it also satisfies such "as measured against the Board approved return on equity of 8.57% included in 2008 rates." Such is submitted as justification for the "need to terminate the IRM plan early". (Hydro Ottawa Decision, Page 11). Further, Horizon Utilities submits that while it may not have exceeded the 300 basis point deadband every year since its last rebasing, the cumulative impact of an ROE that is significantly below the current deemed 8.57% ROE underlying Horizon Utilities' rates or the current fair return standard of 9.85% is detrimental to the LDC.

IRM provides for an annual off-ramp test as a benchmark of financial impairment in any IRM year. However, IRM does not provide any test or guidance on cumulative impairment across more than one IRM year. Horizon Utilities has experienced a cumulative financial impairment that is material in each of 2008 through 2010, but would not meet the off-ramp test in any of those years. The deferrals of expenditures in those years must be addressed along with growing capital and operating requirements as provided in the Application. In the absence of the rebasing application, there is no practical scenario for Horizon Utilities that would result in an ROE that is not 300bps less than its current 8.57% ROE underlying its rates or the 9.85% ROE based on the fair return standard.

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[1] This revised ROE was provided as part of Horizon Utilities' response to Board staff interrogatory 1d).

[2] Computation of the 2011 ROE of 2% is provided in Horizon Utilities' response to VECC interrogatory 1e).

Horizon Utilities submits that the cumulative material adverse impacts noted above across 2008 to 2010 in combination with a forecast 2011 ROE below its current ROE of 8.57% and the fair return standard of 9.85% justifies the need, from a financial perspective, to terminate the IRM plan early

- Implementation of Board Policy Determinants

Hydro Ottawa had specified eight reasons for having advanced its Cost of Service Application. In its Decision, the Board states that four of these eight reasons are related to the implementation of Board policy determinants including: i) the new fair return standard as outlined in the December 11, 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*; ii) the alignment of rate year with fiscal year; iii) Green Energy Act Plan; and, iv) disposition of deferral and variance accounts.

In submitting this Cost of Service Application, Horizon Utilities has not emphasized the early implementation of Board Policy Determinants. Horizon Utilities has emphasized issues with respect to load not materializing and to the impact of such on distribution revenue and the resulting need to defer capital and OM&A expenditures, in a balanced manner, since 2008. Such issues underlie the need for this Cost of Service Application, as elaborated further in this response.

Further, Horizon Utilities has not cited the clearance of deferral and variance accounts or conservation and demand management ("CDM") as drivers for the Application. In fact, Horizon Utilities was recently ordered to clear its Group 1 accounts (as part of EB-2009-0228), with a credit of approximately $19MM being dispersed to customers over a two year period commencing May 1, 2010. The clearance of these credit balances further reduces cash flow during a period where ROEs remain well below the fair return standard of 9.85%.

- LDC-specific Circumstances

Hydro Ottawa had cited implementation of its asset management plan and workforce planning strategy as the LDC-specific issues that needed to be addressed through its Application. The Board found that it expected [Hydro Ottawa] "to accommodate those requirements"…"within the IRM framework." (Hydro Ottawa Decision, EB-2010-0133, Page 11).

Horizon Utilities' circumstances for this Cost of Service Application are unique and represent an urgent need about which it has been communicating to the Board since December 2008. In Exhibit 1, Tab 2, Schedule 1, Appendix 1-7 and Appendix 1-8, Horizon Utilities submitted its December 23, 2008 correspondence to the Board in respect of its loss of load and revenue volatility and the need to address such loss. Further, on September 3, 2009, Horizon Utilities filed its Z-factor Application (EB-2009-0332) for approval of the recovery of certain amounts related to an unforeseen loss of revenue related to a specific large use customer.

In its Application, Horizon Utilities expressed an urgent need for rebasing in 2011 due to at least four pressures, as follows:

1. Material and persisting shortfalls in revenue, principally related to a decline in consumption in the Large Use and General Service classes.
    - Horizon Utilities submitted in Exhibit 3, Tab 1, Schedule 3, Page 3 of 4 that "Demand for General Service >50 kW and Large Use customers in 2009 was lower than the Board Approved Load Forecast by 15.8%. Horizon Utilities' commercial and industrial customers account for approximately 30% of its Operating Revenues. The decline in demand for the Large Use customer class was detailed on page 5 of the Manager's Summary of Horizon Utilities Z-factor application (EB-2009-0332); "For the fourteen month period from May 2008 to June 2009, Horizon Utilities' distribution revenue, from its Large Use class, has decreased by a total of $1,823,474 …" In response to Board staff Interrogatory 3 in the Z-factor Application proceeding, Horizon Utilities

produced a table detailing its Large Use class consumption by customer from January 2006 to October 2009 which further evidenced the loss of load experienced by Horizon Utilities in 2009."

  - Such unanticipated load and revenue volatility persists today with further losses expected among the commercial and Large Use customer classes due to recent press announcements. Such circumstance is elaborated in Horizon Utilities' response to Energy Probe Interrogatory 1a.
  - At Page 5 of its Decision on Horizon Utilities' Z-factor application (EB-2009-0332), with respect to the consequences of declining demand for the Large Use customer class, the Board wrote: "*The Board has concluded that the application should not be granted, and that the appropriate venue for seeking relief is a full cost of service application*."

2. A requirement to address deferrals as a result of 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 lives.

  - In Exhibit 4, Tab 1, Schedule 1, Page 1 of 4, Horizon Utilities submitted that it has "maintained a stable level of Operations, Maintenance, and Administration ("OM&A") costs from 2008 to 2010 due to cost deferral efforts in response to material distribution revenue shortfalls. Such cost deferrals were undertaken with due consideration for risks to the distribution network, employee and public safety, and customer service delivery. This application shows that in 2011, the utility has an immediate requirement to increase OM&A spending in order to sustain its operations."
  - Further, Horizon Utilities submitted its Asset Management Plan and related studies as Appendix 2-1 in Exhibit 2, Tab 3, Schedule 2 of the Application related to capital expenditures necessary to modernize the distribution system to address aging infrastructure and maintain the adequacy, reliability, and

quality of electricity distribution service to Horizon Utilities' customers.

Horizon Utilities provides the following evidence as filed in its Application at:

- Exhibit 2, Tab 1, Schedule 3, Page 4 of 23, Line 3 *While Horizon Utilities has maintained high standards to date with respect to its reliability indices, there is a significant risk to system reliability and quality of service if the level of investment sought in this application for the distribution system is not undertaken in 2011 and beyond. There is a sizeable risk of increased outages and reactive capital expenditures (which are three times more expensive than planned expenditures) if steps are not taken immediately to increase Horizon Utilities' investments in replacement of aged infrastructure. In the past three years, Horizon Utilities has experienced five substation transformer failures on its 4kV and 8kV system in comparison to one in 2007. Failures of these critical infrastructure points affect a large numbers of customers for prolonged periods. Horizon Utilities' Substation Asset Condition Assessment ("SACA") is filed as Appendix F to the AMP, which identifies two principal contributors to those failures: i) the age of equipment is nearing or past end of life; and ii) the health of these assets varies from good to extremely poor condition. System renewal, voltage conversion and replacement of end of life assets are critical to the continued delivery of reliable electricity service to Horizon Utilities' customers. In consideration of the rapid escalation of failures from 2008 to 2010, it is critical to begin this increased investment as soon as possible in order to avoid further deterioration of system reliability.*
- Exhibit 2, Tab 1, Schedule 3, Page 14 of 23, Line 5 *Since 2009, Horizon Utilities has completed various assessments and studies, as outlined in the AMP in Exhibit 2, Tab 3, Schedule 2, Appendix 2-1. Such assessments and studies have refined Horizon Utilities' system investment outlook. It is clear from these reports that the average age of distribution assets in Horizon Utilities' service territory is a significant risk to maintaining system reliability. As an example, 72% of substation transformers are 40 years of age or older and beyond useful life. In the case of circuit breakers, 82% are 35 years of age or older and beyond useful life, and 40% of substation switchgear is 50 years or older and beyond useful life. Based on additional studies, Horizon Utilities has continued to focus on advancing its AMP by completing: load forecasts at a feeder and station level, detailed security and capacity analysis on those feeders, and a substation asset condition assessment. This new information is used to support ongoing capital expenditure forecasts.*

- The justifications for making investments in 2011 and addressing the aforementioned deferrals are as risk mitigation measures to address business continuity requirements associated with renewal of assets that have reached their end of life or are no longer suitable as a result of changes to or growth in the business process.

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

    - Workforce planning is a key area of focus for Horizon Utilities, as it is for the entire electricity sector. Employee demographics within Horizon Utilities and the broader electricity sector demonstrate an accelerated pace of retirements over the next decade. In order to provide for a sustainable electricity distribution utility, Horizon Utilities must address such circumstance with a measured and timed workforce renewal plan. The largest driver of this workforce planning need is the required capital spending in Horizon Utilities' program. As Horizon Utilities submitted at Exhibit 4, Tab 1, Schedule 1, Page 3 of 4, thirteen of the twenty-six planned new trade hires are directly related to planned capital investments. Horizon Utilities submitted further detail on its Workforce Labour Strategy and Plan ("WLSP") in Exhibit 4, Tab 2, Schedule 10, Appendix 4-1.

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 maintain the distribution system on a sustainable basis.

Horizon Utilities made efforts to have its particular circumstances addressed even before the Board issued its Cost of Capital report. As stated elsewhere, while the Z-factor application which was used to address item 1 was rejected, the Board stated at Page 16 of the decision that it "believes that the most appropriate approach for a distributor to take under such circumstances is to file a cost of service application." The recognition of the need for a reasonable rate of return was not a driver in making this Application but instead is one of the normal results that are an integral outcome from a comprehensive cost of service application.

Horizon Utilities has an urgent need for capital expenditures to replace assets that are beyond their useful lives or are no longer able to support current business practices. As noted earlier in this response, Horizon Utilities has experienced revenue shortfalls since its last Cost of Service Application in 2008. While Horizon Utilities attempted to address such revenue and load volatility through the Z-factor Application, such was rejected; the Board indicated that the manner in which to address this issue was a Cost of Service Application.

Horizon Utilities' total 2011 net capital expenditures are $43,992,099 (Exhibit 2, Tab 2, Schedule 2, Page 5). Horizon Utilities' materiality threshold for the 3rd GIRM capital module is $44,027,009, and accordingly, the ICM threshold is not met. However, this is not an ICM application. The IRM and the ICM assume that revenues remain essentially as projected in the last Board-approved Cost of Service Application, and that a distributor is missing only the revenue requirement associated with a significant increase in capital spending. Such is clearly not the case for Horizon Utilities. Horizon Utilities' need for increased capital spending, as supported in its Application, is only one of several critical factors contributing to the need for early rebasing.

Horizon Utilities submits that it has experienced a material decline in expected cash flow as a result of the decline in distribution revenue since its last rebasing. In order to prudently manage its operations, Horizon Utilities has been deferring both capital and OM&A expenditures since 2009 to partially mitigate the impact on the overall levels of cash. Horizon Utilities has managed its capital program in an efficient manner but, as is indicated in the Application, such deferrals of capital expenditures cannot and should not continue.

Horizon Utilities submits that for the aforementioned reasons, as well as those set out in the Application, its specific circumstances are such that it is not able to provide for the necessary investment requirements outlined in the Application in 2011 if it remains on IRM.

Question 4 b

Please identify any aspects of the Board’s Decision with respect to Horizon’s Z-Factor application dealt with under File No. EB-2009-0332, and of subsequent load reductions or growth, that would support an early rebasing application

Response:

This response is being filed separately. A portion of the public version of the response has been redacted for the reasons set out in the cover letter to these responses.

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