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February 12, 2010

BY EMAIL ONLY

**REDACTED
PUBLIC**

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

**Board File No. EB-2009-0332
Horizon Utilities Corporation – Recovery of Forgone Revenue
Confidential Unredacted Final Argument of Energy Probe**

Pursuant to the direction of the Board Panel, issued during the Oral Hearing on January 28, 2010, please find attached the Confidential Unredacted Final Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2009-0332 proceeding for the Board's consideration.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

cc: Indy Butany-DeSouza, Horizon Utilities Corporation (By email)
James Sidlofsky, Borden Ladner Gervais LLP (By email)
Peter Faye, Energy Probe Counsel (By email)
Individuals that have signed the Board's form of Declaration and Undertaking
with respect to confidentiality (By email)

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[REDACTED]

EB-2009-0332

Ontario Energy Board

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

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

[REDACTED] redacted Final Argument On Behalf Of
Energy Probe Research Foundation

February 12, 2010

**[REDACTED] redacted Final Argument On Behalf Of
Energy Probe Research Foundation**

How these Matters came before the Board

1. On September 3, 2009, Horizon Utilities Corporation (the "Applicant" or "Horizon Utilities"), Borden Ladner Gervais LLP, filed an application seeking approval for the recovery of certain amounts related to an unforeseen loss of revenue from one of its Large Use customers (the "Subject Customer"), to be effective January 1, 2010. The Board issued a Notice of Application and Hearing on September 29, 2009.
2. Energy Probe Research Foundation ("Energy Probe") filed its Notice of Intervention on October 9, 2009 and was granted intervenor status and cost eligibility on October 23, 2009 when the Board issued Procedural Order No. 1.
3. After interrogatories were filed by Board staff intervenors on November 4 and November 9 respectively, the Applicant requested an extension from November 26 until December 1, 2009 to file interrogatory responses. The Board in Procedural Order No. 3 granted the extension to the Applicant, and requested parties to make submission on whether they preferred a written or oral hearing.
4. By letter dated December 1, 2009, counsel for the Applicant, Borden Ladner Gervais LLP, requested that some 20 interrogatory responses be filed in confidentiality, as provided for by Board's *Practice Direction on Confidential Filings*.
5. Counsel for the School Energy Coalition ("SEC"), by letter of December 9, 2009, submitted that the Z-Factor be resolved through a one day hearing with the matter of confidentiality being the first issue to be ruled on by the Board. Energy Probe supported SEC in its letter of December 10, 2009.

[REDACTED]

6. On January 18, 2010, the Board issued its Decision and Order on Confidentiality Issues. On January 28, 2010, the Board held a one day Oral Hearing entirely in camera, at which time the Board updated its schedule for argument.

Argument Overview

7. The July 14, 2008 *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "3GIRM Report") establishes the criteria to be met in a Z-factor application as Causation, Materiality and Prudence.

8. In addition, the Board has stated in its September 17, 2008 *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the "Supplemental 3GIRM Report") that distributors should report events that could lead to Z-factor claims promptly and be prepared to demonstrate that the events were beyond management's control.

9. Energy Probe submits that the Applicant has not met the tests for the above criteria and should not be granted Z-factor relief for the following reasons.

Causality

10. Causality requires that amounts claimed in Z-factor applications "*should be directly related to the Z-factor event*" and "*must be clearly outside of the base upon which rates were derived*".

11. The Applicant has made varying and, in Energy Probe's opinion, confusing claims about what the triggering event for its Z-factor application was.

[REDACTED]

12. In its Argument-in-Chief, at paragraph 27, the Applicant states that the “*shutdown and changes in activities of the subject customer*” precipitated the reduction in revenue. At paragraph 16 and again at paragraph 21 reference is made to a “*one in 100 year decline in the economy*” as the culprit. No evidence appears to have been filed relating [REDACTED]
[REDACTED]
[REDACTED]

13. If the triggering event was the recession, Energy Probe submits that all distributors have probably experienced some adverse effects on revenue because the load forecasts underlying their rates have turned out to be temporarily inaccurate. If the Applicant is successful in its Z-factor application, then presumably other distributors and transmitters would potentially have a similar basis for a Z-factor application.

14. For example, Hydro One Networks supplies the distributor at the transmission level. If the present Z factor application is approved by the Board, it would be open to Hydro One to claim that one of its major customers (Horizon Utilities) had reduced its load and adversely affected Hydro One’s revenue thereby justifying a Z factor adjustment for transmission rates.

15. Energy Probe submits that temporary general economic conditions should not be accepted as the basis for Z-factor applications because this amounts to a retrospective adjustment of Management’s load forecast. The risk inherent in load forecasting is one of the business risks that distributors are compensated for in their rate of return. If it is to be removed and assigned to customers, then the distributor’s rate of return should be adjusted downwards to reflect that reassignment of risk.

16. If, on the other hand, the triggering event was an [REDACTED]
[REDACTED] then that should be traceable to a resulting load reduction.

[REDACTED]

17. The forecast load used to determine revenue requirement for the Applicant's 2008 rates included an amount attributed to the subject customer of 1,154,467 kW annually (Application Manager's summary page 5). This translates into about 100 MW on a monthly basis.

18. According to the evidence on page 5 of Confidential Responses to Board Staff Interrogatories, the Subject Customer's load reduction appears to have commenced in about March of 2007. Monthly load in 2007 was about 100 MW in January and February but started a long uninterrupted decline in March of that year ultimately bottoming at 8991 MW in June of 2009.

19. Energy Probe is uncertain about what month of the decline represents the event that triggered the Z-factor. In paragraph 6 of its Argument-in-Chief, the Applicant seeks to characterize the event as the announcement by the company in the spring of 2009 of "*an indefinite shutdown of its Hamilton operations.*" Load in the following three months dropped below 10 MW and this is said to have prompted the applicant's decision to seek a Z-factor adjustment.

20. However, load [REDACTED] and the Applicant has amended its application citing this as the determinative load for revenue loss calculations going forward. This increase in load does not seem to correspond well with the claim that the subject customer has ceased operations in Hamilton. Therefore, the contention that the triggering event was an indefinite shutdown of the customer's Hamilton operations appears to Energy Probe to be suspect.

21. Without clear evidence that the Subject Customer will not further increase its load, Energy Probe submits that the Applicant has not demonstrated causality sufficient to grant Z factor relief.

Materiality

22. The criteria for materiality are set out in the Board's 3GIRM Report as follows:

"The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor."

23. On page V of the appendix to the Board's 3GIRM Report, the discussion of materiality also includes the following statement:

"As is currently the case, the threshold must be met on an individual event basis in order to be eligible for potential recovery."

Individual Event

24. Energy Probe questions whether this requirement for Z-factor relief has been met by the Applicant. Initially, the Applicant used the company's announcement in the spring of 2009 that it was shutting down indefinitely as the triggering event. However, load at the customer's plant had been declining steadily since March of 2007. Energy Probe questions whether this monthly decline in demand represents an individual event or might better be characterized as a succession of individual events.

25. The fact that the load rebounded six months after the triggering event confuses the claim of a single event and suggests that the applicant really doesn't have a good idea of what this customer's intentions are or how its load will vary over time.

26. Energy Probe submits that the Applicant has not demonstrated "an individual event" underlying its Z-factor application and, therefore, has not met the materiality criteria.

Materiality Threshold

27. The Applicant's calculations of its revenue reduction to support its claim of having met the materiality threshold are also questionable, in Energy Probe's submission.

28. Basing its load prediction on the results of the May, June and July 2009 period, the Applicant calculated its revenue shortfall using a base load of 12 MW for the subject customer (Applicant Argument-in-Chief, paragraph 9). During the hearing, it became apparent that the customer's load had unexpectedly recovered to [REDACTED] and the Applicant then adjusted its claim using that as the new baseline load. The Applicant has not explained how the load could have returned to a level three times above the baseline load used in its revenue shortfall calculation.

29. Having abandoned its initial position that the customer's load would be permanently stuck at 12 MW, Energy Probe questions how much confidence the Board can have in the Applicant's latest prediction of [REDACTED]. Because this figure is used to calculate the expected revenue loss in 2010, the Board needs to be assured that it is correct.

30. If the Board cannot determine that the materiality calculation is accurate, there is no way it can determine if the Applicant has met the materiality threshold. Accordingly, Energy Probe submits that the Applicant has not satisfied the materiality threshold requirements for Z-factor relief.

Significant influence on Operations

31. The Applicant's Argument-in-Chief, at paragraphs 29 and 30, seeks to address the materiality requirement that the event have a "*significant influence on the operation of the distributor*".

32. Reference is made in paragraph 29 to the Applicant's costs of providing distribution service as being "*substantially fixed and do not cease to exist because of the subject customer's decision to indefinitely shut down much of its production*".

33. Notwithstanding the possibility that the customer's load will continue to increase and dilute the Applicant's revenue loss further, Energy Probe questions the assumption that any distributor's costs of providing service are substantially fixed. OM&A costs are not fixed in Energy Probe's submission because management can choose what maintenance activities it should undertake, what plant it should keep in service and what administration costs it incurs.

34. If reduced maintenance does not comply exactly with the Board's guidelines for system maintenance, a distributor can propose to the Board that those guidelines should be relaxed in the circumstances. Furthermore, if plant serving a particular customer is no longer necessary, the Applicant can retire it from service either temporarily or permanently to reduce its OM&A costs.

35. Under cross examination, the Applicant's witness confirmed that the subject customer was supplied via separate underground circuits. (Transcript, page 122, line 1). Instead of mothballing or retiring some of these feeders the Applicant continues to use all at reduced load. Energy Probe submits that the distributor could reduce its OM&A costs by reconfiguring supply to this customer so that only the circuits needed have to be maintained.

36. Similarly, the suggestion in paragraph 30 of the Applicant's Argument-in-Chief that cost cutting measures are just deferrals is questionable. If load is permanently declining in the distributor's service territory, as it claims, then it should be responding with adjustments in its organization. These, should include, for example, a complete

reassessment of staff levels rather than just a deferral of filling vacant positions.

37. The Applicant concludes in paragraph 30 that it will be necessary to complete deferred projects in the future because it *“had determined through its normal budgeting process that these projects were necessary”*. This statement appears to ignore the fact that the distributor’s circumstances have apparently changed. If a new budget was prepared with the Applicant’s current outlook for revenue shortfall, it is likely, in Energy Probe’s submission, that the necessity for some projects might change and the budget would be reduced accordingly. Realignment of the Applicant’s expenditures with the customer loading on its system should reduce costs and mitigate the effect of the revenue shortfall.

38. Because the Applicant has not demonstrated that it has taken the necessary steps to reassess its business in light of declining loads, Energy Probe submits that it has not demonstrated that reduced revenue will have an ongoing significant influence on operations. Therefore, it has not met this test for materiality in its Z-factor claim.

Prudence

39. The test of prudence as set out in the Board’s 3GIRM Report states:

“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”

40. The wording of this excerpt suggests that the Board had in mind, for Z-factors, situations in which a distributor incurred some unusual costs because of an unexpected event. The application of the prudence test to this case in which the distributor has not incurred any unusual costs is somewhat unclear to Energy Probe.

41. The Applicant’s argument appears to be that lost revenue has the same effect on it as an unexpected cost because it reduces the return on its investment. Energy Probe questions whether this is a legitimate interpretation of the Board’s intentions for Z-factor

applications.

42. One of the problems that results from this interpretation is how the Board should apply its prudence test. With no unexpected costs incurred, there does not appear to be anything to test.

43. Another way of looking at the problem is to consider that the ongoing costs of operations that would have been financed by revenues from the subject customer are the costs to be examined for prudence. However, all those costs have already passed the prudence test in a cost of service application. It is unclear how the Board could find otherwise now and, if a negative outcome of the prudence test is not possible in a given situation, the test would appear to be useless for assessing that situation.

44. Another way of looking at the problem is to consider the additional revenues that the Applicant would like to recover from customers as the costs to which the prudence test should be applied. In paragraph 34 of its Argument-in-Chief, the Applicant appears to be applying that concept because it argues that there will be *“minimal impacts on its customers while recovering revenue necessary to maintain the safe and reliable supply of electricity to those customers.”* The implication seems to be that without the additional revenue from customers it will not be possible to *“maintain the safe and reliable supply of electricity to those customers.”*

45. However, at the beginning of paragraph 34 the Applicant concedes that the projects that it has deferred to compensate for lost revenue *“may be deferred in the very short term without incurring any immediate risk to system reliability or customer safety.”* Energy Probe takes the phrase “very short term” to mean the next year or so. Within that time period, the Applicant proposes to bring a Cost of Service application in which it could propose new rates that would recover its costs and allow it to reinstate the deferred projects.

[REDACTED]

46. Therefore, there does not appear to be any need for Z-factor relief to maintain a safe and reliable system and if so, the prudence test relying on that need must, in Energy Probe's submission, fail.

Mitigation

47. The Applicant has deferred some projects and points to this action as mitigation of its costs. Energy Probe accepts that this constitutes a reaction to balance cash flow in the face of reduced revenues but questions that it amounts to mitigation of costs.

48. In its Supplementary Report on 3GIRM, the Board notes at Page ix of Appendix B: "The Board expects that any application for a Z-factor will be accompanied by a clear demonstration that the management of the distributor could not have been able to plan and budget for the event and that the harm caused by extraordinary events is genuinely incremental to their experience or reasonable expectations."

49. Being able to plan and budget for load losses requires, in Energy Probe's submission, that a distributor maintain a close relationship with large customers to gain an understanding of their operations and how they are affected by economic conditions. Even though a customer may not disclose that [REDACTED] [REDACTED] much useful information for predicting future load can be gained by regular contact.

50. Under cross examination, the Applicant's witness revealed that Horizon has no customer service staff dedicated to large customers and no key account program to ensure that the distributor has up to date information about a customer's operations. Annual

meetings were apparently held with the subject customer but they were convened by Hydro One (Transcript, Page 129, lines 20-26) for the purpose of forecasting its transmission load.

[REDACTED]

51. The Applicant's role in those meetings is not clear to Energy Probe as it does not seem to have asked even the most fundamental questions about the customer's load pattern. (see Transcript, Page 133, line 14, to Page 134, line 20).

52. Without detailed information about a customer's business, Energy Probe submits that a distributor is in a poor position to anticipate and plan for load reductions.

53. Once load loss became apparent, the Applicant does not appear to have taken any actions to mitigate the lost revenue. In cross examination, it was suggested to the Applicant's witnesses that it might have considered some novel approaches such as requiring a standby fee for continuing to provide the same number of feeders as was available for the 100 MW of load previously taken by the customer. The Applicant's witness replied that it had not considered such an approach. (Transcript, Page 127, line 24 to Page 128, line 4).

54. Again under cross examination, it was suggested that the distributor could have demanded surety to guarantee a certain minimum load or a reconnection fee for lost load if and when it reemerged. The Applicant's witnesses responded that it did not consider those kinds of approaches with the subject customer (Transcript, Page 134, line 21 to Page 135, line 17).

55. The Applicant also hasn't taken any steps to minimize its OM&A costs associated with supplying the subject customer. When asked if it could retire some of the assets used to serve the customer and thereby avoid some OM&A costs, the Applicant replied that it hadn't considered doing so and wouldn't unless the customer suggested it. (Transcript,

56. The Applicant's response to the load loss appears to have been just a continuation of the status quo in operations. It has not looked for new ways to maintain revenue from customers such as standby fees, load guarantees or reconnection fees in the face of significant load loss.

57. Accordingly, Energy Probe submits that the Applicant has not taken the necessary steps to plan and budget for load loss events and has not satisfied the requirement to mitigate its losses. Therefore, it should not qualify for Z-factor relief.

Allocation

58. If the Board decides to grant some or all of the relief requested by the Applicant, the issue of how it should be allocated to customers needs to be considered.

59. The Applicant proposes, at paragraph 38 of its Argument-in-Chief, to allocate the cost of Z-factor relief to all customer classes on the basis that "*the indefinite shutdown of the customer is out of the control of any single customer or customer class*".

60. Energy Probe does not understand how this proposal relates to cost allocation principles. Those principles generally seek to match the cost of serving a customer class with the rates charged to that class. A loss of revenue from one customer class would not ordinarily be a justification to charge other customer classes more.

61. In the course of the Hearing it was revealed that the large user revenue to cost ratio was 92% (Transcript, Page 138, line 26-28). This means that the Applicant is already allocating some of the costs of serving large users to other customer classes. To suggest that

those other classes should contribute even more to subsidizing large users by way of a Z-factor rate rider is, in Energy Probe's submission, unfair and inconsistent with the rate making principle of matching costs with revenues among rate classes.

REDACTED

62. Energy Probe recommends that, should the Board approve the Applicant's request for Z-factor relief, that the large user class should be required to bear the costs. In the event that this would result in a rate increase above the Board's 10% maximum, Energy Probe recommends that the Applicant be directed to record the excess in a deferral account for future disposition.

Costs

63. Energy Probe submits that it participated responsibly in this proceeding. Energy Probe requests the Board award 100% of its reasonably incurred costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

February 12, 2010

Peter Faye

Counsel to Energy Probe Research Foundation