November 29, 2010

BY RESS AND BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St., Suite 2700
Toronto, ON, M4P 1E4

Dear Ms. Walli:

RE: Horizon Utilities Corporation - EB-2010-0131
2011 EDR Cost of Service Application – Reply Submission on the Preliminary Issue

The Ontario Energy Board (the "Board") released Procedural Order ("PO") #3 in respect of the above-captioned matter on November 15, 2010.

Pursuant to PO #3, Horizon Utilities submits its final reply submission on the Preliminary Issue.

Yours Truly,

Original signed by Indy Butany-DeSouza

Indy J. Butany-DeSouza
Vice-President, Regulatory and Government Affairs
Horizon Utilities Corporation
Tel: (905) 317-4765

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") REPLY SUBMISSION ON THE PRELIMINARY ISSUE

DELIVERED NOVEMBER 29, 2010

INTRODUCTION:

1. On August 26, 2010, Horizon Utilities Corporation ("Horizon Utilities") filed with the Ontario Energy Board (the "Board") a forward test year cost of service electricity distribution rate application (the "Application") for distribution rates and other charges effective January 1, 2011.

2. The Board issued Procedural Order No. 1 ("PO#1") on October 21, 2010. In PO#1, the Board determined that it would first consider Horizon Utilities' application for early rebasing for 2011 distribution rates (the "Preliminary Issue") in advance of further procedural steps. PO#1 allowed for an initial round of Board staff and intervenor interrogatories to seek, if they wished, additional information specifically related to the Preliminary Issue. Following the filing of Horizon Utilities' interrogatory responses, Board staff and intervenors would file submissions on whether the Application is justified based on the Board's letter of April 20, 2010. Subsequently, Horizon Utilities would be allowed to file a reply submission.

3. The Board's April 20, 2010 letter, addressed to electricity distributors, advised that four distributors had requested an advanced rebasing in 2011 rather than 2012. The Board directed that "A distributor, including the four distributors referred to above [Horizon Utilities was one of those distributors], that seeks to have its rates rebased in advance of 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. 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."

4. Subsequent Procedural Orders (PO#2-3) addressed the timing of interrogatories, responses and submissions on the Preliminary Issue and a request by Horizon Utilities that portions of its responses to interrogatories on the Preliminary Issue be kept confidential. Pursuant to PO#3, the deadline for Horizon Utilities' reply submission was November 29, 2010.

5. Horizon Utilities is pleased to provide its reply submission on the Preliminary Issue at this time. The reply submission is organized according to the following themes:

- BACKGROUND
    - Horizon Utilities has numerous features that distinguish it from other Ontario electricity distributors
    - Horizon Utilities' history of rate applications
    - Horizon Utilities' basis for rebasing in 2011
    - Years of deferrals of capital and OM&A expenditures must be addressed
- THE BOARD'S IRM PROCESS IS NOT SUITED TO HORIZON UTILITIES' SPECIFIC CIRCUMSTANCES WITH RESPECT TO PERSISTING MATERIAL LOAD SHORTFALLS
- THE BOARD STAFF SUBMISSION
    - Smart meters and impact on ROE
    - Horizon Utilities' load losses/ volatility warrant a cost of service application:
    - A cost of service application is reasonable in the context of demonstrated inadequacy of resource management and meeting financial needs
- THE INTERVENOR SUBMISSIONS
    - The off-ramp provisions of the 3GIRM Report should not be the sole determinant of advancing Horizon Utilities' cost of service application.
    - The load loss and volatility being experienced by Horizon Utilities clearly warrant a cost of service application for rebasing in 2011.
    - Horizon Utilities' backlog of capital and OM&A expenditures must be addressed. Continuing to defer Horizon Utilities' proposed incremental expenditures by

another year does not assist the utility or its customers with respect to the adequacy, reliability, and quality of electricity service

- The benefit to customers of one more year of the stretch factor under IRM has been vastly outweighed by the savings they have realized through the material revenue shortfalls since 2008, for reasons described above.

- CONCLUSION

- RELIEF REQUESTED

6. Horizon Utilities seeks the Board's confirmation that it may proceed with its cost of service application for 2011 rates. Horizon Utilities requests that the Board confirm that this Application for rebasing in 2011 may proceed according to the process established for distributors rebasing in 2011 and without any additional constraints or limitations otherwise proposed by intervenors.

BACKGROUND:

- **Horizon Utilities has numerous features that distinguish it from other Ontario electricity distributors:**

7. As discussed in the Summary of the Application,[1] Horizon Utilities is one of the largest municipally-owned electricity distribution companies in Ontario, providing electricity and related utility services to more than 235,000 residential and commercial customers in Hamilton and St. Catharines. Horizon Utilities has many unique features compared to most other LDCs. The following are two material distinct characteristics of Horizon Utilities, relative to other LDCs, that are particularly important in evaluating Horizon Utilities' request for rebasing:

- Horizon Utilities' service territory covers two of Ontario's most industrial cities: Hamilton and St. Catharines. Horizon Utilities' customer and load profiles differ from those of other LDCs because of the extent of Horizon Utilities' industrial load. Only 30 of Ontario's 80 LDCs have customers in the "Large Use" category and the average number of Large Users for such 30 LDCs is six and the median is three. Horizon Utilities has twelve Large Use customers. While two LDCs have more Large Use customers, Horizon Utilities has the largest average Large Use customer consumption (kWh) of any LDC. The average consumption of all Ontario large users is 48,289,486 kWh (as of 2008), but

[1] See Ex.1, Tab 2, Schedule 1

the average consumption of Horizon Utilities' Large Use customer class is three times greater at 145,665,275 kWh and the next highest average Large Use consumption is just over 100,000,000 kWh annually. and

- Hamilton and St. Catharines are older communities with older electricity distribution systems and low growth rates. As a result, Horizon Utilities faces differing Capital and Operations, Maintenance and Administration ("OM&A") needs compared to other LDCs located in higher growth suburban areas. In low growth areas like Hamilton and St. Catharines, infrastructure renewal must be funded from existing customers rather than from new customers. The same issue arises in the maintenance costs related to underground assets. Not only does Horizon Utilities have one of the highest percentages of underground plant of any LDC, but it also has among the oldest underground systems. While underground systems are thought to be lower cost than overhead systems, the costs of maintaining underground systems naturally vary by the age of the system. LDCs based in older municipalities such as Horizon Utilities have significant capital investment requirements in order to renew distribution plant through controlled replacements in order to manage risks related to service interruption and employee and public safety. As an older LDC, capital investment to address infrastructure renewal is an immediate requirement. As a result of more comprehensive analysis by Horizon Utilities of the condition of its distribution system assets, contained in the Application,[2] Horizon Utilities has determined that a dramatic increase in infrastructure investment is required in comparison to prior years. A growing backlog of infrastructure renewal projects exists in Horizon Utilities' service area, and that backlog will continue to grow in the absence of rebasing.

- **Horizon Utilities' rate applications since 2007:**

8. Horizon Utilities' last rebasing was in 2008, based on a forward test year cost of service application filed in 2007 (EB-2007-0697). In that proceeding, the Board approved Horizon Utilities' distribution rates effective May 1, 2008, with an implementation date of December 1, 2008. Horizon Utilities' distribution rates have been subject to very slight mechanistic adjustments through Incentive Regulation Mechanism ("IRM") applications for 2009 and 2010.

9. Since December 2008, Horizon Utilities has experienced material revenue shortfalls, particularly in its larger commercial customer classes and, most notably, its Large Use customer class, due to customer demand and consumption that have been materially below the load forecast in Horizon Utilities' 2008 cost of service application. Horizon Utilities has advised or otherwise engaged the Board with respect to these shortfalls over the past three

[2] See Ex. 1, Tab 2, Schedule 1

years. In its correspondence to the Board dated December 23, 2008,[3] Horizon Utilities advised the Board of the general decline in commercial load, and of the potential need to bring forward a Z-factor application to address the revenue volatility arising out of the loss of load.

10. In July of 2009, Horizon Utilities met with OEB staff to discuss load shortfalls and volatility and potential regulatory mechanisms to address such. The mechanisms discussed included a Z-factor application, a full cost of service application, and a single-purpose application to simply address the load shortfall. Based on this discussion, it was determined by Horizon Utilities that the most appropriate method, and the one most likely to be received by the Board, was a Z-factor application. Horizon Utilities was pleased with the interest of Board Staff with respect to this issue and found the dialogue very helpful.

11. In September 2009, Horizon Utilities filed its Z-factor Application (the "Z-factor Application" – Board file No. EB-2009-0332) to address the revenue shortfall and volatility noted above in respect of one of its Large Use customers whose consumption and demand had declined dramatically. As discussed in the Application[4] and in Horizon Utilities' response to Board staff IR #3 in that proceeding, Horizon Utilities made it clear that its customer loads had declined generally, but that the Z-factor Application related only to the Large Use customer that was the subject of that proceeding. In filing the Z-factor Application, Horizon Utilities sought adjustments to its rates that would enable it to recover the revenue shortfall related to the Subject Customer for the period May 2008 through April 30, 2011, and advised the Board that "Horizon Utilities anticipates that the requested Rate Rider will be in place until April 30, 2011, as Horizon Utilities is currently planning to file a 2011 cost of service distribution rate application in August of 2010, with rates to be effective May 1, 2011"[5], in order to address the ongoing load and revenue reductions.

12. On March 24, 2010, the Board denied Horizon Utilities' Z-factor Application. In doing so, the Board stated that "The Board has concluded that the application should not be granted, and

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[3] EB-2010-0131, Ex. 1, Appendix 1-7

[4] EB-2009-0332, Application Summary, p. 4 of 9

[5] EB-2009-0332, Manager's Summary, p. 2 of 17

that the appropriate venue for seeking relief is a full cost of service application."[6] Similarly, later in its Decision, the Board stated that "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".[7] On August 26, 2010, Horizon Utilities filed the current advanced cost of service application, which was motivated principally by the ongoing issue of load loss and the cumulative effects of year-over-year revenue shortfalls.

- **Horizon Utilities' basis for rebasing in 2011:**

13. In the Summary of the Application, Horizon Utilities has submitted reasons for filing a cost of service application at this time, for implementation of rates in 2011, rather than filing such Application next year, for implementation of rates in 2012. There are several reasons for this approach, and several pressures on Horizon Utilities that have led to this Application. These can be summarized as follows:

- Material and persisting shortfalls in revenue, relative to its Board approved Base Revenue Requirement, which is adversely affecting Horizon Utilities' ability to finance required business investments. Such shortfall is principally related to a decline in consumption in the larger General Service classes;

- A requirement to address the deferrals of infrastructure investments resulting from the revenue shortfalls noted above, 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;

- 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

[6] Decision, March 24, 2010, EB-2009-0332, at p.5

[7] Decision, March 24, 2010, EB-2009-0332, at p.16

practice. This is crucial to sustain electricity distribution operations and support the increased investment requirements noted in the first bulleted item above. Additionally, this is required to mitigate increasing risks related to severe and more frequent service interruption and ensure public and employee safety; and

- 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 the distribution system on a sustainable basis in a manner that protects public and employee safety.

14. In the Application, Horizon Utilities indicated that the calendar year adjusted return on equity related to its regulated investments was 7.2% in 2008; 6.6% in 2009; and is forecast at 5.9% for 2010. In response to Board staff interrogatory 1(d), Horizon Utilities clarified the estimated 2010 ROE as at September 30, 2010 as 7.2%, which included smart meter revenue and expenses as smart metering is a regulated activity, although not presently part of Horizon Utilities' rates or rate base or its requests in the Application; smart meter investments are presently financed through the Smart Meter Rate Adder mechanism of the Board. Horizon Utilities presently anticipates a lower ROE by its 2010 year end. The removal of Smart Meters from the ROE calculation as at September 30, 2010 reduces such to 6.9% from 7.2%. Furthermore, Horizon Utilities will record a pre-tax charge against income in 2010 of $1.1MM related to its allocation of the Late Payment Penalty ("LPP") settlement, as there is no certainty of recovery of this amount at this time, which further reduces the ROE forecast to 5.95%. Lastly, the relatively warm summer has improved the profitability of Horizon in 2010 by approximately 0.28%. With consideration for the LPP adjustment, a more weather normalized result for 2010 would have further impaired the ROE forecast to 5.67%, just 10 basis points off of the 300 basis point threshold based on the Board-approved 2008 ROE of 8.57%. Horizon Utilities submits that, based on the best information available, and given some consideration for estimation, its 2010 forecast ROE very closely approaches and may exceed the 300 basis point threshold. This notwithstanding, Horizon Utilities also submits that the present level of load volatility relative to its 2008 load forecast reflects a high risk that its ROE may exceed the 300 basis point threshold; both in 2010 and 2011.

15. In the event that the Board denies the Application, Horizon Utilities has previously estimated its adjusted return on regulated investments for 2011 at between 2.0% and 5.0% (as noted in response to VECC IR 1 e)), 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. Whether the 2011 ROE is 2% or 5%, it will be well outside the ±300 basis point dead band relative to the Board-approved 2008 ROE of 8.57% and the recently announced ROE of 9.66% for electricity distributors requesting the alignment of their rate and fiscal years so that new rates would come into effect January 1, 2011.

16. Horizon Utilities' loads and revenues remain materially lower than those assumed in its 2008 cost of service application. As noted above, Horizon Utilities' distribution rates have been subject to modest mechanistic adjustments through Incentive Regulation Mechanism ("IRM") applications for 2009 and 2010. However, Horizon Utilities submits that the IRM process is based on an assumption that a distributor's loads and revenues will, on average across IRM years, be similar to those adopted in the previous forward test year (2008 with respect to Horizon Utilities). This has clearly not been the case for Horizon Utilities. At Exhibit 3, Tab 2, Schedule 2, p 16 of the Application, Table 3-23 provides evidence that both actual customer loads, particularly in the larger commercial classes, and revenue have remained materially lower than those underlying Horizon Utilities' 2008 cost of service application (at Exhibit 3, Tab 1, Schedule 2, p 5, Table 3-3).

17. In the absence of the advanced rebasing, and based on the load forecast in the Application, Horizon Utilities forecasts a 2011 distribution revenue shortfall of approximately $5.0MM. This shortfall is computed as the difference between: i) 2010 Base Distribution Revenue Requirement as provided for in Horizon Utilities 2010 3GIRM Application (Response to Energy Probe IR#5(e)) of $88,636,000; and, ii) 2011 distribution revenue at current rates of $83,666,000 (Response to Energy Probe IR#5(e), Table 1). As will be discussed later in this submission, this $5.0 million shortfall is significantly higher than the amount suggested by at least one intervenor in its reply submission, which failed to incorporate IRM adjustments to LDC rates since a prior rebasing. Horizon Utilities submits that, as a practical matter and without any suggestion of wilful intent, it is misleading to ignore Board approved changes to distribution rates afforded through IRM, and corresponding impacts on distribution rate revenue, by simply comparing the 2011 distribution revenue requirement to the 2008 approved base distribution revenue. IRM recognizes that, between re-basing

years, rates must be adjusted for inflation on LDC cost structure, less a productivity expectation. As such, Horizon Utilities submits that its computation of the 2011 shortfall, absent an advance rebasing, is most appropriate for evaluating financial need as it is consistent with the operation of Board rate making policy including recognition, through IRM rate adjustments, for inflationary impacts on LDC cost structure between rebasing years.

18. Horizon Utilities submits that it will have an estimated cumulative base distribution revenue shortfall of $8.9MM for the period from 2008 to the end of 2010. In a manner consistent with the above shortfall analysis, this cumulative shortfall is computed as the difference of: i) the sum of the actual base distribution revenue earned in each of the 2008, 2009, and forecast 2010 fiscal year[8]; and, ii) the sum of the base distribution revenue requirement computed for each fiscal year, based on the approved 2008 cost of service application and subsequent IRM adjustments for 2009 and 2010. This shortfall will extend to an estimated $13.9MM for 2011 in the absence of an advanced rebasing application.

19. In addition to the base distribution revenue shortfall, Horizon Utilities is also experiencing a decline in other revenue (revenue offsets) since the 2008 cost of service application and forecasts this shortfall to be $1.3MM by the end of 2011, following a forecast shortfall of $0.8MM in 2010 and an actual shortfall of $0.7MM in 2009[9].

20. With consideration for shortfalls in base distribution revenue and revenue offsets, Horizon Utilities expects a cumulative revenue shortfall of approximately $9.9MM from 2008 to the end of 2010, which, in the absence of an advanced rebasing, it further expects to extend to $16.2MM by the end of 2011. This is a material financial shortfall for the utility and a persisting obstacle towards managing resources and financial needs through the remainder of IRM in support of safe and sustainable service delivery Such cumulative shortfall represents approximately 37% of Horizon Utilities' 2011 capital expenditure program or 34% of its OM&A budget for 2011.

21. A significant reduction in load on the part of one of Horizon Utilities' Large Use customers was the subject of Horizon Utilities' Z-factor Application, discussed above. Horizon Utilities'

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[8] Response to Energy Probe 5(e), Pg. 20, Table 1

[9] Exhibit 3, Tab 3, Schedule 1, Table 3-25

forecast load remains materially below that underlying its 2008 cost of service application and is not expected to improve. As recently as last month, one of Horizon Utilities' Large Use customers, U.S. Steel Canada Inc. ("USSC"), announced the idling of its Hamilton Works blast furnace. Horizon Utilities' response to Board staff Interrogatory 4(b), now on the public record in this proceeding, includes a copy of USSC's Q3 announcement in this regard and an October 1, 2010 article from the Globe and Mail reporting USSC's shutdown of its Hamilton steelmaking operations. More recently, USSC's Hamilton employees have been locked out of USSC's facilities. That lockout, which began on November 7, 2010, continues[10]. Recently, Max Aicher North America ("MANA") acquired from USSC the bar and bloom mills Stelco had closed in the months after it came out of bankruptcy protection. Press coverage of this acquisition[11] suggests that production will begin shortly. Such acquisition represents a small fraction of USSC's facilities and an even smaller share of Horizon Utilities' lost load. At this time, it is not clear to Horizon Utilities when and at what capacity these facilities will be operating. Moreover, there is no certainty at this point as to whether the additional load will be of any significance for the 2011 test year or the extent to which it may be of significance thereafter. This announcement does not impact Horizon Utilities' overall assessment of its 2011 load forecast or related risks at this time. Horizon Utilities anticipates that this matter will be addressed through the application process. Horizon Utilities submits that the persisting material loss of load from a very significant large user and employer within its service territory is likely to have collateral adverse load impacts with respect to its local suppliers, employees, and the community in general.

22. Horizon Utilities submits that this material and persisting shortfall between approved and actual loads has resulted in the realization of a material risk to the utility with respect to its ability to generate cash flow to procure and manage resources as are prudent in support of the sustainable delivery of electricity in a safe and reliable manner to its customers. This risk will persist into 2011 in the absence of an advanced re-basing application with implications of further material shortfalls in both revenue and return on equity; the latter projected to be well outside the 300 basis point off-ramp threshold.

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[10] "Workers locked out at U.S. Steel in Hamilton", *Globe and Mail*, November 7, 2010

[11] "Max Aicher's Steel Will", Hamilton Spectator, November 27, 2010

- **Years of deferrals of capital and OM&A expenditures must be addressed:**

23. Both this Application and the Z-Factor Application have described the necessity and magnitude of deferrals in capital and OM&A expenditures since 2009, almost immediately after the issuance of its 2008 distribution rate order, as a direct consequence of material load and revenue shortfalls relative to those underlying Horizon Utilities' approved 2008 cost of service rate application.

24. In the Summary of the Application[12], Horizon Utilities refers to page 8 of the Z-factor Application, in which Horizon Utilities submitted that the loss of distribution revenue for the rate years 2008 and 2009 made it necessary for Horizon Utilities to review its expenditures in order to determine which projects may be deferred on a short term basis without incurring any significant risk to system reliability or customer safety. In its Z-factor Application, Horizon Utilities indicated that it had targeted reductions in 2009 of $2 million in its operating program and $3.6 million in its capital program. In light of the continued load and revenue volatility into 2010, Horizon Utilities continued to make investment decisions with due consideration for risks to the distribution network, employee and public safety, and customer service delivery. These expenditures remain necessary and must be incurred in future years.

25. It is important to note that deferrals have not been undertaken for the purpose of achieving Horizon Utilities' Maximum Allowable Return on Equity ("MARE") or sustaining shareholder distributions reflecting that level of ROE. As discussed earlier and below, Horizon Utilities' returns in 2009 and its anticipated returns in 2010 and 2011 do not approach the 8.57% ROE approved in 2008, or the 9.85% or 9.66% MARE for utilities rebasing in 2010 and January 2011, respectively. The 2010 ROE is projected to closely approach the off-ramp threshold and the 2011 ROE is expected to well exceed the threshold test.

26. Horizon Utilities submits that in the absence of adequate and stable revenue and cash flow, consistent with Board rate making policy, the continued deferral of such capital and OM&A expenditures will increase the risk of more frequent and severe customer service interruption and are also a concern with respect to public and employee safety. Horizon Utilities will

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[12] Exhibit 1, Tab 2, Schedule 1, p. 7

undoubtedly be required to address the resulting increase in the severity and duration of service disruption on a reactive basis, which is far more expensive over time than the proactive approach to renew capital provided in this Application. Horizon Utilities respectively submits that this is not in the best interest of ratepayers.

THE BOARD'S IRM PROCESS IS NOT SUITED TO HORIZON UTILITIES' SPECIFIC CIRCUMSTANCES WITH RESPECT TO PERSISTING MATERIAL LOAD SHORTFALLS:

27. As discussed in the Summary to the Application, since its last rebasing, Horizon Utilities has undertaken a comprehensive Asset Management Plan in conjunction with Navigant Consulting (Exhibit 2, Tab 3, Schedule 3, Appendix 2-1) as well as certain asset condition assessments commencing with the most critical components of the distribution system infrastructure - substations - which are the source of electricity delivery to large geographic areas with many customers. Horizon Utilities' recent asset condition assessments indicate a critical requirement for Horizon Utilities to immediately make material investments in substation asset renewal and decommissioning, in order to avoid expensive and reactive maintenance in the future and related customer service interruption. Such reactive maintenance is generally preceded by more severe and frequent service disruptions to many customers.

28. In order to address infrastructure renewal and distribution system risks described in the Application, Horizon Utilities has increased its distribution system capital expenditures from $23MM in 2008 to over $30MM in 2010 and $33MM in 2011. This pattern of growth is expected to continue to 2016 where it will peak at $46MM and thereafter be sustained at this level for a number of years. Total annual capital expenditures are expected to peak at approximately $52MM by 2016. The Application, including the Asset Management Plan and related studies, provides evidence in support of an urgent need for ongoing increases to capital expenditures, which will be significantly in excess of depreciation and amortization costs and, thus, will increase Horizon Utilities' rate base. These requirements for growth in expenditure increase the urgency of addressing material and persisting load and revenue shortfalls to mitigate the related risks of continuing to defer such. Horizon Utilities requires a corresponding increase to its distribution revenue to end its pattern of asset renewal deficits, address deferrals, and otherwise support a more appropriate level of capital expenditure requirements.

29. Horizon Utilities submits that the Board's IRM regime does not contemplate material and persisting shortfalls in revenue or capital expenditure increases of this nature, as described above, that may not, in any single year, trigger the off-ramp test. As discussed in the Summary of the Application, the 3GIRM rate adjustment process provides for an Incremental Capital Module ("ICM") to address certain increases in capital expenditures during the IRM period, but those increases are similar to Z-factor events. The Board explains the use of the ICM as follows: "the intent is not to have an IR regime under which distributors would habitually have their CAPEX reviewed to determine whether their rates are adequate to support the required funding. Rather, the capital module is intended to be reserved for unusual circumstances that are not captured as a Z-factor and where the distributor has other options for meeting its capital requirements within the context of its financial capacities underpinned by existing rates." As noted in the Summary, the Board also addressed this in Hydro One's 2009 distribution rate application, in which it advised (at page 7-8) that:

> "The Board's objective in establishing the incremental capital module was to enhance the regulatory efficiency of the incentive rate mechanism, which is intended to be formulaic and simplistic in its application, by adding a method to accommodate extraordinary capital spending requirements should they arise during the term of the incentive rate mechanism. The ability to address extraordinary capital spending requirements within the IRM framework increases the efficiency opportunities without requiring a full cost of service rebasing review."

30. In Horizon Utilities' case, it is not confronted with an extraordinary capital expenditure, per se. Rather, it requires graduated and permanent increases to its capital expenditures on system renewal on an ongoing basis to address renewal and distribution system risks in the ordinary course. These increases are materially in excess of those underlying the 2008 rebasing application. It is of critical importance that the ongoing deferral of Horizon Utilities' system renewal be stopped and that the appropriate level of expenditure be addressed as soon as possible through the advancement of the Application.

THE BOARD STAFF SUBMISSION:

31. Horizon Utilities will address three areas in reply to the Board Staff ("Staff") submission as follows: i) smart meters; ii) ongoing load volatility and the implications of the Board's Decision in the Z-factor Application; and, iii) the options regarding the outcome on the Preliminary Issue presented by Board staff.

- **Smart meters and impact on ROE:**

32. Horizon Utilities appreciates the view of Staff that it is "generally comfortable" with Horizon Utilities' use of the "calendar year adjusted return on equity related to regulated investments". Staff recognized the intent of Horizon Utilities in submitting this methodology that "attempts to derive a regulated number that can be benchmarked against the allowed ROE. In Board staff's view, Horizon's approach is superior to that where other utilities have compared accounting returns against the allowed ROE for regulatory rate-making purposes.[13]"

33. Horizon Utilities believes it understands the underlying rationale leading Staff to believe "that the inclusion of smart meters will reduce the calculated ROE"[14]. Generally speaking, the recognition of revenue, based on the amount of current Horizon Utilities' Smart Meter Funding Adder realized in cash, would result in a shortfall relative to related operating, depreciation, and interest expenses. Such shortfall would indeed reduce the calculated ROE if revenue was recognized on this basis.

34. However, Horizon Utilities does not recognize Smart Meter revenue on the basis of Smart Meter Funding Adder cash collections. Horizon Utilities imputes revenue on its Smart Meter investments and expenses on the same basis as Board rate-making policy for rate-based investments and costs. On this basis, the revenue recognized on Smart Meter investments and costs includes cost of capital and PILs, in addition to depreciation and operating expenses. As such, the inclusion of Smart Meter activities has a positive contribution to the overall ROE statistics referred to by Staff on [page 3] of its submission. Therefore, the inclusion of Smart Meters within the ROE calculation does not result in such being "biased downwards"; rather, the opposite is true in the case of Horizon Utilities. The difference between Smart Meter Funding Adder collections and imputed revenue recognized is effectively carried in related Board approved variance accounts that have been settled in the past through Smart Meter Funding Adder applications. Horizon Utilities recently submitted a Smart Meter Funding Adder application to the Board (EB-2010-0292) for its consideration

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[13] EB-2010-0131, Board staff Submission on Preliminary Issue, p.2

[14] EB-2010-0131, Board staff Submission on Preliminary Issue, p.3

with respect to changes in the level of Smart Meter investments and costs since its last application and order for 2009.

35. Based on the foregoing discussion, the impact of removing Smart Meters in 2009 and the 2010 Bridge Year on ROE is as follows: for 2009 it is 6.09% and for 2010 it is 6.93%. When consideration is given to the impact of Horizon Utilities' contribution to the Late Payment Penalty class action settlement the 2010 forecast ROE that results is 5.95%. Horizon Utilities will record such settlement in its 3rd quarter 2010 financial results for reasons noted above. Under a weather normalized scenario, considering the warm 2010 summer, the ROE calculation may have otherwise further declined to 5.67%. Horizon Utilities submits that its 2010 ROE will approach the 300bps off-ramp threshold based on its current regulated MARE of 8.57% and is certain to meet this threshold based on the MARE for 2010 and 2011 cost of service filers of 9.85% and 9.66%, respectively.

36. Staff have suggested that, based on the premise that ROE is biased downwards because of the inclusion of Smart Meters, Horizon Utilities' ROE might be improved by applying for the disposition of incurred and audited smart meter costs. The analysis above demonstrates that Horizon Utilities' ROE is, in fact, adversely impacted as a result of the removal of Smart Meter activities. As such, an application with respect to the disposition of incurred and audited smart meter costs will not improve Horizon Utilities ROE. However, such an application would improve cash flow as a result of an increase to the current amount of Smart Meter funding. This notwithstanding, Horizon Utilities has, in fact, applied for an increased Smart Meter Funding Adder (EB-2010-0292), which, from a cash flow perspective, leaves Horizon Utilities indifferent relative to the suggestion of Staff. Horizon Utilities respectfully submits that the disposition application cannot be a reasonable substitute for a cost of service application, as a disposition application cannot improve Horizon Utilities' ROE or cash flow, with consideration for its outstanding Smart Meter Rate Adder application. Additionally, a smart meter disposition application will not address the full set of pressures that Horizon Utilities is experiencing, and that form the basis of the Application.

- **Horizon Utilities' load losses/ volatility warrant a cost of service application:**

37. Page 4 of the Staff submission provides that, with respect to the Z-factor application, "While the Board denied Horizon's proposed treatment for the loss of load, the Board did note that a cost of service application was the appropriate forum for consideration of load losses, or at least load volatility, that Horizon was experiencing, particularly related to one subject customer."

38. Horizon Utilities agrees with the Staff observation (again, at page 4) that load losses and volatility continue to be issues for Horizon Utilities, and that the recent U.S. Steel shutdown could have repercussions throughout the community if it becomes permanent, with the potential for more far-reaching impacts. Staff submits at page 4 that "employees may curtail residential consumption while seeking re-employment or may have to relocate elsewhere, and businesses serving the community may reduce load if their revenues reduce as a result…."

39. Staff submits that "Horizon's load forecast could be subject to an update." Horizon Utilities submits, as partial but principal basis for the Application, that the load forecast should be subject to an update. Horizon Utilities has been consistent on this point as part of a steady course of action since December 2008, when it wrote to the Board with respect to the decline in consumption on the part of the Large Use customer that was the subject of the Z-factor Application; when it met with Staff to discuss load shortfalls and potential regulatory mechanisms for relief; through the Z-factor Application proceeding; and within the current Application. Specifically, Horizon Utilities continues to submit that there has been a material and persisting shortfall between the 2008 Board approved load forecast underlying its current approved rates and actual loads. Material load shortfalls were experienced in 2010 at the time Horizon Utilities filed the Application in August of this year. This condition persists and is expected to continue into 2011, with further material implications including virtual certainty of meeting the off-ramp condition in that year, in the absence of the Application. Horizon Utilities respectfully submits that it would not be appropriate to allow this condition to persist for another year, which would exacerbate cash flow shortfalls that have made it difficult to procure and manage resources in support of a sustainable, reliable, and safe electricity distribution system. Horizon Utilities submits its agreement with the Board that the most appropriate way to address load losses and volatility is through a cost of

service application. Horizon Utilities has submitted its Application on this basis and for reasons otherwise noted herein. Lastly, Horizon Utilities also acknowledges the Staff submission that states that it is appropriate to re-examine Horizon Utilities' Asset Management Plan and 2011 capital and operating budgets in light of load volatility, but submits that the appropriate forum for such consideration is also the Application.

- **A cost of service application is reasonable in the context of demonstrated inadequacy of resource management and meeting financial needs:**

40. Staff presents two options for the Board's consideration.

41. The first is to dismiss the application on the basis of a strictly precise and mechanistic approach that Horizon Utilities fails to meet the 300 basis point threshold as stipulated in the Board's April 20, 2010 letter. In this scenario, Horizon Utilities would have less than five months to prepare a new cost of service application requesting January 1, 2012 implementation of new rates.

42. As a factual matter, Horizon Utilities has closely approached the 300 basis point threshold in 2009 with an ROE of 6.09%. Furthermore, and based on previous analysis above, Horizon Utilities anticipates closely approaching this threshold in 2010, with consideration for the removal of Smart Meter activities, which are not the subject of the Application and subject to a separate funding mechanism, and recognition of the Late Payment Penalty settlement described above. Lastly, Horizon Utilities has submitted a projected return for 2011 in a range of 2% and 5% (Horizon Utilities response to VECC IR 1e)), which is well outside the 300 basis point threshold. While intervenors have argued that the dead band must only be considered on the basis of audited financial statements, the Board did not appear to have restricted itself to historical years based on its recent Hydro Ottawa Decision (EB-2010-0133). At pages 10-11 of that decision, it is clear that the Board was considering whether the threshold was approached not only in historical years, but also in the bridge and test years.

43. Horizon Utilities submits, based on previous discussion and evidence, that, considering its cumulative returns over the past three years, it expects a cumulative shortfall of 587 basis points from 2008 to 2010 (determined as 3 years * 8.57% less the sum of historical and forecast returns of 7.80% for 2008, 6.09% for 2009, and 5.95% for 2010). Arguably, given a

different mix of expense incurrence across these years, Horizon Utilities has approached and effectively met the 300bps threshold test in 2 out of the past three years. This shortfall widens to between 944 basis points to 1244 basis points with consideration for the expected ROE range for 2011, in the absence of the advanced rebasing application. Horizon Utilities respectfully presents this information to illustrate the material cumulative impact of realized and anticipated ROE shortfalls notwithstanding that the 300bps threshold has not been met in any one historical year. Horizon Utilities submits that this is a material scenario not contemplated by IRM but that otherwise supports its demonstration of financial need and directly related impacts on resource management notwithstanding that an off-ramp condition has not been met.

44. Horizon Utilities is unable to submit that it has met the 300 basis point threshold in any historical year. However, Horizon Utilities submits that there is a high probability that it will approach this threshold in 2010 and it is certain that such will be exceeded in 2011.

45. The second alternative presented by Staff is to allow the Application to proceed even though the off-ramp has not been met, "due to the uncertainty flowing from the load volatility noted above, it is likely that there may be serious implications for the financial well-being of the utility, which would justify re-examination of Horizon's cost of service at this time." Staff provides that, in its April 20, 2010 letter, the Board contemplated early rebasing even where the 300 basis point threshold had not been met. The Board similarly contemplated this scenario at page 9 of the Hydro Ottawa Decision (EB-2010-0133) such that its 3GIRM policy does not fetter its statutory jurisdiction to establish just and reasonable rates. Furthermore, intervenors (including the School Energy Coalition or "SEC") have also argued that there may be times that the Board should consider a cost of service application even where the 300 basis point threshold has not been met.

46. Horizon Utilities submits that, although it has not met the strict off-ramp condition in IRM, its circumstances demonstrate that it cannot adequately manage its resources and financial needs during the remainder of its IRM plan period. Furthermore, Horizon Utilities submits that its circumstances are distinct compared to other LDCs and that such warrants the consideration of its Application. In addition to recognizing the likely serious implications of load volatility for Horizon Utilities, Staff conclude their analysis on the second option of hearing the Application with the following comment (at page 6):

"A review of the updated load, and the necessity and prudence of Horizon's capital and operating plans, in light of updated and possibly volatile load, may allow the Board to provide guidance to the utility's management commensurate with the Board's objectives of maintaining the financial viability of the firms it regulates while protecting customers with respect to the prices, quality and reliability of electricity services."

47. Consistent with the Staff comment above, Horizon Utilities respectfully submits that it is by allowing its advanced Application to proceed that the Board can consider and balance the electricity-related objectives set out in the Ontario Energy Board Act ("OEB Act"), 1998. The first option presented by Staff of rejecting the Application on what is essentially a mechanistic calculation does not permit a consideration of those objectives when there is a demonstration that a distributor cannot otherwise manage its resources and financial needs in the remainder of its IRM period.

THE INTERVENOR SUBMISSIONS:

48. As noted above, it is by allowing this Application to proceed that the Board can consider and balance the electricity-related objectives set out in the OEB Act.

49. The intervenors have submitted that the Board should refuse the Application. Generally speaking, it appears that the principal basis for rejection is the strict application of the off-ramp mechanism, irrespective of Horizon Utilities' circumstances. Horizon Utilities submits that the intervenors' comments can be categorized into a limited number of themes:

- The off-ramp has not been met and, therefore, the Application should be rejected. As a corollary to this, it is being suggested that Horizon Utilities principal motivation for submitting its Application is to capture the revised ROE resulting from the December 11, 2009 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities (EB-2009-0084), referred to here as the "Cost of Capital Report";

- The load loss and volatility being experienced by Horizon Utilities does not warrant a cost of service application, and the Application should be rejected;

- There is no need for Horizon Utilities to undertake its proposed increased capital and OM&A expenditures in 2011, and it should instead defer proposed additional expenditures by a year, to be addressed in a 2012 cost of service application; and

- Rebasing a year early denies customers a benefit of the stretch factor under IRM, and the early rebasing should be rejected on that basis.

50. In order to avoid repetition, Horizon Utilities will respond to these intervenor themes rather than individual intervenor submissions.

- **The off-ramp provisions of the 3GIRM Report should not be the sole determinant of advancing Horizon Utilities' cost of service application:**

51. Energy Probe, for example, argues that Horizon Utilities has not met the Board's 300 basis point off-ramp on a historical basis, and that its projected ROE for 2011, ranging from 2% to 5%, should be ignored.

52. Horizon Utilities has already addressed this matter in its earlier comments, and will therefore revisit it only briefly here. The Board's April 20th letter explicitly contemplates the possibility of proceeding with cost of service applications where the 300 basis point off-ramp threshold has not been met. In reviewing the Hydro Ottawa Decision (page 9), the Board was clear that the off-ramp policy in the 3GIRM Report does not fetter its statutory jurisdiction to establish just and reasonable rates. It also appears clear from that Decision (at page 11) that the Board is prepared to consider forecasts of ROE, and not exclusively historical returns, in applying the off-ramp test.

53. As discussed in its reply to the Staff submissions, Horizon Utilities clearly approaches the 300 point dead band in 2009 at 6.09% and 2010 at 5.95% and will exceed this in 2011 (with projected returns of 2% - 5%). Horizon Utilities submits that it should qualify for early rebasing on the basis that it has approached the off-ramp threshold in 2009, is likely to get closer in 2010, and is certain to exceed this threshold in 2011 in the absence of its Application. Horizon Utilities also refers to related discussion of cumulative ROE shortfalls in response to the Staff submission.

54. Horizon Utilities submits that the off-ramp test is not applied by the Board as exclusively and absolutely in the manner that certain intervenors' submissions would suggest in a determination whether an advance rebasing is justified. SEC recognizes this at paragraphs 3 and 5 of its submission, where it states:

"3. At the same time, it would not be consistent with the above principles if there were no circumstances in which an LDC could seek an early rebasing. The easiest example is the utility – and there are several of them in the province – that has a single customer with a substantial percentage of their load. If that utility loses their main customer, is there any doubt that a full cost of service review is in order? Of course not. Indeed, it is in the interests of the utility, its ratepayers, and the Board to get them in for a review as quickly as possible. There may be significant impacts, and the faster there is a public review of how they should handle this major change, the more likely the response will be effective in minimizing the adverse impacts. It should not, for example, be necessary for them to meet the off-ramp test. If it is obvious that they have a big problem, the time to start solving the problem is right away.

5. In our submission, this line is not a bright line, with a clear delineation between those who qualify and those who don't. As the Board has made clear, it must be decided on a case by case basis. However, while recognizing that fact, it is still true that the level of "need" or "justification" that the Board will generally expect in these applications will be established by the guidance given in this and other decisions. In short, how serious does the situation have to be to justify early rebasing?"

55. The point here is that the Board ought to have the discretion to consider requests for early rebasing on a case by case basis and it is recognized that there are compelling reasons to ensure its discretion is not fettered in this regard. Horizon Utilities agrees. Additionally, as will be discussed below in the context of its load losses and volatility, Horizon Utilities' situation is similar to that contemplated by SEC. Horizon Utilities' circumstances over the past three years represent a situation in which "it is in the interests of the utility, its ratepayers, and the Board to get them in for a review as quickly as possible." Since 2008, Horizon Utilities' returns have been materially below that underlying its 2008 Board-approved revenue requirement and this situation continues to deteriorate. Wage and price inflation is inescapable and cost and investment deferrals increase utility risks.

56. Horizon Utilities understands that the Board may be reluctant to advance a cost of service application based solely on forecast shortfalls of ROE. However, Horizon Utilities has demonstrated a trend of historical material and declining shortfalls in revenue and ROE for reasons out of its control that add credibility to forecasts.

57. Horizon Utilities observes that Staff recognizes the risks inherent in its current situation and the potentially far reaching consequences of load loss and volatility arising from events that it could not reasonably have anticipated.

58. Related to the off-ramp theme expressed by intervenors is their contention that this Application simply represents an attempt by Horizon Utilities to obtain the higher ROE

established through the Cost of Capital Report. SEC most strongly asserts this in its submission as "The Real Reason for this Application: The Increase in the Cost of Capital".

59. Horizon Utilities has submitted a wide body of evidence over the past three years with respect to reasons leading to and underlying its Application. Horizon Utilities has never expressly submitted in any evidence (or anywhere else for that matter) that the principal reason for the Application is to achieve the higher ROE afforded under the Cost of Capital report of the Board. Horizon Utilities has been nothing but consistent and emphatic with respect to four principle reasons motivating this Application, which are restated in this submission above. Horizon Utilities finds SEC's submission in this regard "wild" with respect to its use of the excerpt from Horizon Utilities 2009 Audited Financial Statements and related Management's Discussion and Analysis (SEC submission paragraph 8), particularly given the wide body of evidence to the contrary. The excerpt referenced by SEC is a typical and necessary financial statement disclosure of a material change in a reporting entity's circumstances. This disclosure is entirely appropriate in that it provides readers of Horizon Utilities' financial statements with the following information in respect of the material change in Cost of Capital: i) the nature of the change, ii) the impact of the change, iii) the timing of the change. Nowhere in this excerpt, or in the related MD&A reference, is it explicitly (or even implicitly) provided that the principal reason for filing the Application is to achieve a higher ROE.

60. Horizon Utilities' intention to file a cost of service application for 2011 rebasing was clearly expressed in its Z-factor Application[15]. That application was filed on September 3 2009, months before the Board's Cost of Capital Report was issued or Horizon Utilities' 2009 audited financial statements were completed. Horizon Utilities' concerns about reductions in load were conveyed to the Board almost a year earlier, in December 2008.

61. Horizon Utilities finds SEC's comments in paragraphs 11 and 12 ironic in the context of its very weak arguments regarding the "real reason" for the Application that go on to assert that Horizon Utilities has been less than straightforward with the Board and that this is reflective of some pattern of its behaviour. Horizon Utilities takes very strong exception to these attacks and views such as serious, inflammatory, and unfounded regarding its conduct with

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[15] EB-2009-0332, Application Summary, p. 4 of 9

respect to this and previous Board proceedings and other speculative remarks that unjustly besmirch the reputation and integrity of Horizon Utilities and its employees. Horizon Utilities submits that tactics of this nature are unfair and nefarious and should be strongly discouraged by the Board. Horizon Utilities would rather that SEC employ more professional tactics used by its intervener peer group that are more firmly founded on a constructive review and debate of evidence rather than wild invocations of speculation and inferences of hidden intent. Horizon Utilities asks that the Board review the pattern of argument in SEC paragraphs 6 through 12 alongside the referenced evidence and consider whether the sort of comments in paragraphs 11 and 12 should be formally discouraged, particularly given very poor evidence in support of such strong and impassioned submissions.

62. With respect to SEC's speculation about Horizon Utilities' understanding of the Z-factor Decision, Horizon Utilities submits that the Board's findings are clear – on a plain reading of the Decision, the way to deal with Horizon Utilities' circumstances is by way of a cost of service application. There is no suggestion in the Decision that the filing of such an application is at its next scheduled time under IRM. If that were the case, the Board could simply have rejected the Z-factor Application or indicated that this was a matter to be dealt with in 2012, as part of Horizon Utilities' next scheduled rebasing. The Z-factor Decision did not include such express indication. While the Board did not direct Horizon Utilities to bring a cost of service application for rebasing in 2011, it is reasonable to conclude that the Board clearly did not preclude a filing for 2011, and Horizon Utilities' circumstances continue to warrant "get[ting] them in for a review as quickly as possible."

63. As for the suggestion by SEC (at paragraph 28) that the Z-factor versus cost of service distinction was not central to the Board's reasoning in the Z-factor Decision, Horizon Utilities strongly disagrees. Horizon Utilities refers to page 10 of its Z-factor Decision, where the Board makes the statement quoted by Schools, that "For these reasons, the Board finds that Horizon has not demonstrated that the harm caused by the Subject Customer's reduced load is genuinely incremental to Horizon's experience or reasonable expectations. Having failed to do so, Horizon has not established that a Z-factor event has occurred." However, it is important to also refer to the next paragraph in the Decision, in which the Board states:

"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 views of some intervenors that the Z-factor criteria were not intended to be used for the recovery of revenue losses."

64. Horizon Utilities submits that the Z-factor/cost of service distinction was of great importance in the Z-factor Decision. The Board comments provided in quotations above clarify that the appropriate way to deal with Horizon Utilities' circumstances is not through its past Z-factor Application, but through the cost of service application currently before the Board.

- **The load loss and volatility being experienced by Horizon Utilities clearly warrant a cost of service application for rebasing in 2011:**

65. Please refer to paragraphs 16 to 22 and 37 to 39 above, in addition to the following submissions under this heading.

66. Intervenors (SEC at paragraph 24 and Energy Probe at page 17) suggest that Horizon Utilities is "not particularly vulnerable to loss of load" based on a review of a Standard & Poor's ("S&P") Rating Report filed at Exhibit 1, Tab 3, Schedule 4, Appendix 1-14. S&P does not make this explicit statement in its report and Horizon Utilities would not agree with SEC's submission in paragraph 24 that "it is well accepted that they [large electricity distributors] are not particularly vulnerable to loss of load". As a matter of fact, S&P only uses the word "load" once in its report in reference to the amount of load Horizon Utilities delivers in the Province of Ontario. In any event, Horizon Utilities does not agree with the conclusion of SEC in relation to the S&P report excerpts that it provides in support of such.

67. It is important to note that the opinion of S&P in the report referenced by the intervenors is underpinned by its understanding of regulatory rate-making policy. The S&P report was based on financial statement projections that assumed a re-basing of rates in 2011. Clearly, this was a factor in S&P's determination of Horizon Utilities' credit rating.

68. Rating reports are principally focused on an entity's ability to service debt obligations and risks related thereto. Horizon Utilities respectfully submits that the objectives of a credit rating report are quite different from the Board's objectives in setting just and reasonable rates and its other determinations. As such, a credit rating report cannot reasonably be considered a substitute for a review by the Board of the facts before it. The fact that Horizon

Utilities is presently capable of servicing its debt and can take certain actions of deferral and mitigation to support such in adverse financial circumstances does not mean that this aligns to the interests of the utility or its customers.

- **Horizon Utilities' backlog of capital and OM&A expenditures must be addressed. Continuing to defer Horizon Utilities' proposed incremental expenditures by another year does not assist the utility or its customers with respect to the adequacy, reliability, and quality of electricity service:**

69. In its Application, Horizon Utilities has provided evidence with respect to the condition of its distribution system and necessary related renewal work to ensure continued reliability and quality of electricity service to its customers[16]. The Application also provides for investments in new systems and processes to address those that are either presently at the end of their productive life or are required to deliver productivity enhancements. Many of these investments have been deferred as a result of the significant revenue shortfalls over the past three years. In order to balance risks related to managing utility resources, Horizon Utilities has effectively deferred opportunities that would otherwise support a realization of productivity that aligned to the achievement of the IRM productivity and stretch factor.

70. Energy Probe (at page 15) submits that Horizon Utilities' proposed increases in capital expenditures would not meet the ICM threshold for 2011, and as a result, it would be appropriate to manage that level of expenditure within IRM. This submission might be reasonable if Horizon Utilities was realizing the level of revenue afforded under IRM to finance this level of investment. However, as submitted earlier, Horizon Utilities' forecast revenue for 2011 is materially below that which would be afforded under 2011 IRM by approximately $6.3MM.

71. Energy Probe also submits a reference to the Board's comment [in the Hydro Ottawa decision] that Hydro Ottawa should be able to implement its asset management plan now, within the IRM period. Horizon Utilities does not disagree with this in principle as asset management is a long-term ongoing issue for distributors. However, as a matter of practicality in the absence of the advanced rebasing, it would be imprudent for Horizon Utilities to provide for the full extent of the capital and operating programs contemplated in

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[16] Ex 2, Tab 1, Schedule 3, p.6

the Application when such would result in anticipated returns in the range of 2%-5%. The high end of this range already contemplates a level of deferral relative to expenditures provided in the Application.

72. SEC suggests (at paragraph 37) that because Horizon Utilities invested in an Enterprise Resource Planning ("ERP") system (this expenditure was made in 2008, and as noted in the Schools submission, this was supported by Schools), other projects would have to wait, as "there is not an unlimited budget." Horizon Utilities submits that ERP was a project that significantly improved utility productivity and that its 2008 rate application submission incorporated an amount of productivity benefit into its revenue requirement, which was an innovative approach not previously encountered by the Board. Horizon Utilities is mindful of the impact of budgets on ratepayers, as it was in its 2008 application with respect to ERP. Horizon Utilities' Application does not reflect an unlimited budget but a balanced capital and operating program that has considered the timing of necessary investments, including those that have been deferred over the past three years.

73. In this regard, Horizon Utilities submits that SEC's suggested limitations on a Horizon Utilities cost of service application are impractical and inconsistent with its previous submissions on Horizon Utilities' proceedings. SEC opposed the Z-factor Application, but at paragraph 47 of its submission, it appears to suggest that the scope of the Application should be limited to addressing the loss of load. While the correction of the load losses is of critical importance, this seems to apply a Z-factor approach to a cost of service process. This approach ignores necessary investments that are the subject of a cost of service application. The SEC approach would, in effect, result in Horizon Utilities deferring incremental spending not for one year, but for another four years, through another IRM cycle. This approach is detrimental to both the utility and its customers, including the school boards that will be served by a deteriorating system.

74. Finally on this theme, SEC suggests that Horizon Utilities' solar generation activities, which are permitted under the OEB Act, have shifted the focus from its distribution business. This is entirely unfounded. Horizon Utilities has hired dedicated staff to develop the solar business, which is entirely funded by the shareholder and not ratepayers. The utility and the solar business operate separately with adequate and dedicated management oversight to deliver on their respective objectives and compliance requirements.

- **The benefit to customers of one more year of the stretch factor under IRM has been vastly outweighed by the savings they have realized through the material revenue shortfalls since 2008, for reasons described above:**

75. At page 9 of its submission, Energy Probe argues that accelerating rebasing by one year denies Horizon Utilities' customers the benefit of the 0.4% stretch factor adjustment that would be part of the 2011 IRM adjustment. Horizon Utilities estimates the value of that adjustment to be approximately $300,000 spread across Horizon Utilities' 235,000 customers. Horizon Utilities submits that its customers are not concerned with recovering a stretch factor in isolation of consideration for the totality of their electricity costs and continuous service delivery.

76. As a practical matter, the load shortfalls have been far more valuable to customers than one year of foregone stretch factor. The material revenue shortfalls have resulted in lower customer bills over the past three years than would have been the case if Horizon Utilities' 2008 load forecast had corresponded more closely to the actual circumstances in recent years. Horizon Utilities estimated above that, in the absence of a rebasing in 2011, it will have under-recovered from its customers a total of approximately $13.9MM from 2008 to 2011, of which $5.0MM relates to 2011. Clearly, these amounts are far in excess of the stretch factor and of far greater concern to Horizon Utilities customers. Horizon Utilities does not seek to recover past forgone revenues but does seek to not have this condition persist into 2011.

CONCLUSION: Horizon Utilities seeks the Board's confirmation that it may proceed with its advanced cost of service application for 2011 rates:

77. Horizon Utilities submits that the preliminary issue for the Board is whether the Application should be allowed to advance; not whether the requests in the Application should be granted or whether there should be any limitations or constraints on such relative to other filers scheduled for a 2011 rebasing. The latter issues would be investigated as part of the full and usual process for reviewing cost of service applications. Horizon Utilities understands that, if the Board allows the Application to advance, the Board approved revenue requirement and rates may differ from those proposed in the Application.

78. Horizon Utilities respectfully submits that rebasing in 2011 rather than 2012 is warranted based on the evidence in the Application and as provided through this preliminary

proceeding. In the absence of an advanced rebasing Application, and with consideration for further deferral of capital and operating programs contemplated therein, Horizon Utilities' projected return for 2011 will be well outside the ±300 basis point dead band set out in the Board's July 14, 2008 3GIRM Report. Further, its projected 2010 ROE, when adjusted as noted earlier, will also approach the ±300 basis point dead band. Further submissions in respect of Return on Equity shortfalls are provided above.

79. Horizon Utilities has experienced three years of significantly reduced loads and revenues (the actual 2008 test year and the 2009 and 2010 IRM years), and three years of deferrals of capital and OM&A expenditures. These deferrals have been necessary in the context of endeavouring to adequately manage resources and financial needs in a manner that has balanced customer and shareholder interests. While one more year of IRM may seem like a short time, Horizon Utilities submits that it has reached a point where continuing with IRM would not adequately address managing utility resources or financial needs in the best short or long-term interests of its customers. It must be allowed to re-base in 2011.

80. Horizon Utilities has been in regular contact with the Board and Staff with since 2008 with the objective of creating awareness and engaging in dialogue on addressing the issue of material load shortfall and related impacts. One outcome of such was the Z-factor Application, which was denied but resulted in Board guidance that the way to deal with a loss of revenue of this nature was by way of a cost of service application. Horizon Utilities is now before the Board with such an Application.

81. Horizon Utilities' submits, and respectfully urges, that its Application be permitted to proceed. Horizon Utilities submits that the ±300 basis point dead band set out in the 3GIRM Report should not be used as the sole determinant of whether to advance a cost of service application. This was acknowledged by the Board in its October 27, 2010 Decision on Hydro Ottawa Limited's 2011 cost of service rate application. At page 9 of that Decision, the Board stated that "Section 78 of the Ontario Energy Board Act does not specify or restrict the methodology to be applied by the Board in determining just and reasonable rates. The Board's IRM policy framework also does not fetter the statutory discretion set out in section 78 of the Act." At least one intervenor in that proceeding acknowledges the Board's "long-established practice to listen to any application that a utility files", and "strongly supports the Board's policy and practice of allowing applications by any utility at any time, and we would

not like to see that approach watered down. Not only does it perform the flexibility function that is so important, but it also acts as a relief valve, allowing parties to reach agreements on rates and other issues knowing that if it all doesn't work out, there is a way of getting any problems fixed in a timely manner. Many ADR results would not have been possible but for the knowledge that the relief valve exists."[17]

82. Horizon Utilities' acknowledges the difficulty of the Board in assessing the future and whether past conditions and future forecasts clearly demonstrate why and how a distributor cannot adequately manage its resources and financial needs during the remainder of its IRM plan period. However, Horizon Utilities submits that its significant body of evidence of past conditions communicates a trend that supports a certainty that it will not be able to manage such in the best interests of its customers into 2011, and that such interests have already suffered impairment. Additionally, Horizon Utilities believes that it has provided evidence that IRM does not address all scenarios that may require an off-ramp, such as the cumulative impact of revenue and ROE shortfalls that, in any one year, do not meet the strict off-ramp test provided in IRM. This notwithstanding, Horizon Utilities has realized material impairments in ROE across the last three years as noted above, almost 200 basis points on average and 597 basis points cumulatively. Horizon Utilities submits that there is no practical scenario that would not result in an off-ramp condition in 2011, despite attempts at further deferral.

83. Horizon Utilities understands the impact of the Application on its customers with respect to rising electricity costs. However, with consideration that customers have, in aggregate, incurred far less cost than should have been provided based on the 2008 cost of service application, Horizon Utilities submits that customer interests will be served by the advanced Application which will address the present level of resource management inadequacy and related financing in support of a sustainable and reliable electricity distribution system.

84. Horizon Utilities submits that the Application should proceed in the same manner as other utilities that are on the Board's list for rebasing in 2011, including all related considerations with respect thereto. The Board should reject the alternatives to a full cost of service rebasing application such as, for example, that proposed by Energy Probe at page 19 of its

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[17] School Energy Coalition submission in EB-2010-0133, October 7, 2010, at pages 1-2.

submission. Energy Probe suggests alternatives such as a temporary change or elimination of the productivity and stretch factors used in the IRM process. Horizon Utilities submits that the elimination of approximately $300,000 in stretch factor adjustments for 2011 does not begin to address the millions of dollars of under recoveries it has or is likely to experience otherwise or the related investments that are provided in the Application.

85. In order for the Board to determine any appropriate remedy for Horizon Utilities, it is important for the Board to hear this Application and test it fully in order to "[assess] the actions taken by a distributor" and to evaluate such "in the context of their overall impact on the utility." Horizon Utilities understood from its plain reading of the Z-factor Decision that the Board "believes that the most appropriate approach for a distributor to take under such circumstances is to file a cost of service application" and that it was correct in filing this Application as a result (page 16, Z-factor Decision).

RELIEF REQUESTED:

86. Horizon Utilities requests that the Board confirm that this Application for rebasing in 2011 may proceed according to the process established for distributors rebasing in 2011 and without any additional constraints or limitations otherwise proposed by intervenors and that the Board establish a timeline for the balance of this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 29TH DAY OF NOVEMBER, 2010

[*Original Signed By Indy Butany-DeSouza*]

Indy J. Butany-DeSouza
Vice-President, Regulatory & Government Affairs
Horizon Utilities Corporation