



PUBLIC INTEREST ADVOCACY CENTRE
LE CENTRE POUR LA DEFENSE DE L'INTERET PUBLIC

ONE Nicholas Street, Suite 1204, Ottawa, Ontario, Canada K1N 7B7

Tel: (613) 562-4002. Fax: (613) 562-0007. e-mail: piac@piac.ca. <http://www.piac.ca>

Michael Buonaguro
Counsel for VECC
(416) 767-1666

July 2, 2008

VIA MAIL and E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Vulnerable Energy Consumers Coalition (VECC)
EB-2007-0697
Horizon Utilities Corporation – 2008 Electricity Distribution Rate
Application

Please find enclosed the final submission of VECC in the above noted proceeding.

Yours truly,

A handwritten signature in blue ink, appearing to read 'M. Buonaguro', is written above the typed name.

Michael Buonaguro
Counsel for VECC
Encl.

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Horizon Utilities Corporation pursuant to section 78 of the *Ontario Energy Board Act* for an Order or Orders approving just and reasonable rates for the delivery and distribution of electricity.

FINAL SUBMISSIONS

On Behalf of The

VULNERABLE ENERGY CONSUMERS COALITION (VECC)

June 27, 2008

**Michael Buonaguro
Public Interest Advocacy Centre
34 King Street East
Suite 1102
Toronto, Ontario
M5C 2X8**

**Tel: 416-767-1666
E-mail: mbuonaguro@piac.ca**

Vulnerable Energy Consumers' Coalition (VECC)
Final Argument

1 The Application

- 1.1 On October 22, 2007 Horizon Utilities Corporation (“Horizon”) submitted an application to the Ontario Energy Board for approval of its proposed 2008 distribution rates. This application is based on a projected 2008 Distribution revenue requirement¹ of \$101,580,859 which, after an allowance of \$6,524,481 for revenue from other sources, leaves \$95,056,378 to be recovered through distribution rates. Included in this amount are LV Charges of \$196,399².
- 1.2 According to Horizon, distribution revenues for 2008 at current rates would produce revenues of \$86,291,757³. The resulting difference is \$8,764,620⁴ or 10.2%.
- 1.3 Also included in the Application is a request to clear the balances in a number of deferral and variance accounts.
- 1.4 The following sections contain VECC’s final submissions regarding the various aspects of Horizon’s Application.

¹ Exhibit G, Tab 1, Schedule 1, page 2

² Exhibit I, Tab 1, Schedule 1, page 1

³ Exhibit G, Tab 1, Schedule 2, page 1. Note: Response to VECC #33 a) provides a breakdown of the 2008 revenues at 2007 rates and yields a total of only \$86,095,353.

⁴ Exhibit G, Tab 1, Schedule 5, page 2

2 Rate Base and Capital Spending

Capital Spending

2.1 Horizon's projected 2008 capital spending is \$43,942,709 (net of capital contributions)⁵. The following table compares the proposed capital spending in various areas with that of previous years.

	2006	2007	2008
Distribution Plant	\$25,587,855	\$23,210,834	\$25,190,856
Meters (including Smart Meters)	\$3,095,392	\$8,842,825	\$12,993,330
Computers (Hardware and Soft Ware)	\$788,596	\$1,769,195	\$5,609,356
General Plant & Office Equipment	\$1,693,821	\$3,354,256	\$719,880
Transport Equipment	\$1,880,673	\$1,783,514	\$1,904,733
Communication Equipment	\$649,831	\$468,970	\$242,506
Tools, Equipment & Stores	\$813,747	\$708,663	\$611,480
Capital Contributions	(\$3,602,924)	(\$2,854,992)	(\$3,329,432)
Total	\$30,906,990	\$37,283,265	\$43,942,709

Source: Exhibit B, Tab 2, Schedule 1, pages 1-3

The areas showing increases for 2008 include Meters, Computers and Distribution Plant.

2.2 The increase in spending on Meters is due to Horizon's Smart Meter program where spending in 2008 exceeds 2007 levels by more than \$3.0 M⁶. The other meter-related area showing an increase in 2008 is wholesale meter verification for IESO compliance⁷. VECC's views on the 2008 treatment of Horizon's Smart Meter related costs are set out in the Smart Meter section of this submission. However, in summary, it is VECC's position that Smart Meter capital should not be included in Horizon's rate base but rather the impact recorded in

⁵ Exhibit B, Tab 2, Schedule 1, page 3

Variance/Deferral Account #1555.

- 2.3 The increase in Computer-related costs is attributable to the planned 2008 capital spending of \$4.7 M on Horizon's Enterprise Resource Planning (ERP) system⁸. The purpose of this project is to replace a number of existing business applications that were developed over the past 25 years and have reached the end of their productive lives⁹.
- 2.4 While the total capital spending on Distribution Plant is in line with previous years, there is one area which is of concern to VECC. The number of pole replacements forecast for 2008 is lower than that for either 2006 or 2007¹⁰. In contrast, the overall spending is higher. In 2006 capital spending on pole replacement worked out to \$3,921/pole¹¹. In 2007, the value is \$5,534/pole. Horizon explains that the spending per pole can vary depending on a number of factors and this contributed to the higher value in 2007¹². However, the spending per pole in 2008 is projected to rise to \$6,158. In VECC's submission there is no explanation or rationale for assuming that replacements in 2008 will cost less "on average" than in 2006 or 2007. Using the average of the two previous years (\$4,728) and the projected 340 pole replacements in 2008 yields a total cost of \$1,607,520 versus the 2,094,000 in the submission. As a result, VECC submits that capital spending budget should be reduced by roughly \$450,000.

Working Capital

- 2.5 Rate Base consists of Net Fixed Assets plus an allowance for working capital. Horizon has not performed a lead/lag study but rather has relied on the use of 15% of OM&A plus Cost of Power to determine its working capital requirements.

⁶ OEB Staff #44 b)

⁷ Exhibit B, Tab 3, Schedule 1, page 21

⁸ Exhibit B, Tab 3, Schedule 1, page 34

⁹ June 5, 2008, pages 127-128

¹⁰ J1.11

¹¹ \$1,458,473/372

¹² Board Staff #44 c)

This yields a working capital value of \$69,470,663 for 2008¹³.

- 2.6 For the Power Purchased component of the Cost of Power, Horizon has used its forecast 2008 wholesale load and an average cost of \$56.88/MWh¹⁴. VECC notes that in a number of recent decisions¹⁵ the Board has directed electricity distributors to base their 2008 cost of power on the \$54.5/MWh value contained in the April 2008 RPP Report. VECC submits that Horizon should be directed to use a similar approach.
- 2.7 Also, Horizon does not appear to have used the lower 2008 Transmission Network and Connection charges in establishing the transmission component for its Cost of Power¹⁶. In VECC's view, Horizon should be directed to revise its Cost of Power estimate accordingly.
- 2.8 Finally, materials provided by Horizon during the interrogatory process raise a question as to whether the 15% factor is appropriate for Horizon. In its Application, Horizon's rate base consists of \$293.5 M in net fixed assets plus \$69.5 M for working capital for an overall total of \$363 M. However, in the December presentation to its Board of Directors¹⁷ the fixed and working capital assets for 2008 were reported as \$322 M. Since the fixed asset value is established by accounting standards the difference must be attributable to a different calculation of working capital requirements (i.e. \$30 M per Board presentation versus \$70 M per EDR Application). In VECC's view, this suggests that the appropriate percentage to use in determining working capital requirements for Horizon is significantly less than 15%. VECC notes that for its 2008 EDR Application, Toronto Hydro actually undertook a lead/lag study. The resulting working capital requirements were equivalent to 12.45% of OM&A plus Cost of Power¹⁸. As a compromise, VECC submits that the working capital

¹³ Exhibit B, Tab 4, Schedule 1, page 1

¹⁴ VECC #19 a)

¹⁵ For example: Rideau St. Lawrence; PUC Distribution; and Chapleau PUC

¹⁶ VECC #19 b)

¹⁷ CCC #7, Attachment A-2.

¹⁸ EB-2007-0680, Exhibit D1, Tab1, Schedule 1, Pages 21-23.

requirements for Horizon should be calculated using the same percentage.

3 Load Forecast and Revenue Offsets

Load Forecast

- 3.1 Horizon has used 2004 weather normalized load data developed by Hydro One Networks to establish a weather-normalized average customer use for each weather-sensitive customer class¹⁹. It has then developed its load forecast by multiplying this average (per customer) use for each customer class by the forecast 2008 customer count (by class). For non-weather sensitive loads (Large User, Street Lighting, Sentinel Lighting and USL), Horizon used the average use in 2006 multiplied by the forecast number of connections for 2008²⁰.
- 3.2 Board Staff has expressed concerns regarding the fact that Horizon's approach relies on a single year of weather-normalized historical data to determine future load²¹. In response to a Board Staff Information Request²², Horizon has attempted to produce weather-normalized usage value by customer class for 2002 through 2006 using IESO province-wide weather correction factors. In its submissions Board Staff has asked parties to comment on this alternative approach.²³
- 3.3 The IESO weather factor is a simple annual value based on the province overall. It does not reflect Horizon's customer class mix, penetration rates for weather sensitive loads by class or the fact weather impacts vary across the province. While the Hydro One normalization process was based on 2004 data, it does account for all these factors. As a result, VECC believes the original approach is

¹⁹ Exhibit C, Tab 2, Schedule 2, page 3

²⁰ Exhibit C, Tab 2, Schedule 2, page 4

²¹ OEB Staff Submissions, page 4

²² Staff #19 b)

²³ OEB Staff Submissions, page 5

preferable to the one presented in response to Staff #19.

3.4 Admittedly VECC has concerns, which it has already expressed in submissions made regarding other electricity distributors' 2008 rates, with respect to Horizon's approach. However, in the short-term, it is not clear to VECC that a better alternative exists. Most of Ontario's electricity distributors seem to lack the data that would be required to undertake a valid weather-normalization assessment:

- With only five years of data available (2002-2006) it is unlikely that any statistically valid trend analysis could be undertaken using weather and other explanatory variables.
- Alternatively, the weather normalization process performed by Hydro One Networks (for the Cost Allocation informational filings) requires customer survey data for the year concerned, which is typically not available.

However, VECC acknowledges that this is an issue the Board and utilities will have to resolve over the longer term.

Other Revenues

3.5 VECC has no submissions with respect to Horizon's Other Revenue forecast.

4 Operating Costs

OM&A - General

4.1 Horizon's increase in controllable OM&A expenses (i.e., excluding depreciation and taxes) between 2006 and 2008 is driven²⁴ mainly by:

- Increased Salaries and Expenses (\$4,379,100),
- Increased Vegetation Management (\$950,000),
- Other Increased O&M (\$1,854,352)
- ERP (\$1,296,000)

²⁴ Staff #23 e)

- Regulatory Costs (\$289,000)
- Bad Debt Expense (\$290,000)
- Other Expenses (\$447,822)

4.2 Part of the increase in salaries is due to the addition of new executive positions²⁵. Two of these (VP, Business Development and Director, Business Strategies) have been characterized by Horizon as research and development positions for merger opportunities²⁶. Horizon argues that the costs associated with these positions are legitimately included in the 2008 revenue requirement since they are not transaction costs associated with a specific merger²⁷.

4.3 VECC disagrees. These management positions (and costs) are not related to providing service to existing customers. Rather, their objective is to generate shareholder value. In VECC's view the link to future customer benefits is speculative (at best) and the salaries and other benefits costs associated with these positions should be excluded from the revenue requirement. Horizon has stated that the associated costs are roughly \$500,000²⁸.

4.4 During the oral proceeding it also became clear that both Horizon executives and other staff are spending time working on the potential Horizon-Guelph merger²⁹. Horizon's position is that, to the extent merger transaction costs are associated with internal staff, they should be borne by the rate payers³⁰. Again, VECC disagrees.

4.5 Mergers are a serious (and significant) undertaking. VECC does not accept the argument that the efforts involved are "after hours" activities³¹ that do not take resources away from the day to day utility business. In VECC's view reasonable efforts should be made to identify such internal costs and exclude them from the

²⁵ Staff n#23 c)

²⁶ Transcript, June 5, 2008, page 36, lines 3-12

²⁷ June 5, 2008, page 37, lines 6-14

²⁸ June 5, 2008, page 108, lines 27-28

²⁹ June 5, 2008, pages 39-40

³⁰ June 5, 2008, pages 38, 85 and 89

³¹ June 5, 2008, page 38

proposed 2008 revenue requirement. Furthermore, the appropriate methodology is not to use an “incremental cost” approach but rather a fully allocated cost approach consistent with how services provided to affiliates are valued.

- 4.6 Horizon claims to have included in its 2008 Revenue Requirement a reduced level of ERP-related OM&A in order to reflect future cost savings that will be achieved during the 3GIRM period³². VECC supports this approach. However, it is not clear to VECC that the OM&A costs associated with the ERP project have actually been reduced. The 2008 incremental operating expenses associated with the ERP are forecasted to be \$1,295,000³³. This is virtually the \$1,296,000 OM&A impact that Horizon has attributed to the ERP for 2008³⁴. If the OM&A had been reduced, as claimed by Horizon, then VECC would have expected this second value to be lower by \$479,204 (i.e. the difference between the \$1,351,920 Horizon claims is has included in the 2008 revenue requirement for the ERP³⁵ and the \$1,831,124 ERP revenue requirement forecast for 2008³⁶). VECC invites Horizon to clarify how the \$479,204 difference has been reflected in the Application.
- 4.7 VECC is also concerned that while the costs of Horizon’s current IT systems are shared between the electricity distributor and its affiliates, the cost of the ERP are all being charged to the electricity distributor (and ultimately its rate payers)³⁷. In VECC’s view a portion of the ERP costs should be allocated to Horizon’s affiliates. VECC submits that the ERP costs charged included in the 2008 revenue requirement should be reduced by 17.6% - representing the portion of Corporate and Other Services costs that are allocated to Horizon’s affiliates³⁸.
- 4.8 With respect to regulatory costs, Horizon’s response to Undertaking J1.1 states that the 2008 values do not include any legal or consulting costs related to the

³² Exhibit D, Tab 2, Schedule 1, page 21

³³ Exhibit D, Tab 2, Schedule 1, Appendix A, 2008 Analysis

³⁴ Staff #23 e)

³⁵ Exhibit D, Tab 2, Schedule 1, page 21

³⁶ Exhibit D, Tab 2, Schedule 1, Appendix A, 2008 Analysis

³⁷ June 5, 2008, page 130

³⁸ Exhibit C, Tab 3, Schedule 2, page 5

2008 EDR Application. However, the Regulatory Service budget provided in the original Application³⁹ specifically attributes the \$58,000 increase in 2008 legal expenses to the 2008 Rate Application. The budget also attributes the increase in consulting expenses (\$189,000 versus \$70,000) to 2008 proceedings. Finally, the 2008 budget (and the also the undertaking) includes \$352,000 for intervenor costs, of which \$206,000 is related to the 2008 EDR Application. In VECC's view, 2008 regulatory costs appear to include something in excess of \$300,000 related to the 2008 EDR Application for one-time legal, consulting and intervenor costs.

4.9 Horizon submits that these costs are ongoing and representative of the costs of future applications. VECC disagrees. The explicit purpose of an extensive cost of service based rate filing for 2008 rates is to allow for the implementation of the Board's 3rd Generation IRM regulatory framework in subsequent years – where one of the objectives is reduced regulatory burden and costs. As a result, VECC submits that only \$100,000 (i.e. one-third) of these costs should be included in the 2008 rates. The balance will be recovered through the IRM adjusted rates in 2009 and 2010.

4.10 The 2008 Operating costs also include costs associated with Smart Meters⁴⁰. However, the amount included is unclear. Horizon's response to CCC #17 suggests it is \$1,004,940; while the response to VECC #26 suggests the amount is \$1,372,399. As indicated earlier, it is VECC's view that these costs should not be included in the 2008 Revenue Requirement but rather actual OM&A costs incurred in 2008 related to Smart Meters should be recorded in Account #1556. Further discussion on the regulatory treatment of 2008 Smart Meter costs is provided in Section 7.0. Also, as part of its reply submission, VECC would request that Horizon reconcile the various amounts reported for 2008 smart meter operating and maintenance costs.

Taxes

³⁹ Exhibit B, Tab 1, Schedule 1, Appendix B

⁴⁰ CCC #17

4.11 VECC notes that Horizon will be updating (as part of the Final Rate Order process) its 2008 Revenue Requirement to reflect the latest anticipated 2008 tax rates⁴¹. In VECC's view this update should reflect all known capital and income tax changes for 2008.

Line Losses

4.12 VECC also notes that in response to Staff interrogatory #46 d) Horizon has revised its 2008 Total Loss Factor from 4.51% to 4.21% and has undertaken to update its Rate Order accordingly⁴².

5 Cost of Capital/Capital Structure

5.1 Horizon's proposed 2008 capital structure reflects the direction of the Board in its Report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors⁴³. Furthermore, Horizon has acknowledged that the ROE and short-term interest rate used in the Application will need to be updated to reflect the values issued by the OEB earlier this year⁴⁴. The only issue of contention from VECC is the long-term debt rate proposed by Horizon.

5.2 Horizon's Application proposes a rate of 7% for long-term debt based on the rate reflected in the February 2005 Promissory Note with its affiliate, Hamilton Utilities Corporation⁴⁵. This promissory note replaced an earlier one issued in July 2002.

5.3 The Board's Report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors states that "for embedded debt the rate approved in prior Board decisions shall be maintained for life of each active instrument"⁴⁶. However, it is clear from the oral proceeding that the Board was

⁴¹ June 5, 2008, page 14

⁴² June 5, 2008, page 14

⁴³ Exhibit F, Tab 1, Schedule 1, page 1

⁴⁴ June 5, 2008, page 14

⁴⁵ Exhibit F, Tab 1, Schedule 3, pages 1-2.

⁴⁶ Page 13

not aware of the February 2005 Promissory note when rendering its decision regarding Horizon's 2006 EDR Application⁴⁷. As a result, there is no "prior decision" dealing with Horizon's current promissory note.

- 5.4 Horizon contends that the 2005 Note is simply the 2002 Note with some non-substantive amendments and therefore the 7% (the rate referenced in the 2002 Note) was appropriate⁴⁸. In VECC's view this is incorrect. The 2005 Note included at least two substantive changes:
- It fixed the interest rate at 7%. In contrast the 2002 Note makes reference to it bearing interest at the "permitted rate"⁴⁹. VECC notes that the difference is material in that the permitted or deemed rate long-term rate set by the OEB for 2008 is 6.1% (not 7%).
 - It dropped the provision in the earlier note that the debt was payable on demand, no less than 18 months after a request for repayment⁵⁰.
- 5.5 In VECC's view, the Board must determine – in this proceeding – what the appropriate rate (for regulatory purposes) should be attached to the 2005 Note. The 2006 EDR Handbook indicates that for affiliate debt issued between March 2000 and May 2005 the deemed debt rate is 6.9% for distributor with a rate base between \$250 M and \$1 B⁵¹. However, in VECC's view the resolution of this issue is not as simple as referring to a "handbook".
- 5.6 In the case of Horizon, at the same time as the 2002 Note was issued to the Hamilton Hydro by Hamilton Utilities Corporation, the Corporation simultaneously issued debentures at an interest rate of 6.25%⁵². Horizon has stated that the effective rate is 6.62% after allowing for issuance costs⁵³. However, some questions were raised during the oral proceeding as to the actual impact of the

⁴⁷ June 6, 2008, pages 58-59

⁴⁸ June 5, 2008, pages 203-205

⁴⁹ Exhibit F, Tab 1, Schedule 3, Appendix A

⁵⁰ June 6, 2008, page 41

⁵¹ Page 32 of the 2006 EDR Handbook actually makes reference to the March 2000 Handbook – Table 3-

1.

⁵² Staff #48 a)

⁵³ June 6, 2008, pages 76-77

issuance costs⁵⁴. Finally, at the time that the existing (2005) Promissory Note was issued market interest rates were in the order of 5.21% to 5.26%⁵⁵.

5.7 All this suggests that the 7% does not represent a just and reasonable rate for purposes of setting 2008 rates. In VECC's view, the Board has three choices:

- Adopt the 6.25% rate (adjusted for issuance costs) reflecting the cost of debt at the time the original note was issued,
- Adopt a rate of 5.26% consistent with the cost of Credit A rated borrowing at the time the 2005 Note was issued,
- Adopt a rate of 6.1% consistent with the deemed cost of debt for 2008.

5.8 Given the substantive nature of the changes made to the original promissory note VECC submits that the first option is not appropriate. In VECC's view a rate of 6.1% would be reasonable, save that it is clear that, at the time the applicant negotiated from the floating rate contingent on the "permitted rate" to a fixed rate, the market rates available at the time were, at the high end, 5.26%. Accordingly VECC respectfully submits that it would reasonable for the Board to permit Horizon the lower rate of 5.26%, rather than the 2008 deemed rate of 6.1%.

6 Deferral and Variance Accounts

Balances in Existing Accounts

6.1 In its Application Horizon calculates the balances in the Smart Meter variance accounts up to April 30, 2008⁵⁶. VECC notes that for the period January 1 to April 30, 2008 Horizon has applies an "annualized" cost of capital even though the period involved is four and not 12 months⁵⁷. As noted elsewhere, VECC does not agree with Horizon's proposals with respect to Smart Meters. However, should the Board decide to adopt them, then VECC submits the principal additions for

⁵⁴ June 6, 2008, pages 79-80

⁵⁵ SEC #16 a)

⁵⁶ Exhibit E, Tab 1, Schedule 4

⁵⁷ Exhibit E, Tab 1, Schedule 4, Table 4

January 1- April 30, 2008 need to recalculated.

Recovery of Balances

- 6.2 In its original application, Horizon proposed to refund to/recover from customers the December 2006 balances (along with interest to April 30 ,2008) in its RSVA accounts (#1580-#1588); its Other Regulatory Assets account (#1508); its RCVA accounts (#1518 and #1548) and its Low Voltage account (#1550). It also planned to refund to customers the forecast balance in its Smart Meter accounts (#1555 and #1556) as of April 30, 2008. However, in response to Board Staff interrogatories⁵⁸, Horizon proposed to refund to ratepayers the forecast April 2008 balances in Account #1584 and #1586 (related to Transmission Network and Connection charges).
- 6.3 In VECC's view, the balances in Accounts #1584 and #1586 should only be cleared as of December 31, 2006 (plus interest).
- 6.4 VECC's only other submission is with respect to the treatment of the Smart Meter variance accounts. These accounts should not be cleared (particularly on a forecast basis). Rather, the accounts should be retained and Horizon should continue to record: a) the revenues received from the smart meter rate adder and b) the revenue requirement impact of actual smart meter costs. Furthermore, in VECC's view, Horizon has not provided sufficient information to allow any of its actual capital spending on smart meters to be "posted" to rate base.

7 Smart Meters

Regulatory Treatment

- 7.1 Horizon has indicated that it plans to install 50,000 smart meters in 2007 and a further 80,000 smart meters through out its service territory in the 2008⁵⁹. It has

⁵⁸ Staff #47

included in its 2008 rate base the full capital costs of this project⁶⁰.

7.2 It is VECC's submission that, with respect to the 2008 spending, the Board should adopt the same treatment for Horizon as it did for Toronto Hydro⁶¹. The revenue requirement implications of the capital spending should be tracked in the Smart Meter variance accounts and a smart meter rate adder should be established based on the forecast revenue requirement implications of the 2008 spending and the balances in the Smart Meter variance accounts as of December 31, 2007.

2008 Smart Meter Costs

7.3 In response to VECC Information Request #32 c) Horizon indicated that the revenue requirement impact of including smart meters in rate base was \$665,779. However, VECC has serious concerns regarding the credibility of this value:

- In response to CCC #17, Horizon indicated that the 2008 OM&A costs associated with smart meters are over \$1 M.
- The continuity schedules provided in the original application suggest that the depreciation associated with smart meter is roughly \$860,000⁶².

VECC requests that, in its Reply Submissions, Horizon document the impact of Smart Meters on the 2008 revenue requirement with references to already filed materials.

7.4 Consistent with the regulatory treatment of smart meters recommended above, VECC submits that the Board should approve a Smart Meter Rate adder and continued use of the related deferral/variance accounts for 2008.

7.5 If the Board adopts VECC's recommended approach, the remaining question is to establish an appropriate level for the smart meter rate adder. The major advantage to the rate adder approach is that while the level of adder is important

⁵⁹ Exhibit B, Tab 3, Schedule 1, page 23

⁶⁰ Exhibit B, Tab 2, Schedule 1, Tables 2 & 3

⁶¹ EB-2007-0680, page 24

⁶² Exhibit B, Tab 2, Schedule 1, pages 2-3. Difference between the Accumulaed depreciation for smart meters (1861) in 2008 versus 2007.

in terms of its impact on customer's bills and Horizon's cash flow, at the end of day the Smart Meter Deferral/Variance accounts ensure that both Horizon and its customers are held harmless.

- 7.6 Using the information requested above regarding the 2008 smart meter impact and the information in the Application regarding the smart meter variance account balances as a result of 2006 and 2007⁶³ activities it should be possible to derive an appropriate smart meter rate adder for 2008.

8 Cost Allocation

- 8.1 Horizon has provided the Revenue to Cost ratios resulting from its 2006 Cost Allocation informational filing⁶⁴. It then provided a revised set of ratios that reflected an alternate treatment of the Transformer Allowance. VECC agrees with the alternate treatment proposed by Horizon and notes that it is similar to that raised by a number of other distributors⁶⁵.

- 8.2 The resulting ratios for each of the classes are⁶⁶:

- Residential: 123.6%
- GS < 50 kW: 92.0%
- GS > 50 kW: 72.1%
- Large Users: 49.8%
- Street Lights: 15.6%
- Sentinel Lights: 34.8%
- USL: 34.2%
- Back-up/Standby 51.0%

- 8.3 Based on these results, VECC submits that the main focus of any rate rebalancing should be to increase the ratios for the GS > 50 kW, Large User,

⁶³ Exhibit E, Tab 1, Schedule 4

⁶⁴ Exhibit H, Tab 1, Schedule 2, page 1

⁶⁵ Barrie Hydro, Enersource and Guelph. The issue was also addressed in the recently approved Hydro Ottawa Settlement Agreement.

⁶⁶ Exhibit H, Tab 1, Schedule 2, page 4

Street Lights,, Sentinel Lights, USL and Back-up classes (which are all below the Board's guidelines). Since only the Residential class is above 100% and is also above the revenue to cost ratio range established by the Board, any additional revenues generated should be directed towards reducing its ratio. Horizon's proposed revenue to cost ratios generally all move in the correct direction. However, VECC has concerns with both the methodology Horizon has used to determine the adjustments as well as the degree of the adjustments proposed for some classes.

8.4 In terms of the methodology, Horizon uses the allocation of costs derived from the 2006 informational filing to establish the "100% Cost Allocation" case⁶⁷. It was by comparing the results of this allocation of the revenue requirement to that based Horizon's proposed "revenue shares" that the proposed revenue to cost ratios were calculated⁶⁸. However, this approach is only correct if the relative loads and customer counts for each customer class are the same in the 2008 forecast as they were for the 2006 informational filing. This is clearly not the case.

8.5 As result, Horizon's approach leads to some anomalous results⁶⁹:

- While the revenue to cost ratio for Large Users supposedly increases from 49.79% to 92.12% (i.e. by a factor of 1.85), the revenue allocation share only increases from 5.46% to 6.30% (i.e. by a factor of 1.15). What this means is that the proposed shift in revenue allocation will only increase the ratio for the Large User class from 49.79% to 57.45% - still well below the Board's Guidelines.
- While the revenue to cost ratio for GS>50 kW supposedly increases from 72.12% to 86.31% (i.e. by a factor of 1.20), the revenue allocation share only increases from 15.23% to 16.85% (i.e. by a factor of 1.11). What this means is that the proposed shift in revenue allocation will only increase the ratio for the LGS>50 kW class from 72.12% to 79.8% - just under the Board's Guidelines.

⁶⁷ Exhibit H, Tab 1, Schedule 2, Table 5 and VECC #36 d)

⁶⁸ Exhibit H, Tab 1, Schedule 2, Table 6

⁶⁹ Exhibit H, Tab 1, Schedule 2, Tables 4, 5 & 6

- While the revenue to cost ratio for Street Lights supposedly increases from 15.63% to 23.79% (i.e. by a factor of 1.52), the revenue allocation share increases by a factor of 1.71 (i.e. from 0.44% to 0.75%)
- While the revenue to cost ratio for USL supposedly increases from 34.24% to 88.05% (i.e. by a factor of 2.57), the revenue allocation share increases from 0.15% to 0.85% (i.e. by a factor of 5.67).
- While the revenue to cost ratio for Back-up Power supposedly increases from 50.98% to 65.84% (i.e. by a factor of 1.29), the revenue allocation share actually increases from 0.27% to 0.45% (i.e. by a factor of 1.67).

8.6 Given the current circumstances, the correct starting point should be the revenue allocation factors arising from 2008 revenues at current (2007) rates. The underlying assumption is that revenues at current rates are consistent with the revenue to cost ratios arising from the 2006 Cost Allocation informational filing. Furthermore, to be fully consistent, the revenue shares should be calculated using 2007 rates excluding the smart meter rate adder and the LV Charge adder, as neither of these were included in the 2006 Cost Allocation filing. Then to yield a desired increase in the revenue to cost ratio (e.g., roughly 85% for Large Users), the proportion of revenue allocated would need to be increased by the same factor.

8.7 In terms of the proposed changes in the revenue to cost ratios, VECC's concerns are as follows:

- The revenue to cost ratios for Street Lighting, Sentinel Lighting and USL are all significantly below the Board's Guidelines (with Street Lighting being the lowest). However the Street Lighting ratio is only increasing by 8 percentage points, while the Sentinel Lighting and USL ratios are both increasing by over 50 percentage points to levels well above the Guidelines. VECC submits it would be appropriate to implement a more aggressive change for Street Lights and a less aggressive change for Sentinel Lights and USL, subject to the methodological changes discussed previously.
- Horizon's proposal calls for the revenue to cost ratios for GS>50 and Large

Users to (supposedly⁷⁰) increase to levels well above the Board's Guidelines. As discussed above, in reality, the proposed revenue share for the GS>50 kW means the class is barely achieving the Board's Guidelines while the Large User's revenue share will need to increase further if meaningful progress is to be made to meeting the lower range of the Board's Guidelines.

8.8 However, should the Board reject VECC's perspective regarding the methodology for determining revenue to cost ratio changes, VECC submits that significant caution must be taken when moving class revenue to cost ratios closer 100% than required by the Board's Guidelines. The Board's November Report⁷¹ cited a number of influencing factors that give rise to a degree of uncertainty regarding the accuracy of the cost allocation results and which led to the adoption of the proposed ranges. In Horizon's case, the utility has relied on the 2006 Cost Allocation Model results and, as a result, had not addressed any of the concerns raised by the Board in its Report.

9 Rate Design

9.1 In its Application Horizon proposes to maintain the same fixed/variable proportions as calculated in the 2006 EDR⁷². For the Residential class, the cost allocation shift tends to offset the general increase in the revenue requirement such that the resulting 2008 customer fixed charge (\$13.98)⁷³ is virtually the same as 2007 charge (\$13.99). VECC notes that the 2007 charge is well above the maximum service charge calculated by the Cost Allocation Model⁷⁴ and therefore agrees that the charge should not be increased for 2008..

⁷⁰ AS noted in paragraphs 8.5 and 8.6, VECC does not believe the proposed revenue to cost ratios reported by Horizon have been calculated correctly.

⁷¹ EB-2007-0667, pages 5-6

⁷² Exhibit I, Tab 1, Schedule 1, page 6

⁷³ Exhibit I, Tab1, Schedule 1, page 10

⁷⁴ VECC #41 a)

10 Retail Transmission Rate

10.1 VECC notes that the Retail Transmission rates included in the Application did not reflect the decrease in the province's Uniform Transmission rates arising from EB-2007-0759⁷⁵. In response to Staff #47 Horizon has calculated new Retail Transmission rates for 2008 and has acknowledged that its Application needs to be updated accordingly⁷⁶.

11 LRAM/SSM

11.1 Horizon proposes that the SSM amounts arising from CDM activities in each customer class be recovered from that class⁷⁷. In the case of the current Application this approach leads to a positive rate rider for the Residential class (i.e., a cost to customers) but a negative rate rider for the GS >50 and GS < 50 kW classes⁷⁸. This result arises from the fact that Residential CDM programs produced a favourable net benefit overall while the Commercial, Institutional and Industrial programs did not⁷⁹. In VECC's view this result demonstrates a fundamental flaw with this allocation methodology for SSM amounts. For 2008, the GS>50 and GS<50 customers not only get to benefit from the CDM program but they then get a bill reduction from the fact their programs were not cost effective.

11.2 VECC submits that the resource savings from CDM programs benefit all customers and that the SSM amounts should be allocated to all customer classes. This would generally avoid the creation of such anomalies in the future and lead to a more appropriate allocation that recognizes the system-wide benefits of CDM (as measured by the TRC). In terms of allocation factors, each class' distribution revenues would be an appropriate basis. The amounts allocated to each customer class would then still be recovered through a variable distribution rate

⁷⁵ OEB Staff #68

⁷⁶ June 5, 2008, page 15

⁷⁷ Exhibit J, Tab 1, Schedule 4, page 2

⁷⁸ Exhibit J, Tab 1, Schedule 2, page 2

⁷⁹ Exhibit J, Tab 1, Schedule 4, page 2

rider.

12 Recovery of Reasonably Incurred Costs

12.1 VECC submits that its participation in this proceeding has been focused and responsible. Accordingly, VECC requests an award of costs in the amount of 100% of its reasonably-incurred fees and disbursements.

Respectfully Submitted on the 2nd Day of July, 2008

Michael Buonaguro
Counsel for VECC