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February 12, 2010

**VIA MAIL and E-MAIL**

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

**REDACTED  
PUBLIC**

Dear Ms. Walli:

**Re: Vulnerable Energy Consumers Coalition (VECC)**  
**EB-2009-0332**  
**Horizon Utilities Corporation – Application Relating to the Recovery**  
**of Foregone Revenue**

Please find enclosed the final submissions of VECC in the above noted proceeding.

Yours truly,

Michael Buonaguro  
Counsel for VECC  
Encl.

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

**AND IN THE MATTER OF** an application by Horizon Utilities Corporation for an order approving the recovery of certain amounts related to an unforeseen loss of revenue to be effective January 1, 2010.

**SUBMISSIONS OF THE  
VULNERABLE ENERGY CONSUMERS COALITION  
DELIVERED FEBRUARY 12, 2010**

1. Horizon is applying for relief ostensibly in compliance with the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008 and the Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated September 17, 2008 (collectively referred to as the "3GIRM Report").
2. Horizon submits that it is eligible for Z-Factor relief relating to the reduction in load of a single subject customer relative to the load forecast for that customer embedded in Horizon's base year rate calculations.
3. At its most basic level, Horizon is asking the Board to adjust the load forecast embedded in its base year (2008) rate calculations to reflect the actual and updated forecast load for the subject customer, effective May 1, 2008, allowing Horizon to recover rates from all customers on the basis of (through the use of a variance account) a perfect forecast of the subject customer's load.
4. In this way Horizon is asking the Board to completely eliminate the forecast risk related to the subject customer; any and all variations in load, and therefore revenue related to the subject customer will be at the risk of Horizon's ratepayers.
5. The manner in which Horizon asks the Board to grant it Z-Factor relief does not account for any corresponding reductions in cost associated with a reduced load forecast being used to calculate rates, nor does Horizon's request account for the complete transfer of risk to ratepayers implicit in its proposal.
6. VECC has had the opportunity to review the submissions of Energy Probe and the Consumers Council of Canada and generally supports those submissions except where specifically noted under the issue of Allocation in the event the

Board approves recovery of amounts through a rate rider. The following constitutes VECC's additional submissions in this proceeding.

### **LOST REVENUE AS A RESULT OF A LOSS OF LOAD IS NOT AN APPROPRIATE Z-FACTOR**

7. In VECC's view utilities should not generally qualify for Z-Factor relief with respect to loss of load insofar as it results in lost revenue.
8. A reading of the eligibility criteria relating to Z-Factor adjustments, VECC submits, defines Z-Factors in terms of costs incurred by the utility, whether they are OM&A costs or capital costs, within the subject year. By way of example, costs caused by storm damage and tax changes have been recoverable both under the existing 3GIRM Report and under the second generation IRM, because both events clearly require the utility to spend more money with the subject year than was reasonably contemplated when the base revenue requirement was set. The Board does not expect utilities to forecast and bear the risk of extraordinary storm related costs or the cost of tax changes, so that when an extraordinary storm or a tax change causes costs to be incurred the utility can seek relief from material increases.
9. This limitation to unanticipated expenditures, as opposed to unanticipated revenue loss, is seen in the ways in which eligibility is defined by the 3GIRM Report. In defining the Prudence criteria, for example, the 3GIRM Report requires that:

The amount must have been prudently incurred. This means that the distributor's decision to incur the amount must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.<sup>1</sup>
10. VECC respectfully submits that this criteria clearly has no application to revenue lost in association with reduced load, in that there is no "decision" of the distributor to incur amounts, or any way in which the lost revenue can be represented as "cost-effective".
11. Similarly the Report speaks of the resulting recovery as an "incremental revenue requirement"<sup>2</sup>, which VECC submits can only properly described additional costs, not lost revenues. Whereas new costs incrementally increase revenue requirement, lost revenues do not; they create a revenue deficiency.
12. In VECC's view, it is incorrect to characterize the loss of a load relating to a single customer as a Z-Factor event simply because the customer's load is

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<sup>1</sup> Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008 Appendix: Filing Guidelines page IV.

<sup>2</sup> Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated September 17, 2008, Appendix: Filing Guidelines page IX.

beyond the control of the utility. It is obviously true that a utility has no control over the load of any of its customers. If Horizon is correct, then any load reduction related to a single customer would be recoverable as a Z-Factor subject only to the materiality threshold, a result VECC submits could not be intended by the 3GIRM Report.

13. What the company does have control over, however, is its load forecast. Moreover, the utility specifically bears the risks associated with that forecast, and earns a Return on Equity ("ROE") for having taken on that risk. Accordingly, VECC submits, the current situation is not properly characterized as a Z-Factor event; it is nothing more than an incorrect load forecast.
14. To be clear, that is not to say the Board should not be concerned with incorrect load forecasts, or that Horizon is completely without mechanisms for dealing with sufficiently material lost revenues connected to its incorrect load forecast. It is simply the case, VECC submits, that Z-Factor treatment is not one of those mechanisms.
15. The Report sets out its expectations of distributors with respect to rebasing, and in defining the conditions for off-ramp applications delineates the tolerances for over earning and under earning it expects utilities to operate within, relative to the Board approved ROE, without requiring relief from the Board.
16. Accordingly the expectation from the Board is that utilities will operate under 3GIRM rate regulation for three years following rebasing, subject only to off-ramp proceedings triggered by over/under earning of  $\pm 300$ .<sup>3</sup> In the present case, Horizon continues to operate within the tolerance for under earning.
17. VECC notes that despite the Board's expectation to the contrary, it is Horizon's intent to file a cost of service application for the 2011 rate year in order to adjust its base rates.<sup>4</sup> While VECC questions whether it is appropriate for a utility to move between 3GIRM and cost of service regulation without regard for the expectations the 3GIRM policy places on it with respect to such movement, VECC is unaware of any situation in which the Board has prevented early transitions back to cost of service regulation .
18. Accordingly the flexibility to apply early for cost of service rates despite having failed to trigger off-ramp consideration, in addition to the availability of an off-ramp mechanism, should be considered by the Board as factors that suggest a broad view of the availability of Z-Factor relief is incorrect.
19. VECC is aware that in EB-2004-0527 the Board granted Oakville Hydro relief in the form of the reallocation of revenues lost as a result of the loss of load related

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<sup>3</sup> Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors dated July 14, 2008, pages 7, 38.

<sup>4</sup> Horizon AIC, paragraph 31.

to a large customer.<sup>5</sup> At the time counsel for Oakville Hydro described the loss as "similar to a Z-Factor event"<sup>6</sup>. VECC notes, however, that in that case the Board determined that without relief Oakville Hydro would have achieved an ROE of only .3%, and a return of only 1.3% even with the relief that was granted<sup>7</sup>; the oral evidence of the utility suggested that without relief the company could have been facing a negative return, in contrast to the then Board approved 9.88% ROE.<sup>8</sup>

20. Accordingly, in VECC's view, it appears that in Oakville Hydro's case the utility, even with the relief requested, would have materially exceeded the 300 basis point threshold for off-ramp relief had it been faced with seeking relief under terms dictated by the 3GIRM Report.

**REDUCTIONS IN COSTS ASSOCIATED WITH THE LOSS OF LOAD MUST BE ACCOUNTED**

21. These are VECC's submissions on how loss of load should be translated into Z-Factor relief should the Board find that such relief is appropriate.

22. Horizon calculates its materiality threshold at approximately \$470,000 for the years 2008 and 2009.<sup>9</sup> VECC presumes, for the purposes of argument, that the 2010 materiality threshold would be similar.

23. Horizon's updated calculations with respect to the Z-Factor relief it seeks to recover with respect to each rate year is as follows:<sup>10</sup>

YEAR	LOST REVENUE CLAIMED
2008	\$744,824
2009	\$791,582
2010	\$654,840

24. In VECC's view it would be entirely inappropriate for the Board to consider providing relief for lost load without accounting for the reduction in costs included in revenue requirement specifically associated with that load.

25. During rebasing Horizon made a volume forecast which in part relied on a volume forecast of the subject customer's load.

<sup>5</sup> EB-2004-0527 Amended Decision dated May 11, 2005 and Amended June 15, 2005, page 2.

<sup>6</sup> EB-2004-0527 Transcript Volume 1, dated March 24, 2005, paragraph 1127.

<sup>7</sup> EB-2004-0527 Amended Decision dated May 11, 2005 and Amended June 15, 2005, page 4.

<sup>8</sup> EB-2004-0527 Transcript Volume 1, dated March 24, 2005, paragraphs 854, 863; note that some of the 9.88% ROE was "targeted" for reinvestment in CDM.

<sup>9</sup> Horizon AIC, paragraph 28.

<sup>10</sup> Exhibit J1, updated revised Table 3

26. That volume forecast was used in determining the Revenue Requirement relating to working capital requirements.

27. The relief requested in this proceeding is an accounting of the reduced volume actually consumed by the subject customer relative to the forecast for that customer that was used to develop base rates.

28. One part of that accounting is the relief advanced by Horizon, which is to increase the allocation of revenue requirement recovery to all other customers in relation to the decreased recovery from the subject customer.

29. In VECC's view, the other part of that accounting is the reduction in working capital requirements that were included as a result of the volume forecasted for the Subject Customer which, as it turn out, were not consumed.

30. Horizon has provided a calculation of the applicable revenue requirement decrease applicable in each year at SEC IR # 14:

YEAR	REVENUE REQUIREMENT REDUCTION
2008	[REDACTED]
2009	[REDACTED]
2010	[REDACTED]

31. VECC notes that if one offsets the lost revenue claimed by Horizon for each year with the corresponding reductions in working capital requirements, Horizon does not meet its materiality thresholds in either 2009 or 2010, such that relief is not required for either of those years in any event:

YEAR	LOST REVENUE CLAIMED	REVENUE REQUIREMENT REDUCTION	NET REVENUE LOST
2008	\$744,824	[REDACTED]	[REDACTED]
2009	\$791,582	[REDACTED]	[REDACTED]
2010	\$654,840	[REDACTED]	[REDACTED]

32. In the same SEC IR #14 Horizon explains why it believes that the Board should not offset the lost revenues claimed in respect of the Subject Customer with the decreased Working Capital Requirements and related revenue requirement reductions.

33. In essence, Horizon submits that it has suffered an overall decline in Commercial Distribution Revenue, and suggests that while "... impractical for a variety of reasons for Horizon Utilities to prepare and submit Z-factor applications related to all commercial customers that suffered significant declines in commercial loads

as a result of recent extraordinary economic conditions. . .”,<sup>11</sup> that the Board should take into account its overall increase in Working Capital requirements in refusing to make the requested offsets.

34. In VECC's view Horizon's submission attempts to recover indirectly amounts which it did not and cannot recover directly through a Z-Factor application or otherwise.
35. As noted above, VECC does not agree that Z-Factor relief should be available for revenue losses due to reductions in load. If, however, the Board determines that such relief is available, the materiality threshold would still have to be met; Horizon has advanced the within claim on the basis that the load reduction for the subject customer, as a singular event, met the threshold requirement. There is no evidence that the same is true for any of the other commercial loads referred to by Horizon in SEC #14.
36. In the absence of Z-Factor applications for each of Horizon's other customers, Horizon is asking that the Board consider its Z-Factor claim in the context of other areas of revenue loss and increased costs that it is experiencing in denying any offset related to reduced working capital requirements.
37. As noted above, VECC submits that concerns about general under earning and increased costs (including the increased overall working capital requirements cited by Horizon) have already been addressed by the Board through the inclusion of the off-ramp mechanism such that addressing those same concerns indirectly by using them to effectively increase Z-Factor relief would be inappropriate.
38. By definition Z-Factor consideration isolates the effects of an unanticipated event on the basis that it would be unfair to require the utility to:
  - a) take on the risk that the event happens and
  - b) be out of pocket with respect to the consequential costs.
39. Absent consideration of the effects of the Z-Factor event, the utility is limited to off-ramp consideration and, apparently, early rebasing applications as outlined above.
40. Accordingly consideration of other areas of under-recovery or overspending not related specifically to the Z-Factor event should not indirectly attract relief; for those items the utility is supposed to remain at risk.
41. In this case, it may be true that Horizon's actual working capital requirements exceed the amount included in rates, and it may be true that they have lost revenues from other commercial customers. But unless such increased costs

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<sup>11</sup> SEC IR#14, pages 2, 3.

and lost revenues relate directly to the Z-Factor event, the Board should not indirectly allow relief for these other items by intentionally overstating the effect of the load reduction on Horizon's revenue requirement by failing to account for the reduced working capital requirement associated with the reduced load.

42. Accordingly VECC submits that in order to appropriately account for the revenue requirement impact of the loss of load as a Z-Factor event it is necessary for the Board to adjust the relief downwards in order to account for the reduced working capital requirements. VECC notes that an identical adjustment was approved by the Board in the application by Oakville Hydro discussed above as an appropriate manner in which to adjust rates in connection with lost revenue related to a reduced load from a large customer.<sup>12</sup>

**ANY RELIEF SHOULD ACCOUNT FOR THE TRANSFER OF RISK THROUGH A REDUCTION TO THE ROE RELATED TO THE REVENUE LOSS CLAIMED**

43. At Exhibit J5 the panel asked Horizon to calculate the ROE included in the revenue loss claimed:

YEAR	ROE EMBEDDED IN REVENUE LOSS
2008	[REDACTED]
2009	[REDACTED]
2010	[REDACTED]

44. As already noted, the manner in which Horizon is seeking to recover lost revenue in this case transfers 100% of the forecast risk associated with the subject customer to ratepayers, through the use of a variance account.
45. In VECC's view the Board, if it considers Z-Factor relief appropriate in this case, should account for this transfer of risk by deducting the ROE associated with the transfer from the relief sought in the amounts set out above. In this way the Board will be recognizing that, with respect to the non ROE parts of the revenue requirement allocated for recovery within the "reduced load" associated with the subject customer, the company has divested all risk, i.e. Horizon is guaranteed to recover those costs regardless of the actual load loss.<sup>13</sup>

**GENERAL COST SAVINGS SHOULD BE FIRST APPLIED TO REDUCE THE REQUIREMENT FOR Z-FACTOR RELIEF**

<sup>12</sup> EB-2004-0527 Amended Decision dated May 11, 2005 and Amended June 15, 2005; this decision approved the relief as requested. In the transcript of the hearing, Volume 1, dated March 24, 2005, paragraph 296, the utility described how it adjusted its working capital requirement related revenue requirement as a result of the reduced Cost of Power. As above, VECC resists the Oakville Decision as a precedent for Z-Factor relief per se, on the basis that it was easily justified as an off-ramp related relief.

<sup>13</sup> VECC recognizes that only a portion of the ROE will be specifically related to the forecast risk assumed by Horizon and transferred to ratepayers, such that an adjustment that reflects only that risk may be appropriate.

46. In VECC's view it is inappropriate for Horizon to claim Z-Factor relief from ratepayers at the same time that it is producing savings in other areas relative to its 2008 base year rates. Specifically VECC notes that in Exhibit J2 Horizon has deferred \$320,000.00 related to vacant and new hires that were included in its 2008 rate application.<sup>14</sup> In VECC's view this means that Horizon achieved savings in 2008 and 2009, at a minimum, of \$320,000.00 per year that should be first used to offset the Z-Factor claim.
47. It appears in Exhibit J2 that of the \$320,000.00 Horizon claims that \$180,000.00 relates to labour that will be connected to outstanding OM&A programs that have been deferred to later years. However it is not clear on the face of the Exhibit that this means that the \$180,000 in savings in 2008 and will be offset by costs in excess of \$320,000 in 2010 or beyond when all the positions are filled such that there was no permanent savings.<sup>15</sup>
48. As noted above, VECC's position is that Horizon's 2009 and 2010 claims are not in excess of the materiality threshold, such that the offset for permanent in year savings is moot. For 2008, the base amount claim, once adjusted for reduced working capital requirements and embedded ROE related to forecast risk, should be reduced by an additional \$320,000.00.

**Z-FACTOR RECOVERY SHOULD BE LIMITED TO ACTUAL LOSSES WITHIN THE APPLICABLE RATE YEAR**

49. By including forecast amounts in rates for reduced loads relative to what was embedded in rates Horizon is not simply forecasting amounts related to an actual Z-Factor event, but in fact forecasting a Z-Factor event itself, namely that in future years the event of "reduced load" will manifest, and will meet the materiality threshold.
50. While it may be appropriate to forecast costs in future rate years relating to a single Z-Factor event, VECC does not agree that it is appropriate to forecast Z-Factor events, as well as the relief associated with them.
51. Accordingly VECC submits that the Board should only consider 2008 in terms of Z-Factor relief, if at all.

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<sup>14</sup> It appears to VECC that the deferral of hiring was the only "permanent" in year savings that did not simply move costs to another year;

<sup>15</sup> It does not appear to VECC that deferring \$180,000 in labour costs in this case is equivalent to deferring \$180,000 in capital costs; whereas the future capital costs go up by \$180,000 such that there is no net savings, it appears that until Horizon hires \$180,000 in staff they save that much relative to the amount included in 2008 rates. If this is incorrect, then the adjustment requested is reduced to \$140,000.00.

## **ALLOCATION**

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52. With respect to whether the revenue loss should be recovered on a fixed or variable basis, VECC disagrees with the submissions of CCC. In VECC's view the loss of revenue was based on a load reduction, i.e. was included in the subject customer's rates through a variable charge; in that situation VECC submits that it would be appropriate to allocate that variable rate loss to other consumers on a variable rate basis.

## **COSTS**

53. VECC submits that it has acted responsibly and efficiently in this proceeding and respectfully requests that it be awarded 100% of its reasonably incurred costs.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 12<sup>th</sup> DAY OF  
FEBRUARY 2010**