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May 6, 2011

VIA MAIL and E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Vulnerable Energy Consumers Coalition (VECC)
Notice of Intervention: EB-2010-0131
Horizon Utilities Corporation – 2011 Electricity Distribution Rate Application

Please find enclosed the submissions of VECC in the above noted proceeding. Please note that have at all times worked from redacted, public material such that our argument does not rely on or disclose any information that was deemed confidential.

Thank you.

Yours truly,

Michael Buonaguro
Counsel for VECC
Encl.

HORIZON UTILITIES CORPORATION (HORIZON)
2011 RATE APPLICATION (EB-2010-0131)

VECC'S FINAL SUBMISSIONS

1 The Application

1.1 Horizon has applied for forward test year rates for 2011. As of the date of the Argument in Chief filed by Horizon, the revenue deficiency claimed is $20,721,655, on a base revenue requirement of $102,617,636[1]. From the perspective of a residential ratepayer consuming 800 kWhs per month, this application, if approved as currently filed, represents an 18.97% increase in distribution rates.[2] This is in stark contrast to the .18% rate increase that would have been experienced under the 3rd Generation Incentive Rate Mechanism had Horizon not filed for early rebasing.[3]

1.2 In making its submissions VECC has generally approached each issue as it would a normal cost of service application. However, in VECC's submission, the Board should remain mindful of the disparity between the rates being sought by Horizon and the legitimate rate expectations Horizon's customers had for the current year, particularly in light of the circumstances giving rise to the early rebasing in the first place.

1.3 In this context VECC makes the following submissions with respect to the specific components of the rate application. VECC notes that it has participated in an ongoing exchange amongst several intervenor groups with respect to proposed and draft submissions, and where appropriate has adopted the submissions of others in order to assist the Board in efficiently

[1] Horizon Argument in Chief, page 3.
[2] Revenue Requirement Workform filed by Horizon on April 15, 2011.
[3] The applicable 3GIRM rate of .18% was calculated based on the applicable Inflation adjustment (1.3%) the applicable efficiency factor (.72%) and the applicable stretch factor (.4%) had Horizon applied for 2011 rates under 3GIRM.

processing the application.

2 Capital Spending and Rate Base

2.1 With respect to the 2011 rate base opening balance and the closing to rate base of $2.841M in CWIP in 2011, VECC has reviewed the submissions of Energy Probe and adopts these submissions.[4]

2.2 For 2011, Horizon proposes capital additions (and spending) in total of $45,570,373, an amount that includes $1,578,275 spending on smart meters.[5] Therefore, excluding smart meters, Horizon proposes 2011 capital additions of $43,992,098.

2.3 VECC notes that Horizon's last rebasing was in 2008.[6] VECC further notes that the applicant's witness has referred to the increased requirements for capital spending from 2008 and onwards as evidenced by the following excerpt from the oral hearing:

> Our application provides evidence of capital expenditures from 2008 to 2010 and then in the test year that are well in excess of depreciation, driven largely by distribution system renewal requirements.
> These have driven depreciation increases approaching $5 million, compared to the 2008 approved amount.
>
> We also generated measurable productivity improvements in cost reduction since 2008 that have served to reduce the revenue deficiency that would have otherwise been necessary at this time.[7]

2.4 If we accept that 2008 is a useful starting point for the purpose at hand,

[4] Energy Probe Research Foundation, Argument, pp 4-6
[5] Exhibit 2, Tab 2, Schedule 2, page 5, Figure 2-12
[6] Oral Hearing, Transcript, Volume 1, page 16
[7] Oral Hearing, Transcript, Volume 1, page 31, testimony of Mr. Basilio,

VECC notes that the actual capital additions are as follows:[8]

Year	Capital Additions
2008	**44,996,709**
2009	**43,730,887**
2010	**34,590,491**
Three-Year Average	**41,106,029**

2.5 As shown above, the three-year average of capital additions, starting with 2008, is $41,106,029. In VECC's view, this would be the ceiling for a reasonable Capital Budget estimate for 2011.

2.6 To approach the issue from another angle, VECC notes that in the original application, filed on August 26, 2010, Horizon forecast 2010 capital additions of $38,294,000.[9] However, actual 2010 additions were $34,590,491 as indicated above. The difference between the estimated capital additions and actual capital additions for 2010 is thus $3,703,509, with the estimate exceeding the actual by this amount.

2.7 VECC notes that if one were to assume a similar "optimism" with respect to the 2011 forecasted capital additions, the initially forecasted capital additions of $45,570,373 would be reduced by $3,703,509, yielding a "revised forecast" of 2011 capital additions of $41,866,864,[10] which VECC submits is also a reasonable basis for setting 2011 capital expenditures.

[8] 2008 and 2009 from Exhibit 2, Tab 2, Schedule 2, Figures 2-9 and 2-10. 2010 from Energy Probe Technical Conference Question 1, page 3

[9] Exhibit 2, Tab 2, Schedule 2, page 4, Figure 2-11

[10] The adjustment to rate base would include the removal of the smart meter component of this spending.

2.8 In either case, VECC submits that the appropriate level of 2011 capital expenditures is no more than $41,866,864, i.e., a reduction from the proposal of at least $3.703M, in what VECC would suggest is the most favourable projection for Horizon. VECC is aware that other intervenors, and Board Staff, have made or will make detailed submissions on the appropriate level of Capital Spending with a resulting reduction in Capital Budget in excess of $3.703M, which submissions VECC does not oppose.

Working Capital Allowance

2.9 VECC has reviewed the submissions of Energy Probe on this component of rate base, including its analysis of the Lead Lag Study,[11] and adopts those submissions.

3 Load Forecast and Other Revenues

A. Customer Count Forecast

3.1 Horizon's 2010 and 2011 forecast customer count (by class) is prepared independently of it volume forecast. For the Residential, GS<50, GS>50, Street Lighting, Sentinel Lighting and USL classes the growth in customers was forecast using the geometric mean growth over the period 2003 through 2009[12]. For the Large Use class, the customer count for 2010 and 2011 is held constant at the 2009 level[13].

3.2 In response to Energy Probe #9 b) Horizon has provided the actual 2010 customer count for each rate class and the values are very close to the forecast values in the initial Application, VECC submits that the 2011

[11] Energy Probe Research Foundation, Argument, pp 9-20

[12] Exhibit 3, Tab 2, Schedule 2, page 9 (Revised March 14, 2011)

[13] Exhibit 3, Tab 2, Schedule 2, page 17 (Revised March 14, 2011)

customer counts proposed by Horizon in its original Application[14] are reasonable and should be accepted by the Board.

B. Volume Forecast – Large Use Class

3.3 For in the March 2011 Update, apart from the three customers specifically discussed in the Update, the 2011 forecast for energy and billing demand for the class was based on the 2010 actual results[15]. In VECC's view, this forecast is conservative as it fails to take into account the economic growth forecast for 2011[16].

3.4 For the three customers noted specifically in the Update, the 2011 volumes were set as follows[17]:

- For the first customer, the billing demand was eliminated completely for 2011 based on its announced shutdown, and
- For the other two customers, the actual billing demand for the most recent three months was used to estimate the monthly demand for March through December of 2011. This estimate was combined with the actual billing demand for January and February 2011 to establish a forecast for 2011 overall,

Again, VECC considers this forecast to be conservative. In the case of the first customer, Horizon has acknowledged that the load has not been eliminated for all of 2011[18]. For the other two customers, Horizon has effectively assumed that the current lock-out/closure due to bankruptcy conditions will continue for the balance of the year[19].

3.5 Horizon proposes to establish a variance account related specifically to the sales to two of the three customers and share any increase in distribution

[14] Exhibit 3, Tab 2, Schedule 1, page 6
[15] Transcript Volume #3, page 36
[16] For purposes of developing its non-Large customer load forecast Horizon has assumed an Ontario GDP growth of 3.2% for 2011 – VECC #3 b).
[17] Exhibit 3, Tab 2, Schedule 2, pages 15-16 (Revised March 14, 2011)
[18] VECC #39 a) & b)
[19] Exhibit 3, Tab 2, Schedule 2, pages 15-16

revenues for 2011 and beyond 50/50 between ratepayers and its shareholder[20]. Given the conservative nature of both the forecast for these three customers and the Large Use forecast for 2011 overall, VECC submits that any amounts accruing in the proposed variance account should not be "shared" with the shareholder but rather 100% should accrue to the benefit of ratepayers.

C. Volume Forecast – Non-Large Use Customers

3.6 In order to forecast total sales to the balance of its customer classes, Horizon developed a regression model using 2003-2009 data that related monthly purchases (excluding the Large Use class) to weather, calendar, economic and CDM activity variables[21]. During the course of the proceeding this model was revised twice and the forecast sales for 2010 and 2011 were revised three times in order to reflect revisions to the historical CDM activity variable and projections for 2010 and 2011 regarding the persistence of the savings associated with previous years' programs. The following table summarizes each of the forecasts presented and some of the key parameters associated with the underlying regression model.

[20] Transcript Volume #3, pages 73-74 and Argument-in-Chief, page 6
[21] Exhibit 3, Tab 2, Schedule 2, pages 2-3 (Revised March 14, 2011)

Context/ Reference	Forecast 2011 Purchases	2011 CDM Activity	Regression Coefficients	
			CDM	**GDP**
Initial Appl.	4,127.6 GWh	167.1 GWh	-0.37	1,331,306
IRs/Tech Conf	4,063 GWh	167.1 GWh	-0.38	1.014,366
Tech Conf Undertaking	4,121 GWh	154.3 GWh	-0.38	1,014,366
April Update	3,991 GWh	145.2 GWh	-0.49	826,128

Sources: Initial Application – Exhibit 3, Tab 2, Schedule 2, pages 2-6
IRs/Tech Conference – VECC #2 b) & c) and VECC TC #1 a) & f)
Technical Conference Undertaking – JT1.2
Oral Proceeding Undertaking – UT3.3

3.7 VECC has a number of concerns with Horizon's proposed 2011 (non-Large Use) volume forecast.

Regression Model Used

3.8 VECC's first concern is with respect to the way historical CDM activity has been established for purposes of regression model and the associated coefficient for CDM variable that has been estimated for the model. The regression model seeks to explain monthly purchases, whereas the CDM activity variable used to estimate the model reflects annual CDM activity[22]. Horizon's witnesses claim that the regression model takes this into account

[22] Transcript Volume #3, pages 53-54

by taking a “percentage” of the CDM variable[23]. However, the percentage taken was initially 37% and is now 49%[24] whereas if one were to transform annual savings into equivalent monthly savings the factor used would be 1/12th or roughly 8.3%.

3.9 Horizon suggests that the coefficient could also be picking up other CDM activity within the service area that is not measured by the CDM activity variable and/or picking up effects attributable to other factors such as economic conditions[25]. Horizon acknowledges that the estimated coefficient is “high” but justifies its value and the inclusion of the CDM activity variable in the estimated regression model on the basis that it has a “very good t-statistic”[26].

3.10 In previous Decisions[27], the OEB has indicated that for a forecasting model to be considered robust it must not only have a reasonably sound statistical foundation but the resulting coefficients must not have counter-intuitive signs. VECC submits that a similar problem exists when the regression analysis includes coefficients where the magnitude of the sign is counter-intuitive and that such a situation exists with the CDM activity variable employed by Horizon in its regression model. While the CDM variable may well be capturing (through its coefficient) additional CDM activity over the historical period it is not reasonable to assume that each additional 1 GWh of incremental CDM planned by Horizon for 2011 will generate a total reduction in purchases of 3.2 GWh[28]. It is VECC’s submission that this is particularly true when the level of annual incremental CDM activity for 2011 is significantly higher than that experienced during the historical period used

[23] Transcript Volume #3, page 55
[24] See Table in paragraph 3.6 above
[25] Transcript Volume #3, pages 65-66
[26] Transcript Volume #3, page 55
[27] EB-2009-0259, page 7(Burlington Hydro Inc.)
[28] The 3.2 GWh is calculated using the same methodology as outlined in Transcript Volume #3, pages 63-65, except a coefficient of -0.49 was used instead of -0.37. The arithmetic is as follows: 1 GWh * 78 * -0.49 /12.

to estimate the model[29].

3.11 Horizon's other explanation for the size of the coefficient is that it may be picking up the effects of other factors such as economic conditions. This is a common problem in statistical analysis known as "multicollinearity" and arises when a correlation exists between the various explanatory variables used in a regression analysis. However, when Horizon's expert was asked about the issue the response was that he did not know it well enough to address questions on the topic[30]. VECC notes that this issue has been identified and explained by other electricity distributors seeking to include a CDM activity variable in their load forecast regression model[31]. VECC also notes that the presence of multicollinearity can undermine the robustness of the regression model for forecasting purposes if the changes in forecast values for the (correlated) explanatory variables are materially different, which is the case for Horizon's 2011 forecasts of CDM activity and economic growth.

3.12 VECC also has concerns regarding the timeliness of the final regression model proposed by Horizon and the inability of parties to fully understand the nature of the changes made to the historical CDM activity data and the results the new model produces. In March 2011 Horizon filed an updated 2011 load forecast for its Large Use class but did not update the forecast of purchases for non-Large Use customers[32]. Indeed, it was not until the oral proceeding itself that Horizon undertook[33] to update its forecast using a regression model based on the OPA's actual 2006-2009 reported CDM results. At the same time, Horizon made a number of adjustments to the

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[29] The total incremental CDM over the period 2003-2009 is 64.1 GWh – an average increase of roughly 10 GWh per year (UT3.4). In comparison the 2011 incremental CDM forecast used by Horizon is 70.25 GWh. Note: Even the lower CDM forecast recommended by VECC is significantly higher than the historical average.

[30] Transcript Volume #4, page 32

[31] Niagara Peninsula Energy Inc, EB-2010-0138, Exhibit 3, pages 32-35

[32] VECC #40 b)

[33] Transcript Volume #3, pages 49-50

OPA's forecast CDM program savings' persistence through to 2011[34]. However, parties were unable to fully explore/understand the nature and implications of these adjustments due to their late filing in the process[35].

3.13 Overall, VECC submits that the updated regression model is not sufficiently robust or its development well understood to be used to forecast 2011 volumes.

CDM Adjustment

3.14 VECC's other major area of concern regarding Horizon's 2011 volume forecast is with respect to the CDM adjustment the Company has incorporated into its 2011 load forecast. The 70.25 GWh used by Horizon represents 25% of its preliminary energy savings target of 301 GWh for 2011-2014[36].

3.15 During cross-examination Horizon acknowledged[37] that there are two possible interpretations of "Net Cumulative Energy Savings" as used to define electricity distributors approved CDM energy targets. One interpretation is that it represents the total savings persisting in 2014 as a result of programs implemented over the four year period while the second one is that it represents the total accumulated savings over the four years 2011-2014. Under the first interpretation, the CDM savings from new programs in each year (assuming 100% persistence) need to be roughly 25% of the overall target. Under the second interpretation, the CDM savings in each year (assuming 100% persistence) need to be 10% of the overall target. Horizon has confirmed that it has adopted the first interpretation and that its CDM strategy was developed accordingly[38].

3.16 With regard to the Horizon's interpretation of the its CDM GWh target,

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[34] Transcript Volume #4, pages 27-28
[35] Transcript Volume #4, pages 23-24
[36] Board Staff #12 c)
[37] Transcript Volume #3, pages 57-58
[38] Transcript Volume #3, page 60

VECC notes that in response cross-examination Horizon acknowledged that it has not sought any clarification from either the OPA or the OEB regarding its interpretation of "Net Cumulative Energy Savings" or used the tools developed by the OPA for CDM planning[39]. In contrast VECC notes materials provided in other 2011 rate application proceedings indicate that the OPA's development of the proposed CDM targets for electricity distributors was based on the second interpretation[40]. Furthermore, VECC notes that in its submissions Board Staff indicates that assuming savings equivalent to 10% of the target for 2011 may be "more realistic"[41].

3.17 Horizon's second claim is that their CDM strategy is on track to deliver 75 GWh (or more) in 2011 and therefore this is a reasonable value to use[42]. In VECC's submission little weight should be given to Horizon's claims regarding savings for 2011 when they were unable to provide the final results for 2010[43]. Furthermore, if Horizon has developed its CDM strategy based on a misinterpretation of the required energy savings target then this error should be corrected – not compounded by using this misinterpretation in the development of its 2011 load forecast.

3.18 Finally, in its Decision regarding Hydro One Networks Brampton's 2011 Rates the Board approved a CDM adjustment for 2011 equal to 10% of Brampton's 2011-2014 CDM energy target[44]. VECC notes that this approach is consistent with the second interpretation outlined in paragraph 3.15 above.

3.19 Overall, VECC submits that the second interpretation is the correct one and the Horizon's 2011 CDM energy adjustment should be10% of its approved

[39] Transcript Volume #3, pages 61-62
[40] EB-2010-0133, Exhibit JT1.1
[41] Board Staff Submission (Redacted, page 31
[42] Transcript Volume #3, page 60
[43] Transcript Volume #4, page 32
[44] EB-2010-0132 Decision, page 8

281.42 GWh energy target[45] – 28.142 GWh.

2011 Purchased Volume Forecast

3.20 Horizon's updated forecast of purchase volumes (excluding Large Use) is 3,991.0 GWh[46]. In comparison, VECC notes that the weather normalized actual results for 2009 and 2010 are 4,250.9 GWh and 4,255.4 GWh respectively[47]. VECC submits that even with Horizon's 75.25 GWh of incremental CDM activity in 2011 a reduction of over 260 GWh in purchases is unreasonable, particularly as the CDM impacts will be offset by the impact of forecasted increase in economic activity for 2011. In VECC's view, the 2011 forecast produced by the model is unrealistic and further demonstrates that the model can not be relied on to forecast 2011 purchase volumes.

3.21 In the absence of an alternative "model" for forecasting 2011 (non-Large Use) volumes, VECC submits that the Board should adopt a pragmatic approach. VECC has had an opportunity to review the approach suggested by Energy Probe in its Argument. In VECC's view both their approach and resulting forecast value for 2011 (4,267.5 GWh) are reasonable and should be adopted by the Board.

D. <u>Miscellaneous Revenues</u>

3.22 For 2011 Horizon is forecasting Miscellaneous Revenues of $5,481,969[48]. This value is same as the forecast revenues for 2010, with exclusion of $119,690 in rental revenue due to the loss of a tenant in November 2010[49].

3.23 During the interrogatory process[50] Horizon provided a revised forecast of its 2010 miscellaneous revenues based on actual revenues up to September

[45] VECC #4 a)
[46] UT3.3, Excel Load Forecast Model results
[47] VECC #3 a)
[48] Exhibit 3, Tab 3, Schedule 1, page 1
[49] Exhibit 3, Tab 3, Schedule 3, page 5
[50] Energy Probe #13

2010. The revised forecast is $5,861,659, which is $260,000 higher than the initial forecast for 2010. Subsequently, during for the Technical Conference[51], Horizon provided the actual 2010 miscellaneous revenues which were $6,062,880, which is $461,221 higher than the original 2010 forecast.

3.24 VECC submits that since the forecast 2011 miscellaneous revenues were based on the 2010 forecast adjusted for the lost rental income, the 2011 forecast should be increased by $460,000 to reflect the higher actual 2010 revenues. This would bring the revenues for 2011 up to $5,941,969. VECC notes that the actual miscellaneous revenues for 2007, 2008 and 2008 were all greater than this, even after allowing for the roughly $120,000 loss in rental income.

4 Operating Expenses

OM&A

4.1 The initial Application proposed operating expenses of $47,875,239 for 2011, including property taxes of $337,800; OM&A costs were forecast at $47,537,439 (excluding property taxes).[52]

4.2 The Updated Application proposed operating expenses of $47,875,239.[53] However, in response to IRs on the updated evidence, Horizon provided an updated Revenue Requirement Work Form revising its operating expenses down by $80,000 to $47,795,239 for 2011, including property taxes of $337,800; the revised OM&A costs were also reduced by $80,000 to $47,457,439 (excluding property taxes).[54]

4.3 VECC notes that the actual 2009 and 2010 OM&A figures, comparable to

[51] Energy Probe TC #5 b)
[52] See RRWF at Exhibit 6, Tab 1, Schedule 2, Appendix 6-1, page 3 of 11.
[53] Exhibit 1, Tab 2, Schedule 4, page 1 Updated
[54] Per RRWF provided in response to IRs on March Updated evidence.

the proposed 2011 amount of $47,457,439, are $38,804,535 (actual 2009) and $40,066,077 (estimated 2010).[55]

4.4 Horizon is therefore requesting a 22.30% increase in 2011 OM&A expenses over the 2009 actual OM&A expenses.[56]

4.5 VECC submits that for the most significant component of OM&A, compensation and benefits, the information on the record is deficient especially in respect of average compensation in terms of allowing for a meaningful comparison of the Test Year proposal to earlier historical results.

4.6 This point was made clearly at the hearing[57] culminating in the following exchange:

MR. BUONAGURO: Okay. And then for average -- for the average numbers, average yearly overtime, average yearly incentive pay, average yearly benefits, how does that work? I mean, how do you get -- from what you're telling me, if the head count is on a head count basis -- sorry, if the number of people is on a head count basis at the end of the year, but the compensation is calculated on the basis of FTEs, essentially, how do you calculate an accurate average?

MS. HUGHES: So I would say we've done the average based on the total compensation divided by the year-end head count. That is how we've computed the average.

Now, I know in 2010, I believe the schedule -- and I can't recall the reference, but there were not that many new hires planned for 2010 that were sort of not Jan 1. I believe we identified six new head count that would have been a start date other than January 1.

MR. BUONAGURO: Okay. But just in terms of what I'm reading on the table, I just want to understand where I -- where it's 100 percent

55 Exhibit 4, Tab 2, Schedule 4, page 2, Table 4-1(a)
56 The 2011 increase over 2010 estimated OM&A costs is 18.45%.
57 Oral Hearing, Transcript Volume 4, pages 8-12

accurate and where there are certain discrepancies in terms of what numbers are being combined.

What you're telling me is that on the budget years, because your total compensation is based on, essentially, an FTE basis and the head count numbers that you're using in conjunction with those total compensation numbers are being combined on a head count basis versus an FTE basis, that would mean that the average numbers which are coming here maybe on an actual basis would be different?

MS. HUGHES: Yes.

4.7 VECC submits that this degree of opacity, on this important of a component of OM&A, at this late stage in the proceeding, precludes any sort of “bottom up” or line item approach to adjust the proposal in order to determine an appropriate Test Year OM&A amount as comparisons from year to year are not meaningful, even at a compensation component level for a particular employee group.

4.8 Under the circumstances, VECC submits that the only practical approach for setting the 2011 OM&A component of the revenue requirement is an overall envelope or “top down” approach.

4.9 In this regard, VECC observes that if the Board were so inclined as to limit the increase in OM&A expenses to 10% over the two-year period 2009-2011,[58] Horizon’s 2011 OM&A claim would be limited to $42,684,989,[59] i.e., a reduction of about $4.77M from the proposed figure of $47,457,439.

4.10 In view of the fact that Horizon is a low- or no-growth utility, a 10% increase in OM&A costs over two years seems more than generous in VECC’s view, given that inflation has been about 2% per year.

[58] In EB-2009-0259, the Board limited Burlington to a 10% increase (approximately) for 2010 over the 2008 OM&A, while in EB-2010-0132 Decision the Board limited Hydro One Brampton to a 10% increase from 2009 to 2011.
[59] This is 1.1 x actual 2009 amount of $38,804,535

4.11 As such, VECC submits that Horizon's OM&A approved for 2011 be an amount not exceeding $42,684,989, inclusive of LEAP funding and OMERS related increases. To that end we note that Board Staff's submissions conclude with a similar proposal at page 38, and we are aware that Energy Probe's submissions also take a similar approach and support an OM&A budget between approximately $41,000,000 and $42,000,000 inclusive of required LEAP funding and Energy Probe's recommended treatment of OMERS related amounts.

Depreciation and Amortization

4.12 VECC has reviewed and adopts the submissions of Energy Probe with respect to the issues of depreciation and amortization.

Taxes

4.13 VECC has reviewed and adopts the submissions of Energy Probe with respect to the issue of Taxes.

5 <u>Cost of Capital</u>

Return on Equity

5.1 Despite the position of Board Staff at page 54 of its submission to the effect that Horizon has conceded that the applicable ROE is the one calculated using data 3 months in advance of the effective date of rates, which in this case may be as late as August 1, 2011, VECC notes that, in its argument in chief at page 15, paragraph 42, Horizon confirms that it is seeking cost of capital parameters, insofar as they are applicable to Horizon, based on the Board's calculation of parameters for January 1, 2011 rate years.

5.2 Implicit in Horizon's submission is the rejection of the notion that the effective date of the new rates, which largely depend on the timing of the ultimate decision, is determinative of the relevant point in time in which cost of capital parameters are to be calculated. Rather, it appears to VECC that Horizon is asserting that the appropriate cost of capital parameters for any particular utility are solely dependent on the proposed (and presumably accepted) rate year for that utility, despite any gap between the beginning of the proposed rate year and the actual effective date of rates within that rate year.

5.3 To that end VECC respectfully agrees that the appropriate application of the Board's cost of capital policy, in terms of the relevant date for the calculation of cost of capital parameters that are set by the Board, is the proposed first day of the approved rate year, not the ultimate effective date of the rates within that year. VECC is unaware of any precedent wherein a utility was required to recalculate a utility specific ROE, Short Term or Long Term Deemed Debt Rate based on the unique effective date of their rates when that effective date was at some point beyond the proposed first date of the rate year.[60]

5.4 In VECC's view the issues of the appropriate date upon which cost of capital parameters are calculated is a separate and distinct issue from the effective date of rates based on the timing of the application. In this case, assuming the Board accepts that Horizon's cost of capital parameters should be updated in the test year, VECC submits that the applicable rates would be those that coincide with the approved first date of the rate year, (either January 1 or May 1, 2011) regardless of the effective date of those rates.

5.5 As noted later on in this argument, VECC submits that the Board should determine that the 2011 rate year commence on May 1, 2011, such that the applicable cost of capital parameters, assuming the Board determines that

[60] HONI Transmission and both Union and Enbridge, as they all use a January 1 rate year, have had their ROE's calculated specifically for them, but only because, until the Board allowed LDC's to apply for a change in the rate year, the Board did not routinely issue cost of capital parameters for Jan 1 rate changes.

Horizon's cost of capital should be updated for the 2011 rate year, would be in accordance with the Board's March 3, 2011 Letter setting out an ROE of 9.58%, a Deemed Short Term Debt Rate of 2.46%, and a Deemed Long Term Debt Rate of 5.32%.

Long Term Debt

5.6 VECC respectfully submits that the applicable debt rate on the $116MM HUC Note (the "Note"), a copy of which is provided at Exhibit 5, Tab 2, Schedule 2, Appendix 5-1, is the Board's deemed debt rate for 2011, as set out in the Board Letter of cost of capital parameters for May 1, 2011 rates. In this case that rate would be 5.32%, with resulting impacts on Horizon's weighted average cost of capital.

5.7 In its application Horizon claims a debt rate of 6.1% for that same note:

> Horizon Utilities requests a debt rate of 6.1% with respect to the $116MM HUC Note. Such rate was approved for such note in the 2008 EDR COS Application Decision. There have been no changes to the terms of such note since such decision.[61]

5.8 VECC respectfully submits that Horizon has misinterpreted the Board's decision in the 2008 EDR COS Decision with respect to this issue. At pages 24 and 25 of that decision the Board determined as follows:

> The intervenors have submitted that the rate of interest on Horizon's long-term debt should be 5.26% consistent with the cost of credit at the time the 2005 Note was issued. The intervenors rely upon Horizon's evidence that this rate was the market rate of interest available to Horizon at the time the 2005 Promissory Note was entered into.
>
> While the Board has some sympathy for the intervenors' position, the Board believes that the best approach is to follow the guidelines established in the

[61] Exhibit 5 Tab 1 Schedule 1 page 2.

Board's Report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors. Section 2.2.1 of the report states, in part:

For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate. When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change.[62]

5.9 As the decision sets out, the Board determined that the Board's deemed rate at the time of rebasing should apply to the Note, despite the fact that the market rate of interest at the time the Note was negotiated was lower than the deemed rate. As such, the Board refused to embed the rate associated with the Note, instead relying on the repeated application of the deemed rate over time, independent of either the apparent rate on the face of the note, or the market rate at the time the Note was entered into (2005).

5.10 Accordingly, for this Note, the applicable rate is the Board's deemed rate of 5.32%. In the alternative, should the Board determine that the rate should become embedded, then VECC respectively submits that the applicable rate should be 5.26%, based on Horizon's evidence of the rate available to it at the time it entered into the Note in 2005 as determined by the EB-2007-0697 Decision. However, as there has been no change to the Note since the Board's Decision applying the deemed debt rate to the Note rather than the market rate that was available to Horizon at the time of the issuance of the debt, VECC submits that it is reasonable that the current, higher deemed rate of 5.32% should apply to remain consistent with that decision.

5.11 With respect to the request by Horizon that the long term debt rate for the Note, when replaced in 2012, should be adjusted, VECC agrees with Board Staff's analysis, with the conclusion that there is no need for special treatment for the adjustment of the long term debt rate, as it is a change

[62] EB-2007-0697, Decision dated October 3, 2008, Pages 24 and 25.

that is outside the test period.[63] To be clear, however, as set out above, VECC does not agree with the Board Staff submission that applicable rate to the Note in 2011 is 6.1%.

Delayed Implementation of a new ROE

5.12 VECC is aware that other intervenors may argue that the ROE embedded in Horizon's rates should persist until 2012, at which time Horizon would be permitted to update its ROE, avoiding any windfall to the utility as a result of early rebasing. VECC is not opposed to the proposal, respectfully submitting that, in embedding an ROE in the base year of the 3GIRM, the Board has, arguably, determined that cost for the utility over the course of the 3GIRM term, such that changing that cost prematurely, as in this case, is inappropriate. VECC notes that such a policy for early rebasing applications would obviate the concern that utilities would, relative to non-early rebasing LDC's, be obtaining a windfall (or suffering an unfair loss in the event ROE was going down) as a result of early rebasing for other reasons.

5.13 However, VECC submits, if the Board is considering maintaining the ROE until 2012 before allowing it to be updated, it may also be appropriate to hold all other aspects of the cost of capital constant as well, updating them all in 2012, including, as applied for by Horizon, the long term cost of debt. To be clear, VECC does not agree that Horizon should be permitted to update its long term debt this year, and then do so again next year; VECC is suggesting that if the ROE is to be held constant this year, then arguably all cost of capital parameters should also be held constant, and then all updated next year in accordance with what would have been the scheduled rebasing year for Horizon.

[63] Board Staff Submission (Public Redacted Version), May 4, 2011, pages 54-56..

6 <u>Cost Allocation</u>

Cost Allocation Methodology

6.1 As part of its Application, Horizon has filed the results of a 2011 cost allocation study[64]. The results were subsequently updated to incorporate the March 2010 update to the Large Use class load forecast[65]. The results for both are summarized in the following table.

REVENUE TO COST RATIOS – 2011 Uniform Rate Increase		
Customer Class	**Initial Application**	**March 2011 Update**
Residential	110.14%	110.67%
GS<50	102.76%	102.76%
GS>50	85.17%%	84.83%
Large Use	68.77%	63.90%
Street Lights	75.25%	75.62%
Sentinel Lights	63.07%	62.37%
USL	129.42%	129.94%
Stand By	79.96%	78.96%
Total	100.0%	100.0%

6.2 In VECC's view Horizon has properly applied the Board's cost allocation methodology. VECC notes that the cost allocation was not updated to reflect the April 2011 revision to the load forecast for the non-Large Use classes. Subject to this update, the results are the appropriate starting point for any consideration of adjustments to customer class revenue to cost ratios.

[64] Exhibit 7, Appendix 7.1
[65] VECC #44 d) & g)

Use of the Cost Allocation Study Results in Setting 2011 Rates

6.3 VECC notes that the following comments regarding the use of the cost allocation study in setting 2011 rates reflect the cost allocation based on the March 2011 (but not the April 2011) load forecast update. However, in VECC's view, the principles underlying the following comments would equally apply if the cost allocation were updated for the April 2011 load forecast revision and also to cost allocation results based on the 2011 load forecast ultimately approved by the Board.

6.4 The revenue to cost ratios from the updated Cost Allocation study all fall within the Board's recommended ranges[66] with the exception of Sentinel Lights (which is below the floor value of 70%); USL (which is above the ceiling value of 120%) and Stand By (which is below the floor value of 85% for the Large Use class to which the associated customers belong.

6.5 Despite this, Horizon proposes to move the ratios for all customer classes (with the exception of GS<50) closer to one for 2011. This proposal reflects a stated long term objective of Horizon to "ultimately achieve revenue to cost ratios approaching 100% for each rate class"[67]. Horizon's specific proposal – based on the cost allocation as filed with the March 2011 load forecast update is summarized below[68].

[66] EB-2007-0667, November 2007 Report, pages 8-11
[67] Exhibit 7, Tab 1, Schedule 1,page 1 and J3.7
[68] VECC #44 g)

PROPOSED 2011 REVENUE TO COST		
Customer Class	**Initial Application**	**Board's Policy Range**
Residential	104.0%	85-115%
GS<50	102.7%	80-120%
GS>50	91.2%	80-180%
Large Use	91.2%	85-115%
Street Lights	91.2%	70-120%
Sentinel Lights	91.2%	70-120%
USL	120.0%	80-120%
Stand By	91.2%	85-115%
Total	100.0%	100.0%

6.6 It is VECC's submission that Horizon's approach is inconsistent with the "Application of Cost Allocation for Electricity Distributors" Report (EB-2007-0667). In this report the Board adopted a range approach to revenue to cost ratios (page 4) which established ranges of tolerance around revenue to cost ratios of one. There were effectively two reasons for this:

- it was recognized that as a practical matter there may be little difference between a ratio near one and the theoretical ideal of one, and
- there were a number of influencing factors that suggested the further work was need to improve the accuracy of the "model".

6.7 The Board indicated (page 7) that distributors should endeavour to move their revenue to cost ratios closer to one if this is supported by improved cost allocations (emphasis added).

6.8 Clearly, Horizon's proposal is to move the ratios closer to one than required by the OEB’s range approach. However, this move is not supported by improved cost allocation:

- In response to interrogatories[69], Horizon notes as its one “improvement” the fact that its cost data has been updated to 2011 values. In VECC’s view this is not an “improvement”. The 2006 informational filing was based on the cost and load data relevant to the test year in question. Similarly, the 2011 cost allocation reflects the data for the 2011 test year. In VECC’s view this not an Improvement in the quality of the underlying data but more simply maintaining the status quo. Horizon has confirmed that, except for this data update, it has made no changes to the allocation model[70]. Hence it is fair to conclude that there have effectively been no “improvements” in cost allocation.

- Furthermore, in the case of the demand allocators used for each class, they were established simply by scaling up the value used in the earlier cost allocation informational filings by the change in the energy forecast for the customer class over the intervening period. The effect of this approach is to assume no change in the load profile for each customer class[71]. Aaccordingly one can conclude that the data used in the 2011 cost allocation is “dated” relative to that used in previous applications and therefore the cost allocation results are less reliable as a result of this approach. Indeed, such an approach does not capture at all the fact that the load factors (and hence load profiles) for some customer classes are assumed to change as result of the 2011 load forecast as noted in Horizon’s response to Undertaking J3.2.

Consistency across Utilities

6.9 VECC notes that it is currently in the submission phase on the issue of

[69] VECC #10
[70] Transcript Volume #3, page 68
[71] Transcript Volume #3, pages 69-70

revenue to cost ratios in at least two other cost of service applications; EB-2010-0125, Brant County Power's ("BCP") 2011 Cost of Service application, and EB-2010-0142, Toronto's 2011 Cost of Service application. The identical issue concerning the appropriateness of adjusting revenue to cost ratios for classes that are already within the Board's approved revenue to cost ratio ranges will be argued in each of those two applications.

6.10 The differing situations between the utilities with respect to their proposals highlights a concern that VECC has with respect to the possibility of differing results across utilities with respect to the resolution of this issue, in particular as a result of differing approaches by different utilities.

6.11 In BCP's application, by way of example, the residential rate class is currently below a revenue to cost ratio of 1.0, but within the approved range; despite this fact, BCP has proposed to move the residential class up to a revenue to cost ratio of 100%[72].

[72] EB-2010-0125, Final Submissions of VECC, April 15, 2011, paragraphs 2.1-2.2.

6.12 Similarly, in Toronto's application, the utility has asserted that it has made a similar decision to move the residential rate class, currently below a revenue to cost ratio of 1.0 but within the Board's approved range, up to a revenue to cost ratio of 92%[73].

6.13 Accordingly, as an advocate for the interests of customers that exist within the residential rate class, VECC, in theory, has an interest in supporting the Horizon proposal and opposing the BCP and Toronto proposals, based solely on the rate impacts of their respective "policy decisions", even though those decisions are based on identical presuppositions with respect to the appropriateness of generally moving classes towards a revenue to cost ratio of 1.0 when those classes are already within the Board's approved ranges.

6.14 However the Board will also be aware that VECC has consistently advocated, as it does in this case, that the principled approach to revenue to cost ratios, based on the Board's applicable cost allocation policy, is to refrain from moving ratios for classes that are already within the Board's approved ranges absent specific improvements to the cost allocation information that underpins the ratios.

6.15 VECC is concerned, however, that the Board may in one case agree with the assertion that a utility has a discretion to move ratios that are already within the range towards 1.0, as is proposed in THESL, creating a rate increase for the residential rate class, while at the same time agreeing with the VECC position in other cases, like Horizon's, and deny a rate decrease to the same rate class in another franchise area. Such a concern, VECC would suggest, exists for several rate classes depending on the utility, as it is not only the residential rate class that routinely appears on either side of a revenue to cost ratio of 1.0.

[73] EB-2010-0142, Final Submissions of VECC, April 18, 2011, paragraphs 24-25

6.16 Accordingly VECC respectfully requests that the Board consider a uniform approach to this issue so as to avoid inconsistent results across utilities. In VECC's view this is not an issue that should produce different results across different utilities based largely on the utility's opinion as to the appropriateness and utility of moving revenue to cost ratios that are already within Board approved ranges.

6.17 Consistent with VECC's position in this application, VECC respectfully submits that the appropriate and consistent position that the Board should adopt is a policy that refrains approving movements in cost ratios for classes that are already within Board approved ranges absent specific improved cost allocations, except to absorb shifts in ratios for classes that require movement to the outer bounds of the Board's approved ranges. Consistent application of such a policy would essentially eliminate much of the controversy with respect to revenue to cost ratios, as it would eliminate the supposition that utilities have an absolute discretion to move (or not move) ratios towards 1.0 based on considerations that have, in VECC's view, nothing to do with the accuracy of the cost allocation underpinning the resulting revenue to cost ratios.

Future Revenue to Cost Ratio Adjustments for Street Lighting

6.18 In its March Update Horizon requested[74] that it be granted leave to update its cost allocation and rates for street lighting at the "first opportunity", potentially in its 2012 3GIRM Application. Horizon claimed that it had only recently become aware of the approach taken by Kitchener-Wilmot Hydro and wished to investigate the application of a similar approach to its service area.

6.19 VECC submits that Horizon should not be permitted to update its cost allocation for street lighting (and indirectly for all other customer classes) during its IRM period. As Board Staff notes, the general approach of the

[74] Exhibit 7/Tab 1/Schedule 1, page 4 (Updated March 14, 2011)

Board has been to incorporate updates to cost allocation as part of a Cost of Service Application[75]. In VECC's view, Horizon's circumstance does not warrant departing from this practice.

6.20 Horizon claims it did not complete a "street lighting study" comparable to that undertaken by Kitchener-Wilmot as it was unaware of the approach taken until early this year[76]. However, VECC notes that in its 2006 Cost Allocation Report (EB-2005-0317, page 67) the Board specifically noted the distinction between number of street light fixtures and connections and directed that utilities make adjustments where better information is available. As result, the undertaking of a study such as that performed by Kitchener has been an option open and available to all distributors for the last five years. Indeed, as Board Staff has noted,[77] Waterloo North undertook a somewhat similar study as part of its 2011 Rate Application. Similarly, Horizon's current practice of dividing the number of street light fixtures by two in order to determine the number of connections is an attempt to address this issue.[78] Furthermore, VECC notes that Horizon's consultant (Mr. Bacon) was an active participant in the Board's RP-2005-0316 cost allocation methodology review process and has assisted numerous distributors with their cost allocation studies. As result, VECC does not accept Horizon's claim that it was unaware of the "options" available to it with respect to cost allocation as it applies to street lighting.

7 Rate Design

Fixed/Variable Split

7.1 With the exception of the Large Use class, Horizon is proposing to maintain the existing fixed/variable splits for all customer classes[79]. For the Large

[75] Board Staff Submissions (Redacted), page 63
[76] Board Staff #1 c) – Regarding Updated Evidence
[77] Board Staff Submission (Redacted), page 63
[78] VECC #41 a)
[79] Exhibit 8, Tab 1, Schedule 1, page 7

Use class Horizon is proposing to increase the fixed portion of the revenue recovery from 34.3% to 49.4% - the current fixed portion for the GS>50 class[80].

7.2 For the Residential, GS<50, GS>50 and USL classes, application of the existing fixed/variable split to the class' proposed base revenue requirement yields a monthly service charge that exceeds the range set by Board's guidelines[81]. Similarly, for the Large Use class, Horizon's proposal results in a monthly service charge well in excess of the Board's guidelines.

7.3 In its November 2007 Report – Application of Cost Allocation for Electricity Distributors, the Board explicitly stated[82] that "it does not expect distributors to make changes to the MSC that result in a charge that is greater than the ceiling as defined by the Methodology for MSC and that distributors that are currently above the ceiling are not required to make changes to their MSC to bring it to or below that level at this time". In VECC's view this means that if the monthly fixed rate is currently less than the ceiling then the proposed rate should not exceed the ceiling (even under the application of the current fixed variable split). When applied to Horizon this means that the proposed 2011 month service charges for Residential, GS<50, GS>50 and USL should not exceed the upper bound of the Board's policy range.

7.4 In the case of the Large Use class, where the existing monthly service charge is already above the Board's policy range, a reasonable interpretation of the Board's direction would be that the charge should not be increased any further for 2011.

7.5 VECC submits that the monthly service charges for the Residential, GS<50, GS>50 and USL customer classes should be no greater than the ceiling established through the cost allocation methodology. In the case of the Large Use class the monthly service charge for 2011 should be set

[80] Exhibit 8, Tab 1, Schedule 1, pages 7-10 and Exhibit J3.7
[81] Exhibit 8, Tab 1, Schedule 1, page 11 (Revised March 14, 2011)
[82] Pages 12-13

equivalent to the 2010 value – which is already above the ceiling value for the class.

Retail Transmission Service Rates (RTSR)

7.6 Horizon has calculated the Transmission Network and Connection costs to be recovered from customers using the IESO's and Hydro One Networks' approved 2010 rates and billing quantities for the period May 2009 to April 2010[83]. In response to VECC #13 b) these costs were updated to reflect 2010 billing quantities.

7.7 VECC submits that the results presented in response to VECC #13 b) are the appropriate starting point for determining 2011 Transmission and Connection costs – subject two adjustments. First, the costs should be updated to reflect the approved 2011 Uniform Transmission Rates and Hydro One Networks' approved 2011 Distribution rates. Second, the costs should be adjusted to reflect the percentage change as between the actual 2010 total kWh sales (including Large Use customers) and those forecast for 2011.

LV Costs

7.8 In its Application Horizon proposes to base its 2011 LV costs on the actual LV billing quantities from May 2009 to April 2010 and Hydro One Networks' approved 2010 LV rates[84].

7.9 In response to VECC #12 b), Horizon provided the LV costs based on 2009 billing quantities from Hydro One Networks and Hydro One Networks approved 2011 LV rates. VECC submits that these results adjusted for the change between the 2009 actuals and the approved 2011 forecast purchased kWh (excluding the Large Use class) should be the basis for Horizon's 2011 LV costs. This calculation updates the costs to reflect

[83] Exhibit 8, Tab 1, Schedule 2, pages 1-4
[84] Exhibit 8, Tab 1, Schedule 1, page 10 and VECC #12 a)

Hydro One Networks' 2011 LV rates and also reflects changes in load as between 2009 (the basis of the calculation) and 2011. The use of purchased volumes to customers other than Large Users reflects the fact that Large Use customers are typically not served at low voltages.

Loss Factors

7.10 Horizon has calculated its proposed loss factors based on a five-year historical average[85]. VECC notes that the loss factors over the past 5 years have been fairly consistent and exhibit no particular trends. VECC submits that Horizon's loss factors should be accepted as proposed.

8 <u>Deferral and Variance Accounts</u>

New Proposed Accounts

8.1 As part of its 2011 Rate Application, Horizon is seeking approval of the following deferral accounts[86]:

- A deferral Sub-account to Account #1595 to which it would transfer the balances for those deferral/variance accounts for which it is seeking disposal.
- A deferral account to record the increases in OMERS pension contributions.
- Use of Account #1572 to track any additional net distribution revenues for the latter two customers referenced in paragraph 3.4 above.
- A deferral account to track the impact of the cost of capital arising from the difference between the 6.1% rate on the Horizon's $116 M Note due in 2012 and the rate the Note is actually financed at.

[85] Exhibit 8, Tab 1, Schedule 3, page 6
[86] Horizon's Argument-in-Chief, page 6

8.2 VECC has issues with two of Horizon's deferral account proposals. With respect to the Deferral Account related to additional net revenues from Horizon's Large Use customers:

- VECC submits that the account should be expanded to include all three of the Large Use customers specifically identified and discussed in the March 2011 Update. Horizon has already acknowledged[87] that there are 2011 sales to the customer whose load was totally eliminated from the forecast and the impact of these sales should be captured in the deferral account.

- As already discussed above in paragraph 3.5 it is VECC's view that the eventual disposition of this account should all go to rate payers as opposed to being split 50/50 with Horizon's shareholder.

8.3 With respect to the deferral account related to the cost of Horizon's refinancing of its existing Promissory Note, and as noted in the submission with respect to the Cost of Capital, VECC submits that the need to refinance existing debt arrangements during an IRM period is not an issue unique to Horizon. Other electricity distributors who rebased in 2008, 2009 and 2010 and require refinancing during the IRM period are expected to manage the cost consequences within the allowed IRM adjustment. Possibly, subject to meeting the materiality and other requirements, it is VECC's view that a change in financing cost during the IRM period could be treated as a Z-factor adjustment that could lead to either additional recoveries from or refunds to customers.[88] As a result, VECC submits that Horizon's request for this account should not be approved.

[87] VECC #39 c)
[88] To be clear, VECC is not submitting that changes in financing costs qualify for Z-factor treatment, only that they possibly may depending on the circumstances.

Disposition of Deferral/Variance Accounts

8.4 In its Application, Horizon proposed to dispose of the December 31, 2009 balances (plus interest) in Accounts #1508, #1518, #1548, #1550, #1580, #1582, #1584, #1586 and #1588 over a one year period[89].

8.5 VECC has no submissions regarding the balances proposed for recovery.

8.6 With respect to Horizon's allocation of the balances to be recovered to customer classes, VECC only issue is regarding the allocation of the 1508 Sub-account Incremental Capital Charges. This balance represents the payments made to Hydro One Networks for their incremental capital rate rider[90], an additional charge from Hydro One Networks for Sub-Transmission (i.e., LV) service[91]. Horizon has used Distribution revenues by rate class to allocate the recovery of dollars in this Sub-account. Its rationale[92] is that the Board's EDVARR Report directs the use of distribution revenues for "specific Hydro One Networks Inc. (HONI) accounts" included in account 1508.

8.7 In VECC's view, Horizon has misinterpreted the Board's direction in its EDVARR report. The allocation practices outlined in the Board's EDVARR report for account #1508 are based on the Board's December 2004 Phase 2 Decision re: Recovery of Regulatory Assets. In this Decision the Board dealt with the recovery of a number of Hydro One Networks' 1508 sub-accounts. In VECC's view the EDVARR Report was referring to the use of distribution revenues in allocating these specific accounts. Furthermore, VECC notes that the Board's 2004 Phase 2 Decision did not deal at all with #1508 sub-accounts related to LV charges.

8.8 VECC submits that since the costs concerned related to LV charges from

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[89] Exhibit 9, Tab 1, Schedule 2, pages 2 and 4
[90] VECC #14 a)
[91] VECC TC #5 b)
[92] VECC TC #5 a)

Hydro One the appropriate allocation factor is that used to allocate LV costs to customer classes as set out in Exhibit 8, Tab 1, Schedule 1, page 11.

8.9 In its interrogatories, Board Staff questioned[93] Horizon's use of 2011 data to allocate the balance to customer classes. VECC supports Horizon's use of 2011 data and notes that it will be "the latest Board approved data" when the rates are ultimately finalized. In VECC's view it would be totally inappropriate to use 2008 approved volumes to determine the rate riders, particularly when there has been a significant change in the volumes for some rate classes since then.

[93] Board Staff #53

9 <u>Rate Year and Effective Date</u>

9.1 As customers of a utility being regulated under the 3rd Generation Incentive Rate Mechanism ("3GIRM") ratepayers have certain, legitimate expectations about the distribution rates they were going to be charged.

9.2 As Horizon was rebased under a cost of service application for the year 2008 with a rate year start date of May 1, 2008, there was a legitimate expectation on the part of Horizon's customers that their rates would be set on the basis of the 3GIRM framework, including:

a) distribution rate increases based on the price adjustment factors calculated annually under 3GIRM for the years 2009, 2010, and 2011, with rate changes being effective on May 1st of each year,

b) additional distribution rate increases based solely on the exceptional circumstances set out under 3GIRM, i.e. the application of the capital module and both Y and Z factors, and

c) partial or total abandonment of the 3GIRM based only on Horizon's performance outside a band 300+/- basis point in relation to Horizon's embedded ROE pursuant to the 3GIRM off-ramp.

9.3 Accordingly, VECC submits, for the rate period commencing May 1, 2009 to April 30, 2012, base distribution rates for Horizon's customers were supposed to be fairly predictable, changing only as a result of factors outside the control of Horizon (i.e. the rate of inflation). For the utility, of course, in exchange for the limited ability to change rates under 3GIRM, there was the incentive associated with the retention of any and all cost savings or excess revenues that the utility was able to generate; whether and to what extent the utility could or would generate such cost savings or excess revenues was part of the utility's risk, implicit in the 300 basis point deadband around the 3GIRM off ramp.

9.4 Specific to this application, there was a legitimate expectation on the part of ratepayers that existing rates would persist until April 30, 2011, and then a rate change would commence on May 1, 2011 (assuming a timely application for a rate change by the utility) with an increase in rates, under 3GIRM, of approximately .18%; this compares with the 11.8% increase described in the Notice of Application distributed to ratepayers, now 18.97%.[94]

9.5 Horizon's early rebasing application, of course, runs contrary to that ratepayer expectation. Despite Horizon having failed to demonstrate off-ramp eligibility, Horizon seeks to increase rates, not based on 3GIRM, but rather based on a cost of service approach, with a resulting rate increase request several multiples higher then what would have occurred under 3GIRM.

9.6 Similarly, and at the same time, Horizon is seeking this extraordinary rate increase not only from May 1, 2011, but from January 1, 2011 by virtue of its request to align its rate year with the calendar year, contrary to the ratepayer expectation that the rates that were payable from January 1, 2011 to April 30 2011 would be those implemented on May 1, 2010 in accordance with the 3GIRM.

9.7 Against this backdrop of ratepayer expectations, the Board is asked to determine what would be an appropriate effective date for new rates in relation to a January 1, 2011 rate year for the recovery of the calendar year 2011 revenue requirement.

[94] Notice of Application, EB-2010-0131, page 1, the rate increase specific to the average residential consumer; the actual increase claimed has changed since the Notice was issued; the reference is made here to highlight the scale of the difference between the applicable 3GIRM rate increase and the increase related to the application. The applicable 3GIRM rate of .18% was calculated based on the applicable Inflation adjustment (1.3%) the applicable efficiency factor (.72%) and the applicable stretch factor (.4%) had Horizon applied for 2011 rates under 3GIRM.

9.8 Horizon asks that the effective date be January 1, 2011, with the (expected) actual shortfall in revenues from January 1, 2011 to the actual implementation date of new rates, whenever that may be, collected through a rate rider.

9.9 As Board Staff points out in its argument, Horizon's application for effective January 1, 2011 rates was filed on August 26, 2010, providing for only 4 months of time for the processing of the application before the requested date, based on the Board's general timelines for the processing of cost of service applications of 9 months.[95] On that basis Board Staff submits that the Board should consider an effective date of May 1, 2011, holding Horizon responsible for having failed to allow enough time for the processing of the application in advance of the requested effective date.

9.10 VECC agrees, as a starting point, that an effective date for Horizon's new rates should not be any earlier then May 1, 2011; however VECC's position is that the Board should determine an effective date that is subsequent to the Board's decision and the process for the development of a rate order, a timeline that Board Staff estimates would result in an effective date of approximately August 1, 2011. [96] VECC takes this position for the following reasons.

9.11 Board Staff notes that there was a delay in the process relating to the determination of the threshold issue of whether Horizon's application for early rebasing should be considered by the Board or, as was the case for other applications for early rebasing including Hydro Ottawa, rejected. It appears that Board Staff does not believe that Horizon should be held accountable for that aspect of the delay in the process.[97]

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[95] Board Staff Submission (Public Redacted Version), May 4, 2011, page 8.
[96] Board Staff Submission (Public Redacted Version), May 4, 2011, page 9.
[97] Board Staff Submission (Public Redacted Version), May 4, 2011, page 8.

9.12 VECC disagrees. First, the Board sets out very clearly every year its expectations with respect to which electricity LDC's it expects to come in for rebasing each year, and on April 20, 2010 went even further to address the issue of LDC's that intended to apply for early rebasing:

Early Rebasing Applications

A distributor, including the four distributors referred to above, 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. **Distributors are advised that the panel of the Board hearing the application may consider it appropriate to determine, as a preliminary issue, whether the application for rebasing is justified or whether the application as framed should be dismissed.** Distributors are also advised that the Board may, where an application for early rebasing does not appear to have been justified, disallow some or all of the regulatory costs associated with the preparation and hearing of that application, including the Board's costs and intervenor costs. In other words, the Board may order that some or all of those costs be borne by the shareholder.

Any distributor that proposes to file a cost of service application for 2011 rates, and that is not on the list attached as Appendix A to this letter, must so notify the Board in writing as soon as possible, and in any event no later than May 31, 2010, if it has not done so already. (emphasis added)[98]

[98] April 20, 2010 Letter from the Board to All Licensed Electricity Distributors and All Other Interested Parties Re: Early Rebasing Applications, page 2. It is VECC's understanding, albeit unconfirmed, that Horizon was one of the four distributors referred to in the letter that requested early rebasing.

9.13 Accordingly, VECC submits, utilities were warned that early rebasing applications could require a process to determine a preliminary issue, which would necessarily consume some time such that it is clear that an early rebasing application should be filed, if at all, earlier then a scheduled rebasing application in order to accommodate any preliminary issues.

9.14 It should also be noted that, in that same letter, the Board sets out the 18 LDCs scheduled for rebasing for 2011, highlighting the fact that as early as April 2010 (and presumably even earlier) the Board has set out and resourced for a certain number of full cost of service proceedings. Applications for early rebasing are obviously in addition to the applications the Board is already processing, such that, in VECC's respectful submission, the fact that the within application may be in a position to be implemented as soon as August 1, 2011 is remarkable.

9.15 Accordingly, VECC submits, the timing of the application and the fact that it is an early rebasing application support an effective date synonymous with the actual implementation date, approximately August 1, 2011 or later.

9.16 In VECC's view the fact that this application is an early rebasing application such that ratepayers will be asked to pay substantially higher rates, assuming a material portion of the requested rate increase in granted, than they would have legitimately expected to have paid under 3GIRM during what would have been the 3GIRM rate year between May 1, 2011 and April 30, 2012 should be of concern to the Board and attract some form of consideration when setting rates.

9.17 Similarly the request to advance the beginning of the rate year from May 1, 2011 to January 1, 2011, whether in the context of a "normal" rebasing application or an early rebasing application, raises issues concerning the appropriate and fair manner in which the Board should transition from a May 1 based rate year to a January 1 based rate year. As noted by VECC in the consultation regarding the proposal by some LDCs to transition to a

January 1 rate year, one of the concerns that needs to be addressed is:

The impact on revenues that would arise from the earlier implementation date. As noted earlier, an application seeking to change to a January 1st rate year should specifically address the fact that the utility will be changing (typically increasing) rates four months earlier and thereby collecting incremental revenues from consumers earlier. One way to address this issue would be to estimate the incremental revenues and implement a rate rider that would return the incremental revenues to consumers over the rate year.[99]

9.18 In VECC's view the concern the Board may have over these issues in this particular case may be largely mitigated when, as a result of the timing of the application, the Board allows Horizon to transition to a Jan 1 rate year commencing in 2012 as opposed to 2011. Allowing the transition to take place in the year following the cost of service application, (having justified the transition in the cost of service application), should generally minimize the impacts of advancing the required rate change by 4 months.

9.19 For all these reasons VECC respectfully submits that the Board should

a) allow the transition to a January 1, rate year for Horizon, but only beginning in 2012, and

b) provide for a May 1 rate year for Horizon for 2011, with an effective date subsequent to the Board's decision and the process for the development of a rate order.

9.20 In VECC's respectful submission a policy of allowing LDC's that establish that a Jan 1 rate year is appropriate to make the transition in the first year following the rebasing year, rather than in the rebasing year, serves to mitigate much of the concern with respect to impact of that transition on

[99] EB-2009-0423, VECC Comments dated February 18, 2010, page 4.

ratepayers.

IRM Period

9.21 VECC has reviewed and adopts SEC's submissions with respect to timing Horizon's next IRM rebasing remaining on schedule for 2016.

10 Recovery of Reasonably Incurred Costs

10.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably incurred fees and disbursements.

All of which is respectfully submitted this 6th day of May 2011.