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BY EMAIL

February 28, 2008
Our File No. 2080002

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Horizon Utilities 2008 – EB-2007-0697

We are writing this letter on behalf of the School Energy Coalition to request an oral hearing in the above proceeding.

We are in receipt of Mr. Sidlofsky's letter of yesterday's date, and based on that letter it would appear to us that the Board's best course of action is an oral hearing, with or without a Board-ordered ADR preceding it. In this letter, we propose to address Mr. Sidlofsky's concerns, and provide our rationale for seeking modifications to this process.

We apologize in advance for the length of this letter, which is necessitated by the subject matter, and the Applicant's requests that we be very specific about our reasons for the changes requested.

Conduct of the ADR

The Applicant in their counsel's letter has had a lot to say about the ADR process the Board ordered. We believe it is important to focus here on the known (and non-confidential) facts, as follows:

1. Horizon objected vehemently to a Board-ordered ADR.

2. Horizon decided to refuse to attend the first day of the ADR. While they discussed it with counsel for some of the intervenors, who agreed to their request on the assumption that the ADR would actually start on Tuesday, they did not as far as we know get the Board's permission, and they apparently acted contrary to the Procedural Order by not showing up.

3. When Horizon did show up, it was in our opinion not with the intention of carrying out a negotiation. While Horizon can of course speak for themselves, it is our understanding that they did not in fact send a person who had authority to negotiate, as the Settlement Conference Guidelines require. If there is still to be an ADR in this process, we believe that the Board may need to remind the Applicant of their obligation to send someone with negotiating authority to the ADR.

4. Rather than even talk, the utility has, as it says in its letter, refused to proceed with the ADR until they answer the new "interrogatories" they have received. (See our further comments on this below.)

Thus, it would appear to us that Horizon has refused to participate in a Board-ordered ADR.

It is one thing to be a reluctant participant in ADR. This is not the first time we have seen a utility take this stance. This is quite different, and implies that, even if the ADR were restarted at the Board's insistence, it could be a complete waste of time. Indeed, it is already more costly than it needs to be, with Mr. Sidlofsky's most recent lengthy letter probably costing the utility (and therefore the ratepayers) $5000 or more in legal fees alone, to say nothing of the cost of his other lengthy procedural missives.

This presents the Board with an unpleasant dilemna: insist that the Applicant comply with the Board order, even though it might be a waste of time, or allow them to have what they wanted in the first place, no ADR, simply because they are so adamant. As we note in the last section of this letter, the resolution of this may be driven by pragmatic scheduling issues, rather than process/Applicant management issues.

Board Staff's Issues of Concern

The Company has objected to being surprised by the Board Staff Issues of Concern document. As experienced counsel, Mr. Sidlofsky should in fact we aware of the process that has developed over the years, precisely to ensure that everyone has notice of what issues Board Staff has seen in the application and the IR responses.

In the past, it had been the practice that Board Staff would act as an observer in an ADR, but reserve its rights at the end to question whether the Settlement properly dealt with all material issues. Applicants and intervenors alike were concerned that this left them marching in a direction that could prove to be counterproductive, if Board Staff were planning to raise some issue that had not been discussed or handled fully.

To avoid that problem, the practice developed (in part arising out of the 2006 Board process consultation in which two of Mr. Sidlofsky's partners, Mr. Rodger and Mr. Thompson, participated) that, at the beginning of ADR, all parties would receive a document from Board Staff telling them what questions they thought needed to be answered to have a solid Settlement that would be acceptable to the Board. It was expected that the parties would take those concerns into account when they agreed on a Settlement and, if not, Board Staff could, if they still felt the matters were material, raise them before the Board during consideration of the Settlement Agreement. They need not, of course. Depending on other settled items, a concern could become no longer relevant or

material, or during the course of ADR discussions Board Staff could conclude that their concerns had been answered by further explanation. More often, the Issues of Concern document has worked as one of the checklists for parties when they map out the elements of a Settlement Proposal, and counsel who participate regularly in successful ADRs can attest to the value of the Issues of Concern document in many of them.

The timing of the Issues of Concern document is not accidental. The conventional hearing process, during which the Applicant at all times has the onus and burden to make its case (and present all evidence necessary to do so), starts with the Applicant filing what is hopefully a complete set of information needed to decide the case. Human nature being what it is, that information is never totally complete, and through an interrogatories process additional information is provided. As the Board will see from our comments in the section below on the need for an oral hearing, the interrogatories in this case threw out some highly important information, and raised some significant questions. That is, by the way, exactly why the Board has interrogatories, and in this case they did their job.

The Board could, of course, provide for repeated rounds of interrogatories, but that is rarely sensible. Sometimes, particularly if the factual aspects of the issues are especially complex, the Board will order a technical conference, but most times that is also not really necessary. Where issues are difficult and highly contested, it is often better simply to move to an oral hearing, where any remaining evidence can be elicited in real time, and with the involvement of the Board panel to ensure that they have what they need to make a proper decision.

In the meantime, the ADR takes place. It is also a decision-making process, but by agreement rather than by Board panel, and so it too needs a full evidentiary record. It does not, however, yet have the evidence from the oral hearing. Thus, Board Staff (and intervenors, for that matter), regularly start ADRs by saying, in effect, "Here are some things in respect of which your evidence to date is insufficient to support the orders you are requesting. Let's talk about them." These are not IRs. They are notice of matters that need to be further discussed, both in the ADR and, if not settled, in the hearing itself.

Horizon appears to think that it is being blindsided. That is, frankly, to turn things upside down. At this stage in the process, and particularly when a written hearing is currently ordered, the Applicant has had ample time to provide a full evidentiary record. The fact that there are significant questions that remain unanswered is not the fault of Board Staff, or the intervenors. If anyone has to bear the blame (a largely unproductive exercise, we agree) it is the Applicant.

While the Board Staff Issues of Concern document is provided in the context of ADR, and is generally accorded the protection of the ADR umbrella of confidentiality, there is actually no inherent reason why this particular document needs to be confidential. We therefore by this letter ask Board Staff to consider waiving their right of confidentiality, and filing this Issues of Concern document so that the Board can see exactly what Horizon is complaining about.

Issues List

We have attached a draft Issues List for the Board's consideration. It is based on the recently-approved Issues List for the Hydro One 2008 Distribution rates case, with some removed that don't

affect Horizon (like harmonization), and others added that are specific to Horizon (like credit card payments). This has been discussed between the intervenors and Board Staff, but of course not yet with the Applicant.

Horizon appears to be upset with this Issues List. In our view, this is nothing more nor less than a framework to decide the case, whether in ADR or by the Board panel. Although it is conceivable that one could have an Issues List that is limited to matters that are actually going to be disputed, it would be difficult to do that without a detailed review of the evidence, and there would certainly be disputes about what should or should not go on the list. Therefore, the Board's standard approach is to have an Issues List that contains all questions that have to be answered, whether disputed or not. This actually works well in practice, particularly in ADR, where parties can quickly identify many issues that can be agreed without much controversy. It also forms a useful framework for the hearing, and for parties' submissions.

Unless the Applicant has specific objections to the substance of the Issues List, we therefore propose that the Board adopt it as the Issues List for this proceeding. It should, actually, be pretty non-controversial. Even though some of the issues on the list will, on their substance, be somewhat controversial, the fact that they have to be dealt with by the Board should be pretty self-evident.

Need for an Oral Hearing

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

When School Energy Coalition initially suggested that the Board consider procedural steps in addition to written submissions, counsel for Horizon objected vehemently, the thrust of their comments being that we had not demonstrated that there were any truly "live" issues in this application. In response, we agreed to see what the interrogatory responses would show, and then consider whether additional processes would be appropriate. Having considered the IR responses, we asked the Board to order an ADR, and many parties agreed. The ADR has not been highly successful, but the IR process has certainly made some of the issues clearer for the parties.

While the following list is not in any way exhaustive, the evidence now shows that at least the following "live" issues are among those that need to be addressed:

1. The application seeks a one-year increase in distribution revenue requirement of 10.16% (SEC IRs, page 5) and a total revenue requirement of $101.6 million. The distribution revenue requirement increase is $10.8 million, or 12.85% greater than 2006 actual, a year in which Horizon had a sufficiency of $1.4 million. Put another way, if Horizon's 2008 distribution revenue requirement were to be calculated based on inflation and other factors commonly considered reasonable in an IRM, and starting without a sufficiency, the total revenue requirement would be lower than the proposed amount by $10.7 million, or about 11.3%. Such substantial discrepancies suggest that the Applicant should come before the Board and provide an explanation.

2. The application seeks rate increases that will range from small decreases for residential customers, to increases in the triple digits for some larger customers. For schools, the proposed increases range from 17.07% to 32.75% (SEC IRs, page 6), an average of almost 25% in one year. One school board, Horizon's second largest customer, may have an annual rate increase of more than $300,000 a year. While there may be reasons why some customers have higher than normal increases (including causes relating to cost allocation and rate design), where there are increases this substantial Applicant should be asked to appear before the Board to explain why all of these increases are necessary. In addition, in light of the impact information provided in IR responses, some customers may wish to appear before the Board and comment on the impact these increases would have on their businesses or other activities. If an oral hearing is ordered, SEC will seek instructions as to whether witnesses from the affected school boards would be interested in speaking directly to the Board.

3. The application seeks a working capital allowance of about $69 million, based on a 15% calculation, when there is now a substantial body of evidence from other LDCs (including all of the four largest – Hydro One, Toronto, Ottawa and Enersource) that a lower percentage may be more appropriate. Further, the Applicant in their own presentation to their Board of Directors appears to expect a working capital provision of less than half the proposed level.

4. In the same presentation to the Board of Directors, management projects that, before taking any additional steps to improve productivity, the utility will have a sufficiency over the next three years of about $11.8 million (calculated from CCC IRs, Attachments A1 and A2), ie. about 3.85% more in rates than they actually need to reach their Board-approved rate of return. Further, this is before any savings to be achieved from already planned M&A activities. To provide the Board with an idea of what productivity improvements are actually expected by Horizon but are not included in that calculation, the forecast operating cost per customer for 2008 is $181.77 (CCC IRs, Attachment 2, page 11), but the target for executive bonus purposes is $176.77 (SEC IRs, Attachment A, page 9). If management achieves but not does even exceed that target, there is a further sufficiency of $1.45 million in 2008, and a three-year impact, if maintained, of $4.3 million. We note that this is not a "stretch" target. The target for ROE, for example, 9.2%, is less than the 9.53% management has already forecast to the Board of Directors, in both cases based on equity of 52.33% rather than the 40% equity ratio approved by the Board. Therefore, it is reasonable to ask management, at least, how achievable the $176.77 operating cost target is expected to be, and what the actual operating cost in 2008 is likely to be relative to the budget they are seeking to recover from ratepayers. There is at least the possibility that, in this case, the utility simply does not realize that they must seek to recover only what they actually expect to spend, not an amount with a substantial cushion "just in case".

5. The Applicant is seeking to recover interest on affiliate debt at 7%, when the affiliate-parent (HUC) in fact borrowed on a back-to-back basis on the same terms (with interlocking covenants), to fund that debt, at 6.25%, and when the Applicant admits that the market rate at the time the debt was incurred for a rated debt was 5.21% to 5.26% (SEC IRs, page 48). Further, the Applicant through its parent has capital available to it and its primary business unit, Horizon, on more favourable terms, but has refused, contrary to the Board's rules, to provide details with respect to that facility (SEC IRs, page 51). In addition, while the Applicant claims it has not decided how to fund ongoing capital requirements going forward (SEC IRs, page 51), it has in

fact received approval from its Board of Directors "to create a borrowing program for Horizon that will provide it with financial autonomy and flexibility to support business strategy and general corporate borrowing requirements" (CCC IRs, Attachment A1, page 16, emphasis added). It expects to issue $50 to $75 million of new debt in 2008 under these terms. All of the Applicant's debt cost evidence, in our view, needs to be tested by cross-examination, since the evidence as filed appears to indicate over-recovery of $3 to $4 million per year.

6. The Applicant is proposing to increase its operating costs per customer from 2007 to 2010 by a total of 8.2% (CCC IRs, Attachment A2, page 11), before taking into account increased costs associated with their ERP project (Project Fusion) and their Smart Meters activities, and starting from a base in which they had already implemented a substantial increase.

7. The Applicant is proposing to charge its affiliates and shareholders less than cost for distribution services related to street lighting and sentinel lighting. It is not clear why the utility believes this is justified or even allowed, and the utility should be required to appear before the Board to explain why this is appropriate.

8. The Applicant has proceeded in the bridge year with a substantial IT project, Project Fusion, to implement ERP across the organization. It is not clear whether this is part of Horizon's M&A strategy, or is separately justified as an internal process improvement. What is clear is that Horizon proposes to recover bridge year operating costs related to this project in the test year and beyond. This unusual regulatory approach does not appear to have any precedent, and should be tested by questions before the Board.

There are numerous other issues that arise in the context of this application, which will, when this proceeding is complete, establish rates to recover somewhere between $260 million and $310 million over the next three years.

In light of the foregoing, we respectfully request that the Board order an oral hearing to consider this application.

ADR Value

This leaves one final question, whether an ADR should take place under the circumstances. In our view, the time Horizon says it needs to prepare for an ADR, coupled with the ADR period itself, and the need for an oral hearing, could put the oral hearing in conflict with other OEB activities that make scheduling difficult. The fact that Horizon has to be, in the vernacular, "dragged kicking and screaming to the party", also militates against the Board pressing the ADR point.

On the other hand, we still believe that an ADR, even with a strongly resistant Applicant, can have value in scoping and focusing the hearing. This doesn't just save hearing time. It also allows the Board panel members to focus, in their decision, on the issues that are really problematic, rather than having to figure out what people are truly arguing about.

With this in mind, we propose to the Board two possible schedules:

- **Oral Hearing alone.** The Board would approve the Issues List as soon as possible, then Horizon would provide a list of witnesses and panels by March 14th, with an oral hearing to take place commencing March 19, 2008. We believe the oral hearing could be completed in 5 hearing days, if there is no preceeding ADR, meaning that, with the Easter weekend, it would be completed on March 26th or 27th.

- **ADR plus Oral Hearing.** The Board would ask the parties to finalize an agreed Issues List at the beginning of ADR, and order the ADR to take place commencing March 18th for three days. The date for filing any Settlement Proposal would be March 31st, with a hearing to consider that proposal on April 7th. The oral hearing on any unsettled issues would commence on April 8th, hopefully for less than 5 hearing days.

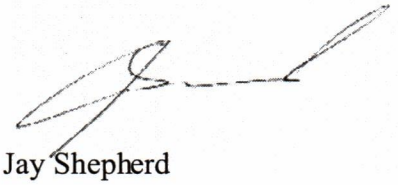
Of course, there are many other possible configurations, but we provide these two as possible solutions to the scheduling minefield that the Board faces in the coming months.

Conclusion

Therefore, the School Energy Coalition requests that the Board order an oral hearing, with or without an ADR, and that the Board accept the Issues List prepared by the intervenors and Board Staff as the Issues List for this proceeding, unless Horizon has specific objections to issues being included.

All of which is respectfully submitted.

Yours very truly,
SHIBLEY RIGHTON LLP



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