EB-2014-0002

HORIZON UTILITIES CORPORATION
SUPPLEMENTARY EVIDENCE RELATED TO COST ALLOCATION AND RATE DESIGN

DELIVERED SEPTEMBER 25, 2014

Introduction:

Horizon Utilities Corporation ("Horizon Utilities") filed a Custom Incentive Rate ("CIR") application (the "Application") with the Ontario Energy Board ("OEB" or the "Board") on April 17, 2014 under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that Horizon Utilities charges for electricity distribution, to be effective January 1, 2015 and each year thereafter until December 31, 2019.

A Settlement Conference was convened in respect of this proceeding on August 27-29, 2014, in accordance with the Board's Procedural Order #2. Settlement was achieved on all issues with the exception of those issues that relate to Issue 4.0, Cost Allocation and Rate Design. The Settlement Proposal was filed with the Board on September 22, 2014. The Board is convening an Oral Hearing on September 30, 2014 with respect to the unsettled issues and the Settlement Proposal.

As part of the Application, Horizon Utilities proposes a reclassification of certain of its customers. More particularly, it is proposed that the current Large Use Class be divided into two classes, LU (1) and LU (2). LU (2) would currently contain Horizon Utilities' four largest customers. This proposal is part of the unsettled issues to be heard by the Board.

The New Development in the proposed LU (2) class:

On the morning of September 17, 2014, Horizon Utilities learned through a news media report that one of the four customers that will comprise the newly proposed LU (2) customer class (U.S. Steel Canada Inc., or "USSC") had obtained a Court Order for protection under the *Companies' Creditors Arrangement Act* ("CCAA") before the Ontario Superior Court of Justice (the "Court Order"). Horizon Utilities had no advance notice about this announcement and learned of this development (the "New Development") initially through the news media on September 17.

Accompanying this Supplementary Evidence as Appendix 10-1 is a copy of USSC's September 16, 2014 letter to suppliers (the "Supplier Letter") advising that USSC had obtained the Court Order. According to the Supplier Letter, "The effect of the Court Order is to stay U.S. Steel Canada's obligations to creditors, suppliers and debt holders, and to provide a forum for U.S. Steel Canada to implement further cost saving measures and commence negotiations with its stakeholders to implement a comprehensive operational and financial restructuring plan. … The Initial Order under the CCAA generally prohibits [USSC] from paying for goods and services that were received before September 16, 2014." Horizon Utilities is an unsecured creditor of USSC.

Horizon Utilities' assessment of the exposure for the period up until September 16, 2014, as an unsecured creditor, is $[redacted] of which recoverable HST and Debt Retirement Charge related costs comprises $[redacted], for a net exposure of $[redacted].

Horizon Utilities continues to assess possible prospective impacts to Horizon Utilities should this customer reduce or discontinue its operations over the course of Horizon Utilities' 5 year Custom IR term. Horizon Utilities is filing this update to the Application with respect to unsettled Issue 4.0, Cost Allocation and Rate Design, in response to this New Development. Horizon Utilities is neither changing nor proposing to change any element of the Settlement Proposal delivered to the Board on September 22, 2014.

Impact of the New Development on Horizon Utilities' CIR Application

Horizon Utilities has requested that the Board establish a new customer class in Exhibit 7, Tab 1, Schedule 1, Page 2 and Exhibit 8, Schedules 1 and 2 of this Application. This relief sought does not change as a result of the New Development.

Horizon Utilities has also included the revenue:cost ratios (Settlement Proposal, Appendix J) and the related bill impacts (Settlement Proposal, Appendix H). This evidence does not change as a result of the New Development.

In the Settlement Proposal that Horizon Utilities filed on September 22, 2014, Horizon Utilities provided revised revenue:cost ratios and bill impacts based on the revenue requirement per the settlement outcome. Those ratios and impacts are subject to change depending on the Board's determination of the outstanding issues.

Given the nature of and potential significant implications resulting from the New Development, Horizon Utilities is very concerned that USSC may not remain viable during the Custom IR rate plan term.

Horizon Utilities has assessed its exposure in the event that USSC closes its Hamilton operations. Table 1 below provides the impact of the loss of USSC if USSC closes its Hamilton operations, using the proposed rates for the LU (2) class, if the Board grants Horizon Utilities' request for the creation of the new LU (2) class, as filed. The impact to Horizon Utilities would be an average of $[redacted] per year over the 2015 – 2019 rate years.

Table 1: USSC Consumption Impact (LU (2) Approved)

[redacted]

Table 2 below provides the exposure to Horizon Utilities should USSC close its operations, assuming the proposed LU (2) class is not approved by the Board. In this scenario, the impact to Horizon Utilities and its customers would be an average of $[redacted] per year over the 2015 – 2019 rate years.

Table 2: Customer 1 Consumption Impact (LU (2) Class Not Approved)

[redacted]

For the Board's assistance, Horizon Utilities has provided (as Appendix 10-2) a copy of the Board's Appendix 2-P illustrating proposed revenue:cost ratios in the event that the Board does not approve the establishment of the LU (2) class. Horizon Utilities has also provided as part of this update a revised live Excel version of the Cost Allocation Model that maintains a single Large Use class and does not include the proposed LU (2) class.

Alternate Relief Sought if LU (2) Class is not Approved

If the Board approves the creation of the new LU (2) class and USSC closes its operations during the 5 year Custom IR rate plan term, Horizon Utilities' exposure is below the materiality threshold. At this time, Horizon Utilities believes it can manage this risk without materially impacting its ability to deliver on its operating and capital plans over the 5 year rate plan term.

However, if the Board does not approve the creation of the LU (2) class, Horizon Utilities' annual exposure could be $[redacted] and the cumulative total exposure over the rate plan term would be $[redacted]. This would have a material negative impact on Horizon Utilities' ability to deliver on its plans.

The new alternate relief that Horizon Utilities now seeks is that, in the event the Board does not approve the establishment of the LU (2) class but instead maintains the current class structure of a single Large Use customer class, then, in this circumstance, the Board authorize the establishment of a symmetrical variance account for the Large Use customer class to mitigate against the $[redacted] risk quantified above.

The baseline for USSC would be the load forecast as filed in the Settlement Proposal under Issue 3.10. If USSC's consumption is higher than that incorporated into the load forecast, the dollar amount associated with that consumption variance would be credited to the Large Use customer class either through the annual adjustment or alternatively at the end of the rate plan. Conversely, if USSC's consumption is lower than that incorporated into the load forecast, the dollar amount associated with that consumption variance would be recovered from the Large Use customer class either through the annual adjustment or alternatively at the end of the rate plan.

Horizon Utilities asked Elenchus Research Associates Inc. ("Elenchus") to consider this proposed approach to the New Development, and Elenchus' report in this regard accompanies this Supplementary Evidence as Appendix 10-3.

Conclusion

The "Financial Performance" outcome in the Board's Renewed Regulatory Framework for Electricity: A Performance Based Approach (the "RRFE") contemplates that "financial viability is maintained; and savings from operational effectiveness are sustainable." In the event that the Board does not approve the creation of the LU (2) class, Horizon Utilities believes the financial impact of the New Development warrants the creation of the requested variance account in order to preserve Horizon Utilities' ability to achieve the expected Financial Performance outcome, as revenue from USSC was assumed by Horizon Utilities in when it conducted its cost allocation and rate design work as part of the Application currently before the Board.

Horizon Utilities has previously filed a Z-factor Application (EB-2009-0332) in similar circumstances, that is, the significant reduction in demand on the part of one of its Large Use customers and the related revenue losses. In that case, the Board found: "As a general matter, the Board finds that revenue loss deficiencies of the kind sought for recovery through this application by Horizon are not appropriately addressed through the Z-factor mechanism because of the need to assess the impacts of such losses on a total utility basis. The Board is in agreement with the views of some intervenors that the Z-factor criteria were not intended to be used for the recovery of revenue losses."[1]

Horizon Utilities previously requested that the Board establish a variance account related to the load for two Large Use customers in its 2011 Cost of Service Application (EB-2010-0131). In the 2011 Application, Horizon Utilities filed an updated load forecast for two Large Use customers; the load for one customer for 2011 was set to zero and for the second customer Horizon Utilities used the actual demand for January and February 2011 and the average demand from December 2010 to February 2011 for the remainder of the 2011 Test Year. Horizon Utilities proposed that a variance account be established to track the difference between the forecasted (as revised during the course of the proceeding) and actual demand for the two specified customers. Any overage in revenues due to higher demand than was forecast would be shared 50:50, with its Large Use customers and Horizon Utilities proposed that it would bear the risk for any underage in demand for the two customers. In its Decision in the

[1] At p. 10 of the Board's Mar. 24, 2010 Decision in Horizon Utilities' Z-Factor Application, available at: http://www.rds.ontarioenergyboard.ca/webdrawer/webdrawer.dll/webdrawer/rec/183099/view/dec_Horizon%20Z%20Factor_20100324.PDF

2011 Application, the Board did not adopt this approach, but instead accepted the updated Large Use customer load forecast with a minor increase for growth.

Horizon Utilities submits that its current circumstances resulting from the New Development differ from those at the time of the 2011 application. Horizon Utilities makes this application for alternative relief in the context of a Custom IR application. The Board's RRFE states that: "This rate-setting method is intended to be customized to fit the specific applicant's circumstances[2]." Horizon Utilities supplementary evidence describes the New Development and the change this represents in Horizon Utilities' specific circumstances. Horizon Utilities had provided a detailed discussion of its uniqueness and its particular circumstances regarding the Large Use customer class in Exhibit 1, Tab 2, Schedule 4 of the pre-filed evidence in the current Application. The evidence states that:

> "*Horizon Utilities differs from other LDCs in terms of commercial customer load profile and collection risk, because it serves two of Ontario's most industrial cities, both of which have large commercial customers (i.e., GS>5MW, also known as Large Use). Only 23 of Ontario's 73 LDCs have customers in the "Large Use" customer class and the average number of Large Use customers for these 23 LDCs is six and the median is three. Horizon Utilities has eleven Large Use customers.*
>
> *While two LDCs have more Large Use customers, Horizon Utilities has some very Large Use customers based on historical circumstances. Many of Horizon Utilities' Large Use customers are located in areas that predate Ontario Hydro's and now Hydro One's ownership of the provincial transmission grid. While most of the major Large Use customers in Ontario are transmission connected,* ***some Large Use customers in Horizon Utilities' service area are distribution connected based on legacy connection arrangements. The result is that, compared to most LDCs, Horizon Utilities bears a disproportionate concentration risk with respect to revenue and credit loss.*** *Serving cities with a heavy industry concentration, including steel processing and manufacturing, Horizon Utilities also experiences a greater level of exposure to adverse economic conditions compared to other LDCs. This is certainly the case compared to most suburban and small town LDCs."* [emphasis added]

In the context of Horizon Utilities' challenges and the New Development related to this particular large industrial customer within the Custom IR Application, it is necessary for Horizon Utilities to

[2] Page 18 of the Report of the Board: A Renewed Regulatory Framework for Electricity: A Performance Based Approach, October 18, 2012.

request an innovative method in which to address this potential loss. As noted previously, Horizon Utilities is not proposing to change the load forecast for USSC. The baseline for the variance account would be the load forecast incorporated into the load forecast agreed upon by the parties to the Settlement Proposal.

Horizon Utilities submits that in the event that the Board does not approve the establishment of the LU (2) class, the proposed variance account applicable to the Large Use class reasonably allows for the maintenance of the revenue from USSC anticipated prior to the New Development and incorporated into Horizon Utilities' cost allocation and rate design models, with no impacts on other customer classes. Horizon Utilities further submits that it is appropriate that such alternative relief be granted, particularly in the context of a Custom IR Application.

APPENDIX 10-1

USSC SEPTEMBER 16, 2014 LETTER

U. S. Steel Canada Inc.
A Subsidiary of United States Steel

September 16, 2014

To Our Valued U. S. Steel Canada Suppliers:

As one of our valued business partners, I wanted to provide you with some details on the important and necessary actions we have taken to address U. S. Steel Canada's current financial affairs.

On September 16, 2014, U. S. Steel Canada obtained a Court Order for protection under the Companies' Creditors Arrangement Act (CCAA) before the Ontario Superior Court of Justice. The effect of the Court Order is to stay U. S. Steel Canada's obligations to creditors, including suppliers and debt holders, and to provide a forum for U. S. Steel Canada to implement further cost saving measures and commence negotiations with its stakeholders to implement a comprehensive operational and financial restructuring plan.

Despite substantial efforts over the past several years to make U. S. Steel Canada profitable, we continue to experience significant losses. We have taken decisive action to improve the competitiveness and performance of U. S. Steel Canada. Unfortunately, these efforts to turn around the business have not resulted in sufficient sustainable improvement.

As a critical partner in our business we can appreciate the commitment you have already made while continuing to support our operational requirements over the past several months. We are looking for your continued support as we move through this restructuring process.

Entering CCAA was the only responsible course of action under the circumstances and it was taken only after all other options were thoroughly explored. CCAA will allow the business to conduct a dialogue with key stakeholders regarding restructuring solutions.

All suppliers will be paid for the ongoing supply of goods and services on and after September 16, 2014. In order to facilitate payments for goods and services provided after this date, we require that you sign and return the attached Letter of Understanding and Agreement. We value your continued support and we are committed to keep all our suppliers informed as we move forward.

A new credit facility will be put in place to provide funding for the company to operate through the CCAA process. Specifically, U. S. Steel Canada has a commitment from its parent company, U.S. Steel, to provide a debtor-in-possession ("DIP") credit facility to finance its operations during the CCAA. Court approval for this credit facility will be sought at the next hearing (in approximately 3 weeks). Access to DIP financing of this nature allows restructuring companies to continue to meet post-CCAA filing obligations to suppliers, customers and employees. In the interim, U. S. Steel Canada has sufficient cash on hand to meet its operating requirements.

The Initial Order under the CCAA generally prohibits us from paying for goods and services that were received before September 16, 2014. We understand the impact this may have on you and we are committed to working with you throughout the restructuring process.

If you are owed monies for goods or services supplied prior to the filing, you will have the opportunity to file a Proof of Claim once the Court has approved a claims process. You will be provided further information in that regard once a claims process has been approved.

As part of the CCAA process, the Court has appointed Ernst and Young to act as the Monitor. The Monitor's role in the CCAA process is to monitor the activities of the Company, provide advice to the Company and to provide assistance to the Company's stakeholders in respect of the CCAA process. Additional information can be obtained by contacting the Monitor at (844) 941-7764 or by email at ussc.monitor@ca.ey.com.

The Monitor will also be maintaining a website at www.ey.com/ca/USSC where information in respect of the Court filing can be obtained. You may also wish to contact your Buyer to discuss any other business concerns you may have.

Regards,

Michael A. McQuade
President and General Manager
U. S. Steel Canada

UNDERTAKING AND AGREEMENT

TO: **U.S. STEEL CANADA INC. ("USSC"** or the "**Company**")

FROM: ____("**Supplier**")

(Name of Good or Service Provider)

WHEREAS, on September 16, 2014, the Ontario Superior Court of Justice made an order granting certain relief to USSC under the provisions of the *Companies' Creditors Arrangement Act* (Canada) (the "**Initial Order**");

AND WHEREAS, prior to the date of the Initial Order, USSC and Supplier had entered into various transactions pursuant to which USSC may be indebted or otherwise liable to Supplier (the "**Prior Claims**");

AND WHEREAS, USSC and Supplier intend to enter various transactions on and after the date of the Initial Order (the "**Subsequent Transactions**");

NOW THEREFORE, in consideration of the sum of $1 and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Supplier hereby acknowledges, undertakes and agrees with USSC as follows:

1. All payments of money, goods, services or other consideration received by Supplier from USSC on and after the date of the Initial Order (the "**New Consideration**") shall be used or applied by Supplier on account of USSC's obligations in connection with the Subsequent Transactions and for no other purpose whatsoever unless otherwise specifically directed in writing by USSC.

2. Supplier shall not set off or apply any New Consideration received by it on account of any of the Prior Claims.

IN WITNESS WHEREOF this agreement and undertaking is executed by Supplier this day of ____________________, 2014.

SUPPLIER

Per:

Name ________________________________

Title ______________________________

Email ______________________________

Ph# _____________________________

Address ____________________________

____

Please return form to supplierresponses@uss.com or fax to 412-433-5823

APPENDIX 10-2

OEB APPENDIX 2-P ILLUSTRATING PROPOSED REVENUE:COST RATIOS IN THE EVENT THAT THE BOARD DOES NOT APPROVE THE ESTABLISHMENT OF THE LU (2) CLASS.

Appendix 2-P

Please complete the following four tables.

A) Allocated Costs

Classes	Costs Allocated from Previous Study	%	Costs Allocated in Test Year Study (Column 7A)	%
Residential	$ 57,738,673	56.41%	$ 66,606,920	58.20%
GS < 50 kW	$ 11,823,974	11.55%	$ 14,885,519	13.01%
GS > 50 kW	$ 19,773,789	19.32%	$ 21,095,945	18.43%
Large Use (1)	$ 2,257,890	2.21%	$ 6,818,065	5.96%
Large Use (2)	$ 6,577,075	6.43%	$ -	0.00%
Street Lighting	$ 2,963,902	2.90%	$ 3,345,563	2.92%
Sentinel Lighting	$ 57,144	0.06%	$ 44,771	0.04%
Unmetered Scattered Load (USL)	$ 533,639	0.52%	$ 389,927	0.34%
Standby	$ 620,650	0.61%	$ 1,251,620	1.09%
Total	$ 102,346,736	100.00%	$ 114,438,330	100.00%

Notes

1 Customer Classification - If proposed rate classes differ from those in place in the previous Cost Allocation study, modify the rate classes to match the current application as closely as possible.

2 Host Distributors - Provide information on embedded distributor(s) as a separate class, if applicable. If embedded distributor(s) are billed as customers in a General Service class, include the allocated cost and revenue of the embedded distributor(s) in the applicable class. Also complete Appendix 2-Q.

3 Class Revenue Requirements - If using the Board-issued model, in column 7A enter the results from Worksheet O-1, Revenue Requirement (row 40 in the 2013 model). This excludes costs in deferral and variance accounts. Note to Embedded Distributor(s), it also does not include Account 4750 - Low Voltage (LV) Costs.

B) Calculated Class Revenues

Classes (same as previous table)	Column 7B	Column 7C	Column 7D	Column 7E
	Load Forecast (LF) X current approved rates	L.F. X current approved rates X (1 + d)	LF X proposed rates	Miscellaneous Revenue
Residential	$ 63,449,250	$ 66,931,078	$ 66,931,078	$ 3,327,283
GS < 50 kW	$ 12,412,754	$ 13,093,913	$ 13,130,100	$ 688,490
GS > 50 kW	$ 17,197,714	$ 18,141,452	$ 18,331,968	$ 1,012,123
Large Use (1)	$ 6,548,823	$ 6,908,194	$ 6,908,194	$ 414,238
Large Use (2)	$ -	$ -	$ -	$ -
Street Lighting	$ 2,202,026	$ 2,322,864	$ 2,329,283	$ 140,057
Sentinel Lighting	$ 37,542	$ 39,602	$ 39,712	$ 2,102
Unmetered Scattered Load (USL)	$ 509,223	$ 537,167	$ 444,316	$ 23,596
Standby	$ 745,248	$ 786,144	$ 645,763	$ 70,027
Total	$ 103,102,579	$ 108,760,414	$ 108,760,414	$ 5,677,916

Notes:

1 Columns 7B to 7D - LF means Load Forecast of Annual Billing Quantities (i.e. customers or connections X 12, (kWh or kW, as applicable). Revenue Quantities should be net of Transfomrer Ownership Allowance. Exclude revenue from rate adders and rate riders.

2 Columns 7C and 7D - Column total in each column should equal the Base Revenue Requirement

3 Columns 7C - The Board cost allocation model calculates "1+d" in worksheet O-1, cell C21. "d" is defined as Revenue Deficiency/ Revenue at Current Rates.

4 Columns 7E - If using the Board-issued Cost Allocation model, enter Miscellaneous Revenue as it appears in Worksheet O-1, row 19.

C) Rebalancing Revenue-to-Cost (R/C) Ratios

Class	Previously Approved Ratios Most Recent Year: 2011	Status Quo Ratios (7C + 7E) / (7A)	Proposed Ratios (7D + 7E) / (7A)	Policy Range
	%	%	%	%
Residential	111.76%	105.48	105.48	85 - 115
GS < 50 kW	104.52%	92.59	92.83	80 - 120
GS > 50 kW	85.35%	90.79	91.70	80 - 120
Large Use (1)	93.73%	107.40	107.40	85 - 115
Large Use (2)	45.74%			85 - 115
Street Lighting	75.01%	73.62	73.81	70 - 120
Sentinel Lighting	61.98%	93.15	93.39	80 - 120
Unmetered Scattered Load (USL)	131.61%	143.81	120.00	80 - 120
Standby	79.83%	68.40	57.19	Undefined
0				

Notes

1 Previously Approved Revenue-to-Cost Ratios - For most applicants, Most Recent Year would be the third year of the IRM 3 period, e.g. if the applicant rebased in 2009 with further adjustments over 2 years, the Most recent year is 2011. For applicants whose most recent rebasing year is 2006, the applicant should enter the ratios from their Informational Filing.

2 Status Quo Ratios - The Board's updated Cost Allocation Model yields the Status Quo Ratios in Worksheet O-1. Status Quo means "Before Rebalancing".

D) Proposed Revenue-to-Cost Ratios

Class	Proposed Revenue-to-Cost Ratios					Policy Range
	2015	2016	2017	2018	2019	
	%	%	%	%	%	%
Residential	105.48	106.01	105.66	106.70	105.51	85 - 115
GS < 50 kW	92.83	92.34	92.24	93.96	91.85	80 - 120
GS > 50 kW	91.70	91.20	92.15	88.29	93.06	80 - 120
Large Use (1)	107.40	105.27	105.40	105.08	104.70	85 - 115
Large Use (2)		-	-	-	-	85 - 115
Street Lighting	73.81	72.68	73.29	73.39	73.24	70 - 120
Sentinel Lighting	93.39	93.59	91.81	90.69	89.27	80 - 120
Unmetered Scattered Load (USL)	120.00	120.00	119.47	120.00	119.93	80 - 120
Standby	57.19	56.85	56.11	56.44	56.50	Undefined
						0
0						

Note

1 The applicant should complete Table D if it is applying for approval of a revenue to cost ratio in 2013 that is outside the Board's policy range for any customer class. Table (d) will show the information that the distributor would likely enter in the IRM model) in 2013. In 2014 Table (d), enter the planned ratios for the classes that will be 'Change' and 'No Change' in 2014 (in the current Revenue Cost Ratio Adjustment Workform, Worksheet C1.1 'Decision – Cost Revenue Adjustment', column d), and enter TBD for class(es) that will be entered as 'Rebalance'.

APPENDIX 10-3

ELENCHUS RESEARCH ASSOCIATES INC.
REPORT DATED SEPTEMBER 25, 2014

34 King Street East, Suite 600
Toronto, Ontario, M5C 2X8

Horizon Utilities 2015-2019 Cost Allocation Addendum: Variance Account Creation & Disposition

A Report Prepared by
Elenchus Research Associates Inc.

On Behalf of
Horizon Utilities

September 25, 2014

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Table of Contents

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1 INTRODUCTION

On April 17, 2014 Horizon Utilities ("Horizon") filed its 2015-2019 Custom IR Application. Exhibit 7 of the application included a report at Tab 1, Appendix 7-1 prepared by Elenchus Research Associates ("Elenchus') entitled "Horizon Utilities 2015 – 2019 Cost Allocation". The Elenchus report contained a recommendation to split the existing Large Use Class (LU) into two separate large use classes based on their peak demand. In its application, Horizon has proposed to replace the current LU class with two new rate classes designated as LU (1) and LU (2) with customer with peak demand below 15 MW being classified as LU (1) and customers with peak demand equal to or above 15 MW being classified as LU (2). Four existing customers of Horizon Utilities would be classified as LU (2) based on their current demand.

On September 17, 2014, Horizon Utilities learned that one of the four customers that would be included in the proposed LU (2) class has sought and obtained a Court Order for protection under the Companies' Creditors Arrangement Act ("CCAA"). This new information indicates that the future load of this customer is uncertain. While it is possible that this customer will continue its operations without a major change in its electricity requirements, its future is uncertain. It is also possible that the customer's operations could be curtailed, perhaps to the point where it would be reclassified as a LU (1) customer or, conceivably, operations could be terminated during the term of Horizon's 2015 – 2019 Custom IR. Conversely, it is also conceivable that the restructuring of the customer's operations that will take place in the coming months and years could result in a renewal that will result in maintained or increased electricity requirements. While the new information does not provide a basis for altering the forecast of this customer's future demand, it does clearly highlight that there is new increased risk associated with Horizon Utilities' future revenue.

As a result of this new information, Horizon Utilities now requests that "In the event that the Board does not approve the establishment of the LU (2) class but instead maintains the current class structure of a single Large Use customer class, then, in this circumstance, Horizon Utilities requests that the Board approve the establishment of a symmetrical variance account for the Large Use customer class to mitigate against the risk that one of the members of that class, identified in Exhibit 10 to this Application, reduces or closes its Hamilton operations."

Horizon Utilities has asked Elenchus to prepare this report to explain the creation and disposition of this variance account that would be consistent with the generally accepted principles of cost allocation.

2 Creation and Disposition of the Proposed Variance Account

The purpose of variance accounts is generally to flow the exact amount of actual costs through to customers despite any variances between forecast and actual costs.

In the context of the proposed variance account, costs have been allocated to customer classes based on the forecast of demand that Horizon Utilities had established, as modified in the Horizon Utilities Settlement Proposal that was filed with the Board on September 22, 2014. The demand forecast assumed the customer continues operating as previously expected. Assuming the Settlement Proposal is accepted by the Board, the final Horizon Utilities rates will be established on the basis of an updated cost allocation that reflects the Settlement Proposal and the decision of the Board.

In our opinion, there are two options for creating and disposing of the proposed variance account.

Option #1: Since a cost allocation study is normally updated only at the time of a cost of service application, the costs allocated to the LU class would not be updated during the Custom IR term as a result of a change in the customer's demand, including the change that would result from a shutdown of operations. Hence, if demand is reduced, the revenue collected from the LU class would be less than the costs allocated to the class. It would therefore be consistent to dispose of future amounts in the proposed variance account to LU customers. An implication of this approach is that the creation and disposition of the proposed variance account would have no impact on other customer classes.

Option #2: An alternate view would be to create and dispose of the deferral account in a manner that approximates the impact on allocated costs if actual demand, which is currently not known, had been used in the cost allocation study. This conceptual approach implies that a variance in demand would imply a retroactive change in allocated costs among customer classes. For example, if actual demand ends up being below the current forecast, the proportion of costs allocated to the LU class would decline and some costs would shift to all other customer classes. While it would not be possible to determine precisely the impact on allocated costs or rates without undertaking an update to the cost allocation study, this impact could be approximated by disposing of the variance account to all customers.

3 CONCLUSION

Elenchus has identified above two approaches to creating and disposing of the proposed variance account in future years that would be consistent with the way in which the variance in recovered costs, resulting from a variance in the identified customer's demand, would be allocated to customer classes by Horizon Utilities cost allocation model.

In our opinion, the simplest and most reasonable approach would be to adopt an approach that is consistent with viewing the approved cost allocation model as being the basis for allocating costs and setting rates, regardless of future variances from forecast demand for the identified customer. This approach is termed Option #1 above.

While Option #2 has conceptual legitimacy, it implies the need for a retroactive update to the cost allocation model to reflect variances in demand related to the customer that has been granted CCAA protection.

Elenchus therefore recommends that the proposed variance account, if approved, would be disposed of to LU customers on the basis of their billed demand.