

## 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.

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### Written Argument Of The Consumers Council of Canada

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### WRITTEN ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

#### INTRODUCTION:

1. By Application dated October 22, 2007, Horizon Utilities Corporation (“Horizon”) applied to the Ontario Energy Board (“Board”) for approval of rates and other charges effective May 1, 2008. By Procedural Order No. 4 dated April 16, 2008, the Board approved the Issues List for Horizon and determined that three issues would be considered at an oral hearing. The Board also determined that the other issues would be considered by the Board in a written hearing.

2. On June 5 and 6, 2008, the Board held an oral hearing to consider the following issues:

1. Operating, Maintenance and Administration Costs
2. Capital Expenditures
3. Cost of Capital

3. The Consumers Council of Canada (“Council”) participated in the settlement conference and the oral hearing. This is the final argument of the Council. The Council will make submissions on the issues considered through both the oral and written hearing processes. The Council does not intend to comment on all issues in the Application. The submissions will follow the order set out in the Board-approved issues list.

## OVERVIEW:

4. Horizon has requested approval of the following:

- Rates to be effective May 1, 2008;
- A revenue requirement of \$101.6 million, less revenue from other sources of \$6.5 million, resulting in a base revenue requirement of \$94.8 million;
- Service charges as set out in its evidence;
- Deferral and Variance Account balances as at December 31, 2006 together with carrying charges to April 30, 2008;
- An increase in the allowance to be paid to customers that own their own transformation;
- A new service charge for customers use of credit card payment facilities' for the payment of past due balances;
- The continuation existing deferral accounts;
- Recovery of amounts related to the Lost Revenue Adjustment Mechanism and Shared Savings Mechanism through rate riders;
- The establishment of a smart meter rider representing a credit against the fixed distribution charge for metered customers. Horizon will require further adjustments to this rider in 2009 and 2010 in order to recover its smart meter-related capital and operating expenditures for those years; and
- New Retail Transmission rates as directed by the Board;

5. Horizon's rates were declared interim by the Board as of May 1, 2008. Horizon has requested that the Board find that the new rates be set so as to recover the annualized revenue requirement over the remaining period of the 2008 rate year. In making that proposal Horizon has acknowledged that, for 2009, adjustments would have to be made to adjust the rates so that the revenue requirement will then be recovered over 12 months.

6. The Council notes that the Board did not, in declaring rates interim, decide that Horizon would be entitled to recover its full 2008 revenue requirement. The Council acknowledges that Horizon's reluctance to agree to an oral process and, initially a settlement process, has resulted in delaying the process and ultimately the Board's ability to consider this application in a timely manner. Having said that, the Council acknowledges that other factors

played a role in delaying the various steps in this proceeding. The Council has consistently supported an LDC's position that full recovery of an approved revenue requirement is appropriate and only under exceptional circumstances should such a request be denied. In this case the Council supports recovery of the revenue requirement as of May 1, 2008.

7. Horizon has proposed that rates be set to recover the annualized amount over the remaining period of the 2008 rate year (which will depend upon the timing of the Board Decision). The Council submits that rates be set assuming recovery over the full twelve month period. The shortfall should be recovered through a rate rider. This will ensure that the rate levels approved by the Board are consistent with a 12-month rate year and potentially comparable to the rates established for other LDCs.

#### **REVENUES:**

#### **LOAD FORECAST/CDM IMPACTS:**

8. The Council is not taking issue with the load forecast as presented by Horizon in this proceeding. In reviewing several 2008 cost of service applications it has become apparent that there is no standard applied in assessing the impacts on the load forecast of conservation and demand management ("CDM") either generally, or with respect to specific local distribution company ("LDC") programs. The Council submits that the Board should consider how this should be assessed in the future and establish a standard methodology by which these impacts should be considered. This is important in terms of establishing a revenue requirement and essential if Ontario LDCs continue to seek recovery for lost revenue associated with these programs.

#### **2008 OTHER REVENUES:**

9. "Other Distribution Revenue" includes revenue such as late payment charges, specific service charges, Standard Supply Service Administration charges, rent for electric property, retail service revenues, miscellaneous service revenues and interest.

10. In 2006 the variance between 2006 Board approved levels of Other Distribution Revenue was \$1.8 million. The variances were primarily related to "Rent From Electric Property" and "Miscellaneous Service Revenues". (C/T3/S1/p. 1) The Miscellaneous Revenue

variance in 2006 was \$804,320 which Horizon has explained as resulting from “the implementation of the new inter-company management fees for services provided by Horizon Utilities” (C/T3/S2/p. 2).

11. In 2007 Miscellaneous Service Revenue increased by \$690,000 over the 2006 actual amount primarily because of a one-time gain on the sale of the Dundas Service Centre Property, plus a gain on the sale of trucks, for a total increase over 2006 actual of \$350,000. The balance consists of an increase in the sale of scrap of \$250,000, an increase in the revenue derived from Board approved specific service charges, and a reduction on pole rental income of \$139,000. (C/T3/S2/p. 2)

12. Horizon has indicated that Miscellaneous Revenues have been reduced in the 2008 budget to remove one-time occurrences for sale of scrap, gains of sale of assets and management fees no longer recoverable with the sale of FibreWired. (AIC, p. 7)

13. The Council is concerned about the variances between what was forecast and what was actually achieved in the past with respect to Other Distribution Revenues. These variances have resulted in a windfall to Horizon’s shareholder. This has amounted to a benefit to the shareholder of \$4.4 million over the period 2006 to 2007. Accordingly, the Council proposes that the level of Other Distribution Revenue be set at an average of 2006 and 2007 actual amounts less an amount for the sale of scrap. This would result in a forecast amount of \$7.33 million, less \$250,000 or \$7.08 million.

14. Because the oral hearing was limited to three issues only, there was no opportunity to test the forecast of Other Distribution Revenues. However, given the historical pattern of revenues being significantly above those embedded in rates, the Council submits that the adjustment is required. In addition, Horizon should be required to adjust the methodology used to develop the forecast, to ensure that the forecast is more accurate.

#### **COST OF CAPITAL:**

#### **CAPITAL STRUCTURE/RETURN ON EQUITY:**

15. In determining the revenue requirement Horizon is using the Board approved capital structure of 60% debt and 40 % equity as set out in the Board’s Report on Cost of Capital

and 2<sup>nd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors. The Council accepts this approach as appropriate.

16. With respect to the Return on Equity ("ROE") Horizon's current filing is based on allowed ROE of 8.86%. Horizon has agreed to adjust this to the most updated Board approved ROE of 8.57% for the purpose of setting final rates following the Board's final decision. The Council supports this approach.

#### **DEBT COSTS:**

17. The issue as set out on the issues list is whether the interest rate and other terms of Horizon's affiliate debt are appropriate, and should the interest payable on the debt be fully recoverable from ratepayers.

18. Horizon's only long-term debt is embedded debt in the form of a Promissory Note with Hamilton Utilities Corporation ("HUC"). The original note was issued July 1, 2000 in the amount of \$142 million and replaced on August 10, 2001 in order to amend the restrictions on the holding company's ability to demand repayment prior to July 1, 2001 and to amend the interest rate to the permitted rate. On July 18, 2002, Horizon's predecessor, Hamilton Hydro made a payment on the note in the amount of \$26 million. The note was again restated and replaced in the outstanding amount of \$116 million due and payable July 30, 2012. Horizon's evidence is that the latest Promissory Note dated February 28, 2005, reflects an amendment to the terms of the Promissory Note with respect to the frequency of interest payments. No other terms were amended at that time. (F/T1/S3/p. 1)

19. The interest rate on the Promissory Note is 7%. Horizon's evidence is that its deemed long term debt rate as approved in prior decisions is 7%. As Horizon has no new debt, no variable rate debt, and no affiliate debt that is callable on demand, its position is that, consistent with Board guidelines, the rate for determining rates should be 7%. (F/T1/S3/p. 2) Horizon has assumed that in approving rates for 2006 the Board explicitly approved the costs flowing from the February 2005 Promissory Note. The Board did not give such explicit approval.

20. Two key points are relevant to the Board's consideration of this issue. First, the 2002 note did not have a fixed rate of 7%, but makes reference to the "permitted rate." (F/T1/S3/Appendix A) The current permitted rate established by the Board is 6.1%. The second is that the rate agreed to by Horizon in 2005 was significantly higher than the market rate.

21. The Board must decide what interest rate should be used for rate-setting purposes. As with all issues in a cost of service proceeding the Board must balance the interests of the utility ratepayers and the shareholders. The Council submits that it is simply unfair and inappropriate for Horizon to charge its ratepayers 7% when the actual cost to the parent is less. In addition, the evidence makes it clear that there was an opportunity to reduce the rate in 2005 when the terms of the note were renegotiated, but Horizon chose not to do so. Given the differential between what is in rates and the cost to HUC, Horizon's parent has been benefiting at the expense of its ratepayers for several years. Horizon has not accounted for what amounts to a windfall to its shareholder, though arguably it should be required to do so.

22. The Council submits that the Board has two choices. The Board can either approve a debt cost that would reflect market conditions at the time of the "renegotiation" of the note in 2005, or the Board can consider its approved "permitted" rate as a proxy.

23. Horizon's approach to the debt rate issue raises two troubling questions. The first is whether Horizon has been entirely candid and forthcoming with the Board about the status of the relevant debt obligations entered into over the past five years. The second is whether Horizon has, as it must, acted in the best interests of its ratepayers or whether it has preferred the interest of its shareholder.

24. In 2005, Horizon entered into a new financing arrangement with its parent. Horizon tried to characterize the 2005 arrangement as nothing more than "housekeeping for terms generally accepted in July of 2002"(Tr., Vol. 2, p. 12). Horizon also sought to characterize the changes between the 2002 and the 2005 agreements, as "non-substantive" (Tr., Vol. 2, p. 40). The Council submits that Horizon's characterization of the 2005 agreement as "housekeeping" and the changes from the earlier agreement as "non-substantive" are, with respect, not credible. The Council submits that the Board should find, on all of the evidence, that the 2005 agreement is a new agreement, with terms different from, and more onerous than, the 2002 agreement.

25. At the time the 2005 agreement was entered into, the market interest rate for the long term debt was 5.26 percent (Tr., Vol. 2, p. 31). If, as the Council believes it should, the Board rejects as bogus the argument that the 2005 agreement embodies provisions agreed to in 2002, then the question arises as to why Horizon agreed to pay interest at 7 percent when the market rate was so much lower. Horizon provided no explanation for that.

26. What the evidence does suggest is that Horizon has not acted in the best interests of its ratepayers. For example, Horizon conceded that, in 2002, the representatives of its predecessor, Hamilton Hydro Inc., agreed to borrow money at 7 percent from its parent, Hamilton Utilities Corporation. On the very same day, those same representatives, acting for Hamilton Utilities Corporation, borrowed money at 6.25 percent. (Tr., Vol. 2, p. 76) The evidence suggests that the interests of the shareholder were preferred to that of the ratepayers.

27. The evidence raises troubling questions about whether the interests of the shareholder and the ratepayer can be appropriately protected when the same individuals represent both. (Tr., Vol. 2, p. 78) Indeed, the history of the debt arrangements raise troubling questions about how the interests of ratepayers can and should be protected in the municipally-owned LDCs. While Horizon acknowledged that, when a utility is dealing with an affiliate, it should be treated as an arm's length party (Tr., Vol. 2, p. 20), the Council submits that the evidence shows that that has not been the case in the dealings between Horizon and its parent.

28. The Council submits that the Board should reduce the interest rate on the long term debt from the 7 percent Horizon proposes to the 5.26 percent which was the market rate at the time of the 2005 agreement.

29. The Council further submits that the Board should remind Horizon of its obligations to its ratepayers and require Horizon to put in place structures that ensure that the interests of the utility and its ratepayers are independently and effectively represented in all dealings with the parent.



## **COST OF SERVICE:**

### **2008 OPERATION, MAINTENANCE AND ADMINISTRATION BUDGETS:**

30. Horizon's 2008 Operations Maintenance and Administration budget for 2008 is \$41.9 million. This represents a 29.4% increase over the amount actually spent in 2006 of \$32.4 million. These amounts are exclusive of Conservation and Demand Management and property taxes. Horizon's evidence is that the main drivers behind the increases over the 2006 actual numbers are:

1. Increases in Salaries and Expenses;
2. Increase in the Tree Trimming Budget;
3. Increases in "Other OM&A"
4. ERP Expenses;
5. Increases in Regulatory Costs;
6. Increased Bad Debt Expenses;
7. Other Miscellaneous Expenses.

### **SALARIES AND EXPENSES:**

31. The Council will make specific submissions regarding Salaries and Expenses and Regulatory Costs. The Council's submission regarding Salaries and Expenses are related to the implication of the proposed merger with Guelph Hydro. The Council supports the submissions made by the School Energy Coalition regarding the overall level of OM&A costs and the proposed adjustments.

32. Horizon is currently in the final phase of negotiations to merge with Guelph Hydro. There was an expectation at the time of the hearing that the approval of the transaction by the three relevant municipal councils would occur at the end of July. This would be followed by an application to the Board. Upon Board approval the transaction would be finalized. (Tr. Vol. 1, p. 31)

33. Horizon has indicated that there is an expectation that the merger will result in savings that will bring value to the shareholders and value for Horizon's customers. (Tr. Vol. 1, p. 34) In its Report entitled *Rate-making Associated with Distributor Consolidation* (the "Report") dated July 23, 2007, the Board recognized that mergers would result in costs and savings and has proposed that merged entities would have up to five years to rebase following a merger. From the Board's perspective allowing a consolidated entity to propose a time for rebasing that best suits its unique circumstances gives the entity time to retain savings to offset costs while protecting the interests of consumers. (Report, p. 4)

34. Horizon's evidence was that all third party direct transaction costs were being accounted for separately and those costs were being excluded from the 2008 revenue requirement (Tr. Vol. 1, p. 85) What has not been excluded are the related costs associated with Horizon's employees that are spending time working directly on the proposed merger. Mr. Basilio acknowledged that he has been focused on the merger, as has Mr. Cananzi, over the past year and that they continue to be throughout 2008. He also acknowledged that they are being supported by other staff in the organization. (Tr. Vol. 1, pp. 37-40) It is clear that Horizon's business strategy is to focus on merger and acquisition activities. The costs associated with the pursuit of those activities should not be borne by ratepayers.

35. Horizon's revenue requirement includes costs related to two new positions, VP Business Development and Director of Business Strategies. With respect to the VP, Business Development, the job description is set out in the evidence:

The newly created position on the Executive Management Team is designed to enhance the strategic capacity and corporate development expertise of the team and provide a specific focus on business development initiatives. This position will be focused actively seeking out merger opportunities and developing comprehensive plans through to successful execution of mergers aligned to provide mutual benefit to all parties, most specifically consumers. (Board Staff 22)

36. The role of the new Director, Business Strategies, was described as:

This role supports the VP Business Development and provides specific focus on the development of business strategies to enhance the strategic capacity and corporate development expertise of Horizon Utilities. A key function of this role will be to develop

comprehensive plans for business opportunities through to successful execution of mergers and other opportunities that are aligned to provide mutual benefit to all parties, most specifically customers. (Board Staff IR 22)

37. The Council has a number of concerns about the merger and the treatment of the forecast and actual costs and savings. The immediate concern is that there are costs in the 2008 revenue requirement related to the merger that are being fully funded by the ratepayers. This is being done without any assurances that benefits from the merger will materialize and will flow to the ratepayers. As with other services provided to affiliates these costs should be calculated on a fully allocated basis. The Council does not accept that the work on the merger and related business development is, as Mr. Basilio argues, done outside of the work day on “nights and weekends”. If Horizon employees are effectively providing services to the shareholders the costs of those services should be excluded from the revenue requirement. Mr. Basilio has estimated that he has been focused on those activities between 10 and 20% of the time. (Tr. Vol. 1, p. 39) He also acknowledged involvement in merger activities of other senior executives and support from other Horizon employees. (Tr. Vol. 1, p. 40) The Council supports an adjustment to the 2008 revenue requirement to reflect the time spent by these employees on activities clearly directed at benefiting the shareholder.

38. In addition, the Council does not accept that the two new positions described above are being put in place largely to benefit ratepayers. Given the descriptions set out above the primary focus of these employees will be on current and future merger activities. In the absence of evidence that explicitly demonstrates that their roles directly benefit the ratepayers the compensation costs associated with these two positions should be excluded from the 2008 revenue requirement. Mr. Basilio estimated the cost to be approximately \$500,000. (Tr. Vol. 1, p. 108)

39. With respect to future years the Council has concerns about the fact that although all direct transaction costs are to be borne by the shareholders, all benefits of any merger, up until rebasing, flow directly to the shareholders as well. It is only upon rebasing (which may not be for five years) that the ratepayers see those savings, and the effect is not cumulative, only the annual amount is captured. Even upon rebasing there is no assurance that the benefits will flow

to ratepayers. For this reason it is critical that the Board ensure that the base year upon which rates are to be set prior to a merger does not include the costs of pursuing that merger.

40. Horizon's evidence is that the merger with St. Catharines Hydro Utilities realized more than \$5 million annualized costs savings that resulted in reduced rates and reductions in costs (Board Staff IR 53, p. 55). Horizon anticipates that the proposed merger with Guelph Hydro will result in savings, but was unwilling to disclose what those forecast savings will be. (Tr., Vol. 1, p. 32). The costs and benefits of that merger are not, subject to the submissions above, factored into the revenue requirement in this application. It is Horizon's position that there is a "regulatory mechanism" in place that assures ratepayers of their fair share of those savings (Tr., Vol. 1, p. 33).

41. The "regulatory mechanism" Horizon relies on is the Report. That Report allows distributors to defer the date for the rate rebasing of a consolidated entity for up to five years from the date of the closing of the transaction, and to keep the savings achieved from the transaction for the period up to the rebasing. The Report asserts that "rebasings at the end of an incentive regulation term ensures that ratepayers also benefit from savings achieved" (Report, p. 7).

42. The Report is not a "regulatory instrument" in the sense that it is binding on this, or any other, panel considering whether to approve a distributor's rates. It is merely a policy, which the hearing panel may consider but which does not, and cannot, bind it. It is a non-binding guideline, as described by the Ontario Court of Appeal in *Ainsley Financial Corporation v. Ontario (Securities Commission)* 21 O.R. (3d) 104 at 108.

43. The precise characterization of the Report, and of its legal effect, are not immediately relevant to the relief Horizon seeks in this case, with this exception. As the evidence with respect to the debt rate clearly suggests, Horizon has lost sight of its obligation to protect the interests of its ratepayers. That has two implications in this context. The first is that the Board should be sceptical of Horizon's claims that the costs of those employees working on mergers and acquisitions should be borne by ratepayers because ratepayers benefit. The second is that, if and when the Board considers the Guelph acquisition, it should require a precise

calculation of the costs and forecast benefits in order to ensure that, once again, Horizon's shareholder does not benefit at the expense of its ratepayers.

## **REGULATORY COSTS:**

44. If Horizon merges with Guelph Hydro the Board it is possible and likely probable that Horizon will not rebase its rates for five years. In response to an undertaking Horizon provided to the Council Horizon has set out the elements of its regulatory budget:

| Description                                       | 2006 Actual      | 2007 Forecast    | 2007 Actual      | 2008 Test Year   |
|---------------------------------------------------|------------------|------------------|------------------|------------------|
| Internal Regulatory Department Costs              | 717,193          | 668,032          | 700,408          | 750,714          |
| Legal included in USoA 5630                       | 4,295            | 326,500          | 495,273          | 99,900           |
| Consultants included in USoA 5630                 | 55,620           | 328,604          | 205,929          | 189,000          |
| <b>Sub Total</b>                                  | <b>777,108</b>   | <b>1,323,136</b> | <b>1,401,609</b> | <b>1,039,614</b> |
| OEB Assessment Costs & Intervenor Costs           | 683,437          | 648,984          | 620,507          | 1,007,510        |
| Wholesale settlement & energy statistics programs | 66,857           | 176,268          | 37,436           | 106,503          |
| <b>Regulatory Expense USoA 5655 as filed</b>      | <b>750,294</b>   | <b>825,252</b>   | <b>657,943</b>   | <b>1,114,013</b> |
| <b>Total Regulatory Services Department</b>       | <b>1,527,402</b> | <b>2,148,388</b> | <b>2,059,552</b> | <b>2,153,627</b> |

(J1.1)

45. Embedded in the 2008 budget are costs specifically related to this application. Horizon's evidence is that in the next several years the regulatory burden will be similar. The Council does not agree. As noted above Horizon will not be required to file a full cost of service proceeding for several years. Therefore, the costs associated with this proceeding should not all be recovered in 2008 and again in each year until the rates are rebased. It would be more appropriate to recover them over the next several years. The Council accepts that regulatory initiatives will be occurring over the next several years, but Horizon's demands should be significantly less than those in 2008, a year in which they are faced with a full cost of service proceeding.

46. Given there was no opportunity in the hearing to seek clarification on the undertaking responses the Council submits that it would be helpful if Horizon would break out in its Reply Argument all of the costs directly attributable to this proceeding embedded in the 2008 budget. It is important for Horizon to reconcile those costs with the costs set out in Exhibit B/T1/S1/Appendix B (p. 837 of 1557) and Exhibit J1.1. Once that evidence is clear, the Council proposes that the recovery of those costs be spread over the remaining incentive regulation period 2009-2010. This would require recovery in 2008 of one third of those costs.

## **ERP EXPENDITURES AND PROPOSAL FOR COST RECOVERY:**

47. One of Horizon's major initiatives is the implementation of its Enterprise Resource Planning Solution ("ERP"). The ERP project is, from Horizon's perspective, required in order to replace existing business applications developed internally over the past 25 years that are at the end of their useful and productive lives. (B/T3/S1/p. 27)

48. Horizon is proposing to recover its investment in the ERP solution over five rate years. The Council accepts this approach as appropriate with two exceptions. The first is that OM&A expenses related to the ERP that occurred in 2007 cannot and should not be recovered in 2008 and beyond. The second issue for the Council is the fact that although Mr. Basilio acknowledged that the ERP project will benefit Horizon's affiliates, no costs associated with the project have been allocated to those entities. The Council submits that Horizon should be required to allocate a portion of these costs to its affiliates on the same basis as it allocates Corporate and Other Services. This will ensure that the ratepayers are not subsidizing a system that benefits Horizon's unregulated activities.

## **RATE BASE:**

### **WORKING CAPITAL:**

49. Horizon has indicated that the rate base used to calculate the revenue requirement follows the definition set out in the 2006 EDR Handbook. This requires a determination of the forecast average of balances at the beginning and the end of 2008, plus a working capital allowance. The 2006 EDR Handbook proposes a working capital allowance of 15% of the sum of the cost of power and controllable expenses. (B/T1/S1/p. 1) That is the level proposed by Horizon in this application.

50. In its Argument in Chief, Horizon acknowledges it has used the 15% working capital allowance and in support of its position refers to the Board's Filing Requirements for Transmission and Distribution Utilities. (AIC, p. 23) Horizon also cites the Board's Decision in the Oshawa PUC Networks Inc. proceeding in which the Board rejected the Association of Major Power Consumers in Ontario's ("AMPCO") argument that Oshawa should compute its working capital allowance based on the results of the Hydro One Network's study, rather than the standard 15%. (AIC, p. 23)

51. The Council has a number of concerns about Horizon's proposed working capital allowance:

1. Horizon is using, for the purposes of setting 2008 rates, a cost of power that is not consistent with the Board's April 2008 Regulated Price Plan Report;
2. Horizon has not used the lower 2008 Transmission Network and Connection charges in establishing the transmission component of the Cost of Power;
3. In the December presentation to Horizon's Board of Directors (CCC 17) the working capital requirements presented are less than 15%;
4. The working capital allowance proposed by Hydro One Networks resulting from its lead-lag study was 11.6%;
5. The working capital allowance proposed by Toronto Hydro Electric Services Limited ("THESL") was 12.45% based on a lead-lag study;
6. Both Enersource and Hydro Ottawa Inc. accepted working capital allowances of less than 15% consistent with the levels determined by the larger LDCs that had actually carried out a lead-lag study. Hydro Ottawa Inc. used 12.5% in the determination of its 2008 rates. Enersource has used 13.3%;
7. Most of the above LDCs represent predominantly urban areas, similar to Horizon's franchise area. Horizon is not a typical Ontario LDC;
8. When LDCs have actually carried out a lead-lag study it has resulted in a working capital allowance of less than 15%;
9. Horizon presented no evidence to support the 15% other than to refer to the Board's guidelines;
10. The 15% was not based on a lead lag study, but is a value used by the Board simply as a proxy, subject to evidence of what the actual rate should be;

11. If the working capital requirement is set too high Horizon recovers more from its ratepayers than is required.

52. Horizon has not carried out a lead-lag study to assess its working capital requirements and in the absence of such a study is seeking approval of 15%. Horizon has not presented evidence to support the fact that it actually requires the \$69.5 million working capital allowance that results from the application of the 15%. Two of the other larger LDCs in the province have carried out lead-lag studies resulting in lower allowances and two have accepted that the 15% is too high. The Board has approved the lower amounts for each of those LDCs.

53. The Council submits that Horizon should be directed to calculate its working capital allowance on the same basis as THESL, using 12.45%. THESL's working capital allowance was based on an actual lead lag study for a service territory similar to Horizon's. This amount is higher than that approved for Hydro One Networks, but lower than the proxy value applied to a broad range of LDCs.

#### **COST ALLOCATION AND RATE DESIGN:**

##### **REVENUE TO COST RATIOS:**

54. On November 28, 2007, the Board released its report entitled, *Application of Cost Allocation for Electricity Distributors*. In that Report, the Board created bands or ranges of tolerance around revenue to cost ratios of one. The Board concluded that an incremental approach was appropriate and a range approach preferable to the implementation of specific revenue to cost ratio. The ranges established by the Board are intended to be minimum requirements. The Board determined that to the extent distributors can address influencing factors that are within their control (such as data quality) they should attempt to do so and to move revenue to cost ratios nearer to one.

55. Horizon has set out in the evidence its proposed revenue to cost ratios resulting from its 2006 cost allocation filing and to adjust for transformer allowances. The ratios are set out below:



- 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% (H/T1/S2/p. 4)

Horizon has proposed 2008 revenue to cost ratios consistent with the Board's Report. Those ratios are set out below:

- Residential: 112.44%
- GS < 50 kW: 92.5%
- GS > 50 kW: 86.31%
- Large Users: 92.12%
- Street Lights: 23.79%
- Sentinel Lights: 91.49%
- USL: 88.05%
- Back-up/Standby: 65.84% (H/T1/S2/p. 7)

56. The Council is generally supportive of the ratios proposed by Horizon, as they are consistent with the Board's Report with one exception. The street lighting class continues to significantly under-contribute relative to the costs of serving that class. Residential customers continue to subsidize this class. It is the Council's understanding that street lighting is provided by the City of Hamilton, one of the owners of the utility. Horizon's reluctance to move the street lighting ratio closer to one is likely driven by its ultimate owner.

57. The Council submits that Horizon should be required to move the street lighting revenue to cost ratio to 70%, consistent with the range outlined in the Board's Report. To the extent Horizon is directed to do so any additional revenue should be used to reduce the ratio for the residential class. Horizon has indicated that its proposal with respect to street lighting is driven by a need to mitigate the total bill impact for this class to less than 10%. (AIC, p. 25) The Council submits that the 10% is a guide and given the nature of the customers in this class a larger bill impact could and should be tolerated. Clearly, there should be a greater effort made to reduce the cross subsidization of street lighting by residential customers.

## **FIXED VARIABLE SPLITS:**

58. Horizon is not proposing to adjust the fixed/variable distribution revenue split in setting its 2008 rates relative to the levels approved by the Board in the 2006 EDR proceeding. Horizon's primary reason for not adjusting the split is that, before making any fundamental changes, it is awaiting the results of the Board's proceeding on Rate Design for Recovery of Electricity Distribution Costs (EB-2007-0031) (I/T1/S1/p. 10). The Council supports this approach as the Board's proceeding may ultimately result in fundamentally different approaches to rate design. Given that the outcome is pending, it would be premature to make any significant changes at this time

## **SMART METERS:**

### **REGULATORY TREATMENT OF SMART METERS:**

59. The Council accepts that smart meter costs that have been prudently incurred should be recovered from an LDC's customers. This is consistent with government policy and all of the decisions made by this Board with respect to smart meter expenditures to date.

60. Horizon is proposing to include all of its 2007 and 2008 smart meter capital expenditures in rate base. Horizon is also including approximately \$1 million of smart meter operating costs in the 2008 revenue requirement. (AIC, p. 30, CCC 17) For 2008 the total smart meter capital budget is \$10.9 million. (CCC 17)

61. The Council, has in previous Board proceedings related to the 2008 cost of service applications, taken a consistent position with respect to the regulatory treatment of smart meters. That treatment can be summarized as follows:

- LDCs should be able to recover the full costs of all prudently incurred smart meter capital and operating costs incurred consistent with the minimum functionality standards set by the Board.
- The LDCs that participated in the generic smart meter proceeding should be permitted to include in 2008 rate base the actual capital costs that were approved by the Board in that proceeding.
- Smart meter costs incurred after April 30, 2007 should be subject to a prudence review by the Board before those costs can be expensed or booked to rate base.

- Forecast smart meter costs, both capital and operating, should continue to be tracked through the continuation of the existing variance accounts and not cleared until a future prudence review. The impact on rates would essentially be the same, but this approach would allow for an assessment of the actual costs incurred not a forecast. This will ensure that ratepayers and shareholders are both kept whole with respect to smart meter costs. Only prudent actual costs will ultimately be recovered from ratepayers.
- It is inappropriate for a forecast of smart meter costs to be included in rates on a final basis. If, for example, the LDC actually spends less than forecast the shareholders would obtain a windfall. This would be inconsistent with the government policy's that actual smart meter costs are to be recovered from the ratepayers;
- There should be a continuation of the smart meter adder to recover the costs that have not been subject to an after the fact prudence review instead of recovering the costs through final rates.

62. The Council notes that the Board has in large measure recently accepted the regulatory treatment set out above. Enersource and Hydro Ottawa both agreed to the continued use of the variance accounts and rate adders. The Settlement Proposals for those two LDCs were subsequently approved by the Board. In the most recent Toronto Hydro Electric System Decision the Board approved similar treatment.

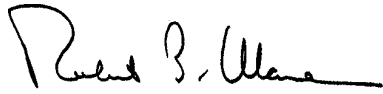
63. The Council urges the Board to reject Horizon's approach to include forecast costs in rates in the absence of a variance account. In addition, the rate adder should be continued. Horizon should be required to re-calculate the rate adder for 2008 having regard to the fact that it has over-recovered smart meter costs through the current adder.

64. One of the benefits of tracking all smart meter costs through a variance account is that the costs remain transparent. From a ratepayer perspective it is critical that, at the end of the day, the costs and benefits associated with the smart meter initiative are clear. This will ensure accountability on the part of the LDCs, the Government and the Board.

## **COSTS**

65. The Council asks that it be awarded 100% of its reasonably-incurred costs for its participation in the Horizon application. The Council submits that it has acted both prudently and responsibly.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

A handwritten signature in black ink, appearing to read "Robert B. Warren". The signature is fluid and cursive, with a long horizontal stroke at the end.

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Robert B. Warren  
Counsel to the Consumers Council of Canada

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