May 6, 2011

BY EMAIL & COURIER

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

Dear Ms. Walli:

Board File No. EB-2010-0131
Horizon Utilities Corporation – 2011 Cost of Service Application
Energy Probe – Argument

Pursuant to direction from the Board at the Oral Hearing April 11, 2011, please find attached the Argument of Energy Probe Research Foundation (Energy Probe) in respect of the EB-2010-0131 proceeding for consideration of the Board.

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

Yours truly,

Original signed by

David S. MacIntosh
Case Manager

cc: Indy Butany-DeSouza, Horizon Utilities (By email)
James C. Sidlofsky, Borden Ladner Gervais LLP (By email)
Randy Aiken, Aiken & Associates (By email)
Peter T. Faye, Counsel to Energy Probe (By email)
Intervenors of Record (By email)

EB-2010-0131

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 just and reasonable rates and other charges for electricity distribution to be effective January 1, 2011.

ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

ARGUMENT

May 6, 2011

HORIZON UTILITIES CORPORATION
2011 RATES

EB-2010-0131

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A - INTRODUCTION

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the setting of 2011 rates for Horizon Utilities Corporation ("Horizon") effective January 1, 2011.

This Argument has been structured to reflect the major components of the Horizon evidence. Where readily available, Energy Probe has attempted to provide the impact of its submissions on the revenue requirement of Horizon. However, in order to minimize intervenor time and costs, a comprehensive impact analysis has not been undertaken. If the Board accepts any or all of the Energy Probe submissions, it is assumed that the direct and indirect impacts will be determined by Horizon and reviewed by intervenors and Board Staff through the associated draft rate order. An example of a comprehensive impact analysis would include the direct impact on rate base of a reduction in $100,000 in OM&A expenses and a $250,000 reduction in capital expenditures. Depreciation expense would also be directly impacted by the capital expenditure change. The indirect impacts would include the change in total cost of capital and income taxes (due to CCA and interest expense changes) and the change in the working capital allowance.

a) The Deficiency

Based on the Revenue Requirement work Form ("RRWF") attached to the response to Undertaking J3.3, Horizon has a revenue deficiency of $20,721,855 on distribution revenues at current rates of $81,895,983. Overall, the deficiency represents an increase in distribution revenues of 25.3%.

The impact of the requested deficiency on a typical residential customer consuming 680 kWh per month is distribution costs of $3.85 per month, or an increase of more than 18%. The impact on the GS < 50 kW customer class distribution costs range from 25.4% to 27.30%. The impact on the GS > 50 kW customer class distribution costs range from 34.0% to 35.7%. The impact on the Large Use customer class distribution costs range from 120.0% to 121.5%. All of these figures are provided in the response to Undertaking J3.6.

b) Lost Revenues

This cost of service application is the result of an early rebasing application by Horizon. The need for this early rebasing application was driven by the loss of revenues from the Large Use and GS > 50 kW customer classes, relative to those approved in the 2008 cost of service application.

As shown in the response to Energy Probe Interrogatory #1c on the Preliminary Issue, the actual return on deemed equity was 7.2% in 2008 and 6.4% in 2009. The actual return on deemed equity for 2010 was 7.3% (Tr. Vol. 1, pp. 33-34).

As shown in the response to Undertaking J1.1, Horizon provided the estimated impact on the return on deemed equity under the assumption that it did not lose the revenue associated with the Large Use and GS > 50 kW classes. The returns shown are 10.6% in 2008, 7.4% in 2009 and 9.4% in 2010. The average over these three years - 9.13% - is nearly 60 basis points above the return on equity of 8.57% built into the 2008 base rates. This clearly demonstrates that the lost revenues from the Large Use and GS > 50 kW classes was significant and was the main driver behind the need for an early rebasing application. Without the loss of this revenue, Horizon could have actually over earned during the 2008 through 2010 period.

Energy Probe submits that this cost of service application should be viewed as an opportunity to correct the problems created by the loss of load noted above. It should not

be viewed as an opportunity by Horizon to significantly increase either its capital expenditures or its OM&A expenses as compared to past years.

Horizon has lost significant load and is forecasting to lose additional loads in the 2011 test year. Energy Probe submits that the distributor should stay the course and keep its OM&A expenses at historical levels, with adjustments to reflect customer growth and inflation. Similarly, capital expenditures should be reduced wherever possible.

Energy Probe submits that Horizon is very close to a death spiral in rates. As noted above, the proposed increase in distribution rates for the Large Use class is approximately 120%. This increase could well result in the loss of additional load in this class as customers move elsewhere or simply close up shop. This would result in more costs being allocated to the other rate classes in the future, driving their rates up even more.

As shown in the response to Undertaking J1.7, Hamilton and St. Catharines have median incomes that were below the Ontario average in 2005. It can reasonably be assumed that these areas, which have felt the impacts of the recession more acutely through the loss of well paying manufacturing jobs that other parts of the province, are still well below the Ontario average at the current time. In other words, affordability is more important in these communities than in many others.

B - RATE BASE

a) 2010 Actuals

In its original evidence, Horizon was forecasting a 2010 closing net book value ("NBV") of $307.418 million and construction work-in-progress ("CWIP") of $6.316 million (Exhibit 2, Tab 2, Schedule 2, Figure 2-11). The CWIP was carried forward to the 2011 test year and remained at that level at the end of 2011. Ms Hughes explained that their budgets had been forecasting assuming a consistent level of CWIP (Tr. Vol. 1, pp. 39-40).

As shown in the response to Energy Probe Technical Conference Question #1b, the actual closing NBV for 2010 was $304.891 million while the closing CWIP balance was $9.157 million. The NBV was $2.527 million lower than forecast, while the CWIP balance was $2.841 million higher than forecast.

Energy Probe submits that the actual 2010 NBV should be reflected as the opening balance for 2011 in the calculation of the rate base for the test year. Energy Probe also submits that the lower capital expenditures closed to rate base in 2010 should be reflected in the test year depreciation expense.

As for the change related to CWIP, Horizon proposes to close the incremental $2.841 million to rate base in the test year. Ms. Hughes explained that the increase in CWIP at the end of 2010 was not expected to persist through 2011, but would rather return to the level of $6.316 million as originally forecast (Tr. Vol. 1, pp. 40-41). Energy Probe submits that this is reasonable.

Ms. Hughes agreed that reflecting the reduction in the test year opening rate base, along with the increase in CWIP closed to rate base in 2011 was "a fair approach". Energy Probe agrees and submits that the Board should direct Horizon to reflect both of these changes in the calculation of the 2011 rate base.

Energy Probe further submits that the $2.841 million in CWIP closed to rate base should be assumed to occur at midyear. Horizon has not provided any evidence as to when the $2.841 million would be closed to rate base in 2011, so Energy Probe submits that the midyear approach is appropriate. This is relevant in that the depreciation expense would then be calculated based on the half year rule, even though Horizon does not use this approach to calculate depreciation.

b) 2011 Capital Expenditures

i) General Submission

Horizon is forecasting 2011 capital expenditures closed to rate base in 2011 of $43,992,099. This figure is derived from the figure of $45,570,373 shown in Exhibit 2, Tab 2, Schedule 2, page 5 (Figure 2-12) and reflects a reduction of $1,578,274 for smart meters.

Energy Probe has reviewed the actual level of capital expenditures closed to rate base in 2007 through 2010, as found in Figures 2-8 through 2-10 for 2007 through 2009 and in Energy Probe Technical Conference Question #1b for 2010. These figures are summarized in the table below.

Year	2007 Actual	2008 Actual	2009 Actual	2010 Actual	2011 Test
Capital additions	$34,088,890	$44,996,708	$43,730,886	$34,590,491	$43,992,099
% change		32%	(3%)	(21%)	27%

The average capital additions over the 2007 though 2010 period was approximately $39.35 million. As a result, the forecast for 2011 (excluding smart meters) is an increase of about $4.6 million or 11.8% over the 2007 through 2010 average.

In recent Decisions the Board has expressed concern that capital expenditures should be relatively stable over time to ensure overall rate stability. This was clearly stated in the EB-2009-0259 Decision and Order dated March 1, 2010 for Burlington Hydro Inc. In that Decision the Board stated at page 19:

> *"The Board is of the view that capital programs should generally be stable over time to ensure overall rate stability, and that if an overall increase is required then that should be planned for on a staged basis in a way which smoothes the rate effects. The Board also recognizes that periodically a distributor will undertake capital projects at significant cost which are beyond the regular level of activity. Burlington's capital program has varied over the period 2006 to 2009, but the level forecast for 2010 is significantly higher than the average, even taking into account inflation. The evidence indicates that the 2010 increase is due to growth in the total number of projects and associated expenditures, and not due to a particular project which would substantiate the need for a significant increase from the average over the period 2007 to 2009. The*

Board finds that the 2010 capital budget, for rate base determination purposes, will be limited to $8.6 million, which approximates the average over the period 2007 through 2009 (thereby excluding the low expenditures in 2006) and incorporates an additional amount to represent inflation and overall growth in expenditures."

Energy Probe notes that the $8.6 million allowed was approximately 3% higher than the average over the period 2007 through 2009, as the allowance for inflation and overall growth in expenditures. Energy Probe also notes that the growth in the number of customers/connections for Burlington Hydro was approximately 1.8% (Exhibit 3, Tab 2, Schedule 1, Table 3-10).

Following the same logic as in the Burlington Decision, Energy Probe submits that the test year capital additions should be limited to $40.5 million. This is derived as the 2007 through 2010 average of $39.35 million increased by 3%. This would result in a reduction to capital additions of about $3.5 million from that forecast by Horizon for the test year.

Energy Probe submits that the 3% increase is appropriate even though Horizon's customer growth is only 0.5% (Revised Table 3-5 in Exhibit 3, Tab 2, Schedule 1, Updated March 14, 2011) and is considerably below the 1.8% for Burlington. This is because the Burlington average was calculated over a three year period from 2007 through 2009 whereas the average calculated by Energy Probe is over a four year period 2007 through 2010, in this proceeding.

As noted earlier, Energy Probe agrees with the $2.841 million closed to rate base in 2011 from the CWIP carried forward from 2010. This amount would be in addition to the $40.5 million related to the 2011 capital additions recommended above.

ii) Specific Submissions

First, the Evidence on fleet additions is provided in E2-T3-S1 page 95. Total capital expenditures for fleet in 2011 are forecast at $1,445,500, in 2012 at $1,110,000 and in 2013 at $1,656,000. The $1,445,500 cost in 2011 is for the acquisition of 3 large units

and 9 small units. Energy Probe understands the large units to be work equipment and the small units to be transport equipment. The kind of additions in 2012 and 2013 are not specified.

The large units mentioned are detailed in Table 2-48 on page 95 for a total cost of $800,000 leaving the balance of $645,000 for the 9 smaller transport units. Dividing one by the other results in a per unit cost of about $71,700 for the transport units.

Starting at line 256 on page 94 and continuing in lines 1-2 on page 95 reference is made to the need for "*additional new vehicles to support the increase in underground and overhead technical and trades positions during 2011and 2013, as defined within the Workforce Labour Strategy and Plan"*. At least part of those requirements, in Energy Probe's submission, would be related to advance hires for prospective retirements, although Horizon does not identify what portion of the fleet capital additions is attributable to the increase in technical and trades positions.

As it is unlikely that a utility would need new large equipment for apprentices to train on, Energy Probe submits it is reasonable to assume that only some additional transport equipment would be devoted to this group. A conservative estimate of the transport needs for the 6.6 excess advance hire FTEs is, in Energy Probe's submission, about 1.5 of the smaller units. At an average cost of $71,700 per unit the total capital additions to fleet that should be avoidable by not hiring the excess 6.6 FTEs identified earlier in these submissions would total $107,550.

Therefore, Energy Probe submits that the Board should reduce Fleet capital additions by $107,550 over the three year period from 2011 to 2013 to recognize the overstated requirement for advance hires of 6.6 FTEs.

Second, the intention of the company to incorporate hybrid vehicles in its fleet is mentioned on page 11 of the Construction and Maintenance Services business Plan in evidence at E1-T2-S2 Appendix 1-9c. This was the subject of cross examination at the oral hearing.

In response to a question from Counsel for Board staff, Horizon's witness reported in undertaking J1.6 that three hybrid vehicles had been provided for in the 2011 budget and the premium per vehicle was between $5,000 and $7,000. (Redacted Public Transcript Vol 2 page 2 lines 5-7). The witness goes on to say that "*we expect that this premium will be offset by fuel savings in the future"*. No additional evidence was introduced to support the expectation that fuel savings would offset the premium cost.

Energy Probe submits that the Board should deny recovery of the hybrid premium until the applicant provides evidence that the additional cost will be recovered in fuel savings or that there is some other demonstrable benefit to ratepayers of the distributor investing in hybrid technology.

The witness continued at lines 8-10 of the transcript that "*We are also moving to hybrid vehicles really just to reduce emissions, because it is important for Horizon from a sustainability perspective"*. Energy Probe submits that there is no benefit to ratepayers of the company trying to brand itself as a leader in reducing greenhouse gas emissions. In the absence of any ratepayer benefit, the company's shareholder not its ratepayers should bear the cost of the hybrid vehicle premiums.

c) Working Capital

Energy Probe submits that the allowance for working capital has been overstated by more than $4.5 million as compared to the updated Navigant Report, and by more than $2.0 million relative to the amount included in the Revenue Requirement Work Form filed in the response to Undertaking J3.3. The components of this overstatement are discussed below.

i) Lead/Lag Study

Horizon filed a Lead/Lag Study prepared by Navigant Consulting in Appendix 2-3 of Exhibit 2, Tab 4, Schedule 1. An update was filed on March 14, 2011. Energy Probe accepts the results of the Lead/Lag Study with the following exceptions.

Issue 1 - Service Lag

The Navigant Report utilizes a service lag of 30.27 days that is based on a weighting of the number of customers/connections that are billed on a monthly and bimonthly basis. This weighting is shown in the response to Energy Probe Interrogatory #7a. Energy Probe submits that this weighting is not appropriate. Energy Probe further submits that the proper weighting to be used to calculate the service lag is distribution revenues.

Horizon provided an example in the response to part (d) of Energy Probe Technical Conference Question #4 that was also discussed during the proceeding (Tr. Vol. 1, pp. 46-50). The example states that all else being equal, Horizon believes that an average lag of 22.5 days is appropriate for the two customers noted, one of which has a service period of 30 days and one of which has a 60 day service period. The example then goes on to calculate a service lag of 16.5 days based on revenues of $1,000 from the bimonthly customer and $9,000 from the monthly customer. Horizon concludes that this result would not be appropriate. This conclusion is based on the premise that "it is not representative of how service was provided to both customers, particularly the bimonthly customer" (Energy Probe Technical Conference Question #4, page 3, lines 7-9). Energy Probe respectfully disagrees.

The purpose of lead/lag study was described by Mr. Subbakrishna (Tr. Vol. 1, page 41):

> *"In general terms, the purpose of a lead/lag study is to determine **the amount of time it takes for a utility**, in the sense that it's an electric distribution company, to **realize revenues from its customers**, compared with the amount of time it takes for the same utility to pay its vendors."*
> (emphasis added)

In the example provided, the utility gets the $9,000 from the monthly billed customer on average 15 days before it gets the $1,000 from the bimonthly billed customer. In other words, it will realize revenues from customers based on both the service period (monthly or bimonthly) and the amount of the revenue. This last point can be illustrated even further with a small change to the example noted above.

If the revenue from the monthly customer were only $1 instead of $1,000, the customer weighted lag endorsed by Horizon would still be 22.5 days, whereas the dollar weighted lag endorsed by Energy Probe would essentially be 15 days. Assuming the billing lag, collection lag and payment processing lag are the same for both customers, and for the sake of the example equal 45 days in aggregate, the utility will get all but $1 within 60 days of the service being provided (i.e. 45 days plus 15 days for the bimonthly customer). The Horizon approach would lead to the conclusion that the utility did not get its money until 67.5 days (i.e. 45 days plus 22.5 days). Clearly the Energy Probe revenue approach provides a better reflection of the actual cash flow enjoyed by the utility.

As shown in the response to part (d) of Energy Probe Technical Conference Question #4 the service lag based on revenue weighting would be 26.70 days, a reduction of 3.57 days in both the service lag and the overall revenue lag.

Issue 2 - Collection Lag

Horizon contends that if the service lag is weighted based on revenues, then the methodology used to calculate the collection lag would have to be modified as well.

As shown in the response to part (c) of Energy Probe Technical Conference Question #4, the collection lag has been estimated based on the receivables balances dollars for all customers.

Mr. Subbakrishna alluded to this at page 43 of Volume 1 of the Transcript. He indicated that the collection lag is dollar weighted to one degree, but not to another. The other degree would be to actually do the analysis of the accounts receivable by separating each of the rate classes. Energy Probe agrees with this assessment.

The response provided to Undertaking J1.3, part (iii) indicates that using the revenue weighting for the service lag decreases the service lag component of the overall revenue lag from 30.27 days to 26.70 days, but at the same time it concurrently increases the collections lag from 24.00 days to 26.84 days. The calculations resulting in this figure are provided in Tables 1 and 2 of the response. Subject to the comments provided below with respect to the need to update the revenue weightings, Energy Probe accepts these calculations as being appropriate.

The net result, as shown in Table 1 in the response, is a reduction in the total revenue lag from 72.84 days to 72.10 days. The impact of this change is shown in Section 1 of Appendix A. This table has been calculated based on the figures provided in Table 8 of the updated Navigant Report in Exhibit 2, Tab 4, Schedule 1, Appendix 2-3. As can be seen by a comparison of the two tables, this net reduction in the service and collection lag of 0.74 days results in a reduction in the working capital requirement included in rate base from $62.7 million to $61.7 million. These figures are confirmed in Note 1 to the response to Undertaking J1.3. The comparison also shows that the percent of OM&A and cost of power declines from 14.1% to 13.9%.

It was noted by Horizon that it was using a percentage of 14.0% to calculate the working capital requirements (Tr. Vol. 1, page 45). As a result, reducing the factor from 14.0% to 13.9% would reduce the working capital requirement by approximately $1.0 million.

Issue 3 - Updates and Corrections

Horizon is silent on whether it proposes to simply apply the 14.0%, or the percentage approved by the Board, to the Board approved OM&A and cost of power expenses or

whether it proposes to update Tables 8 and 9 from the Navigant Report to reflect the changes in the expenses that may result from the Board Decision.

Energy Probe submits that the latter approach, while rarely done, is the better way to proceed and submits that the Board should direct Horizon to update the tables to reflect the Board approved changes.

In the interim, however, Energy Probe has attempted to update Table 8 from the Navigant Report to reflect the April 13, 2011 update that reduced the load forecast. This table is found in Section 2 of Appendix A. Energy Probe has not attempted to update Table 9, as its impact on Table 8 is relatively small.

The table provided in Section 2 uses the same total revenue lag as used in Section 1 of 72.10 days. In addition, the table has been updated to reflect the figures in the Revenue Requirement Work Form found in Undertaking J3.3 (with the exceptions noted below). In particular, the OM&A expense is $47,795,239 and PILs are 5,904,367. In addition, the debt reduction charge amount has been reduced to $30,487,445 to reflect the decrease in the load forecast filed on April 13, 2011 of 4,355,349,298 kWhs at a rate of $0.007 per kWh.

In addition to the above changes, Energy Probe has reduced the cost of power to $378,810,503. This is lower than the figure provided in the Revenue Requirement Work Form in the response to Undertaking J3.3. In part (ii) below, Energy Probe deals with what it believes is an error in the calculation of the cost of power resulting from the update to the load forecast. Appendix B provides the calculation of the figure used by Energy Probe.

Energy Probe has also changed the interest expense to $9.044 million. As explained in the Navigant Report, this line item is related to the interest on long term debt (page 11). Energy Probe believes the $10.1 million used in Table 8 in the Navigant Report utilities a 7.0% rate for the $116 million loan obtained in 2002. However, as shown in Table 5-1 of

Exhibit 5, Tab 1, Schedule 2, Horizon is requesting a deemed rate of 6.1% on this loan and the total long term interest is $9.044 million. Energy Probe submits it is not appropriate to include the actual interest on the loan when the rate paid by ratepayers is proposed to be lower than the actual rate charged.

As shown in the table in Section 2 of Appendix A, the working capital requirement remains at 13.9%, the dollar value declines to $59.4 million as a result of the updates and corrections.

Issue 4 - Revenue Adjustments Applicable to the Service and Collection Lag

As noted above in sections related to the service and collection lags, Energy Probe supports the use of revenues weights for both of these lags.

As indicated in the response to Energy Probe Technical Conference Question #4 parts (d) and (e), the weights used were based on 2009 data. The weights of 24% for monthly billed customers and 76% for bimonthly billed customers are shown in Table 1in the response to Undertaking J1.3.

Energy Probe submits that the revenues used to calculate the service and collection lags should be based on the 2011 proposed revenues to be recovered by rate class. Energy Probe submits there are several reasons to accept this update to the revenue weights.

First, the 14.0% proposed to be used by Horizon is based on the 2011 calculation provided in Table 8 of the Navigant Report. This table shows a 14.1% allocation factor for 2011, based on the updated 2011 expenses and revenues. Based on actual 2009 data, this factor was 13.6%, as shown in Table 6 of the Navigant Report. Energy Probe submits that it would not be appropriate to calculate the working capital requirement based on updates that reflect 2011 figures and not update the composition of the revenues. The change from 13.6% in 2009 to 14.1% in 2011 is driven by the change in the mix of the components and to exclude the change in the revenue component would not be appropriate, in the view of Energy Probe.

Second, the Board determined that it would hear the application because it believed that it was reasonable for Horizon to believe that the Board would accept a cost of service application from Horizon at this time (Decision on the Preliminary Issue of Early Rebasing and Procedural Order No. 4 dated December 15, 2010, page 6). This Decision was based on the earlier Z-factor application that was to deal with the loss of revenue from the large use customer class.

Energy Probe submits that there has been a significant shift in load between 2009 and the forecast proposed for 2011. For example, based on the April 13, 2001 forecast filed as part of Undertaking J3.3, there is nearly a 5% decline in the kWh billing determinants for the residential rate class between 2011 and 2009, while there is less than a 1% decline in the kW billing determinants for the large use class. Clearly there has been a change in the composition of the billing determinants since 2009.

Finally, Horizon has significantly different proposals for the revenue to cost ratios and the design of rates from that in place in 2009. While it does not appear that Horizon has filed an April 13, 2011 update to Table 3-1 in Exhibit 3, Tab 1, Schedule 2, it did so as part of its March 14, 2011 update for the large use forecast. As can be seen from the Revised Table 3-1, the revenue changes by rate class are significant. Again as an example, the residential revenues for 2011 were forecast to increase by about 17% in 2011 over 2009. The increase for the large use class, however, is more than 70%.

In conclusion, Energy Probe submits that revenue weights should be updated to match the 2011 proposed revenue by rate class. This will more accurately reflect cash flow in 2011 than using out of date 2009 ratios.

As noted above, it does not appear that an updated Schedule 3-1 that reflects the April 13, 2011 forecast has been provided by Horizon. As a result, Energy Probe has calculated the monthly and bi monthly billing distribution revenue shares based on Revised Schedule 3-1 that was updated on March 14, 2011. Based on that schedule, the monthly

billing distribution revenues (for the large use, GS > 50 and streetlight classes) are 28% of the total distribution revenue. The remaining 72% is for the classes that have bi-monthly billing.

Application of the 28/72 split results in a weighted service lag of 26.16 days in place of 26.70 days using the same 15.21 day service lag for monthly billed customers and 30.42 day service lag for bimonthly billed customers shown in the table provided in response to part (e) of Energy Probe Technical Conference Question #4.

Similarly, application of the 28/72 split results in a weighted collection lag of 26.47 days in place of the 26.84 days shown in Table 1 of Undertaking J1.3 and uses the same 29.34 day lag for bimonthly customers and 19.08 days for monthly customers.

The net impact on the service and collection lags is a further reduction of 0.91 days on the total revenue lag (0.54 for the service lag and 0.37 for the collection lag). This reduces the overall revenue lag from 72.10 days to 71.19 days.

The table provided in Section 3 of Appendix A shows the cumulative impact of the updates and corrections to the expenses and the reduction in the overall revenue lag. The cumulative impact is a reduction to the working capital requirement to $58.2 million and a percent factor of 13.6%. This is a reduction of $2.0 million from the allowance for working capital of $60.2 million shown in the Revenue Requirement Work Form attached to the response to Undertaking J3.3, and a reduction of $4.5 million from the figure calculated in Table 8 of the updated Navigant Report.

ii) Cost of Power

As indicated in the Revenue Requirement Work Form attached to the response to Undertaking J3.3, the cost of power used in the calculation of the working capital allowance is $382,184,837. Energy Probe submits that this figure is not the correct figure, based on the revised forecast provided by Horizon.

Horizon's original cost of power forecast was $394,028,103, as shown in Exhibit 2, Tab 4, Schedule 1, Appendix 2-2. Through the interrogatory process, Horizon identified a number of errors in the calculation provided in the original evidence.

A corrected Exhibit 3, Tab 2, Schedule 2, Appendix 3-2 was provided with the March 14, 2011 Update. Based on the corrections made and the updated Large Use forecast, the cost of power totaled $395,726,410. Energy Probe submits that this is the correct starting point based on the forecast as presented at that time and on the assumptions used by Horizon.

Two of the key assumptions used by Horizon in the updated cost of power were RPP and non-RPP prices from the April 15, 2010 Regulated Price Plan Report (Energy Probe Interrogatory #6a). Horizon also indicated that it had estimated the RPP/non-RPP volume splits based on January to March, 2010 actual billings (Energy Probe Interrogatory #6c).

In the response to Energy Probe Interrogatory #1 on the Revised Evidence, Horizon updated the cost of power to reflect the RPP/non-RPP volume splits based on actual 2010 data as provided in the response to Energy Probe Interrogatory #6d, as well as on the calendar RPP and non-RPP prices based on the October 18, 2010 Regulated Price Plan Report, as confirmed by Horizon in parts (e) and (f) of Interrogatory #6. As shown on page 3 of the response to the interrogatory on the revised evidence, the total cost of power declined to $390,152,271, a reduction of $5,574,139 from the March 14, 2011 update.

This reduction, at 14% for working capital allowance calculation purposes, resulted in a reduction in rate base of $780,379. This is the figure shown in the table on page 2 of the response provided to Undertaking J3.3, shown as "#2 Cost of Power update due to Large User Forecast change". In other words, Horizon has accepted the RPP/non-RPP volume split based on 2010 actual data, the update to the October 2010 RPP Price Report and the calculation of the calendar year prices for both the RPP and non-RPP prices. These

calendar year price forecasts match the rate year that Horizon is proposing. Energy Probe submits that each of these changes is appropriate and should be accepted by the Board.

Horizon has provided the estimated impact on the rate base of the reduced load forecast in the table on page 2 of the response to Undertaking J3.3, shown as "#8 Reduced Load Forecast". The figure of $1,115,441 is the result of a reduction of $7,967,436 in the cost of power. This difference is consistent with the reduction from $390,152,271 provided in the response to Energy Probe Interrogatory #1 on the Revised Evidence and the $382,184,837 shown in the Revenue Requirement Work Form attached to Undertaking J3.3. However, the calculations that result in this figure are not consistent with the use of the October 2010 RPP and non-RPP prices adjusted to a calendar year basis.

As shown in the cost of power calculation dated April 15, 2011 and attached to the April 15, 2011 letter from Mr. Sidlofsky, Horizon has used a rate $0.06938 for RPP volumes and $0.06438 for non-RPP volumes. These rates are consistent with the original evidence which were based on the April 2010 RPP Price Report.

Energy Probe has provided Appendix B to this submission which shows the cost of power calculations using the October, 2010 RPP and non-RPP prices, adjusted to the 2011 calendar year to match the rate year, the 2010 actual split of RPP and non-RPP volumes, all as accepted by Horizon, along with the updated load forecast provided on April 13, 2011. As shown in Appendix B, the resulting cost of power is $378,810,503, a reduction of $3,374,334. The rate base impact, at 14%, is a reduction of $472,407. Energy Probe submits that this is correct cost of power reflecting all the updates to the load forecast and the changes related to prices and volume splits accepted by Horizon. In summary, the rate base reduction of $1,115,441 shown in the table on page 2 of Undertaking J3.3 should be a reduction of $1,587,848.

Energy Probe submits that if the Board makes any adjustments to the load forecast in its Decision, these changes should be reflected in the calculation of the cost of power and in the working capital component of rate base.

iii) Management Fee Related Costs

In the 2011 test year, Horizon is forecasting revenue associated with its Management Fee related to affiliates of $784,515 (VECC Interrogatory #26). In the response to Energy Probe Interrogatory #14, Horizon provided the costs associated with providing the services for which the management fees are collected. These costs total the same $784,515 since Horizon does not collect any amounts in the management fee for depreciation or a return on capital costs (VECC Interrogatory #27).

As indicated in the response to Energy Probe Interrogatory #14, the costs associated with providing the services for which the management fees are collected are included as OM&A expenses. This results in an increase in rate base of approximately $109,832 (i.e. $784,515 x 14%) through the working capital allowance calculation. However, as noted above, Horizon does not include any return on capital in its management fee. In other words, ratepayers are paying a return on this component of rate base that is the direct result of services provided to affiliates. Horizon agreed with this assessment (Tr. Vol. 2, pp. 7-8).

Energy Probe submits that the Board should direct Horizon to remove the costs associated with providing the services for which the management fee is charged from OM&A costs and including them in account 4380 - expenses of non-utility operations. This would be a revenue offset to the management fee currently recorded in account 4390 - miscellaneous revenues. The transfer of these costs to account 4380 would have no direct impact on the revenue requirement, but would have the indirect impact of reducing the working capital component of rate base by $109,832 as noted above. Horizon also agreed with this assessment (Tr. Vol. 2, pp. 8-9).

iv) Changes to Controllable Expenses

Energy Probe submits that if the Board makes any adjustments to the controllable OM&A expenses in its Decision, these changes should be reflected in the calculation of the working capital component of rate base.

v) Summary of Impact of Proposed Changes

In summary, Energy Probe submits that the allowance for working capital should be reduced by approximately $2.6 million to reflect the impact of changes to the lead/lag study (service and collection lags, updated expenses, and corrections to the cost of power) and the transfer of the management fee related costs out of OM&A. The reduction from the figure provided in Table 8 of the updated Navigant Report is approximately $4.6 million.

C - REVENUES

a) Forecast Methodology

Energy Probe has serious concerns about the forecast methodology proposed by Horizon for estimating the non Large Use volumes. The first concern revolves around the level of CDM forecast for the 2011 test year. The second concern is with the equation used to estimate the purchased power.

Horizon filed a revised equation and forecast dated April 13, 2011 as part of the response to Undertaking J3.3. The 2011 forecast of power purchased based on this equation was 3,991.0 GWh, a reduction of more than 3.3% from the original forecast of 4,127.6 GWh (Exhibit 3, Tab 2, Schedule 2, Table 3-9) and substantially lower than the normalized actual consumption (excluding the Large Use customer class) of 4,255.3 GWh (VECC Technical Conference Question #2).

i) CDM Forecast

Horizon has reduced the 2011 power purchased volume forecast by 75.25 GWh which is 25% of the 301 GWh target that was to be achieved by Horizon based on the Board's letter on Electricity Conservation and Demand Management Targets (EB-2010-0216) dated June 22, 201 (Board Staff Interrogatory #12). Energy Probe submits that this estimate is both out of date and too large for the 2011 test year.

In the EB-2010-0215/EB-2010-0216 Decision and Order dated November 12, 2010, the Board specified the GWh savings target over the 2011 through 2014 for each distributor

in Ontario. The Horizon target is 281.42 GWh. Horizon confirmed this figure in the response to VECC Interrogatory #4.

Energy Probe submits that the appropriate CDM target to include in the volume forecast for Horizon for 2011 is 28.142 GWh, not 75.25 GWh. This figure is based on the specific target of 281.42 GWh assigned to Horizon by the Board for the cumulative savings for 2011 through 2014 and represents 1/10th of this cumulative target.

Distributors such as Horizon will be expected to provide on-going CDM plans throughout the 2011 to 2014 period to reduce consumption by the targeted amounts. Horizon indicated during the hearing that it plans to split this four year obligation equally over four years (Tr. Vol. 3, pp. 56-62). Energy Probe submits that this is not appropriate and is a misinterpretation of the cumulative savings required over the 2011 through 2014 period.

If the official CDM target of 281.42 GWh was split equally between the four years, then this would seem to imply a CDN target of 70.355 GWh for Horizon in each of 2011 through 2014. However, this would result in **cumulative** savings well in excess of the four year target of 281.42 GWh. CDM savings that are achieved in one year are expected to persist in subsequent years. In other words, if Horizon achieves 70.355 GWh of savings in 2011 and these savings persist in 2012, 2013 and 2014, it will have met its cumulative savings target of 281.42 GWh without having to do any CDM programs after 2011. The 2011 savings would produce the cumulative savings required without the pursuit of any further savings. Energy Probe does not believe that this is practical or the intention of the targets. Indeed if this was the intention then instead of a four year cumulative savings target, the target could have simply been stated as one-fourth of the cumulative figure, but achieved in 2011.

On the other hand, the achievement of equal **incremental** savings in each of 2011 through 2014 is a reasonable approach for distributors to follow. The effort, and resources required, to achieve CDM savings of 281.42 GWh over this four year period

would be equal across all years. In order to achieve the target, the distributor would have to obtain 1/10th of its overall cumulative target. This can be seen through a simple mathematical exercise.

If the four year cumulative target is 100 units and an equal incremental amount is achieved by the distributor in each of the four years then the target will be met as follows. In the first year, 10 units are obtained. In the second year, 20 units are obtained, consisting of the second year of the results from the first year, plus the incremental 10 units achieved in the second year. In the third year, 30 units would be obtained, consisting of the third year of the results from the first year, the second year of the results from the second year and the incremental 10 units achieved in the third year. The fourth year would generate total savings of 40 units. In aggregate the total savings are 100 units (10 + 20 + 30 + 40), achieving the target.

In summary, Energy Probe submits that the CDM target should be reduced to 28.142 GWh in the 2011 load forecast to reflect the current official CDM targets for the province and a reasonable expectation of when those savings will be achieved.

Horizon's position with regard to the CDN adjustment for 2011 is very similar to the position taken by Hydro One Brampton in the EB-2010-0132 proceeding. In that Decision and Order dated April 4, 2011, the Board found (at page 8):

> *"The Board finds that the appropriate CDM adjustment to be included in the load forecast for 2011 is 19 GWh, which represents 10% of its cumulative CDM target for the period of 2011- 2014. The Board is of the view that CDM targets will be achieved on an incremental, staged basis and that any adjustment to the test year's rates should be commensurate with the quantum of forecast savings for the test year. The Board is also inclined to defer imputing a larger impact arising from CDM initiatives into the test year load forecast until a true-up mechanism has been developed. The Board therefore agrees with Board staff's observation that a true-up mechanism is likely required to address any revenue deficiency or sufficiency over the IRM period resulting from the implementation of CDM programs intended to achieve HOBNI's cumulative target. However, the Board will not establish a true-up mechanism at this time as this is a generic issue that is likely to be*

applicable to all rate regulated distributors and should be determined in that context."

Energy Probe submits that there is no reason for the Board to deviate from the Decision in the Hydro One Brampton proceeding. Based on the April 13, 2011 equation and forecast included in Undertaking J3.3, Energy Probe estimates that replacing the 75.25 GWh with 28.142 GWh, the forecast for power purchased (excluding the Large Use customer class) would increase from 3,991.0 GWh to 4,139.4 GWh.

Based on the normalized actual volumes shown in the response to VECC Technical Conference Question #2, Energy Probe submits that this is not a reasonable forecast. The lowest normalized actual shown in the response to the VECC question is 4,250.9 GWh in 2009. The 2011 adjusted forecast of 4,139.4 noted above is more than 110 GWh below this figure. This decrease is larger than what can be attributed to CDM, and makes no allowance for economic growth and the addition of customers. In short, Energy Probe submits that this forecast, even corrected for the level of CDM, is not plausible.

It should also be noted that this approach assumes all of the 28.142 GWh of CDM will be achieved from the classes included in the data used, which means no CDM savings have been forecast for the Large Use class.

ii) Purchased Power Regression Equation

Energy Probe submits that there are a number of serious problems with the regression equation used by Horizon to forecast the purchased power for the non Large Use customer classes. The problems are so severe, in the view of Energy Probe, that none of the three equations noted below should be used to forecast the 2011 test year power purchases.

Throughout this proceeding, there have been three regression equations put forward, each dealing with a different calculation of historical CDM savings. The first of these equations is the one found in the original evidence at Exhibit 3, Tab 2, Schedule 2, pages 3 and 4 ("Equation 1"). The second is found in the response to VECC Interrogatory #2

("Equation 2"). The third and final equation is found in the response to Undertaking J3.3 and is the April 13, 2011 update ("Equation 3"). All of these equations have Adjusted R Squared and F-Test statistics that are similar. All of the coefficients (excluding the intercept) in each of the equations are statistically significant at a 95% level of confidence. None of the equations stands out as being superior to the other two.

The first issue with the equations is the historical data used for the CDM variable. The level of historical CDM changed throughout the proceeding, and it is still not clear to Energy Probe that the correct levels have been used in any of the three equations.

What is clear, however, is that when any change in the CDM data is made, there is a significant impact not only on the CDM coefficient, but also on the GDP coefficient. This is the second issue: the degree of correlation between the CDM variable and the GDP variable. When there is a strong level of correlation between two explanatory variables, multicollinearity can be present. Energy Probe notes that the correlation between these two variables over the January, 2003 through December, 2009 period, based on the data provided in the worksheet accompanying the response to Undertaking J3.3 is relatively high at 0.785 (a value of 1.0 signifies perfect correlation).

When multicollinearity is present, the estimates of the coefficients are sensitive to the data used in the estimation. If the data is changed, the result can be large changes in the coefficient estimates of the correlated variables. In the presence of multicollinearity, the coefficient estimates are both imprecise and unstable. In simple terms, the regression equation cannot distinguish between the effects of the correlated explanatory variables on the dependent variable.

The following table summarizes the coefficient estimates obtained from the three equations noted above. The Max/Min column shows the ratio of the largest of the coefficients to the smallest across the three equations. A ratio close to 1.00 indicates that the coefficients are stable, while a coefficient further away from 1.00 indicates instability in the coefficient.

Equation	#1	#2	#3	Max/Min
Heating Degree Days	95,047	94,813	94,926	1.002
Cooling Degree Days	910,043	910,307	912,670	1.003
Days in the Month	8,780,815	8,805,499	8,809,319	1.003
Spring Fall Flag	(10,042,271)	(9,997,493)	(9,886,989)	0.985
CDM Savings	(0.37)	(0.38)	(0.49)	0.755
Ontario Real GDP Index	1,331,406	1,014,366	826,128	1.612

As shown in the above table, the coefficients related to the CDM and GDP variables reflect significant instability when the CDM variable is changed, while the other four coefficients are relatively stable.

For forecasting purposes, multicollinearity may not be a serious problem if the same relationship among the explanatory variables is maintained over the forecast period. However, this is not the situation in the current proceeding. The historical relationship between the CDM variable and the GDP variable is not being maintained in the 2011 test year. This is because the CDM variable is forecast to grow significantly faster in 2011 than it did in the past, while the GDP variable continues to grow at a relatively stable rate compared to past years.

The third issue is whether or not the equations yield reasonable results. Energy Probe submits that these equations do not pass this test. As noted earlier in this submission, the reduction in the CDM forecast for the 2011 test year from 75.25 GWh to 28.142 GWh results in an increase in the forecast from 3,991.0 GWh to 4,139.4GWh. In other words, a reduction in the CDM figure of about 47 GWh increases the forecast by more than 148 GWh. This is not a reasonable outcome. This is because the model is trying to isolate the effect of CDM from the effect of GDP and because of the high degree of correlation between these two variables, it cannot do so accurately.

In summary, Energy Probe submits that none of the equations noted above are robust or reliable enough to use as a basis for the forecast of power purchases.

iii) An Alternative Forecast

If none of the equations discussed above is suitable to use to forecast the 2011 power purchases for all customers except the Large Use customers, then how should the Board determine what is a reasonable forecast?

Energy Probe submits that the following methodology should be used to determine the 2011 forecast. The 2011 forecast can be derived from the 2010 normalized actual figure of 4,255.3 GWh provided in the response to VECC Technical Conference Question #2, along with two adjustments to this figure.

The first adjustment is the estimated impact of CDM activities undertaken in 2011. As noted above, Energy Probe submits that a reduction of 28.142 GWh is the appropriate CDM related adjustment that should be made.

The second adjustment that needs to me made is an increase related to the growth in the economy, as measured by the GDP variable used in the equations. As noted earlier, the presence of multicollinearity can result is significant changes to the coefficients of the correlated variables when even small changes to one or the other variable are made. However, Energy Probe submits that the three GDP coefficients can be used to provide an estimate of the impact of the growth in GDP in 2011 as compared to 2010.

The following table shows the impact on the GWh forecast from each of the three equations noted above. The change in the GDP is taken from the data used to generate the forecast used in the response to Undertaking J3.3. In particular, the sum of the monthly GDP figures in 2010 is 1,643.95, while the corresponding total in 2011 is 1,692.80, an increase of 48.85.

Equation	#1	#2	#3
GDP Coefficient	1,331,306	1,014,366	826,128
Change in GDP	48.85	48.85	48.85
GWh Change	65.034	49.552	40.356

As the above table illustrates, the impact of the growth in GDP could range from an increase of 40 GWh to more than 65 GWh. Energy Probe submits that an increase of 40.356 GWh to reflect the growth in GDP is warranted. This is the most conservative of the figures shown in the above table.

Energy Probe notes that other explanatory variables were found to be statistically significant in the various equations estimated by Horizon. No adjustment, however, needs to be made to the 2010 normalized actual figure to account for them. Both heating and cooling degree days are already accounted for in the normalized 2010 figure. There is no change in the number of days in the month or in the spring fall flag.

The net result of the adjustments to the 2010 normalized actual results in a 2011 forecast of 4,267.5 GWh (4,255.3 - 28.142 + 40.356). Based on the normalized actual consumption levels shown in the response to VECC Technical Conference Question #2 of 4,250.9 GWh in 2009 and 4,255.3 GWh in 2010, along with the reduction associated with CDM and the increase associated with an increase in economic growth, Energy Probe submits that this is a reasonable forecast.

Finally, Energy Probe submits that there is no evidence in this proceeding to suggest a reduction in the power purchased volume in the 2011 test year as compared to the 2010 normalized actual of 4,255.3 GWh for the non Large Use customer classes. It is submitted that this figure is the lowest forecast that should be approved by the Board.

b) Large Use Forecast

i) Forecast

Energy Probe submits that Horizon has under forecast the Large Use volumes.

Horizon has updated the 2011 test year forecast to reflect 2010 actual data, along with adjustments related to two customers to reflect an ongoing strike at one customer and a shut down at another customer. Energy Probe takes no issue with the reductions

associated with the two Large Use customers as Horizon has proposed a variance account around these two customers. This variance account is dealt with separately below.

However, Energy Probe believes that Horizon has failed to take into account any growth in volumes at the remaining 10 Large Use customers. Horizon has used a growth rate of 3% for gross domestic product ("GDP") (Exhibit 3, Tab 2, Schedule 2, Appendix 3-1) in its forecast of power purchases, excluding the Large Use class. Energy Probe submits that it would be reasonable to expect some level of growth in the volumes consumed by the 10 Large Use customers over their 2010 actual levels of consumption as the economy continues to expand.

ii) Variance Account

Energy Probe submits that the Board should approve an asymmetrical variance account around the net distribution revenue forecast for the two customers (GM and USSC) as noted on page 20 of the March 14, 2011 updated evidence at Exhibit 3, Tab 2, Schedule 2.

As noted above, Energy Probe believes the forecast for the remainder of the Large Use customers may be somewhat understated. The use of variance account for the two noted customers would provide protection to ratepayers and provide a counterbalance to the conservative forecast for the remaining 10 Large Use customers.

Energy Probe notes that Horizon is proposing to share any net distribution revenues in excess of those forecast for the two customers on a 50/50 basis with its large use customers (Exhibit 9, Tab 1, Schedule 1, page 4, updated March 14, 2011). Energy Probe disagrees with both aspects of this proposal.

First, Energy Probe disagrees that any amount to be refunded to customers should be refunded only to the Large Use customer class. This issue was discussed at length (Tr. Vol. 3, pp. 73-79). It is Energy Probe's understanding that Horizon is proposing to deal with the allocation of any excess revenue, or portion thereof, included in the variance

account when it seeks to dispose of the amount. Energy Probe submits that this is appropriate. However, if the Board were to determine now how any amount is to be disposed of, Energy Probe submits that it should be to all customers based on the allocation of costs. Horizon has indicated that based on a complete run of the cost allocation model, there are cost impacts to other rate classes. Energy Probe submits that any revenue should be refunded based on the cost impacts to all rate classes of not including the higher revenues achieved for these two customers.

Second, Energy Probe disagrees that there should be any sharing of the net distribution revenues that may accrue in the account between ratepayers and the company. Energy Probe submits that 100% of any such revenues should accrue solely to the ratepayers.

Horizon is obtaining all of the benefit and reduced risk associated with the forecast for these two customers. This results in an increase in the revenue deficiency as compared to what it would be if the forecast were higher and in higher rates for all customer classes. If there is additional revenue, it should all flow back to the ratepayers since they are the ones paying the price associated with a forecast that turned out to be too low.

c) kW Forecast Methodology

Horizon has three rate classes (in addition to the Large Use class) that are charged volumetric distribution on a per kW basis. These classes are the GS 50-4,999, Street Lighting and Sentinel Lighting classes.

The methodology employed by Horizon to forecast the kW's for each of these three rate classes is based on a review of the historical ratio of kW to kWhs over the 2003 through 2009 period and applying the average ratio for this period to the forecasted kWh for 2011 to arrive at the kW forecasts for the test year for these classes (Exhibit 3, Tab 2, Schedule 2, pages 12-14).

In Energy Probe Interrogatory #11, regressions were run on the three set of kW to kWh ratios to determine if there were any statistically significant trends that could be

identified. As can be seen in the response to parts (a) and (b) of that interrogatory, the GS 50 - 4,999 class had a trend variable that was found to be statistically significant, while the other classes did not.

Energy Probe submits that the methodology of using the average kW to kWh ratio is appropriate for the Street Lighting and Sentinel Lighting classes because there is no statistically significant trend for these classes.

However, Energy Probe submits that there is a statically significant trend in the kW to kWh ratio for the GS 50 - 4,999 rate class. Energy Probe submits that the Board should direct Horizon to use this methodology to forecast the kW to kWh ratio for this class of customers as it provides a more realistic forecast.

As can be seen in Table 3-20 of Exhibit 3, Tab 2, Schedule 2, Horizon forecast the ratio for 2010 and 2011 for the GS 50 - 4,999 class at 0.2727%, the average for 2003 through 2009. However, as shown in the response to Energy Probe Interrogatory #11d, the actual ratio for 2010 was 0.2872%. This is a material increase over the forecast level of 5.3%.

The response to part (c) of the interrogatory indicates that adopting the trend methodology for the GS 50 - 4,999 rate class results in a reduction in the revenue deficiency of $622,840. This amount is larger than Horizon's materiality threshold of $500,000 (Exhibit 2, Tab 1, Schedule 2).

d) Other Operating Revenue

As shown in Table 3-25 of Exhibit 3, Tab 3, Schedule 1, Horizon forecast a decline in Other Operating Revenue from $6,083,647 in 2009 to $5,601,659 in the 2010 bridge year and to $5,481,969 in the 2011 test year. The reduction in 2011 relative to 2010 reflected a reduction of $166,960 in Account 4210 - Rent from Electric Property, which was due to the forecasted loss of a tenant at Horizon's John Street location (Exhibit 3, Tab 3, Schedule 3, page 5). This reduction was partially offset by an increase of $47,270 in

Account 4390 - Miscellaneous Non-Operating Income. Energy Probe accepts these changes between the 2010 forecast and the 2011 forecast as being reasonable.

However, the response to Energy Probe Technical Conference Question #5 reveals that the actual 2010 Other Operating Revenue was $6,062,880. The response also indicates that Account 4325 - Revenues from Merchandise, Jobbing represents 3 years of Merchandising Revenue. Energy Probe submits that on a normalized basis, this would result in a reduction of approximately $100,000 in the actual 2010 figures to approximately $5,962,880. This figure is an increase of $361,221 or 6.4% over the forecast for the bridge year. The increase over the forecast level was driven by higher late payment charges, interest and dividend income, miscellaneous service revenues and the gain on disposition of utility and other property.

Energy Probe notes that Horizon has not forecast any gain on the disposition of utility and other property despite recording revenues in this account every year from 2008 through 2010, ranging from about $91,000 to more than $270,000. Similarly, Horizon has not forecast any interest and dividend income for the 2011 test year, despite recording an average amount of more than $60,000 over the 2008 through 2010 period.
Energy Probe submits that the 2011 test year forecast for other operating revenue is understated. Energy Probe further submits that an appropriate forecast for the test year can be determined using the adjusted 2010 actual figure of $5,962,880 derived above, and adjusting for the two changes in the 2011 forecast relative to the 2010 forecast, both of which were noted above. This would result in a 2011 forecast of $5,843,190 ($5,962,880 - $166,960 + $47,270). This is an increase of more than $360,000 from that forecast by Horizon for 2011.

Energy Probe notes that the increase proposed above would include the correction to the Management Fee Revenue to $784,515 from $772,376 as shown in the response to VECC Interrogatory #26.

Energy Probe has also submitted that a total of $784,515 in costs associated with providing the services for which the management fees are collected should be transferred out of OM&A and into Account 4380.

D - OM&A EXPENSES

a) Overall Increase in OM&A Costs

Horizon is forecasting total OM&A costs, excluding depreciation, PILS and interest costs of $47,457,439 for the 2011 test year as shown in the RRWF attached to the response to Undertaking J3.3. This is an increase of 20.2% from the level of $39,500,000 actually spent for the 2010 bridge year (Energy Probe Technical Conference Question #7). This increase is significantly higher than the increase posted in previous years.

The following table is based on the information provided in Table 4-1 of Exhibit 4, Tab 2, Schedule 1 (for 2007 through 2009), Energy Probe Technical Conference Question #7 (for 2010) and the RRWF attached to the response to Undertaking J3.3 (for 2011).

	2007	2008	2009	2010	2011
Total OM&A	37,004,670	38,749,191	38,804,535	39,500,000	47,457,439
% Change		4.7%	0.1%	1.8%	20.2%

As can be seen in the above table, the average increase in total OM&A over the 2008 through 2009 period was 2.2%. This reflects measures taken by Horizon in response to the loss of significant revenues, notably in the Large Use and GS > 50 kW classes. Energy Probe submits that Horizon should be commended for controlling its expenses to the degree that it was able to do so over this period. However, Energy Probe submits that the time for cost control is even more important in 2011 and future years.

Horizon is forecasting the loss of more load, especially in the Large Use customer class. As a result, it is submitted that Horizon needs to continue to control its OM&A expenses in the test year and beyond for the foreseeable future. To do otherwise will inevitably lead to a spiraling increase in rates for all customer classes.

As noted above, Horizon is requesting the Board to approve an increase in OM&A costs of more than 20% from the actual level of expenditures in 2010. The 2011 figure represents an increase of 22.3% over the 2009 expenditures. Under either comparison, Energy Probe submits that the increase is excessive and should be rejected by the Board.

In the EB-2009-0259 Decision and Order dated March 1, 2010 for Burlington Hydro Inc., the Board approved an increase in the 2010 test year OM&A expenses of almost 10% over the 2008 actual levels. Actual expenditures for 2009 were not available.

In the EB-2010-0132 Decision and Order dated April 4, 2011 for Hydro One Brampton Networks Inc., the Board approved an increase in the 2011 test year OM&A expenses of 10% over the 2009 actual spending. Again, the Board did not have actual OM&A expenses for the bridge year.

In the Hydro One Brampton Decision, the Board provided further rationale for the 10% increase. The Board indicated that the 10% increase over the two years reflected the 2.2% per annum forecast growth in customers and allowed for slightly less than 3% per annum increase in spending per customer, which was more than the rate of inflation.

Energy Probe submits that the Board should apply the same reasoning as in the above two Decisions when determining an appropriate increase for OM&A for Horizon.

Based on the Hydro One Brampton Decision, the Board approved an increase of 5% per year (not compounded) which was made up of 2.2% for customer growth and 2.8% for the increase in spending per customer.

As shown in Revised Table 3-5 in Exhibit 3, Tab 2, Schedule 1 (Updated March 14, 2011), the percent change in the number of customers/connections for 2010 and 2011 are forecast by Horizon to be 0.5%.

Adding this customer growth figure of 0.5% to the 2.8% growth in the spending per customer allowed by the Board for Hydro One Brampton results in an increase of 3.3%, or 6.6% over two years.

If the 6.6% figure is applied to the actual capital expenditures from 2009 ($38,804,535), the resulting 2011 expenditures would be $41.4 million. However, unlike the Burlington Hydro and Hydro One Brampton cases, the Board does have an actual bridge year OM&A expenditure ($39,500,000). Applying the 3.3% growth factor to this actual figure would result in 2011 expenditures of $40.8 million.

Applying the 2.8% growth in spending per customer from the Hydro One Brampton Decision to the OM&A per customer for Horizon would result in 2011 expenditures of about $40.6 million. This figure is based on actual OM&A expenditures in 2010 of $39.5 million (Energy Probe Technical Conference Question #7), 235,000 customers in 2010 (Exhibit 4, Tab 2, Schedule 8, Table 4-11) for an OM&A per customer figure in 2010 of $168.09. Increasing this by 2.8% and multiplying by the 235,000 customers shown for 2011 in Table 4-11 results in the estimate of $40.6 million.

Based on the above analysis, Energy Probe submits that the base OM&A should be in the range of $40.6 to $41.4 million for the 2011 test year.

Energy Probe submits that certain other costs should be added to and removed from the base OM&A figure.

First, the costs associated with providing the services for which the management fee is charged, which total $784,515, should be removed from the base OM&A figure and transferred to account 4380. This transfer was discussed above related to the Management Fee Related Costs under the Working Capital section of Rate Base.

Second, the cost associated with LEAP should be added to the base OM&A. As indicated in the response to Board Staff Interrogatory #24, the LEAP expense would be

approximately $130,450, based on 0.12% of the proposed service revenue requirement. Horizon also noted that it had already included $55,000 in the revenue requirement associated with the Winter Warmth programs in its service territory. As a result, there would be an increase of $75,450 associated with the LEAP program. Energy Probe submits that this amount will need to be recalculated to reflect the Board's Decision in this application to reflect 0.12% of the approved service revenue requirement.

Third, the Board may want to consider how it prefers to deal with the OMERS related increase. As indicated in the response to Board Staff Interrogatory #52, Horizon has included an incremental $235,000 in OM&A expenses related to the increase in the OMERS contribution rate. This represents the OM&A portion of the total increase of $340,000 forecast for the 2011 test year. This total increase is similar to the increases projected for 2012, 2013 and 2014, as shown in part (d) of the response to the Board Staff interrogatory. As such, the Board could estimate an average or "annualized" level of OMERS contributions to reflect the increases in 2011 through 2014. The increase in this four year average, as compared to the $340,000 included for 2011, adjusted by 69% to reflect the portion that is expensed, would then be added onto the base OM&A.

Based on the figures provided in part (d) of the response, the total incremental OMERS costs associated with the increase in the contribution rate would appear to be approximately $3.4 million over the 2011 through 2014 period. Annualized over four years, this would amount to an average cost of $850,000, of which $340,000 has already been accounted for. Taking the incremental amount of $510,000 and applying the 69% factor would result in an increase to the base OM&A of approximately $352,000. Energy Probe submits that this approach is appropriate and notes that it mirrors the approach taken by the Board in the Hydro One Brampton Decision.

The alternative approach that the Board could consider would be to make no adjustment to the amount included in the 2011 revenue requirement associated with the OMERS increase and provide a variance account to track differences in the 2011 through 2014

period. Energy Probe does not support this approach, as Horizon as provided a forecast that can be used for this period.

b) Specific Adjustments to OM&A

Energy Probe would normally provide an analysis of specific reductions to OM&A expenses that would approximate the overall reduction in OM&A expenditures proposed in part (a) above. However, this is not possible in this case.

Ms. Hughes indicated that Horizon remapped their accounts in September 2008. This means that 2007 data and Board Approved 2008 data and actual 2008 data are not comparable to 2009 through 2011 data on an account by account basis (Tr. Vol. 2, pp. 101-103).

c) Head Count and/or FTEs

i) Staff Retirement Impacts

Exhibit E4-T2-S6 Appendix 4.2 is the company's Workforce Labour Strategy and Plan. The Plan impacts operating costs because it proposes to advance hire new employees to replace those expected to retire over the planning horizon. One of the key assumptions set out in the plan is that employees will retire when they are eligible for an undiscounted pension. (top of page 3)

Energy Probe IR#50 asked for the history of actual retirements compared to eligible retirements over the period 2000-2010. The response to that IR concluded that 97% of employees take retirement when they become eligible for an undiscounted pension. This factor of 97% is used to forecast the number of retirees that will need to be replaced over the period 2010-2014 and is shown in the retirement forecast table on page 3 of the response to IR#50.

Energy Probe questioned the calculation of the 97% factor in its Technical Question #14 because it was not obvious from the response to IR#50 how it was arrived at. The answer to TC#14 reveals that the calculation is an arithmetic average of the percentage of

employees actually retiring compared to those eligible to retire with an undiscounted pension in each of the years 2004-2010. This method of averaging yearly percentages is not, in Energy Probe submission, a legitimate means of arriving at the conclusion that 97% of eligible retirees will actually retire when they become eligible without penalty.

At the Technical Conference, as a result of requesting a more complete response to the Technical Question, Energy Probe obtained Undertaking No. JT1.4 – To Provide Actual Calculation for Energy Probe Technical Conference Question No. 14.

"Response:

The table provided in Horizon Utilities' response to Energy Probe Interrogatory 50 a) is reproduced below.

	2004	2005	2006	2007	2008	2009	2010
# of employees eligible for undiscounted retirement	13	5	9	13	11	21	9
# of employees that actually retired	4	20	3	3	3	14	9
Percentage	31%	400%	33%	23%	27%	67%	100%

The actual retirement rate over the 7 year period was 97%.

If one assumes that 2004 is Year ("Yr.") 1 through to 2010 being Yr. 7, the percentage is calculated as follows:

$$= \frac{\text{(Yr.1\%+Yr.2\%+Yr.3\%+Yr.4\%+Yr.5\%+Yr.6\%+Yr.7\%)}}{\text{Number of Years}}$$

$$= \frac{\text{(31\%+400\%+33\%+23\%+27\%+67\%+100\%)}}{7}$$

= 97%"

(Horizon Utilities Submission of Technical Conference Undertaking, 2 March 2011)

A number of inconsistencies are apparent in the response table to IR#50 which sets out the data on which the 97% calculation is based.

First, in all but two of the years listed from 2004 to 2010, far fewer actual retirees are recorded than those eligible to do so with an undiscounted pension. The two exceptions are in 2005 when 20 employees retired but only 5 were eligible for an undiscounted pension and in 2010 when 9 employees were eligible and 9 actually retired.

The 2005 percentage of those retiring compared to those eligible to retire with an undiscounted pension turns out to be 400%. However, only 5 employees were eligible o retire with an undiscounted pension in that year. Energy Probe submits that the number of employees who actually retired in that year who were eligible to do so with an undiscounted pension cannot logically exceed the number (5) who were eligible for that undiscounted pension. The balance of retirees recorded in that year (15) were not eligible for an undiscounted pension and so should not be compared to the number who were eligible.

Energy Probe is not certain of the circumstances prevailing in 2005 that encouraged such a large number of employees to retire but suggests that the amalgamation of Hamilton and St. Catharines LDCs may have resulted in a retirement incentive being offered to employees. If so, that unusual situation should not, in Energy Probe's submission, be used to predict future retirements which are not influenced by early retirement incentives.

Regardless of what the circumstances were, though, that led to the unusually high number of retirees in 2005, the fact remains that only 5 of them were eligible for an undiscounted pension and so only 5 (at most) should be used to derive a percentage of actual retirees compared to eligible ones. In that case, the percentage would be 100% not 400% as noted in the table.

Energy Probe also submits that a simple average of percentages over the 2004-2010 period is not mathematically legitimate because it ignores the weighting affect of the actual numbers in individual years. The only condition under which a simple arithmetic average would be a legitimate method of calculating an overall percentage over time would be if all of the numbers in each category respectively were the same in each year.

Energy Probe submits that the proper way to calculate the percentage of employees who actually retired against those eligible to do so with an undiscounted pension is to sum those who actually retired with an undiscounted pension and divide it by the sum of those who were eligible to retire with an undiscounted pension.

The following table summarizes what Energy Probe believes to be the proper method:

	2004	2005	2006	2007	2008	2009	2010	Total
#employees eligible for undiscounted pension	13	5	9	13	11	21	9	81
#employees who actually retired	4	5	3	3	3	14	9	41
percentage	31%	100%	33%	23%	27%	67%	100%	51%

Using this method only 51% of employees eligible for an undiscounted pension actually retired in the year they qualified on average over the eight year period. By comparison, Horizon's method yielded 97% as the average and the company then applied that percentage to forecast the number of retiring employees in each year from 2011-2014 that would need to be replaced.

Advanced hiring for expected retirements is shown in the "Summary of Staffing Changes and Recruitment Plans" on page 3 of the Workforce Labour Strategy and Plan (E4-T2-S6 Appendix 4.2). The total number of advanced hires during the period 2011-2014 is 14 and is derived using the 97% factor. Using Energy Probe's factor of 51% would result in just 7.4 advanced hires over the same period leaving an excess advance hiring of 6.6 FTEs.

Horizon has provided estimated costs for apprentices in Appendix 1-9c of E1-T2-S2. Page 6 notes that increased costs from 2010 – 2011 for apprentices are $275,000 (third line of upper table entitled "Analysis of C&M Budget Change from 2010 – 2011"). The

lower table "Analysis of C&M manpower change 2010 – 2011" shows an additional 7 apprentices added in 2011. Dividing the total cost increase for apprentices by the number of apprentices added results in a unit cost of $39,285 per year.

Because advanced hiring is focused on apprentices that will require a lengthy training period to become competent, Energy Probe submits that it is reasonable to conclude that the excess hires identified above are most likely apprentices and should be costed as such. Therefore, applying the annual cost $39,285 per year for the 6.6 excess FTEs identified above results in an overstatement of OM&A costs over the period 2010 – 2014 of $259,285.

Energy Probe submits that the Board should reduce Horizon's OM&A expenditures by $259,285 over the period 2010-2014 to correct for the faulty calculation underlying the company's forecast of advanced hiring requirements for retirements.

ii) General Submissions – Head Count and/or FTEs

While it is not possible to analysis the OM&A expenditures on a line by line basis, it is possible to review the head count and/or FTE's. Horizon indicated that it uses these two terms interchangeably (Tr. Vol. 2, page 26), although it became apparent that it was not possible to directly compare the actual figures for historical years with the forecasted figures for the bridge and test years in Table 4-25 of Exhibit 4, Tab 2, Schedule 10. (Tr. Vol. 2, pp. 27-28).

The response provided to Undertaking J2.4 included a revised Table 4-25 that provided 2009 data on an as budgeted basis so that these figures would be comparable to the 2010 and 2011 forecasts, as well as 2010 actual data that would be comparable to the actual data show for 2009 and previous years.

What the evidence shows, regardless of which approach is used, is that Horizon is projecting a significant increase in the number of employees in the 2011 test year. At the end of 2010 Horizon had 386 people of staff, the same number as at the end of 2009 (Tr.

Vol. 4, pp. 46-47). At the end of 2011, Horizon is forecasting that it will have 428 people on staff, an increase of 42 from the end of 2010 (Tr. Vol. 4, pp. 47-48). For the period from the end of 2007 to the end of 2010, the total increase in the number of employees was 19, or an average of just over 6 people per year. If the same increase was projected for 2011, the number of employees at the end of 2011 would be 392, a reduction of 36 positions.

Energy Probe notes that in the Hydro One Brampton Decision, the Board indicated that it *"is not included to delve into the specific numbers of FTEEs or the impact of whether work is done by full time staff or contracted out. That is a matter for HOBNI to manage within this spending envelope"* (page 23). Energy Probe submits that the same should apply to Horizon. Any reduction in the spending envelope approved by the Board should be managed by Horizon. However, since the increase in the number of employees in 2011 is the major driver in the OM&A increase forecast for the test year, it is submitted that this is an area where considerable reductions from the forecast can be achieved.

E - DEPRECIATION & AMORTIZATION

a) Depreciation Rates Used

Energy Probe does not have any issues with the rates used for depreciation, as shown in Table 4-35 in Exhibit 4, Tab 2, Schedule 13.

b) Half Year Rule

As noted on page 5o f Exhibit 4, Tab 2, Schedule 13, Horizon commences amortization in the month that the asset is capitalized. In other words, Horizon does not use the half year rule for depreciation of assets added during the year.

This was confirmed in the response to Energy Probe Interrogatory #27. Moreover, this was the same methodology employed by Horizon to set rates in the 2008 EDR application and is the same methodology used by the distributor to calculate the actual depreciation expense for 2008, 2009 and 2010.

Energy Probe submits that the Board should approve the methodology used by Horizon to calculate the depreciation expense for the 2011 test year. It is consistent with that used in the 2008 EDR application and with the way the actual depreciation expense for 2008 through 2010 has been calculated. It is also more accurate than the half year methodology in that depreciation commences in the month that an asset is placed into service.

c) Changes to Capital Expenditures

If the Board makes any changes to the capital expenditure forecast for 2011, then Energy Probe submits that these changes should be reflected in the calculation of the depreciation expense calculated for the 2011 test year.

In addition, changes to the level of 2010 capital expenditures which are reflected in the actual 2010 gross asset continuity schedules, should also be reflected in the calculation of the depreciation expense in the 2011 test year.

F - TAXES

Energy Probe submits that the Board should accept the corrections made by Horizon with respect to the calculation of PILS/taxes as discussed in paragraph 39 of the Argument-In-Chief dated April 21, 2011.

Specifically these corrections relate to the Class 52 assets for the capital cost allowance, the calculation and inclusion of Federal and Ontario apprenticeship-related tax credits and the tax reduction associated with the Ontario small business tax rate on the first $500,000 of taxable income. These changes are reflected in the response to Undertaking J2.2.

Energy Probe submits that if the regulatory taxable income is changed as a result of the Board's Decision, then the income tax calculation should also be updated to reflect the revised level of regulatory taxable income.

G - LOSS ADJUSTMENT FACTOR

Horizon is requesting a loss adjustment factor of 4.07%. This request is based on a five year average of 2005 through 2009 and the calculation is shown in Table 8-19 of Exhibit 8, Tab 1, Schedule 3.

Energy Probe submits that the loss adjustment factor should be 3.92%. This would be the result if the average of the last three years shown in Table 8-19 for the period 2007 through 2009 were to be used.

Energy Probe usually supports the use of the five year average, rather than the three year average. Further, Energy Probe notes that in the June 28, 2010 version of Chapter 2 of the Filing Requirements it is stated that five years of historical data is preferred and that a minimum filing of three years of data is required.

In this instance, however, Energy Probe submits that the use of the three year average is more appropriate. A review of Table 8-19 reflects a significantly higher total loss factor for 2006 than has been recorded in any of the years shown. The total loss factor in 2006 is 4.71% whereas the next highest level shown is 4.13% for 2008. The 2006 level is 0.58% higher than the next highest percentage. However, the loss factors for 2005, 2007, 2008 and 2009 are all relatively stable, with the difference between the highest (4.13%) and the lowest (3.70%) being only 0.43%.

Energy Probe submits that the Board should approve a total loss factor based on the average of 2007 through 2009 as this average removes the impact of the 2006 data which appears to be an outlier.

H - COST OF CAPITAL

a) Capital Structure

Horizon has used a deemed capital structure of 56% long term debt, 4% short term debt and 40% equity. Energy Probe accepts this as being appropriate.

b) Allowed Return on Equity

i) Early Rebasing Windfall

Energy Probe has reviewed the submission of the School Energy Coalition ("SEC") related to the early rebasing windfall and supports those submissions. In particular, Energy Probe submits that in the current proceeding the increased ROE under the new cost of capital parameters is nothing other than a windfall and is not connected to the reasons that Horizon sought and was granted the early rebasing.

Based on the increase in the return on equity from the 8.57% included in the current rates to the 9.66% requested by Horizon, Energy Probe has calculated that the impact on the revenue deficiency, including the impact of taxes, is about $2.3 million, which amounts to 11% of the deficiency claimed by Horizon in Undertaking J3.3.

ii) 2011 Return on Equity

In its original evidence (Exhibit 5, Tab 1, Schedule 1), Horizon indicated that it understood that the Board would finalize the return on equity for 2011 rates based on January 2011 market interest rate information. However, Horizon has applied for a 2011 rate year that begins January 1, 2011, rather than May 1, 2011.

The Board issued a letter dated November 15, 2010 that set out the cost of capital parameter updates for 2011 cost of service applications for rates effective January 1, 2011. The return on equity was calculated to be 9.66%. Energy Probe submits that this is the appropriate figure to be used by Horizon, if the Board approves the change in the rate year to January 1, as requested by Horizon.

However, if the Board maintains the rate year beginning May 1, 2011, then Energy Probe submits that the return on equity should be 9.58% as set out in the Board letter dated March 3, 2011 that set out the cost of capital parameter updates for 2011 cost of service applications for rates effective May 1, 2011.

c) Short Term Debt Rate

Energy Probe submits that the short term debt rate should be 2.43% to reflect the Board's November 15, 2010 letter if the Board approves the change in the rate year to January 1, 2011. Similar to the return on equity submission above, it the Board determines that the rate year should remain May 1, 2011, then the short term debt rate should be 2.46% to reflect the Board`s March 3, 2011 letter.

d) Long Term Debt

i) Long Term Debt Rate

Horizon has calculated its weighted average long-term debt rate to be 5.80%, as shown in Table 5-1 of Exhibit 5, Tab 1, Schedule 2. This figure is based on two existing debt instruments with affiliates. The first is a 2002 debt instrument in the amount of $116 million that bears interest at a rate of 7.0% (line 4 of Exhibit 5, Tab 1, Schedule 1, page 2). This note matures in July 2012. Horizon is requesting a deemed rate of 6.1% be applied to this note. This was the rate approved for this note in the 2008 EDR COS Application Decision. Horizon has indicated that there have been no changes to the terms of the note since that Decision (Exhibit 5, Tab 1, Schedule 1, page 2, lines 18-20).

The second promissory note was issued in 2010 and was forecast to be at a rate of 4.92% that matures in July 2020. As shown in the response to School Energy Coalition Interrogatory #34, the interest rate on the final signed note is 4.89%.

Energy Probe submits that the use of a deemed rate of 6.1% on the $116 million promissory note is not appropriate. Energy Probe agrees with and supports the submissions of the SEC on this issue. In particular, the deemed rate of 6.1% approved in the EB-2007-0697 Decision was the deemed rate applicable to the 2008 test year, not the deemed rate at the time the note was executed. Energy Probe submits that the rate should be set on the same basis this time around. In other words, this Board panel should adopt the same conclusion (on the same instrument) as the previous Board panel, and thus apply the deemed rate. If the Board adopts a January 1, 2011 rate year, this deemed rate

would be 5.48%; if the Board maintains the May 1, 2011 rate year, this deemed rate would be 5.32%.

ii) Horizon Proposal for Refinancing

As noted above, the $116 note matures on July 31, 2012. This note is currently held by Hamilton Utilities Corp., an affiliate of Horizon.

Horizon has indicated that it intends to refinance this note when it matures through the issuance of a promissory note to Horizon Holdings Inc., another affiliate of Horizon (Exhibit 5, Tab 1, Schedule 1, page 3, lines 6-14).

Horizon is requesting that, effective with the time of such refinancing of the $116 million note in its next scheduled incentive rate mechanism adjustment, its long-term debt rate be adjusted, substituting the deemed rate of 6.1% on the current note with the rate of the replacement note in the calculation of the overall long-term debt rate. Horizon provided a number of options of how this could be accomplished under IRM in the response to School Energy Coalition Interrogatory #33.

Energy Probe notes that a 10 basis point change in the rate applicable to the $116 million note, when applied to the deemed amount of long term debt has an impact of approximately $225,000 (including the impact of tax) on the revenue requirement.

Energy Probe submits that the use of a variance account would be appropriate to deal with any material differences associated with the impact on the revenue requirement over the IRM period. Energy Probe further notes that Horizon has adopted a materiality threshold of $500,000 (Exhibit 2, Tab 1, Schedule 2, page 1). If the impact is less than $500,000 (increase or decrease), then Energy Probe submits that it is not material. However if the impact is larger, then it should be considered material and dealt with either at the next rebasing application, or through the clearance of deferral and variance accounts during the IRM term.

Energy Probe has reviewed the submissions of Board Staff related to the adjustment for the long term debt rate during an IRM period (page 56 of Board Staff Submission dated May 4, 2011). Energy Probe agrees that under normal circumstances the impact of debt renewal should be managed under IRM without any adjustment or deferral account treatment.

However, in the specific circumstance of this proceeding, Energy Probe believes that the Board should consider special treatment. The specific circumstance is that Horizon is rebasing one year early and as a result is reaping the benefit of a higher return on equity one year in advance of when they would otherwise do so. If they filed a rebasing application on schedule, 2012 would have been the test year and the company would have had to provide a forecast of the cost of the replacement debt based on current interest rates at that time.

I - DEFERRAL AND VARIANCE ACCOUNTS

a) Accounts and Amounts to be Cleared

Energy Probe has reviewed the submissions of Board Staff related to the accounts and amounts to be cleared and adopts their submissions.

b) Allocation to Customer Classes

Energy Probe has reviewed the allocation of the amounts to be recovered and has no significant concerns with the Horizon proposals.

c) Recovery Period

Horizon has followed the guidelines in the July 31, 2009 Report of the Board on the Electricity Distributors' Deferral and Variance Account Review and is proposing the default one year disposition period (Exhibit 9, Tab 1, Schedule 2, page 1). Given the relative small size of the proposed rate riders, Energy Probe supports the one year disposition period.

In the event that the Board determines that the effective date for rates does not correspond with the beginning of the rate year, thereby having the new rates in places for less than 12 months for the rate year, Energy Probe submits that the Board should take into consideration the overall rate impact on customers of whether or not the proposed rate riders should be in place for 12 month period, or for a shorter period to align with the distribution rates.

d) New Accounts

In its original evidence at Exhibit 9, Tab 1, Schedule 1, pages 4 through 8, Horizon requested the establishment of a number of new deferral and variance accounts. The requested accounts included the following: a new sub-account of Account 1595; an account for the Provincial Meter Data Management and Repository ("MDM/R") Costs from the IESO for the Smart Meter Entity; an account to deal with the OMERS contribution increase; and an account for the Late Payment Penalty Charge ("LPP").

In the response to VECC Interrogatory #37, Horizon withdrew its requests for both the MDM/R account and LPP account. Energy Probe supports these withdrawals as the LPP charges were the subject of a generic hearing by the Board and because the IESO has not yet filed an application with the Board requesting the recovery of the MDM/R related costs.

With respect to the new sub-account of Account 1595, Energy Probe understands this request is simply an accounting issue in that the balances of the deferral and variance accounts for which Horizon is seeking disposal in this application would be transferred to the new sub-account. The recoveries and dispositions through the rate riders would then be recorded to this account. Given the nature of this account Energy Probe has no objections to its establishment.

With respect to the deferral account associated with the OMERS contribution increase, Energy Probe submits that the Board should deny this request. Elsewhere in this submission, Energy Probe has proposed that the OMERS cost increase forecast by

Horizon over the 2011 through 2014 period be amortized over four years and included in the 2011 revenue requirement. If the Board accepts this proposal, then it is submitted that no deferral or variance account around this amount is required.

In addition to the accounts originally requested, Horizon is requesting approval to use Account 1572 for the tracking of any additional net distribution revenues above the established baselines in the revised load forecast for the two Large Use customers identified in the March 14, 2011 update to Exhibit 3, Tab 2, Schedule 2 and the approval of a variance account to the track the impact on cost of capital arising from the difference between the 6.1% rate on the existing $116 million promissory note due July 31, 2012 and the rate on the refinancing of the note once it is refinanced in July 2012. Energy Probe has provided its submission with respect to both of these proposed accounts in previous sections of this submission.

J - COST ALLOCATION & RATE DESIGN

a) Cost Allocation

Energy Probe submits that the updated cost allocation study prepared for the current application is appropriate. Based on the response to VECC Interrogatory #8c, the cost allocation excludes the smart meter rate adder/rider, the LV rates and is net of the transformer ownership allowance. The response provided to VECC Interrogatory #44g provides a Revised Table 7-3 that reflects the change in the Large Use forecast and reflects the status quo ratios, along with the proposed ratios. Energy Probe submits that these status quo revenue to cost ratios are, therefore, the correct starting points.

As shown in the revised Table 7-3, Horizon is proposing to move all the revenue to cost ratios closer to unity. This would be achieved by moving all classes except Residential GS < 50 and USL to 91.2%. The USL class would be lowered from 129.8% to 120.0% and the GS < 50 class would be reduced marginally from the 2011 cost allocation figure of 102.8% to 102.7%. The net result on the Residential rate class is a reduction from 110.7% to 104.0%.

Energy Probe further notes that two rate classes - Street Lighting and Large Use - are below the corresponding Board approved ranges while one class - USL - is above the range.

Horizon proposes to bring the USL ratio down to the top of the range, moving the ratio from 120.0% to 120.0%. Energy Probe agrees with and supports this proposal, subject to comments below.

The Large Use class has a revenue to cost ratio of 63.9% while the bottom of the approved range is 85%. Similarly, the Street Lighting class has a ratio of 62.4%, while the bottom of the approved range is 70%. Energy Probe submits that both of these rate classes should be moved to the bottom of the range in the test year. Based on the figures provided in the response to Undertaking J3.5, it does not appear that the total bill impact for either of these rate classes would be close to 10%, so a phase in to the bottom of their respective ranges would not be required.

Energy Probe further submits that the additional revenue generated by increasing the revenue to cost ratios for the Large Use and Street Lighting classes, net of the reduction in revenue associated with the decline in the USL class, should be used to reduce the Residential revenue to cost ratio.

The question then becomes whether or not there should be further movement of the classes within the Board approved ranges, and if so, how that movement should be determined.

Energy Probe notes that the Horizon proposal appears to be inconsistent with respect to its treatment of the USL class. In particular, while moving the two rate classes currently below the Board approved range (Large Use and Street Lighting) to levels significantly above the bottom of the respective ranges, Horizon is not proposing to reduce the USL ratio below the top of the corresponding approved range. Energy Probe submits that if the Board does accept the Horizon proposal, it should move the ratio for the USL class

down to match that of the next highest rate class. In this case that would be the Residential class.

Energy Probe has consistently argued that once all the rate classes are within their Board approved ranges there is no need to move the ratios any further towards unity. The only exception would be when there was a need to mitigate a total bill impact of more than 10%. There does not appear to be any need for mitigation in this proceeding.

The Board policy on appropriate revenue to cost ratios has evolved over the last several years. The Report of the Board on *Application of Cost Allocation for Electricity Distributors* issued on November 28, 2007 set the benchmark ranges for each rate class. In a number of cost of service application Decisions for 2008 rates (EB-2007-0901 - Espanola Regional Hydro Distribution Corporation, EB-2007-0931 - PUC Distribution Inc., EB-2007-0742 - Guelph Hydro Electric System Inc.), the Board concluded:

> *"As the Board has noted in the Cost Allocation Report, cost causality is a fundamental principle in setting rates. However, observed limitations in data affect the ability or desirability of moving immediately to a revenue to cost framework around 100%. The Board's target ranges are a compromise until such time as data is refined and experience is gained."*

In those Decisions, the Board accepted the general principle that where the proposed ratio for a given class was above the Board's target range there should be a move of 50% toward the top of the range from what was reported in the Information Filing and where the ratios in the Informational Filing were below the Board's ranges there should be a move by 50% toward the bottom of the Board's target ranges.

The Board was even more specific in the EB-2007-0693 Decision and Order dated August 11, 2008 for Wellington North Power Inc. where it stated:

> *"The Board has adopted a practice in virtually all of the rebasing applications for 2008 rates where utilities have been obliged to move revenue-to-cost ratios to points within the ranges depicted above, wherever practicable, and closer to the range in circumstances where achieving the range would result in what is considered to be an unreasonable rate impact.*

> *An important element in the Board's report on cost allocation was its express reservation about the quality of the data underpinning cost allocation work to date. The report frankly indicated that the Board did not consider all of the data underpinning the report to be so reliable as to justify the application of the report's findings directly into rate cases. For this reason, among others, the Board established the ranges depicted above and mandated the migration of revenue to cost ratios currently outside the ranges to points within the ranges, but not to unity. In short, the ranges reflect a margin of confidence with the data underpinning the report. No point within any of the ranges should be considered to be any more reliable than any other point within the range. Accordingly, there is no particular significance to the unity point in any of the ranges.*
>
> *As is noted above, with the exception of the street lighting and sentinel lighting classes, all of the Applicant's proposed revenue to cost ratios fall within the range as provided in the Board's report on cost allocation.* ***The Board will not approve any further movement within the ranges as requested by a number of the intervenors in this proceeding, and by the Applicant itself with respect to the Residential class.****"* (emphasis added)

A review of the EB-2008-0237 Decision and Order dated March 25, 2009 for Niagara-on-the-Lake Hydro Inc. ("NOTL") shows a change in the Board policy. In particular, based on the proper starting point that correctly reflected the transformer ownership allowance, the GS > 50 class had a revenue to cost ratio of 179.01%, just below the upper end of the Board approved range for this rate class. The Street Lighting and Sentinel Lighting classes were below the lower boundary of the range established by the Board, and were proposed to be moved to the bottom of the range over a number of years.

The School Energy Coalition ("SEC") submitted that the level of cross-subsidization by the GS > 50 kW class was unacceptable and that NOTL should be required to reduce the revenue to cost ratio for this class to 100% over the next two years.

In its Decision, the Board deviated from the policy reflected in previous decisions, as follows:

> *"The Board concurs with SEC regarding the level of cross-subsidization by the GS>50 KW customer class.* ***While previous Board decisions have not approved any further movement for customer classes already within target ranges, there is no other mechanism to mitigate the cross-subsidization by***

> ***the GS>50 kW customer class.*** *The Board finds that* ***it is within the utility's discretion to move towards revenue to cost ratio of unity as long as the impact can be borne by affected rate classes****. Accordingly, the Board finds that NOTL's proposal to set rates that move the revenue to cost ratio for residential and GS<50 kW customer classes half of the way towards 100% and to move USL to 100% is appropriate. The additional revenue shall be allocated to reduce the revenue to cost ratio for the GS>50 kW customer class."* (emphasis added)

Unlike the situation in NOTL described above, no revenue to cost ratio based on the 2011 cost allocation is significantly higher than the others. Indeed, the highest revenue to cost ratio is for the USL class which is proposed to be moved to 120%, the top of the range for this class.

Based on the total bill impacts shown in Undertaking J3.5, Energy Probe submits there is no need to adjust any ratios within the Board approved ranges at this time.

b) Rate Design

Horizon is proposing to maintain the current fixed/variable split shown in Table 8-6 of Exhibit 8, Tab 1, Schedule 1, with the exception of the Large Use customer class. Energy Probe submits that maintaining the fixed/variable split for classes except the Large Use class is appropriate. Energy Probe does not take a position on the proposed change for the Large Use class.

K - CHANGE IN RATE YEAR

Horizon has proposed to align their rate year with their fiscal year. Horizon has provided a number of benefits to both the utility and to ratepayers in support of this proposal (Exhibit 1, Tab 2, Schedule 1, page 15-17).

In addition to the benefits noted by Horizon, Energy Probe believes that moving to a rate year that is the same as the fiscal year will make it easier to review the financial results on a historical basis with the Board approved Decisions. There will no longer be any lag in the change in revenues that can skew the annual financial results reported by the distributor.

However, Energy Probe submits that the Board should consider whether it is appropriate to change the rate year as part of an early rebasing application. Without the requested change in the rate year, Horizon would have been under IRM for two years (2009 and 2010) following the 2008 rebasing year. By seeking to change the rate year, they will effectively have been under IRM for only 20 months.

Energy Probe submits that this is a unique circumstance. The Board has not dealt with a simultaneous early rebasing cost of service application and a request to change the rate year. Given the unique circumstances, the Board may wish to consider a unique response. Energy Probe submits that the change in the rate year should be approved, but for January 1, 2012 rather than January 1, 2013. This would result in Horizon being on IRM for 2 years rather than only 20 months, will still allowing 2011 base rates to form the basis for rates in the 2012 through 2014 IRM period.

L - EFFECTIVE DATE FOR RATES

Horizon has requested an effective date for rates of January 1, 2011. In their Argument-in-Chief dated April 21, 2011, Horizon notes that the Board approved an effective date for rates in the Hydro One Brampton case (EB-2020-0132) of January 1, 2011. Hydro One Brampton also aligned its rates year with the calendar year.

Energy Probe submits that the Board should not approve an effective date for rates for Horizon of January 1, 2011. Energy Probe submits that the Hydro One Brampton Decision that approved an effective date of January 1, 2011 is not applicable to Horizon.

The Board issued a letter on April 15, 2010 that concluded the consultative process to review the need for and the implications of a potential alignment of the rate year with the fiscal year of LDCs (EB-2009-0423). As part of that letter, the Board stated that:

> *"Any distributor applying for an alignment to be effective on January 1, 2011 is requested to file that application as soon as possible".*

Hydro One Brampton filed their application and evidence in June 2011. Horizon did not file until the end of August 2011. In other words, Hydro One Brampton filed a full two months ahead of Horizon. In addition, Horizon should have anticipated that, as an early rebaser, it would have to deal with that preliminary issue. The Board clearly identified this in a letter to distributors dated April 20, 2010.

Energy Probe submits that the effective date should be the beginning of the month following the issuance of the Decision in this proceeding. This is consistent with the Board's findings in the EB-2009-0146 Decision dated November 25, 2010 for Renfrew Hydro Inc. In that Decision, the Board went on to state at page 6:

> *"The preparation and filing of a cost of service rebasing application is a core activity for a distributor – the setting of rates is the foundation upon which the distributor conducts its business. Further, customers are entitled to expect that rates will be set on a prospective basis, with limited recourse to the collection of revenue deficiencies accumulated during the period of interim rates".*

Energy Probe notes that Horizon did not provide any evidence as to why it did not file earlier than it did, especially when it knew that it was going to file a cost of service application for 2011 rates in September 2009. Horizon indicated to the Board in the cover letter to its' Z-Factor Application (EB-2009-0332) dated September 3, 2009 that it would be filing a cost of service application for 2011 rates. At that time it had expected to file in August 2010 for an effective date of May 1, 2011 for rates.

Energy Probe submits that Horizon had ample time to accelerate the filing of its 2011 cost of service application before the end of August 2010.

M - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review. This has been accomplished through cooperation with other intervenors to ensure no significant overlaps in cross examination.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

May 6, 2011

ENERGY PROBE RESEARCH FOUNDATION

APPENDIX A

Section 1

Line	Description	Revenue Lag Days	Expense Lead Days	Net Lag Days	Working Capital Factor	Expenses $M	Working Capital Requirement $M
	(A)	(B)	(C)	(D)	(E)	(F)	(G)
1	Cost of Power	72.1	32.77	39.33	10.78%	395.7	42.6
2	OM&A Expense	72.1	13.74	58.36	15.99%	47.5	7.6
3	PILS	72.1	34.44	37.66	10.32%	6.1	0.6
4	Interest Expense	72.1	(62.74)	134.84	36.94%	10.1	3.7
5	Debt Reduction Charge Amount	72.1	28.27	43.83	12.01%	31.4	3.8
6	Total					490.8	58.4
7	GST/HST						3.3
8	Total - Including GST/HST						61.7
9	As a Percent of OM&A inc. Cost of Power						13.9%

Section 2

Line	Description	Revenue Lag Days	Expense Lead Days	Net Lag Days	Working Capital Factor	Expenses $M	Working Capital Requirement $M
	(A)	(B)	(C)	(D)	(E)	(F)	(G)
1	Cost of Power	72.1	32.77	39.33	10.78%	378.8	40.8
2	OM&A Expense	72.1	13.74	58.36	15.99%	47.8	7.6
3	PILS	72.1	34.44	37.66	10.32%	5.9	0.6
4	Interest Expense	72.1	(62.74)	134.84	36.94%	9.0	3.3
5	Debt Reduction Charge Amount	72.1	28.27	43.83	12.01%	30.5	3.7
6	Total					472.0	56.1
7	GST/HST						3.3
8	Total - Including GST/HST						59.4
9	As a Percent of OM&A inc. Cost of Power						13.9%

Section 3

Line	Description	Revenue Lag Days	Expense Lead Days	Net Lag Days	Working Capital Factor	Expenses $M	Working Capital Requirement $M
	(A)	(B)	(C)	(D)	(E)	(F)	(G)
1	Cost of Power	71.19	32.77	38.42	10.53%	378.8	39.9
2	OM&A Expense	71.19	13.74	57.45	15.74%	47.8	7.5
3	PILS	71.19	34.44	36.75	10.07%	5.9	0.6
4	Interest Expense	71.19	(62.74)	133.93	36.69%	9.0	3.3
5	Debt Reduction Charge Amount	71.19	28.27	42.92	11.76%	30.5	3.6
6	Total					472.0	54.9
7	GST/HST						3.3
8	Total - Including GST/HST						58.2
9	As a Percent of OM&A inc. Cost of Power						13.6%

APPENDIX B

2011 COST OF POWER FORECAST CALCULATION

Electricity - Commodity		**2011**	**2011**		
Class per Load Forecast	**2011 Forecasted Metered kWhs**	**Loss Factor**	**Uplifted**	**Cost Of Energy**	**Total Cost**
Residential	1,521,550,679	1.0410			
- Rpp			1,333,514,251	0.06736	$89,825,520
- Non Rpp			250,420,006	0.06466	$16,192,158
GS<50kW	531,554,427	1.0410			
- Rpp			467,081,181	0.06736	$31,462,588
- Non Rpp			86,266,978	0.06466	$5,578,023
GS>50kW	1,728,901,613	1.0421			
- Rpp			203,590,786	0.06736	$13,713,875
- Non Rpp			1,598,097,585	0.06466	$103,332,990
Large User	520,292,236	1.0067			
- Rpp			0	0.06736	$0
- Non Rpp			523,778,194	0.06466	$33,867,498
Unmetered Scattered Load	12,541,586	1.0410			
- Rpp			12,200,637	0.06736	$821,835
- Non Rpp			855,154	0.06466	$55,294
Sentinel Lighting	502,459	1.0410			
- Rpp			508,519	0.06736	$34,254
- Non Rpp			14,541	0.06466	$940
Street Lighting	40,006,298	1.0410			
- Rpp			220,727	0.06736	$14,868
- Non Rpp			41,425,829	0.06466	$2,678,594
TOTAL	**4,355,349,298**		**4,517,974,388**		**$297,578,437**

Transmission - Network		**Volume**			
Class per Load Forecast		**Metric**	**2011**		
Residential		kWh	1,583,934,257	$0.0059	$9,345,212
GS<50kW		kWh	553,348,159	$0.0052	$2,877,410
GS>50kW		kW	4,714,763	$2.0572	$9,699,210
Large User		KW	2,417,347	$2.3501	$5,681,007
Unmetered Scattered Load		kWh	13,055,791	$0.0053	$69,196
Sentinel Lighting		kW	1,421	$1.7095	$2,429
Street Lighting		kW	111,295	$1.6195	$180,242
TOTAL					**$27,854,707**

Transmission - Connection		**Volume**			
Class per Load Forecast		**Metric**	**2011**		
Residential		kWh	1,583,934,257	$0.0049	$7,761,278
GS<50kW		kWh	553,348,159	$0.0045	$2,490,067
GS>50kW		kW	4,714,763	$1.7739	$8,363,518
Large User		KW	2,417,347	$2.0385	$4,927,762
Unmetered Scattered Load		kWh	13,055,791	$0.0046	$60,057
Sentinel Lighting		kW	1,421	$1.4275	$2,028
Street Lighting		kW	111,295	$1.3918	$154,900
TOTAL					**$23,759,610**

Wholesale Market Service		**Volume**			
Class per Load Forecast		**Metric**	**2011**		
Residential		kWh	1,583,934,257	$0.0052	$8,236,458
GS<50kW		kWh	553,348,159	$0.0052	$2,877,410
GS>50kW		kWh	1,801,688,371	$0.0052	$9,368,780
Large User		kWh	523,778,194	$0.0052	$2,723,647
Unmetered Scattered Load		kWh	13,055,791	$0.0052	$67,890
Sentinel Lighting		kWh	508,519	$0.0052	$2,644
Street Lighting		kWh	41,646,556	$0.0052	$216,562
TOTAL			**4,517,959,847**		**$23,493,391**

Rural Rate Assistance		**Volume**			
Class per Load Forecast		**Metric**	**2011**		
Residential		kWh	1,583,934,257	$0.0013	$2,059,115
GS<50kW		kWh	553,348,159	$0.0013	$719,353
GS>50kW		kWh	1,801,688,371	$0.0013	$2,342,195
Large User		kWh	523,778,194	$0.0013	$680,912
Unmetered Scattered Load		kWh	13,055,791	$0.0013	$16,973
Sentinel Lighting		kWh	508,519	$0.0013	$661
Street Lighting		kWh	41,646,556	$0.0013	$54,141
TOTAL			**4,517,959,847**		**$5,873,348**

	2011
4705-Power Purchased	$297,578,437
4708-Charges-WMS	$23,493,391
4714-Charges-NW	$27,854,707
4716-Charges-CN	$23,759,610
4730-Rural Rate Assistance	$5,873,348
4750-Low Voltage	$251,010
TOTAL	**378,810,503**