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BY E-MAIL

February 12, 2010

Attention: Ms. Kirsten Walli, Board Secretary

**REDACTED
PUBLIC**

Dear Ms. Walli:

**Re: Board Staff Submission
Rate Rider Application to Address an Unforeseen and Significant Loss of
Distribution Revenue
Horizon Utilities Corporation
EB-2009-0332**

Please find the attached Board staff submission in the above proceeding. Please note that pending resolution of confidentiality issues related to this application, this submission is being filed in confidence. Please forward the following to Horizon Utilities Corporation and all other parties to this proceeding who have signed the necessary confidentiality agreements.

Sincerely,

Original Signed By

Martin Davies
Project Advisor, Applications & Regulatory Audit

Attachments



ONTARIO ENERGY BOARD

STAFF SUBMISSION



RATE RIDER APPLICATION TO ADDRESS AN UNFORESEEN AND SIGNIFICANT LOSS OF DISTRIBUTION REVENUE

Horizon Utilities Corporation

EB-2009-0332

February 12, 2010

INTRODUCTION

On September 3, 2009 Horizon Utilities Corporation ("Horizon" or the "Applicant") filed an application (the "Application") with the Ontario Energy Board (the "Board") requesting an order or orders of the Board granting approval for the recovery of certain amounts related to an unforeseen and significant distribution revenue deficiency due to a change in operations on the part of one of its Large Use customers (the "Subject Customer"). Horizon proposed to recover this deficiency through a Z-Factor related rate rider that would take effect January 1, 2010, subsequently revised to May 1, 2010, and would remain in place until the rate order arising out of Horizon's next forward test year cost of service distribution rate application took effect on May 1, 2011.

The Vulnerable Energy Consumers' Coalition ("VECC"), the School Energy Coalition ("SEC"), the Energy Probe Research Foundation ("Energy Probe"), the Consumers Council of Canada ("CCC") and U.S. Steel Canada Inc. ("U.S. Steel") were granted intervenor status in this proceeding. All but U.S. Steel were determined to have cost eligibility.

This submission reflects observations and concerns arising from Board staff's review of the pre-filed evidence, the interrogatory responses made by Horizon and the cross-examination of Horizon's witnesses at the oral hearing held on January 28, 2010, and is intended to assist the Board in evaluating Horizon's application and in setting just and reasonable rates.

THE APPLICATION

Horizon applied under Section 78 of the *Ontario Energy Board Act 1998*, S.O. 1998, c. 15, (Schedule B), for approval of a proposed rate rider effective January 1, 2010, subsequently revised to May 1, 2010, through which the distribution revenue deficiency of \$926,075, related to the significant reduction in electricity consumption by the Subject Customer from the Applicant for the period May 2008 to June 2009, and the anticipated distribution revenue deficiency of \$1,924,411 for the period July 2009 to April 30, 2011, which total \$2,850,486, would be recovered through a Z-factor adjustment. This proposed recovery was based on a projected customer demand by the Subject Customer of 12,000 kW per month for the period from July 2009 until April 2011.

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In its responses to interrogatories,¹ Horizon provided an update of these numbers to incorporate customer demand data for July through October 2009. This produced a lower recovery claim of \$2,318,032, consisting of an actual distribution revenue deficiency of \$1,213,340 for the period of May 2008 to October 2009, and a projected distribution revenue deficiency of \$1,104,690 for the period November 2009 to April 2011. The projected deficiency is based on a revised projected monthly customer demand of [REDACTED] per month.

At the oral hearing, the recovery claim was lowered to \$2,191,246,² consisting of an actual distribution revenue deficiency of \$1,305,883 for the period May 2008 to December 2009 and a projected distribution revenue deficiency of \$885,361 for the period January 2010 to April 2011. The projected deficiency continues to be based on a projected customer demand of [REDACTED] per month.

Horizon proposed that the Z-factor adjustment be recovered through a variable rate rider as the distribution revenue deficiency is related to the decline in the Subject Customer's load. Horizon sought recovery for the sixteen month period commencing January 1, 2010 and ending April 30, 2011. This was subsequently revised to a twelve month implementation period beginning May 1, 2010.

Horizon also provided calculations to support a fixed rate rider which Horizon suggested better reflected the recovery of the distribution revenue deficiency required to continue to meet the fixed capital investment and ongoing operating costs of providing distribution service to the Subject Customer. Horizon submitted that the fixed rate rider was the appropriate method to recover the distribution revenue deficiency and sought the Board's consideration and direction on the recovery methodology.

Horizon's application also incorporated a proposal that the difference between the anticipated distribution revenue from the Subject Customer at a baseline volume of 12,000 kW per month during the period of the rate rider and the actual amount of distribution revenue received from the Subject Customer during the same period be recorded in the variance account 1572 for disposition at a date to be determined.

Horizon stated that, among other Board documents, the July 14, 2008 *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* (the

¹ Board staff #6 and VECC #4

² Undertaking J1

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"3GIRM Report") and the September 17, 2008 *Supplemental Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* including Appendix B: Amended Filing Guidelines, Z-factors (the "Supplemental 3GIRM Report") provide for the recovery of amounts related to unforeseen events through the application of a Z-Factor Adjustment. Horizon further stated that page 35 of the 3GIRM Report stated as follows:

The Board has determined that the eligibility criteria [Causation, Materiality and Prudence, addressed at pages iv and v to the Appendix to the 3GIRM Report and pages vi and vii of Appendix B to the Supplemental 3GIRM Report] are sufficient to limit Z-factors to events genuinely external to the regulatory regime and beyond the control of management and the Board.

Horizon stated that it had complied with the Board's 3GIRM and Supplemental 3GIRM Reports as they pertained to the recovery of amounts related to unforeseen events. Horizon noted that it had given notice to the Board on December 23, 2008, of its concerns with the Large User shutdowns and the resulting impacts on its ability to meet its revenue requirement, and advised the Board that "The persistence of the Large User shutdowns noted [in the letter] will result in a Z-factor claim by Horizon Utilities." Horizon further stated that it had met the Board's three criteria for Z-factor adjustments – causation; materiality; and prudence.

Board staff's comments are focused on five areas related to this application: The first is whether or not Horizon's application meets the eligibility requirements established by the Board for "Z-factor" recoveries. The second is whether or not Horizon has demonstrated financial impairment and what, if any relevance, this would have in establishing a Z-factor claim. The third is what relief, if any, should be granted to the Applicant. The fourth concerns Horizon's proposal for a fixed rate rider. The fifth relates to its proposed recording of variances in account 1572.

Z-FACTOR RECOVERIES

3GIRM Requirements

In Section 2.6 of the 3GIRM Report, the Board noted that Z-factors are intended to provide for unforeseen events outside of management's control and stated: "In general, the cost to a distributor of these events must be material and its cost causation clear."³

The Board also stated the following:

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.⁴

The 3GIRM Report states the eligibility criteria are sufficient to limit Z-factors to events genuinely external to the regulatory regime and beyond the control of management and the Board. The eligibility criteria are causation, materiality and prudence and are described in the Appendix to the 3GIRM Report (the "Appendix"). In order for amounts to be considered for recovery in the Z-factor, the amounts must satisfy all three criteria.⁵

The criteria are described as follows in the Appendix:

- | | |
|-------------|--|
| Causation | Amounts should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived. |
| Materiality | The amounts must exceed the Board-defined materiality threshold and have a significant influence on the operation of the distributor; otherwise they should be expensed in the normal course and addressed through organizational productivity improvements. |

³ 3GIRM Report, p. 34

⁴ Ibid., p. 37

⁵ Ibid., Appendix, p. IV.

Prudence 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.⁶

Basis for Recovery

Background

Horizon acknowledged that events prompting Z-factor applications are often one-time occurrences (such as ice storms or other natural disasters). Horizon stated that in the present application, the Z-factor precipitating event consists of both the past reduction in revenue due to the Subject Customer and the anticipated forgone revenue in the 2010 rate year.

Horizon submitted that it was appropriate to treat both the past loss of the Subject Customer's load and the anticipated ongoing reduction of the Subject Customer's load as a single event as other events which may lead to Z-factor applications, such as changes in tax policy, may also have prospective consequences for utilities.

Horizon further submitted that unnecessary complexity and a multiplicity of proceedings would result if the Applicant was required to file a Z-factor application for revenue forgone to date and an application for a rate adjustment for anticipated forgone revenue. Horizon submitted that its variance account proposal provided an appropriate safeguard against over or under recovery of the lost revenue that the Board may approve in this application.

Discussion and Submission

Z-Factor Events

Staff submits that Horizon must first establish that a Z-factor event occurred. If it does so, it must then establish that it meets each of the eligibility criteria. It is staff's submission that Horizon has failed to establish that a Z-factor event has occurred.

⁶ 3GIRM Report, Appendix, p. V

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The 3GIRM Report characterizes Z-Factor events as those “genuinely external to the regulatory regime and beyond the control of management and the Board”⁷. During the oral hearing Horizon agreed with Board staff counsel that customer losses and gains are an ongoing part of normal utility operations.⁸

Horizon gave evidence that the loss of customer revenue might not have resulted in the present application if this loss had been offset by revenues from another new customer, as the following exchange during cross examination of Mr. Basilio by Mr. Buonaguro makes clear⁹:

MR. BASILIO: One difference might be, though, that if we had experienced -- we did experience a \$750,000 or thereabouts loss for U.S. Steel with respect to the 2008 rate year. If for one much [sic] our other large use customers we would have picked up \$750,000 of revenue such that the two washed, no enterprise level impact, we would have not sought this correction. No.

MR. BUONAGURO: Really?

MR. BASILIO: That's correct.

Staff submits that Horizon's position further substantiates that large customer losses and gains are not a unique event in the operation of a utility, and their impacts are difficult to isolate, given that losses may be sustained by many in a customer class, and that not all losses may be pursued.

Horizon's evidence supports this conclusion. Staff notes that Horizon has experienced revenue losses from a number of its Large Use customers, but is applying to recover only one such loss. During cross examination by Board staff counsel, reference was made to Horizon's evidence that for the fourteen month period from May 2008 to June 2009, Horizon's distribution revenue from its Large User class decreased by a total of \$1,823,474, of which \$926,075, or 51% was due entirely to the Subject Customer's shutdown and 49 percent or \$893,502 was due to other large customer losses. When asked by counsel why recovery had not been sought of the remaining \$893,502 of large customer losses, Horizon explained that the revenue losses attributable to the Subject Customer were the only ones large enough to meet its materiality threshold.¹⁰

⁷ *Report of the Board on 3^d Generation Incentive Regulation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, p. 35, emphasis added.

⁸ T1, p.39, L20-L25

⁹ T1, p.76, L11-20

¹⁰ T1, p. 41, L22 -L28, p.42, L1-L28

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Staff also notes that some of the revenue losses were offset by savings. In its Argument-in-Chief, Horizon stated that approximately \$180,000 of the \$515,000 human-resources-related deferrals referred to in its response to Board staff interrogatory #5(a) had been reallocated to contracted services. This would suggest that Horizon achieved a permanent saving in 2009 of \$335,000 in human resources-related costs.¹¹

The evidence has established that Horizon has and will continue to lose and gain customers and distribution revenue as part of its ongoing operations as a utility, and that in the course of its recent operations, it has sustained other significant Large Use customer revenue losses concurrently with those attributed to the Subject Customer's load reduction.

Staff submits that "genuinely external to the regulatory regime" requires the event or occurrence to be one which is not experienced frequently and ordinarily as part of the utility's operations. Given the frequency of Large Use customer revenue losses which it has experienced, and that such losses are predictable during periods of economic downturn, staff submits that Horizon has failed to establish that a Z-factor event has occurred.

Staff notes that Horizon has put forward a financial impairment argument that the loss of the Subject Customer's revenue had an impact on Horizon's overall financial position which was of such a magnitude that it was genuinely external to that experienced in the normal regulatory regime. This argument is dealt with in the latter half of these submissions.

If the Board does accept that a Z-factor event has occurred, it must find that each of the criteria for causation, materiality and prudence set out in the 3GIRM Report have been met.

Causation:

As noted by Horizon, the causation criterion is described as representing amounts which "should be directly related to the Z-factor event. The amount must be clearly outside of the base upon which rates were derived."¹²

¹¹ Horizon Utilities Corporation, Argument-in-Chief, pp. 12-13

¹² Horizon Utilities Corporation, Application for Approval of a Rate Rider, Manager's Summary, p.10

During cross examination by Board staff counsel, Horizon further explained the basis on which it believed that this criterion had been met¹³:

MS. BUTANY-DE SOUZA: If I can add to that, the Board's tests also include causation. So the amounts should be directly related to a Z-factor event. And in this case, and I draw your attention to our manager's summary, page 10, paragraph 3.7, as we set out there, the subject customer accounts for 30 percent of the large user load, and that decline or the shutdown of the subject customer in the Hamilton plant and what appeared to be the indefinite shutdown of the subject customer had a significant single event impact on our large user load.

And so in terms of a test for causation, as well, we believe that this event qualified under the treatment for a Z-factor.

Horizon submitted that its request met this criterion as the indefinite shutdown of the Subject Customer and the resulting reduction in distribution revenue was, in its view, a single event¹⁴ clearly outside of the Large User load base upon which rates for 2008 and the 3rd Generation IRM period have been set.¹⁵

Staff is in agreement with Horizon that the loss of revenue from the Subject Customer is outside the Large User load base upon which rates for 2008 and the 3rd Generation IRM period have been set. However, this criterion makes reference to amounts that are directly related to the Z-factor event. Board staff is of the view that a Z-factor event has not occurred and, as such, this criterion has not been met.

Materiality:

During cross examination by Board staff counsel, Mr. Basilio, the Chief Financial Officer for Horizon, stated that the materiality test was the triggering point to start looking at the other criteria.¹⁶

To engage the materiality criterion, Horizon stated that the Z-Factor related amounts must exceed the Board-defined materiality threshold and have a significant influence on

¹³ T1, p. 43, L25-L28, p.44 L1-L9

¹⁴ While Horizon referred to it in its argument on causation, the Appendix states that the materiality threshold must be met on an individual event basis in order to be eligible for potential recovery—3GIRM Report, Appendix, p. V.

¹⁵ Horizon Utilities Corporation, *Application for Approval of a Rate Rider Manager's Summary*, p.10

¹⁶ Unredacted and Confidential Transcript of Proceeding ("T1"), p. 44, L25-L28

the operation of the distributor. Horizon submitted that the revenue decline from the Subject Customer's shutdown represented a single event valued at \$2,850,486 (subsequently revised downwards as discussed previously), which when viewed relative to its materiality thresholds of \$433,305 and \$437,855 respectively for 2008 and 2009¹⁷ clearly met the materiality requirements for a Z-factor adjustment.

Staff accepts that the revenue losses attributable to the Subject Customer exceed Horizon's materiality criterion and that the materiality criterion has been met.

Prudence:

Horizon stated that the revenue loss was an event clearly beyond its control and, as such, beyond the ability of Horizon to take any prudent action to prevent the indefinite shutdown of the subject customer. Horizon submitted that it was acting prudently in making the application, which had minimal impacts on its customers while recovering revenue necessary to maintain the safe and reliable supply of electricity to Horizon's customers.¹⁸

Staff submits that there is no evidence on the record in this proceeding which would suggest that imprudent actions by Horizon led to the loss of revenues from the Subject Customer.

FINANCIAL IMPAIRMENT

Basis for Recovery

Background

Horizon submitted that the loss of distribution revenue which it has experienced related to the Subject Customer is significant to its regulated operations and cash flow. Horizon stated that the loss required a review of its expenditures in order to determine which projects may be deferred without incurring any risk to system reliability or customer safety. Horizon added that the deferral of any project from 2009 to 2010 would only be a

¹⁷ Horizon Utilities Corporation, Application for Approval of a Rate Rider, Manager's Summary, p.10

¹⁸ Horizon Utilities Corporation, Application for Approval of a Rate Rider Manager's Summary, pp.11-12

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short term deferral as any project being deferred is still necessary and must be completed in 2010 – a year in which the applicant anticipates further losses of distribution revenue. Horizon submitted that despite such deferral, it will not achieve its maximum allowable return on equity, and that such deferrals are necessary as prudent measures in relation to available regulated cash flows.

Horizon also stated that the impact of the distribution revenue deficiency now requires it to consider a plan to accelerate the filing of its next cost of service application to August 2010 for implementation May 1, 2011.

A Board staff interrogatory asked Horizon to further discuss the basis for its conclusion that project deferrals are necessary and to provide a breakdown of the projects which have been deferred.¹⁹

In its response, Horizon included a table which showed that \$1,490,000 of operating expenses and \$676,000 of total capital had been deferred from fiscal 2009 to fiscal 2010.

Discussion and Submission

Staff notes that during the course of the hearing, it became clear that the deferrals outlined by Horizon in its response to the Board staff interrogatory were not just attributable to the loss of revenue from the Subject Customer, but arose from other revenue losses as well. This was evident in the following exchange between Board staff counsel and Mr. Basilio regarding the list of deferred expenditures provided in Horizon's response to the Board staff interrogatory²⁰:

MS. CAMPBELL: So just in a general -- just a general question, first of all. Is it Horizon's position that every single one of these projects was deferred because of the 51 percent of the \$1.8 million revenue loss occurring because of decline in load by the large user class?

MR. BASILIO: That would have been a contributor, but, more broadly, to the general decline in commercial loss, those deferrals.

MS. CAMPBELL: So, in other words, what you're saying to me is it is a contributing factor, the loss of approximately \$900,000 worth of income, in that specific time period?

MR. BASILIO: Exactly. It is a contributor.

¹⁹ Board staff interrogatory #5

²⁰ T1, p. 54, L18-L28, p. 55 L1-L3

During cross examination Horizon also made it clear that in the case of some of these expenditure reductions, there were offsetting increases in expenditures. One such example was stated in Horizon's response to the Board staff interrogatory which noted that "the capital expenditure deferrals of \$0.7MM are expected to be offset by \$2MM in higher distribution system capital expenditures for 2009." Horizon confirmed that this was the case during cross examination by Board staff counsel and also confirmed that it was able to spend the larger amount of capital in spite of the loss of revenue occasioned by the Subject Customer.²¹

The fact that some of these expenditure reductions were offset by other expenditures was also evident in Horizon's response to Ms. Chaplin's query as to how much of the \$515,000 shown as Human Resources reductions in response to the Board staff interrogatory was offset by increased expenditures on outside contractors. Horizon stated in its Argument-in-Chief that approximately \$180,000 of this amount had been reallocated to contracted services.²²

Board staff submits that based on the above instances, it is unclear exactly what the extent of the overall cuts undertaken by Horizon was, or even if on an overall basis there were cuts, and, if so, to what extent such cuts were specifically related to the revenue losses from the Subject Customer.

Staff also notes that it is Horizon's position that if a utility does not achieve its allowed rate of return, the Board should provide the utility with the means to get to its rate of return. Mr. Basilio confirmed that this was Horizon's position during cross examination by Board staff counsel.²³ Staff disagrees. The Board sets the rate of return and the distributor has the opportunity to earn that rate of return based on a forecast of revenues and expenses.

Horizon is participating in an incentive regulatory plan and under such a plan it is not the Board's role to provide Horizon with any kind of guarantee that it will achieve its allowed ROE. Board staff notes that there are off ramps in the plan in the event a utility falls seriously short of its allowed ROE.

²¹ T1, p. 57, L10-L28, p. 58 L1 -L19

²² Horizon, Utilities Corporation, Argument-in-Chief, pp. 12-13

²³ T1, p. 60, L 27-28, p. 61 L1-L15

In this context, Horizon's claim of financial impairment rests on its forecasts which show that it will not achieve its maximum allowable level of ROE. Horizon's allowed ROE was set at 8.57% in the Board's EB-2007-0697 Decision with Reasons of October 3, 2008.

In response to a Board staff interrogatory²⁴, Horizon stated that on an adjusted basis it was expecting to achieve ROEs of 6.29% and 6.11% for 2009 and 2010 respectively.

Counsel for VECC noted during cross examination of Mr. Basilio that the Board's 3GIRM Report makes reference to a trigger mechanism with an annual ROE dead band of plus or minus 300 basis points, meaning that when a utility performs outside of this deadband, a regulatory review may be initiated.²⁵ Board staff notes that Horizon's projected ROE for 2009 and 2010 is within these bands.

Board staff would note that a utility earning above the deemed level of ROE but within the deadband, would not be expected to return its earnings.

When asked during cross examination by Board staff counsel whether Horizon was unable to finance its capital program as a result of the loss of revenue from the Subject Customer, Mr. Basilio stated that he did not immediately have a liquidity event without this revenue, but that its loss could have a medium term impact.²⁶

Board staff submits that Horizon has not demonstrated that the cash flow impairment it has experienced represents a form of financial distress, such as a non financeable cash flow deficiency, or anything close to that magnitude of impact such that it could be considered genuinely external to the normal regulatory regime. Based on Mr. Basilio's testimony, the financial impairment outlined by Horizon appears to be no more than would normally be experienced by a utility with a revenue shortfall, something all utilities experience at times, along with, at other times, revenue excesses.

Staff is of the view that in mitigating costs and discretionary expenses, Horizon has done exactly what a distributor should do when confronted with the type of revenue shortfall it is presently facing. It is the submission of staff that rate relief of the kind sought by Horizon in this application should only be provided by the Board when a distributor is facing conditions where the degree of financial impairment it has suffered is genuinely external to the normal regulatory regime.

²⁴ Board staff interrogatory #5d

²⁵ T1, p. 91, L22-L28, p. 92 L1-L9

²⁶ T1, p.64, L15-28, p. 65 L1-L28

ALLOWABLE LEVEL OF RECOVERY

Horizon is requesting a total recovery based on its revised numbers of \$2,191,246, consisting of an actual component for the period May 2008 to December 2009 of \$1,305,883 and a forward looking component of \$885,331 for the period January 2010 to April 2011. Staff's position on the appropriateness of the proposed recovery of the forward looking and actual components of the requested relief are outlined below:

(i) Forward Looking Component

Staff is of the view that the forward looking component of the application should be denied. This is because, first, there appears to be significant volatility in the future load of the Subject Customer, which makes it difficult to establish the amount of relief that is actually being sought. Staff notes that the application as filed was based on an assumed load for the subject customer of 12,000 kW per month, which [REDACTED] in the updated forecast, filed in response to interrogatories and was further revised upwards to [REDACTED] in response to an undertaking²⁷.

Second, Horizon has acknowledged that the Board may have concerns about this component of the application and that it would not pursue it aggressively. This was evident in the following cross examination of Mr. Basilio by Board staff Counsel²⁸:

MS. CAMPBELL: We have just had a discussion which indicates that the forecasts that you base the application on has now changed somewhat radically. I mean I appreciate your point that they're nowhere near what they were, but they are three times over the forecasts that you filed with the initial application. How is the Board going to assess what essentially becomes a moving target?

MR. BASILIO: We offered this for the consideration of the Board. I am not going to pursue the prospective piece aggressively under cross, I mean if the Board is uncomfortable with that, if Staff are uncomfortable with the notion of dealing with what we think are -- is a continued likely deficiency through the period prospectively, I think we understand that.

This was an offering, again, with the intention that it might be efficient and that there would be a true-up to actual.

If there's some discomfort, again, it is not something I would pursue aggressively if the Board ordered that, you know, it does not want to grant a prospective rider. We don't take serious issue with that. We would, you know, it puts us back in the position of having to come back with

²⁷ Undertaking J1

²⁸ T1, p. 48, L14-L28, p. 49 L1-L17

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another Z-factor claim in a year and a half if, in fact, events play out as we have continued to see since the amount of -- since the retroactive amount that is in the application, and as we think are likely to continue to unfold.

I mean we are hopeful [REDACTED] comes back to [REDACTED], certainly our utility has a vested interest in that, a community interest, but you know the likelihood of that, we think, is -- we think it is low.

Third, staff would note that Horizon has stated its intention to apply for a cost of service rate review later this year, which would provide it the opportunity to have its rates reset on the basis of a revised load forecast incorporating reduced consumption from the Subject Customer if the reduced consumption continues.

Finally, staff would note that the Board's requirement to record amounts related to Z-factor events in account 1572, and the Board's practice to confirm any amounts proposed for disposition in deferral or variance accounts with the applicant's audited financial statements, suggest that the Z-Factor guidelines do not apply to forward-looking recoveries and that the Board has not previously approved such a recovery.

On the basis of the above considerations, staff submits that the forward-looking component of the requested relief should be denied.

(ii) Actual Component

The actual component of the proposed recovery is \$1,305,883. Board staff is of the view that this relief should also be denied.

This is because while Horizon has demonstrated that the materiality and prudence criteria have been met, subject to the noted concerns about the applicability of these guidelines to revenue losses, staff does not believe that Horizon has demonstrated that a Z-factor event has occurred as it has not shown that the revenue losses attributable to the Subject Customer are the result of an event genuinely external to the regulatory regime.

Staff is of the view that large customer revenue losses could be a Z-factor event if the loss of revenue from a particular customer could be shown to have a significant enough impact on the utility to qualify as genuinely external to the normal regulatory experience. As has been discussed earlier, staff does not believe that the impacts experienced by Horizon as a result of its large customer revenue losses are of this magnitude,

especially given that these losses have been offset at least partially as a result of the program deferrals discussed earlier.

VARIABLE VERSUS FIXED RATE RIDER

Background

Horizon has stated in its application that while it has prepared its application on the basis of recovering the proposed Z-factor amounts through a variable rate rider, it has also included a fixed rate rider proposal as its preference would be to recover the amounts through a fixed rider as such a rider would better reflect the risks related to servicing the customer in question.

Discussion and Submission

Staff notes that the issue as to whether or not utilities should recover approved costs through fixed or variable charges, or a combination of both is a generic one with applicability to all other distributors.

During cross examination by Board staff counsel, Horizon was asked whether its argument that a fixed rate rider was preferable was unique to this particular application and Mr. Basilio responded that it was not.²⁹

Staff is of the view that Horizon has not demonstrated that there are any circumstances specific to this application that would justify the use of a fixed rate rider to allow for the recovery of such amounts. Accordingly, staff is of the view that in the event the Board was to approve an amount to be recovered by Horizon through this application, it should be done through use of a variable rate rider.

VARIANCE ACCOUNT

Background

Horizon has also proposed that the difference between the anticipated distribution revenue from the Subject Customer at a baseline volume of 12,000 kW per month

²⁹ T1, p.67, L21-23

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during the period of the rate rider and the actual amount of distribution revenue received from the Subject Customer during the same period be recorded in the variance account 1572 for disposition at a date to be determined.

Discussion and Submission

Staff notes that the adoption by the Board of Horizon's proposal related to the variance account treatment would be a potentially precedent-setting decision with generic implications.

Mr. Buonaguro suggested to Mr. Basilio during his cross examination that the effect of Horizon's proposal was to remove any risk that Horizon might have in its forecast by truing it up at the end. Mr. Basilio responded that this mechanism aligned closely with what Mr. Buonaguro was suggesting, acknowledging that it took the risk out of variance and load relative to the 2008 application for the Subject Customer.³⁰

Staff submits that in the event the Board was to accept Horizon's request for recovery of the forward-looking component of its application, it would be staff's position that given the specific circumstances of this application, and particularly the variability that has been evident in the forecast consumption of the Subject Customer, the variance account proposal would be appropriate.

- All of which is respectfully submitted -

³⁰ T1, p.99, L12-L25