EB-2010-0131

Ontario Energy Board

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

AND IN THE MATTER OF an application by Horizon Utilities Corporation for an order approving just and reasonable rates and other charges for electricity distribution to be effective January 1, 2011.

SUBMISSIONS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")
ON PRELIMINARY ISSUE

November 23, 2010

A – INTRODUCTION

The Ontario Energy Board (the "Board") issued Procedural Order No. 1 on October 21, 2010 in relation to the cost of service rebasing application of Horizon Utilities Corporation ("Horizon"). This procedural order noted that in a letter sent to distributors dated April 20, 2010 (the "Letter"), the Board indicated that a distributor filing a cost of service application, if it was not on the list attached to the Letter, must demonstrate that it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period, and as such, is applying for early rebasing.

The Letter further indicated that the Board may determine, as a preliminary matter or issue, whether the application is justified, and if not justified, that it may disallow some or all of the costs associated with the preparation and hearing of the application.

In Procedural Order No. 1, the Board determined that it would consider Horizon's application for early rebasing foe 2011 distribution rates (the "Preliminary Issue") in advance of further procedural steps with respect to the current application.

Board Staff and intervenors filed interrogatories on the Preliminary Issue on October 28, 2010. On November 3, 2010, Horizon filed a letter advising that it would be unable to provide responses to the interrogatories until November 8, 2010. In Procedural Order No. 2 dated November 4, 2010 the Board approved this request indicated that written submissions from Board staff and intervenors should be filed on or before November 18, 2010.

This is the submission of the Energy Probe Research Foundation ("Energy Probe") on the Preliminary Issue.

B - REPORTS OF THE BOARD ON 3RD GENERATION INCENTIVE REGULATION FOR ONTATRIO'S ELECTRICITY DISTRIBUTORS

The July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors was the result of consultations that

> *"considered all of the necessary elements of an IR mechanism framework including the form and term of the plan, the inflation and productivity factors, the potential for earnings sharing, and the treatment of unforeseen events. The consultations also included a focus on specific issues associated with capital investment to support infrastructure maintenance and development, lost revenue due to changes in electricity consumption and distributor diversity."* (page 2)

The elements of the plan, as set out in the Report of the Board that are relevant to the current application by Horizon include the term of the plan, off-ramps and the stretch factor included in the X-factor.

With regards to the term of the IR plan, the Board determined that the plan term for the 3rd Generation IR would be fixed at three years (i.e. rebasing year plus three years). The Board further stated that:

> *"The rates of the distributor are not expected to be subject to rebasing before the end of the plan term other than through an eligible off-ramp."* (page 7)

The Board`s policy with respect to off-ramps is that the 3rd Generation IR plan would include a trigger mechanism with an annual ROE dead band of +/- 300 basis points. In particular, when a distributor performs outside of this earnings dead band, a regulatory review may be initiated.

Specifically, the Board determined that a distributor would be required to make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements in the event that the distributor falls short of or exceeds its ROE by 300 basis points. This report would be reviewed to determine if further action by the Board would be warranted. Any such review could result in modifications to the IR plan, a termination of the IR plan, or the continuation of the IR plan. The Board indicated that this was to be an early warning mechanism rather than necessarily terminating the IR plan.

In the September 17, 2008 Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors the Board noted that stretch factors are consumer benefits and that they are somewhat analogous to earnings sharing mechanisms (pages 19-20). The Board set stretch factors of 0.2%, 0.4% and 0.6% for Group I, II and III distributors, respectively. The definition of these groups of distributors was based on benchmarking evaluations.

C - JUSTIFICATION FOR A COST OF SERVICE REBASING APPLICATION

The Board had made its expectations clear in both the April 20th Letter and the EB-2010-0133 Decision dated October 27, 2010 in the matter of an application by Hydro Ottawa Limited regarding the nature of the justification needed to support an early application for rebasing. In particular, the Board stated at page 10 of the EB-2010-0133 Decision that:

> *"The only issue for the Board to determine is whether Hydro Ottawa was justified in coming forward with a cost of service application for rate-setting and terminating its participation in the IRM framework 16 months early. This issue is an important aspect of the Board's IRM policy framework. The multi-year approach contains various trade-offs, and balances a variety of ratepayer and utility concerns. As with all its policies, the Board will consider alternative approaches, but these alternatives must be justified. In this case, the Board has made its expectations clear in the April 20th letter regarding the nature of the justification needed to support an early application for rebasing."*

In its pre-filed evidence, at Exhibit 1, Tab 2, Schedule 1, pages 6 though 10, Horizon provides its justification for the need for its cost of service application. Horizon provides four reasons for coming forward with cost of service application for rate-setting and terminating its participation in the IRM framework 16 months early.

It is the submission of Energy Probe that Horizon has failed to justify the need for a 2011 cost of service methodology application for rates.

D - FAILURE TO JUSTIFY

Energy Probe submits that the early rebasing application by Horizon should be denied by the Board based on the following submissions:

a) Off-Ramp

As noted above in section B above, the Board policy is that the 3rd Generation IR plan would be fixed at a rebasing year, followed by three years under the IR price cap mechanism. The Board policy is also cleared stated in that the rates of the distributor would not be expected to be subject to rebasing before the end of the plan other than through an eligible off-ramp. The only off-ramp identified in the Report of the Board occurs when a distributor performs outside of the earnings dead band of +/- 300 basis points.

Horizon had its rates determined based on a cost of service application (EB-2007-0697) for the 2008 test year. As a result, the IR plan would include the setting of rates based on the price cap for 2009, 2010 and 2011. Horizon is attempting to rebase one year earlier (and with a change in the rate year) than would be the case under the Board's policy.

The Board approved return on equity included in the 2008 rates was 8.57% (Energy Probe Interrogatory #5c). Horizon has confirmed that it did not meet the condition of an off-ramp in 2008 or 2009. The ROE recorded in 2008 was 7.2% (Exhibit 1, Tab 2, Schedule 1, page 6) and the corrected ROE for 2009 was 6.4% (VECC Interrogatory #1c). Both of these returns are well above the 5.57% ROE floor based on a 300 basis point range around the 8.57% embedded in rates.

Moreover, Horizon is not projecting that it would trigger an off-ramp based on the latest 2010 bridge year financial projections. These financial projections are based on 9 months of actual data. The estimated ROE for 2010 is 7.2% (Board Staff Interrogatory #1d). This interrogatory response also indicates that through the first nine months of the bridge year, the estimated annualized ROE for 2010 is 7.9%. Both of these figures are in stark contrast to the 5.9% forecast in the evidence at line 28 of Exhibit 1, Tab 2, Schedule 1, page 6. This increase in the return on equity is driven by a reduction in OM&A costs of $1.6 million, a reduction in depreciation expense of $0.3 million and a reduction in interest costs of $0.9 million. These differences can be seen by comparing the responses to Board Staff Interrogatory #1c and #1d. As can also be seen in those responses, no change has been made to the projected regulated rate base figure.

Over the 2008 through 2010 period, the average ROE earned and projected to be earned by Horizon is an average of 6.93% (7.2% in 2008, 6.4% in 2009 and 7.2% in 2010). If the figure of 7.9% is used for the 2010 bridge year, this average increases to nearly 7.2%. In either case, the return on equity is still in excess of the floor of 5.57% based on the Board approved return on equity of 8.57% included in 2008 rates less the 300 basis points needed for an off ramp.

In summary, Energy Probe submits that no off-ramp has or will be triggered based on 2008 and 2009 actual results and projected 2010 results that include 9 months of actual data.

b) Return on Equity for 2011 Test Year

Horizon has placed significant importance on the projected return on equity for the 2011 test year in its justification of the need for the early rebasing application. Horizon has estimated that the its adjusted rate of return on equity would be between 2% and 5% (VECC Interrogatory #1e).

Energy Probe submits that the Board should not give any weight to these forecasts for the return on equity for the 2011 test year in determining whether Horizon should be allowed to rebase 16 months early for the following reasons.

First, as noted in section B above, the Board policy includes a trigger mechanism with an annual ROE dead band of +/- 300 basis points. By relying heavily on the forecasted ROE for 2011, Horizon appears to imply that an early rebasing application can be triggered by a forecast that the return on equity will fall outside of the 300 basis points range around the Board approved ROE. Energy Probe respectfully disagrees.

At pages 38 and 39 of the July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, the Board states that *"When a distributor performs outside of this earnings dead band, a regulatory review may be initiated."* Energy Probe submits that this clearly refers to an historical performance and not to a future performance.

In the Report the Board then goes on to state that:

> *"In support of this approach, a distributor will be required make a report to the Board no later than 60 days after the company's receipt of its annual audited financial statements, in the event that the distributor falls short of or exceeds its ROE by 300 basis points. The report will be reviewed to determine if further action by the Board is warranted. Any such review would be prospective and could result in modifications to the IR plan, a termination of the IR plan or the continuation of the IR plan."*

This statement clearly supports the Energy Probe submission that the trigger event is based on historical results and not on forecasted results. The Board unmistakably states that it will determine if further action is warranted based on a report to the Board from a distributor that is based on its annual audited financial statements.

In further support of its position, Energy Probe notes that if the review could be triggered by forecasted results for the potential test year, then the Board would need to require all distributors currently under 3rd GIRM and not filing a cost of service application to file a detailed forecast for the potential test year to see if they are projected to exceed 300 basis points above the Board approved return on equity. In essence, all of the distributors not filing a cost of service application would have to file a cost of service level of detail for the potential test year so the Board and intervenors could determine if the projected ROE triggered a review. Clearly this is not intention of the trigger mechanism under the Board policy.

The second reason, in the view of Energy Probe, that the Board should not give any weight to the forecasted return on equity for the 2011 test year in determining whether Horizon should be allowed to rebase 16 months is related to the fact that the Board has evidence before it of the inaccuracy of the 2010 bridge year forecast filed as part of the application.

The return on equity based on the 2010 bridge year as filed was forecast to be 5.9% (Board Staff Interrogatory #1c). Based on 9 months of actual data and projections for the remainder 3 months of the year, the return on equity is now forecast to be 7.2% (Board Staff Interrogatory #1d). This increase is a result of a 22.4% increase in the adjusted regulatory net income, which in turn is the result of lower OM&A expenditures, lower depreciation costs and lower interest costs than originally forecast, partially offset by the related increase in income taxes. This drove the return on equity estimate from 5.9% to 7.2%, under the assumption of no change in rate base from that originally forecast.

In light of the significant change in the bridge year forecast, Energy Probe submits that the parties should have no confidence in the test year forecast, which would be subject to even more volatility because it is a forecast for a further year in the future than is the bridge year forecast included in the evidence.

c) Term Reduction - Loss of Consumer Benefits

As noted earlier in these submissions, the Board included a stretch factor into the X-factor portion of the price cap under the 3rd generation IR plan. This stretch factor was characterized as consumer benefits. By arbitrarily shortening the term of the IR plan under the price cap/productivity/stretch factor methodology from 3 years to 20 months, Horizon is effectively denying the full consumer benefits that would accrue to consumers if the Board's policy with respect to the term in the absence of an off-ramp is not followed.

Energy Probe notes that Horizon is in the Group II of distributors that represent distributors that are in the middle two quartiles on OM&A unit cost comparison and have been assigned a stretch factor of 0.4%.

d) Not Comparable to THESL and Hydro One Distribution

In its evidence at Exhibit A1, Tab 2, Schedule 1, page 10, Horizon brings up the situation of Toronto Hydro Electric System Limited ("THESL") and Hydro One Distribution. Horizon attempts to cast itself in the same light as THESL and Hydro One and notes that the Board did not require either of these distributors to meet the standard for early rebasing.

Energy Probe notes that the Board dealt with this argument in the EB-2010-0133 Decision for Hydro Ottawa. At page 10 of that Decision, the Board noted that *"the circumstances are different in the case of Hydro Ottawa* ***and all other distributors*** *seeking early rebasing this year"*. (emphasis added)

Energy Probe submits that the same circumstances apply to Horizon as the Board found apply to Hydro Ottawa.

e) Z-Factor Decision (EB-2009-0332)

Horizon has submitted that there are specific aspects of the Board's March 24th, 2010 Z-factor Decision that support an early rebasing. Energy Probe respectfully disagrees.

The Board did not grant the Z-factor relief sought by Horizon in the EB-23009-0332 application to recover a revenue deficiency related to significant reduction in electricity consumption by the Subject Customer. The Board indicated that Horizon had not demonstrated that a Z-factor event has occurred.

At page 5 of the EB-2009-0332 Decision the Board stated that the appropriate venue for seeking relief (for the lost revenue) is a full cost of service application. It did not, however, indicate that the lost revenue was, by itself, a sufficient reason for an early rebasing application. Indeed, the loss of revenue is factored into the trigger mechanism as part of the Board policy with respect to IRM. The loss of revenue from the Subject Customer has not resulted in the trigger being pulled in 2008, 2009 or 2010.

At page 10 of the EB-2009-0332 Decision the Board noted that Mr. Basilio (CFO for Horizon) testified that Horizon planned to deal with any long-term effects of these losses through the filing of a cost of service application later this year. The Board did not direct Horizon to file an early rebasing application, nor did it approve the filing of an early rebasing application.

Due to the timing of the EB-2009-0332 proceeding, the Board did not have access to the final financial results for the 2009 year, nor did it have any preliminary financial results for 2010. In other words, the Board did not know whether or not the loss in revenue and the resulting actions taken by Horizon to reduce costs, would result in a return on equity in either 2009 or 2010 that may trigger the off ramp. Parties are now aware that the off ramp was not triggered based on the 2009 financial results and it will not be triggered based on the 2010 financial results before the Board which includes 9 months of actual data.

Finally, at page 16 of the EB-2009-0332 Decision the Board stated:

> *"In making these findings, the Board is mindful of the need to provide guidance to distributors as to the appropriate approach to take when confronted with such revenue losses. The Board notes the importance of assessing the actions taken by a distributor to deal with customer load loss in the context of their overall impact on the utility, including the overall financial impacts on the utility. The Board believes that the most appropriate approach for a distributor to take under such circumstances is to file a cost of service application. A distributor could also bring forward a request for*

> *special treatment of such losses within the context of the overall cost of service application."*

The Board indicates that the most appropriate approach for a distributor to take in dealing with the customer load loss, including the overall financial impacts on the utility is to file a cost of service application. Energy Probe submits that these comments cannot be taken in isolation from the Board's policy with regard to the IRM off ramp.

If the customer load loss resulted in a return on equity that was outside of the 300 basis point range, then the review mechanism is triggered and a cost of service application may be an appropriate approach.

However, in the current circumstances, Horizon has not triggered the review mechanism because the return on equity for 2008, 2009 and the projection based on 9 months of actual data for 201 is not below the bottom of the 300 basis point range around the approved ROE. The Board's comments in the EB-2009-0332 Decision must be taken in the context of the existing Board policy. If the customer load loss triggers a review, a cost of service application may be appropriate. However, if the customer load loss does not trigger a review, then early rebasing is not appropriate.

Energy Probe notes that a customer load loss is not the only factor that could result in a return on equity sufficiently low to trigger the review. Any factor, or combination of factors, that impact the financial results to a sufficient degree could result in a review. As noted elsewhere in this submission, this has not happened in the case of Horizon.

Energy Probe further submits that the loss of load from one large customer is not sufficient to trigger a review. The Standard and Poor's rating report dated July 8, 2010 found at Appendix 1-14 to Exhibit 1, Tab 3, Schedule 4 appears to support this view. At page 3 of the report, Standard and Poor's states that *"Net distribution revenues are not exposed to any single industrial customer sufficient to cause a rating concern in our view. The bulk of the about 235,000 customer base is residential."*

The Board never indicated in the EB-2009-0332 Decision that Horizon should be entitled to file an <u>early</u> rebasing cost of service application. The Decision never stated that Horizon was eligible to file an early rebasing application if it did not trigger the off ramp provision just because it had lost some load. The Decision never gave any indication that the Board's policy with respect to 3rd GIRM was not applicable to Horizon.

<u>f) Horizon Justifications</u>

In its evidence dated August 26, 2010, Horizon lists 4 pressures that it is facing as justifying its need for filing and advanced cost of service application. Energy Probe provides submissions on each of these considerations below.

> *1. Material and persisting shortfalls in revenue, relative to its Board approved Base Revenue Requirement, which is adversely affecting its ability to finance required business investments. Such shortfall is principally related to a decline in consumption in the larger General Service classes. Horizon Utilities proposes to address the risks underlying such material shortfalls through its proposals in this Application.*

Material and persisting shortfalls in revenue are only one part of the financial performance of a distributor and should not be viewed in isolation. Indeed, this is why the Board set an earnings dead band around the approved return on equity as the trigger mechanism for an off ramp. The Board acknowledged the uncertainty associated with various components of an IRM plan. The return on equity provides a comprehensive view of the results of the IRM plan.

If a distributor is entitled to terminate its IRM plan 16 months early, as proposed by Horizon, because of lost revenues relative to a Board approved forecast, whether those loses be from a single large customer, the larger General Service rate classes, or across the board due to an economic recession and still earn a return on equity with the dead band established by the Board, then it is submitted that the level of its business risk is significantly reduced. In these circumstances the return on equity should also be reduced to reflect the reduction in business risk.

Horizon is essentially requesting that ratepayers be required to compensate it for a certain level of business risk through the return on equity and then a second time because some of those risks materialized in the form of reduced revenues from that forecast. Energy Probe submits that this is not appropriate.

In its most basic level, Horizon is asking the Board to allow it to rebase 16 months early in a 3 year IRM plan because some of its revenue forecasts are not coming true. Energy Probe submits that a distributor bears the risks associated with its load forecast and earns a return on equity for having taken on that risk.

By using the lost revenues as a justification for an early rebasing application, Horizon is effectively trying to reduce its risks while still being compensated through the return on equity as if they still have those risks.

The Board's July 14th 2008 Report sets out its expectation of distributors with respect to rebasing and defines the conditions for off ramp applications. The Board policy clearly set the limits for over earning and under earning in which it expected the distributors to operate within.

The limits set by the Board were +/- 300 basis points around the Board approved return on equity, which as noted above, is a comprehensive view of the performance of the distributor under IRM. Horizon continues to operate well within the range set by the Board policy. Energy Probe submits that the loss in revenue is not sufficient justification to terminate the IRM plan.

> *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 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 studies and reports.*

Horizon forecast the need for net capital expenditures of just under $44 million in 2011 (Energy Probe Interrogatory #9a). While this amount is higher than the 2008 through 2010 figures, it is not significantly more. Horizon calculated the materiality threshold for using the incremental capital module available to it under 3rd GIRM (Energy Probe Interrogatory #9c). The threshold was calculated to be just over $44 million. In other words, the forecasted capital expenditures in 2011 would not qualify for recovery through the incremental capital module. Energy Probe submits that this is evidence that the forecast level of expenditures is not outside of the range of capital expenditures that could and should be handled under the IRM mechanism.

Horizon refers to its asset management plan, upon which it has based its capital and maintenance requirements. In the EB-2010-0133 Decision for Hydro Ottawa, the Board indicated that there was no reason why Hydro Ottawa could not implement its asset management plan now, within the IRM plan period (page 11). The Board further stated that asset management is an ongoing issue for distributors and the company should be able to accommodate this requirement, and indeed is expected to do so, within the IRM framework. Energy Probe submits that the same should hold true for Horizon.

> *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. There is a continuous need to address an aging workforce and significant imminent retirements with advanced and accelerated hiring practice. Such is crucial to sustain electricity distribution operations and support the increased investment requirements noted in item 1. Additionally, such is required to mitigate increasing risks related to severe and more frequent service interruption and ensure public and employee safety.*

The workforce requirements are not unique to Horizon and do not provide any justification for a cost of service rebasing application one year ahead of schedule. Indeed, given that the workforce requirements are a long-term issue, it is hard to see how coming forward one year in advance of the scheduled rebasing application would have any significant impact on the distributor.

Energy Probe submits that there is no reason why Horizon cannot implement its workforce planning strategy now, within the IRM plan period. Workforce planning is an ongoing issue for distributors and the company should be able to accommodate that requirement and should be expected to do so within the IRM framework. This was the conclusion of the Board in EB-2010-0133 (page 11).

> *4. A requirement for a reasonable rate of return on regulated investments in order to provide necessary and stable cashflow to support the delivery of customer service and the distribution system on a sustainable basis in a manner that protects public and employee safety. The calendar year adjusted return on equity related to regulated investments has been 7.2% in 2008; 6.6% in 2009; and is forecast at 5.9% for 2010. Such return in 2010 is 2.7% below the regulated rate of return underlying Horizon Utilities' 2008 Board approved COS application and 3.9% below the current regulated rate of return for 2010 COS applications. Without the relief requested, Horizon Utilities estimates its adjusted return on regulated investments for 2011 between 2.0% and 5.0%, depending on the extent to which it can continue to defer*

> *costs and absorb inflation, without creating undue risk to its distribution system and customer service delivery. Such levels of return on investment will not support the amount of investment and OM&A costs required to sustain the electricity distribution infrastructure, underlying systems and processes, and customer service delivery in a manner consistent with good and safe utility practice.*

Energy Probe submits that the desire to apply the Board's current return on equity policy is not a sufficient justification to proceed with an early cost of service application. This was the Board's finding in the EB-2010-0133 proceeding (page 11). In particular, the Board stated that its policies are clear that the current return on equity policy is to be adopted in the contest of a cost of service application, but the policy itself is not a reason to advance a cost of service application.

Horizon indicates that a stable cashflow is required to support customer service and the distribution system on a sustainable basis. Horizon has not provided any evidence that it has any cashflow problems. In the response to Energy Probe Interrogatory #1c, Horizon states that it has not experienced any significant issues related to its cash flow in 2008 through to the present time. Similarly, in the response to Energy Probe Interrogatory #1b, Horizon indicates that it has not been unable to obtain the necessary financing required to fund business investments in 2008 through to the present time.

Further, as shown in the Standard & Poor's ratings report attached as Appendix 1-14 of Exhibit 1, Tab 3, Schedule 4 dated July 8, 2010 for the parent company of Horizon, Horizon Holdings Inc., the corporate credit rating is A/Stable. A credit rating of A/Stable or A+/Stable has been maintained by Horizon Holdings, or its predecessor Hamilton Utilities Corporation, from 2006 through 2010 (VECC Interrogatory #2a). The credit rating in 2010 is the same as it was in 2006 and is only marginally below the A+/Stable rating in 2008 when Horizon underwent it last cost of service rates application. Clearly over this period the parent company has not experienced any financial difficulties.

Horizon Utilities is the main asset owned by Horizon Holdings so it is reasonable to assume that the credit rating for the regulated distributor is as good as or better than that of the parent which includes riskier unregulated enterprises.

Horizon Utilities has also not had any significant financial difficulties over the 2008 through to the present time. As shown in Table 2 of the response to VECC Interrogatory #3a, the distributor has continued to pay a consistent level of dividends. In fact, the high dividend payment took place in respect of fiscal 2008 at more than $9 million. The dividend amount of $3 million shown for 2010 reflects Dividend Policy of Horizon Utilities as shown as Appendix 1 to VECC Interrogatory #1, which provides for $1.5 million quarterly dividends, plus any adjustment needed to bring the total annual dividend to the target dividend payment rate of 60% of annual net earnings.

The final part of the justification provided by Horizon in this fourth point is that such levels of return on equity as those that it is forecasting for 2011 will not support the amount of investment and OM&A costs required to sustain the electricity distribution infrastructure, underlying systems and processes, and customer service delivery in a manner consistent with good and safe utility practice. On this point Energy Probe partially agrees with Horizon.

Energy Probe agrees that a sustained return on equity in the range of 2% to 5% forecast by Horizon for 2011 may not support the investment and OM&A costs required to sustain the system and services in a manner consistent with good and safe utility practice. However, Energy Probe disagrees with Horizon that one year with a return on equity in this range, followed by a cost of service application for the

2012 test year, will have any significant short term or long term impacts on the system. Horizon is still forecasting a net positive return on equity. It is not forecasting a loss. It is forecasting a substantial increase in OM&A costs and in the level of capital expenditures that drives up rate base, increases depreciation costs and increases interest expenses. In light of all of those forecast increases, Horizon is still forecasting net income of between $3 and $7.8 million (VECC Interrogatory #1e).

Energy Probe submits that based on the evidence before it, the Board can safely conclude that Horizon has no cash flow problems, no issues with obtaining additional debt, and will continue to earn a positive return on equity in the remaining year of its IRM term. Horizon is not in financial difficulty, nor is Horizon Holdings. From a financial perspective, therefore, there is no justification to terminate the IRM plan early.

E - ALTERNATIVES TO EARLY REBASING

In the July 14, 2008 Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors, the Board indicated that if an off ramp is triggered it would review the circumstances that caused the distributor to fall outside of the earnings dead band. This review would be prospective and could result in modifications to the IR plan, a termination of the IR plan, or the continuation of the IR plan.

Energy Probe submits that if the Board determines that Horizon has provided sufficient justification for termination of the IR plan, then the Board should consider alternatives to a full cost of service rebasing application for 2011. These alternatives could include a temporary change (or elimination) to the productivity and stretch factors used in the price cap calculation used to set 2011 rates. This would provide some relief to Horizon until it rebased on schedule for 2012 rates.

Another alternative would be to allow an increase in rates for 2011 to reflect the average loss in revenue from the 2008 Board approved figure, again as a temporary measure for 2011 only. Table 3-1 in Exhibit 3, Tab 1, Schedule 2 shows that the actual total operating revenue for 2008 and 2009 averaged approximately $89.6 million. This level is $3.8 million below the Board approved figure. Allowing Horizon to recover this amount through a rate rider on 2011 rates would provide Horizon with some relief until they rebase on schedule for 2012.

Energy Probe submits, however, that any special treatment for Horizon would need to be taken into account as part of the 2012 rebasing application in terms of an appropriate return on equity. If a distributor receives any sort of relief when it has not triggered an off ramp, then that distributor has reduced its overall business risk. It should not expect to receive the same return on equity as other distributors who have not had their overall business risk reduced.

F – SUMMARY

In the April 20, 2010 letter related to the Early Rebasing Applications, the Board indicated that a distributor "*that seeks to have its rates rebased in advance of the its next regularly scheduled cost of service proceeding must justify, in its cost of service application, why an early rebasing is required notwithstanding that the "off ramp" conditions have not been met".*

The Board went on to state that *"Specifically, the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period".*

Energy Probe submits that Horizon has not justified why an early rebasing is required. Nor has Horizon demonstrated that it cannot adequately manage its resources and financial needs during the one year remaining in its IRM plan.

On the contrary, the evidence demonstrates that despite the loss of revenues as compared to those approved in the 2008 cost of service proceeding, Horizon has been able to post strong financial results with returns on equity of 7.2% in 2008, 6.4% in 2009 and a projected figure of 7.2% in 2010.

Energy Probe respectfully submits that the Board should find that there is no justification or need for Horizon to terminate the 3rd Generation IRM plan in advance of its scheduled rebasing application for the 2012 test year.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

November 23, 2010

Randy Aiken

Consultant to Energy Probe