HORIZON UTILITIES CORPORATION - 2011 RATES APPLICATION

SUBMISSIONS OF THE CONSUMERS COUNCIL OF CANADA

PRELIMINARY ISSUE

Introduction:

By Application dated August 26, 2010, Horizon Utilities Corporation ("Horizon") applied to the Ontario Energy Board ("Board") for approval of rates and other charges effective January 1, 2011. Horizon's current rates had been set through a cost of service proceeding in 2007 (for 2008 rates). Under the Board's 3rd Generation Incentive Regulation Mechanism ("3rd GIRM") plan Horizon was scheduled to rebase its rates in 2012. The application is, thus, for early rebasing.

By Procedural Order dated October 21, 2010, the Board determined that it would consider Horizon's request for early rebasing in advance of any further procedural steps. The Board is seeking submissions on this "Preliminary Issue" before it decides whether to proceed with a full consideration of Horizon's application.

These are the submissions of the Consumers Council of Canada (“Council”) on the Preliminary Issue. In consideration of this issue it is important to provide the background leading up to the application and the context in which Horizon's application has been made. Accordingly, the Council will set out below the facts that establish that context.

Background:

On July 14, 2008, the Board released its Report, "Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Consumers", establishing a new framework for a multi-year rate setting plan for Ontario electricity distribution companies ("LDCs"). A number of conclusions set out by the Board in its Report are relevant to Horizon's current application. These include:

1. The report sets out the Board's policies and approach to 3rd Generation IRM and presents guidelines that the Board expects distributors to use in preparing their rate applications (P. 2)

2. The Board has determined that the plan term for 3rd Generation IRM will be fixed at three years (i.e. rebasing plus three years). 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 (P. 7)

3. The Board has determined that there will be an incremental capital module in 3rd Generation IRM. Distributors with an amount of capital spending that exceeds the materiality threshold may best be accommodated through rebasing . However, on balance, as all participants acknowledged, some incremental capital investment needs may arise during the IR term and the Board notes that a clearly defined modular approach is generally accepted 9p. 32)

4. The Board has determined that the eligibility criteria are sufficient to limit Z-factors to events genuinely external to the regulatory regime and beyond the control of management (p. 35)

5. The Board has determined that the 3rd Generation IRM will include a trigger mechanism with an annual ROE dead band of +/- 300 basis points. When a distributor performs outside of this earnings dead band, a regulatory review may be initiated. In support of this approach a distributor will 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. 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 a continuation of the IR plan (p. 38)

In 2009 Horizon submitted an application to the Board for recovery of an unforeseen and material loss of revenue outside of the control of management, due to a change in operations on the part of one of its Large Use customers ("subject customer") The recovery of the losses was sought through a Z-factor application. The Board rejected Horizon's application on the basis that Horizon had not demonstrated that the harm caused by the subject customer's reduced load is genuinely incremental to Horizon's experience or expectations. Having failed to do so, the Board concluded:

> Horizon has not established that a Z-factor event has occurred. As a general matter the Board finds that revenue loss deficiencies of the kind sought for recovery through this application by Horizon are not appropriately addressed through the Z-factor mechanism because of the need to assess the impacts of such losses on a total utility basis. The Board is in agreement with the view of some intervenors that the Z-factor criteria were not intended to be used for recovery of revenue losses. (Decision with Reasons, March 24, 2010, p. 10).

The Board also found that Horizon had not met the off-ramp criteria establish in the 3rd GIRM report. (p. 16)

Although the Board rejected Horizon's application, on the basis that it did not meet the criteria for relief either through a Z-factor or an off-ramp, the Board did make the following observation:

> In making these findings the Board is mindful of the need to provide guidance to distributors as 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 such special treatment of such losses within the context of the overall cost of service application.
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> However the Board cautions distributors that such an approach should not be undertaken lightly. The Board expects that any requests for load loss recoveries would be defended in the context of the overall business, that the Applicant would provide a detailed explanation of all mitigation actions it had undertaken and why further relief continued to be required under such circumstances. (pp. 16-17)

On April 20, 2010, the Board sent a letter to all distributors addressing potential applications for early rebasing (the "April 20 Letter"). In the April 20 Letter, the Board stated that a distributor that seeks to have its rates rebased in advance of it 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 stated that the distributor must clearly demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IR plan term. The Board indicated its intent to determine, as a preliminary matter, whether an application for rebasing is justified or whether it should be dismissed.

The application of the principles in the April 20 Letter has been considered in one case. Hydro Ottawa Limited ("Ottawa") applied to the Board on June 14, 2010, seeking approval of rates effective January 1, 2011. Like Horizon, Ottawa's request constituted an early rebasing application which would prematurely terminate its participation in the IRM framework. The Board concluded that Ottawa had not justified the need for an early rebasing and directed Ottawa to file for 2011 rates based on the IRM formula.

Horizon's Application:

Horizon has set out several reasons for filing a forward test year cost of service application for 2011:

1. Material and pressing shortfalls in revenue, relative to its Board approved Base Revenue Requirement, which is adversely affecting its ability to finance required business investments, principally related to a decline in consumption in the larger General Service Classes;

2. A requirement to address the deferrals noted in 1 above and an urgent need for increased investment in the renewal and maintenance of the electricity system and related underlying enabling systems and processes that are beyond their productive life or no longer suitable;

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;

4. A requirement for a reasonable rate of return in order to provide necessary and stable cash flow to support the delivery of customer service and the distribution system on a sustainable basis in a manner that protects public and employee safety. (Ex. 1/T2/S1/p. 6)

In response to written interrogatories, Horizon maintained that it has been able to obtain the necessary financing required to fund business investments during the IRM period, and that it has not experienced any significant issues related to its cash flow (EP interrogatory -1). In addition, it is clear that its actual returns have not fallen below the 300 basis point dead band which constitutes the trigger for an off-ramp.

Submissions:

The Board has put in place a rate-setting process, in the IRM framework, that balances the interests of utility ratepayers and utility shareholders. It is important that the integrity of that rate-setting process be maintained. If LDCs are permitted to seek rate increases outside of that framework, there must be compelling reasons to override the 3rd GIRM rate-making cycle. The Council acknowledges that, in some cases, in order to ensure the financial integrity of an LDC, exceptions should be made. However, the burden for establishing why an LDC should be allowed to rebase early should be significant. The April 20 Letter in effect reiterates that point. For the reasons set out below, the Council does not believe Horizon has met that burden.

The 3rd GIRM framework allows for LDCs to seek relief during an IRM plan. The Board has established a Z-factor mechanism that is intended for unforeseen events outside of management's control. In addition, the incremental capital module is intended to address concerns over capital investment that may arise during the term of a plan. Finally, the framework provides for an off-ramp when a distributor performs outside of an annual ROE dead band of +/- 300 basis points. In the case of an off-ramp a distributor is 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 a distributor falls short of or exceeds its ROE by 300 basis points.

With respect to Horizon, the Board determined in its last application that Horizon had failed to demonstrate that a Z-factor event had occurred. Horizon has not applied for relief in this case citing the incremental capital module. The data provided by Horizon clearly demonstrates that Horizon has not met the criteria established by the Board for off-ramp relief. Horizon's application is premised on the principles set out by the Board in the April 20 Letter. (Ex. 1/T2/S1/p. 10) In the April 20 Letter, the Board noted that the distributor must demonstrate why and how it cannot adequately manage its resources and financial needs during the remainder of its IR plan term.

Horizon's primary argument for relief is what it projects to be a range for its ROE in 2011. That estimate is between 2% and 5% (VECC interrogatory 1) This is not consistent with what has been contemplated by the Board. The Board's policy requires LDCs who have experienced returns outside of that dead band to file a report based on actual audited results. If the Board were to consider applications for relief based on untested forecast returns the 3rd Generation IRM framework would unravel.

Horizon's 2010 projected ROE is 7.2% (Board Staff interrogatory 1) Given the fact that the current ROE embedded in rates is 8.57%, Horizon has not demonstrated how it is will be unable to "manage it resources and financial needs" during the remaining term of the plan.

Horizon has referred to the fact that Hydro One Distribution ("HON") and Toronto Hydro Electric System Limited ("THESL") were not required to live within the 3rd GIRM framework (Ex. A1/T2/p. 10). The Board considered this argument in the Ottawa proceeding and made it clear that the circumstances for those seeking an early rebasing in 2011 are different, and not comparable to HON and THESL.

The Council submits that Horizon has not met the test reiterated by the Board in the April 20 Letter. Horizon has not demonstrated that it will unable to manage its resources and financial needs over the remaining year of the plan. The Council acknowledges that in some cases an early rebasing may be justified, but the Board needs to be certain that allowing an LDC to rebase early appropriately balances the interests of the utility ratepayers and shareholders. It should not be simply about enhancing returns. Horizon is a sophisticated utility that should be able to manage its utility in a cost-effective way for the remainder of its IRM term. They have provided no evidence that by rejecting the application, system safety and reliability would be compromised.

If the Board determines that Horizon's application should be considered, the Council submits that it should be on the condition that Horizon would not be eligible for the new ROE levels established by the Board in it Cost of Capital Report, and that new rates should only be effective May 1, 2011. The financial benefits realized by rebasing January 1, 2011, and applying a new ROE would simply be a windfall for Horizon, that should not be in place until Horizon rebases on a schedule consistent with all other LDCs under the IRM framework.

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