



SHIBLEY RIGHTON LLP
Barristers and Solicitors

Jay Shepherd
Direct Line (416) 214-5224
Direct Fax (416) 214-5424
jay.shepherd@shibleyrighton.com

TORONTO OFFICE:
250 University Avenue, Suite 700, Toronto, Ontario, M5H 3E5
Main 416 214-5200 Toll free 1-877-214-5200
Facsimile 416 214-5400

WINDSOR OFFICE:
2510 Ouellette Avenue, Windsor, Ontario, N8X 1L4
Main 519 969-9844 Toll free 1-866-522-7988
Facsimile 519 969-8045

www.shibleyrighton.com

Please Reply to the TORONTO OFFICE

BY EMAIL

March 25, 2008
Our File No. 2080002

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Horizon Utilities 2008 – EB-2007-0697

We are writing this letter on behalf of the School Energy Coalition, and with the knowledge of the other intervenors, to request an oral hearing in the above proceeding with respect to some, only, of the issues. We will also propose in this letter that the remaining issues be dealt with by way of written submissions in conjunction with final argument on the oral hearing component.

Issues List

As the Board will be aware, the Board-ordered ADR in this proceeding was carried out from March 18-20, 2008. Horizon, represented by their CFO, counsel, head of regulatory affairs and other staff, was in attendance throughout, as were representatives from School Energy Coalition, Consumers Council of Canada, Energy Probe, Vulnerable Energy Consumers Coalition, and Board Staff. Notwithstanding the best efforts of all parties, no agreement was reached on any of the issues in this application.

The Board will be aware that there was no formal Issues List in this case, so earlier in the process the intervenors drafted one based on the then approved Hydro One Issues List. During the period of the ADR, the intervenors met separately from the utility and reviewed that previous draft issues list, which had 50 items on it. After that review, the intervenors removed 16 items from the list, accepting the applicant's positions either as filed or as revised. A copy of that "reduced" issues list is attached to this letter.

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The intervenors also determined the issues on which they felt that they needed to cross-examine the witnesses of the Company. The attached Issues List thus divides the issues into oral and written hearings requested. Essentially, the intervenors concluded that they would like the opportunity to cross-examine Company witnesses on three areas of their application:

- a. OM&A budget.
- b. Capital expenditures budget.
- c. Rate of interest on long term debt.

While there are other issues in dispute, the intervenors concluded that those other issues could be dealt with just as effectively in submissions, without the need for oral evidence. We therefore propose that the attached Issues List be adopted by the Board panel as the Issues List for this proceeding.

Need for an Oral Hearing

In our view, the substance and type of issues to be determined, and the nature of the questions that have to be addressed to decide those issues, necessarily require that an oral hearing be held to consider this application. In such a hearing, the remaining gaps in the evidence can be filled, Horizon witnesses can explain to the Board their rationales for these aspects of their application, and their explanations can be tested by cross-examination and direct Board questions.

Both Horizon and Board Staff have asked that, if we are seeking an oral hearing, we provide specific reasons for that request, to better assist the Board. While the following list is not in any way exhaustive, the evidence now shows that at least the following “live” issues are among those that need to be addressed in this application:

1. The application seeks a one-year increase in distribution revenue requirement of 10.16% (SEC IRs, page 5) and a total revenue requirement of \$101.6 million. The distribution revenue requirement increase is \$10.8 million, or 12.85% greater than 2006 actual, a year in which Horizon had an adjusted sufficiency of \$2.3 million, and the allowed ROE was higher than it is today. Put another way, if Horizon’s 2008 distribution revenue requirement were to be calculated based on inflation and other factors commonly considered reasonable in an IRM, and starting without a sufficiency, the total revenue requirement would be lower than the proposed amount by \$11.6 million, or about 11.4%. Such substantial discrepancies suggest that the Applicant should come before the Board and provide an explanation. This is especially true since any excess revenue requirement will last for at least three years under the Board’s current IRM model and, because of the announced merger between Horizon and Guelph Hydro, could well continue for six years.
2. The application seeks rate increases that will range from small decreases for residential customers, to increases in the triple digits for some larger customers. For schools, the proposed increases range from 17.07% to 32.75% (SEC IRs, page 6), an average of almost 25% in one year. One school board, Horizon’s second largest customer, may have an annual rate increase of more than \$300,000 a year. While there may be reasons why some customers have higher than

normal increases (including causes relating to cost allocation and rate design), where there are increases this substantial Applicant should be asked to appear before the Board to explain why all of these increases are necessary. SEC had originally considered leading evidence from School Boards with respect to the impact of such large increases, but following discussions with other intervenors we have agreed that the cost allocation and rate design aspects of this case can be handled by written submissions. On the other hand, the large increases in revenue requirement that make the cost allocation/rate design choices so problematic do have to be addressed in a hearing.

3. In a presentation to its Board of Directors, management of Horizon projects that, before taking any additional steps to improve productivity, based on this regulatory process the utility will have a sufficiency over the next three years of about \$11.8 million (calculated from CCC IRs, Attachments A1 and A2), ie. about 3.85% more in rates than they actually need to reach their Board-approved rate of return. That sufficiency commences in the Test Year. Further, this is before any savings to be achieved from already planned M&A activities. To provide the Board with an idea of what productivity improvements are actually expected by Horizon but are not included in that calculation, the forecast operating cost per customer for 2008 is \$181.77 (CCC IRs, Attachment 2, page 11), but the target for executive bonus purposes is \$176.77 (SEC IRs, Attachment A, page 9). If management achieves but not does even exceed that target, there is a further sufficiency of \$1.45 million in 2008, and a three-year impact, if maintained, of \$4.3 million. We note that this is not a “stretch” target. The target for ROE, for example, 9.2%, is less than the 9.53% management has already forecast to the Board of Directors, in both cases based on equity of 52.33% rather than the 40% equity ratio approved by the Board. Therefore, it is reasonable to ask management, at least, how achievable the \$176.77 operating cost target is expected to be, and what the actual operating cost in 2008 is likely to be relative to the budget they are seeking to recover from ratepayers. There is at least the possibility that, in this case, the utility simply does not realize that they must seek to recover only what they actually expect to spend, not an amount with a substantial cushion “just in case”.
4. The Applicant operated on an OM&A total in 2004 of \$32.7 million, and since that time has publicly reported annual operating savings from the St. Catherines/Hamilton merger of \$3.9 million. With that adjustment, the proposed 2008 OM&A budget of \$42.7 million represents an increase of about 50% over four years, despite small customer growth. The Application does not deal with that substantial overall OM&A increase at all, instead focusing on the individual line items in the forward budget. Based on inflation over the same period, and taking into account the savings that the Company enjoyed from the merger during that period, which now must accrue under the Board’s policies to the benefit of the ratepayers, the OM&A budget for the Test Year would be about \$31.2 million (before normal productivity adjustments). The excess, some \$11.5 million per annum or more for each of the next three to six years, is not adequately explained.
5. It appears that some portion of the time of executives, senior management, and administrative staff – which could well be substantial - is being spent in the Test Year working on the merger with Guelph Hydro, the benefits of which will accrue to the benefit of the shareholder for at least five years, and on the development of other potential merger deals, which if completed will also benefit the shareholder. Yet, the Application does not contain any allocation of that time and

expense to the affiliate parent or to non-utility activities. There is no information currently on the record to indicate what portion of the OM&A budget requested is represented by those merger-related costs.

6. The Applicant is seeking to recover interest on affiliate debt at 7%, when the affiliate-parent (HUC) in fact borrowed on a back-to-back basis on the same terms (with interlocking covenants), to fund that debt, at 6.25%, and when the Applicant admits that the market rate at the time the debt was incurred for a rated debt was 5.21% to 5.26% (SEC IRs, page 48). Further, the Applicant through its parent has capital available to it and its primary business unit, Horizon, on more favourable terms, but has refused, contrary to the Board's rules, to provide details with respect to that facility (SEC IRs, page 51). In addition, while the Applicant claims it has not decided how to fund ongoing capital requirements going forward (SEC IRs, page 51), it has in fact asked for and received approval from its Board of Directors "to create a borrowing program for Horizon that will provide it with financial autonomy and flexibility to support business strategy and general corporate borrowing requirements" (CCC IRs, Attachment A1, page 16, emphasis added). It expects to issue \$50 to \$75 million of new debt in 2008 under these terms. All of the Applicant's debt cost evidence, in our view, needs to be tested by cross-examination, since the evidence as filed appears to indicate over-recovery of \$3 to \$4 million per year.
7. The Applicant is proposing to increase its operating costs per customer from 2007 to 2010 by a total of 8.2% (CCC IRs, Attachment A2, page 11), before taking into account increased costs associated with their ERP project (Project Fusion) and their Smart Meters activities, and starting from a base in which they had already implemented a substantial increase.
8. The Applicant has proceeded in the bridge year with a substantial IT project, Project Fusion, to implement ERP across the organization. It is not clear whether this is part of Horizon's M&A strategy, or is separately justified as an internal process improvement. What is clear is that Horizon proposes to recover bridge year operating costs (ie. sunk costs) related to this project in the test year and beyond. It also appears that, in calculating the proposed recovery, Horizon may not have given the ratepayers full credit for the \$1.2 million tax shield that arises by operation of law in each of the in-service year and the next subsequent year. The unusual regulatory approach proposed does not appear to have any precedent, and should be tested by questions before the Board.

There are numerous other issues that arise in the context of this application, which will, when this proceeding is complete, establish rates to recover somewhere between \$270 million and \$620 million over the next three to six years.

In light of the foregoing, we believe that an oral hearing, probably two days (we suggest the weeks of April 7th or 14th, on whatever days are convenient for the Board) , be ordered to consider those of the issues indicated in the attached draft Issues List. We further propose that the remaining issues set out in the attached Issues List be dealt with by written submissions, and that the written submissions on those issues, as well as the final argument on the issues dealt with in the oral hearing, be set out in a single document and process that includes all submissions by the parties on all of the issues.

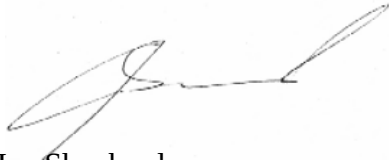
Conclusion

Therefore, the School Energy Coalition requests that the Board order an oral hearing on the issues identified by the intervenors, and that the Board accept the attached Issues List prepared by the intervenors as the Issues List for this proceeding.

All of which is respectfully submitted.

Yours very truly,

SHIBLEY RIGHTON LLP

A handwritten signature in black ink, appearing to read 'Jay Shepherd', is written over a faint, rectangular background.

Jay Shepherd

cc: Bob Williams, SEC (email)
Jamie Sidlofsky, BLG (email)
Cameron McKenzie, Horizon (email)
Maureen Helt, OEB (email)
Interested Parties (email)