Ontario Energy Board

Commission de l'énergie de l'Ontario

Ontario

EB-2007-0697

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Horizon Utilities Corporation for an order approving or fixing just and reasonable rates and other charges for the distribution of electricity to be effective May 1, 2008.

BEFORE: Gordon Kaiser
Vice Chair and Presiding Member

Cynthia Chaplin
Member

Decision With Reasons

October 3, 2008

BACKGROUND

Horizon Utilities Corporation ("Horizon") filed an application with the Ontario Energy Board (the "Board") on October 22, 2007, under section 78 of the *Ontario Energy Board Act*, *1998*, seeking approval for changes to the rates that it charges for electricity distribution, to be effective May 1, 2008. Horizon is the licensed electricity distributor serving a customer base of approximately 232,000 customers in the cities of Hamilton and St. Catharines.

Horizon is one of over 80 electricity distributors in Ontario that are regulated by the Board. In 2006, the Board announced a multi-year electricity distribution rate-setting plan for the years 2007-2010. In an effort to assist distributors in preparing their applications, the Board issued the *Filing Requirements for Transmission and Distribution Applications* on November 14, 2006. Chapter 2 of that document outlines the filing requirements for cost of service rate applications, based on a forward test year, by electricity distributors.

On May 4, 2007, as part of the plan, the Board indicated that Horizon would be one of the electricity distributors to have its rates rebased in 2008. Accordingly, Horizon filed a cost of service application based on 2008 as the forward test year.

Horizon requested a revenue requirement of $94.86 million to be recovered in rates effective May 1, 2008. The application indicated that the existing rates would produce a revenue deficiency of $8.76 million. If the Board approved Horizon's proposed revenue requirement, a customer consuming 1,000 kWh per month would experience a decrease of approximately 2% on the distribution component of the bill.

The Board assigned the application file number EB-2007-0697 and issued a Notice of Application and Hearing dated November 5, 2007. The Board approved four intervenors in this proceeding: School Energy Coalition ("Schools"), Vulnerable Energy Consumers Coalition ("VECC"), Consumers Council of Canada (the "Council") and Energy Probe.

On December 4, 2007 the Board issued Procedural Order No. 1 which set out the dates for filing interrogatories, responding to interrogatories and filing submissions. The Procedural Order also stated that the Board intended to dispose of this application by way of a written hearing.

On January 31, 2008, the Board received a request from Schools to convene a settlement conference. Horizon postponed the first settlement conference citing the need for more time to respond to information requests and to prepare for the negotiation. A settlement conference was held from March 18 to March 20, 2008 but the parties were unable to reach a settlement on any of the issues.

On March 25, 2008, Schools filed a letter asking for a limited oral hearing on three specific areas of Horizon's application. Schools proposed that the remaining issues be dealt with through written submissions.

The Board convened an oral hearing on June 5 and 6, 2008. The following issues were addressed in the oral hearing:

- Capital expenditures
- Operating, maintenance and administrative expenses
- Cost of long-term debt

Board staff and intervenors filed their submissions on all issues on June 30 and July 2 respectively; Horizon filed its reply argument on July 23, 2008.

THE ISSUES

The following issues were raised in the submissions filed by Board staff, Schools, VECC, the Council and Energy Probe:

- Load Forecast
- Other Revenue
- Rate Base and Capital Expenditures
- Smart Meters
- Operating, Maintenance and Administrative Expenses
- Cost of Capital
- Cost Allocation and Rate Design
- Conservation and Demand Management (“CDM”)
- Deferral and Variance Accounts

LOAD FORECAST

Horizon based the load forecast for its weather-sensitive customer classes on 2004 Hydro One data for weather normalized average use and Horizon’s forecast of customer numbers for 2008. Board staff expressed concern that Horizon’s forecast could be somewhat higher as a result of using a single year of weather normalized data rather than a forecast that incorporates weather normalized data from 2002 to 2006. Schools expressed similar reservations with the approach used and recommended that better methodologies be used in the future. Schools concluded that, apart from adjusting the forecast for the number of GS>50 kW customers, the Board should accept the forecast. VECC also expressed concerns with the approach but concluded that in the short-term a better alternative may not exist. Horizon submitted that it is unaware of a more refined methodology that has demonstrated greater forecasting accuracy and, as such, the methodology utilized is appropriate for this application.

The total customer number forecast shows 0.7% annual average growth between 2006 and 2008, which is virtually identical to the annual average growth in the period 2002-2006.

Schools noted that the historical data shows the general service classes declining by an average of 8 customers per year during the historical period but declining by 30 customers per year during the forecast period. Schools submitted that the customer numbers for the GS>50 kW class should be increased by 22 for the test year to correct the trend. Board staff also questioned why the pattern of customer number growth for the GS>50 kW class had changed for the forecast period.

Horizon responded that no adjustment is required in the number of GS>50 kW customers. Horizon pointed to the evidence which shows that the number of customers in the GS>50 kW class are forecast to grow from 2,127 in 2006 to 2,213 in 2008. Horizon noted that it is the GS<50 kW class which is expected to shrink somewhat, again in line with historic trends.

The forecast shows 0.9% annual average kWh load growth between 2006 and 2008. This compares with negative 1.1% annual average kWh load growth in the period 2002-2006. The Council stated that it is not taking issue with the load forecast though submitted that the Board should consider how the impact of CDM should be assessed in the future.

Board Findings

The Board accepts the proposed forecast. The average use per customer is taken from Hydro One's weather normalized data. This approach has been used by a number of distributors for purposes of setting 2008 rates, and has been accepted by the Board, despite its limitations. Horizon's forecast of customer numbers is in line with historic trends for its customer classes.

OTHER REVENUE

Horizon's forecast of "Other Revenues" for 2008 is $6.5 million. This revenue comes from late payment charges, service charges, service revenues, rent, etc. These revenues serve as an offset to the revenue requirement.

Schools and the Council both submitted that the forecast should be increased. Schools submitted that it should be increased by $1.0 million so that 2008 is the same as 2007. Schools noted that, although the 2007 level included “unexpected” amounts, it was inappropriate to assume no “unexpected” amounts over the test period or during the IRM. The Council noted that the variance between actual and Board approved in 2006 was $1.8m. The Council proposed that the forecast be set to $7.1 million, being the average of 2006 and 2007 less an amount for the sale of scrap.

Horizon responded that the forecast should not be influenced by past one-time events, such as the sale of scrap, the reduction in management fees and interest, and the sale of FibreWired. Horizon argued that Schools had not provided any justification for the continuation of one-time events and that including such an assumption in the forecast would put Horizon at risk.

Board Findings

Horizon claims that Schools has not justified an adjustment based on one-time events. However, the evidence shows a recent pattern of one-time events and therefore suggests a strong likelihood of such events in the future. The Board believes a modest increase to the forecast is appropriate in the circumstances. The forecast of Other Revenues will be increased by $250,000. This reflects that significant events such as the savings flowing from the impact of the sale of FibreWired are unlikely to be repeated, while activities such as the sale of trucks and scrap, and fluctuations in interest income, are the types of events likely to recur in one form or another.

RATE BASE AND CAPITAL EXPENDITURES

Horizon forecast its rate base to be $362,942,366 in 2008. This represents an increase of approximately 5% over 2007 Bridge Year rate base and an increase of approximately 10% over 2006 Actual rate base.

As noted in the table below, Horizon forecast capital expenditures of $43,942,709 in 2008. This represented an increase of approximately 42% compared to 2006 actual capital expenditures. The proposed 2008 capital expenditures include $10,962,329 for smart meters expenditures that are discussed later in this Decision.

Summary of Capital Expenditures 2006-2008

	2006 Actual	2007 Bridge	2008 Test
Capital Budget Expenditure	$30,906,990	$37,283,265	$43,942,709
Annual percentage increase over prior year		20.6%	17.9%
Capital Budget Expenditure (excluding smart meters)	$29,682,362	$30,166,204	$32,980,380
Annual percentage increase over prior year		1.6%	9.3%

The issues addressed in this section are:

- General capital expenditures
- Enterprise Resource Planning (“ERP”)
- Working capital

General Capital Expenditures

Horizon proposed 2008 capital expenditures of $2,094,000 for 340 pole replacements. VECC noted that the average pole replacement costs were $3,921 per pole in 2006 and $5,534 per pole in 2007, but that for 2008 the average is expected to be $6,158 per pole. VECC expressed concern with the increasing per unit cost of pole replacement and submitted that the forecasted unit cost for 2008 should be the average of the two previous years. VECC submitted that the budget should be reduced by $450,000 as a result.

In reply, Horizon submitted that the number of poles identified for replacement was only a proxy for the actual number of poles that may require replacement and Horizon would work within its 2008 Test Year budget to ensure that the required number of pole replacements was completed. Replying to VECC’s concern of increasing average cost per pole, Horizon submitted that the per unit costs were impacted by pole height, number of conductors or circuits attached to the pole, number of transformers attached to the pole and the location of the pole; increasing labour and material costs also contributed to the unitized cost differences over time.

Horizon proposed transportation related capital expenditures of $1,898,233 for 2008; planned spending in 2007 was estimated to be $1,712,014. Schools submitted that Horizon had planned major spending on transportation capital in 2007 and 2008, but no spending in 2009 or 2010. Schools argued that transportation assets had relatively high depreciation rates and it was inappropriate for Horizon to plan no spending in 2009 and 2010. Schools submitted that Horizon's 2008 capital expenditures for transportation should be equally spread over four years, from 2007 through to 2010, although it acknowledged that the rate impact of this adjustment would be small.

Horizon responded that the recurring capital expenditures for transportation for 2009 and 2010 are $775,000 and $800,000, respectively and that these amounts are included under Other Recurring Capital spending. Horizon submitted that it was only non-recurring capital spending which is included in 2007 and 2008 but not for 2009 and 2010. Horizon argued that it would be inappropriate to artificially spread the non-recurring capital spending over a multi-year period, as this approach would improperly defer the inclusion of in-service assets in rate base.

Horizon proposed 2008 capital expenditures of $1,436,768 for wholesale meter upgrades/replacements. Board staff raised a concern about the potential deferment of the wholesale meter upgrade and referenced to Horizon's evidence that noted deferment of upgrades from 2007 to 2008. Board staff noted that Horizon had indicated that it must rely on Hydro One Networks to provide the construction crews necessary to complete the projects. Horizon responded that many of the wholesale meter upgrades in 2008 had already been completed and affirmed that it would continue the scheduled work even though the costs are greater than the capital requirement requested in its application.

Horizon proposed a 2008 capital expenditure of $2,151,000 for the Halson substation conversion project, as a part of its sustaining and asset replacement capital program that was developed based on a Kinectrics study. Horizon stated that the total cost of this three-year (2006-2008) project is estimated to be $7,791,929. Horizon explained that the purpose of this project was to improve reliability and service restoration times and to reduce operating costs. Horizon indicated that the Halson conversion project completion date was postponed to 2008 due to the deferment of work in 2006. Board staff questioned whether this project was expected to be completed and in-service in 2008, or if it should be treated as Construction Work in Progress. Schools echoed Board staff's concern regarding the delay in this project; however, it submitted that there is no point in adjusting the 2008 capital budget or the rate base given the fact that there is a need for Horizon to undertake this asset replacement project.

Horizon responded that the project was planned in three phases with phase one and phase two being completed in 2006 and 2007, respectively. Horizon listed other customer and system demands on capital as the reasons for the delay in the project and confirmed that the project would be completed and in-service in 2008.

Board Findings

The Board will accept the capital expenditures as forecast for pole replacement, transportation capital, wholesale meter upgrade and the Halson conversion project. Horizon has explained the various cost components for a pole replacement and has adequately explained the reasons for the increases over time. The Board finds that there is no rationale for deferring the non-recurring transportation capital spending for 2007-2008 over the 2007-2010 period. The company's forecast in this respect is reasonable. The Board also finds that the risk of deferment of the wholesale meter upgrades and the Halson conversion project are not so high as to warrant an adjustment to the budget.

Enterprise Resource Planning (ERP)

Horizon identified Enterprise Resource Planning (ERP) as a major capital project in its 2008 rate application. ERP is designed to replace Horizon's many legacy systems with an integrated system designed to enhance efficiency in the areas of asset management, work order management, supply chain management, finance, and human resources. Horizon estimated a total cost of about $8.8 million over the period 2007 to 2013, of which $4.7 million is capital expenditures and $4.1 million is operating expenses during the period 2008-2013. The capital expenditures are to be completed in 2008 and the system is to be in service in 2008.

Horizon proposed a new methodology of recovery of the capital and operating costs to include recognition of the expected $2 million savings. Under Horizon's proposal, it would recover the investment over five years by adjusting the total revenue requirement down by the amount of the expected savings. Horizon estimated that this approach would save customers $657,000 over five years. The alternative approach would be to postpone the recognition of the savings until the next rebasing, which would increase customer costs by about $132,000 per year over the next five years.

Board staff noted that Horizon's treatment for the recovery of capital and operating costs for the ERP project was a departure from the usual treatment of projects of similar nature including other capital projects in Horizon's application. Horizon responded that its proposed approach for recovery of ERP costs was not consistent with the traditional regulatory approach for capital projects, and agreed to revert to the traditional rate making approach with respect to ERP costs. Horizon proposed to include only those costs that would be incurred in the 2008 test year and remove all costs related to 2007 and future years when it prepares its draft rate order. Horizon agreed to reduce its 2008 test year expenditure related to ERP by $27,300 to reflect the estimated savings in 2008.

VECC noted that Horizon had allocated all the ERP costs to the electricity distributor and no costs to the affiliates. VECC proposed that Horizon's ERP costs included in the 2008 revenue requirement should be reduced by 17.6% which is based on the proportion of Corporate and Other Services costs that are allocated to Horizon's affiliates. Schools and the Council concurred with VECC's submission.

Horizon disagreed with the proposed affiliate allocation of approximately $1.6 million in ERP costs. Horizon confirmed that licensing and related support costs would continue to be charged to the affiliates in accordance with the allocation methodology. Horizon submitted that the affiliates would not receive any incremental value from ERP which support complex business processes and high volumes transactions for Horizon's regulated distribution operations.

Schools noted that Horizon purchased the multi-company version at a higher cost which could provide certain financial benefits to Horizon's merger activity. Schools submitted that a reduction of revenue requirement of about $700,000 would be appropriate to reflect the cost adjustment for the ERP system. Horizon responded that the ERP system was scalable to facilitate future merger integrations for the IT architecture. Horizon further argued that investment in ERP is neither a merger benefit, nor a merger-related cost, but is required and appropriately included in its application in support of sustainable electricity distribution activities.

Schools opposed the 20% depreciation rate proposed for ERP and submitted that a ten year life or 10% depreciation rate would be suitable. Horizon confirmed that its amortization method was consistent with Canadian generally accepted accounting principles and the Account Procedure Handbook ("APH").

Board Findings

The Board accepts Horizon's ratemaking treatment, as originally proposed. Although it is novel and departs in some respects from traditional ratemaking, the Board finds that it is appropriate in the circumstances. It balances the significant costs incurred with a timely recognition of the benefits. This provides a benefit to customers at the beginning of a new IRM period.

The Board will make no adjustment to the depreciation rate; the proposed rate is in line with standard practice for investments of this type.

No adjustment to the development costs will be made for an allocation to Horizon's affiliates. The project was driven by the requirements of the distribution company, not by the corporation as a whole. The Board notes that the licensing and support costs will be allocated to the affiliates according to the established methodology.

The Board will not disallow ERP costs associated with the choice of the multi-company version. The Board accepts Horizon's testimony that the primary driver for the project is the age and condition of the legacy systems, and that the incremental benefits from a more flexible system have not had a significant cost impact. The Board also notes that IT costs will be allocated to other companies using the system as appropriate.

Working Capital

Horizon proposed in its application to use the standard methodology of calculating the working capital allowance in rate base at 15% of the sum of controllable expenses and cost of power.

VECC submitted that Horizon had used an average cost of $56.88/MWh in the power purchased component of the cost of power for determining the working capital allowance. The Council, Energy Probe, VECC and Board staff submitted that the most recent cost of power of $54.5/MWh, documented in the April 2008 RPP report issued by the Board, should be used. These parties also submitted that the working capital calculation should reflect the most recent Board-approved Transmission Network and Connection charges. In its Reply Submission, Horizon agreed to adjust its working capital based on the revisions to underlying charges.

Schools, the Council, Energy Probe and VECC submitted that the 15% working capital allowance was too high, and requested the Board to direct Horizon to revise its working capital allowance. the Council and VECC submitted that Horizon should calculate its working capital allowance by using the same allowance as Toronto Hydro Electric

System Limited ("THESL), namely 12.45%, since they have similar service territories and the fact that THESL's working capital allowance was based on a lead/lag study.

Energy Probe submitted that the working capital allowance of Horizon should be adjusted from 15% to a range within 11.6% to 13.3%. Energy Probe explained that this range is based on THESL, Hydro One Network, Enersource Hydro Mississauga Inc, and Hydro Ottawa Inc.'s approved working capital allowances, and the working capital allowance should be within the range deemed appropriate for other similar utilities.

Horizon responded that its approach for calculation of its working capital allowance based on 15% of O&M plus cost of power complies in all respects with Section 2.3 of the Board's Filing Requirements (EB-2006-0170). Horizon also noted that the Board had accepted the use of 15% of O&M plus cost of power formula approach used by other electricity distributors in the 2008 EDR rebasing rate setting proceedings without any further adjustment and only directed distributors to revise the figures used for Transmission and Connection Network charges and cost of power.

Horizon argued that the lead/lag studies performed by THESL and Hydro One Network were for their specific operations. Horizon also noted that both Enersource Hydro Mississauga Inc and Hydro Ottawa Inc. accepted lower working capital allowance within their settlement agreements in their respective 2008 forward test-year rate proceedings. Horizon argued that its operating environment is not similar to THESL, Hydro One Network, Enersource Hydro Mississauga Inc, or Hydro Ottawa Inc. in terms of customer demographics, age of plant, etc. Horizon submitted that without a proper lead/lag study, the adjustments requested by intervenors would be arbitrary.

Schools, VECC and the Council submitted that there was evidence that the working capital requirement is lower than 15% in the form of a presentation to Horizon's Board of Directors in December 2007. VECC submitted that the reporting of assets in that document implies a working capital requirement of only about $30 million (compared to the proposed $70 million). Schools also pointed to the Initial Business Plan[1] which, in Schools' view, reports lower working capital requirements. Horizon disagreed with the proposed adjustment and submitted that the information within the Initial Business Plan was incompatible with a determination of working capital for ratemaking purposes because it represented a "snapshot" in time and not a comprehensive lead/lag study.

[1] This document was filed with the Board in confidence.

Board Findings

The Board accepts the working capital as proposed, including the revisions agreed to by Horizon in its reply submission regarding the cost of power and transmission rates. Horizon rightly notes that its allowance of 15% is in line with the Board's filing requirements and the level approved for other distributors with undergoing rebasing in 2008. THESL and Hydro One undertook specific studies; there is no evidence that those results are applicable to Horizon. The intervenors point to evidence filed by Horizon that suggests the working capital allowance is too high. The Board finds that this evidence, prepared at a different time and for a different purpose, is not sufficient to warrant an adjustment to Horizon's working capital allowance. However, the material does suggest directionally that a lower working capital allowance may be appropriate, and the results of THESL and Hydro One's lead/lag studies have indicated that working capital allowances of less than 15% are appropriate. Therefore, the Board directs Horizon to complete a lead/lag study for purposes of its next rebasing application.

SMART METERS

Horizon proposed to include $10,962,328 for capital expenditures and $1,004,940 for operating expenditures related to Smart Meter implementation in its 2008 revenue requirement.

Horizon is one of the thirteen named distributors authorized to undertake smart meter activities, and was named in the combined Smart Meter proceeding conducted by the Board in 2007 under file number EB-2007-0063.

Board staff noted that in THESL's 2008 distribution rate application (EB-2007-0680), the Board determined that smart meter costs in the test year should not be recovered in rate base and revenue requirement, but should instead continue to be tracked in the established deferral/variance accounts 1555 and 1556. However, historical smart meter costs to December 31, 2007, which had been audited, were reviewed and approved by the Board for inclusion in rate base.

In light of that decision, Board staff suggested that Horizon's 2008 smart meter operating expenses and capital expenses should be removed from the revenue requirement and rate base, and be tracked in variance accounts 1556 and 1555, respectively. Board staff also submitted that revenue and costs for 2008 smart meter activities should be subject to review and disposition in a subsequent rates application after they are audited.

VECC and the Council made similar submissions. The Council submitted that smart meter costs incurred after April 30, 2007 should be subject to a prudence review by the Board before those costs are added to rate base. The Council and VECC argued that Horizon's smart meter rate adder should be re-calculated based on forecast revenue requirement implications and the over-recovery of costs to date. Schools adopted the Council's submissions.

In its reply submission, Horizon agreed to remove capital, OM&A, and revenue related to Smart Meter implementation from its revenue requirement calculations and re-establish variance accounts 1555 and 1556. Horizon stated that it would file for an updated 2008 smart meter rate adder as a separate application.

Board Findings

The Board accepts Horizon's revised proposal to remove the costs from the revenue requirement and to re-instate the variance accounts. This is consistent with recent Board decisions in this area. The Board also notes Horizon's intention to file a separate application for a new rate adder. The Board finds this approach to be acceptable, and the current rate adder will be retained.

OPERATING, MAINTENANCE AND ADMINISTRATIVE EXPENSES

Controllable OM&A

The following table from Board staff's submission sets out historic and forecast amounts for operations, maintenance, billing and collection, community relations and administrative and general expenses. Together, these categories comprise the "controllable" OM&A expenses:

Controllable OM&A Expenditures

	2006 Actual	2007 Forecast	2008 Forecast
Operations	6,932,390	7,825,862	7,994,350
Maintenance	5,405,357	5,842,710	7,069,679
Billing & Collection	7,533,580	7,597,486	7,786,624
Community Relations	390,903	499,943	477,418
Administration & General	12,084,417	17,188,334	18,523,850
TOTAL	32,346,647	38,954,335	41,851,921

These expenses are forecast to increase by 29% between 2006 actual and the 2008 forecast. Intervenors and Board staff identified the ERP plan, merger costs, regulatory costs, salaries and expenses, and tree trimming to be major areas of concern. (The Board has addressed ERP in the Rate Base and Capital Expenditure section of this Decision.)

Merger Costs

Intervenors argued that Horizon was not allocating appropriate costs attributable to its merger-related business activities to the account of the shareholder. Energy Probe submitted that the Board should direct Horizon to compute 2008 internal merger and acquisition costs, perhaps in the area of $1.0 million, and allot them to the shareholder. The Council also supported an adjustment to the 2008 revenue requirement to reflect the time spent by Horizon employees on activities which were, in its view, clearly directed at benefiting the shareholder. The Council also expressed the view that $500,000, the costs associated with two new positions (VP Business Development and Director of Business Strategies), should be excluded from the revenue requirement in the absence of evidence that explicitly demonstrates that their roles directly benefit the ratepayer. VECC supported the exclusion of the two positions and stated that merger-related costs should be excluded on a fully allocated basis. Schools supported the Council's submission and also argued that $150,000 related to the renumbering of switches, which were a direct cost of the last merger, should also be excluded from the revenue requirement.

In its reply submission, Horizon argued that these costs, with the exception of the $150,000 related to the renumbering of switches, were legitimate costs for recovery. Horizon did agree to remove the $150,000. Horizon further argued that its position is consistent with Board policy provided in the *Report of the Board on Rate-making*

Associated with Distributor Consolidation (the “Consolidation Report”), dated July 23, 2007.

Board Findings

As a general principle, costs that are not related to the provision of distribution services should not be recovered in rates. Horizon takes the position that the costs associated with the two disputed positions (VP Business Development and Director of Business Strategies) are appropriately considered distribution expenses. The Board disagrees. While mergers may result in net benefits to customers, they are a shareholder-driven activity. As VECC submitted, “the link to future customer benefits is speculative.”[2]

The Board has established a framework to facilitate mergers and consolidation in the sector. The Board’s policy relates particularly to the attribution of incremental transaction costs and savings and the requisite timing for rebasing. The Board notes that the costs in dispute in this proceeding, in relation to the staff additions and management time, are of a different nature. The Board’s policy does not address these types of proposed ongoing costs focused exclusively on a corporate merger strategy.

The Board concludes that it would be inappropriate to recover the costs for these two positions, which are dedicated to merger activities, from distribution ratepayers. The Board will therefore disallow $500,000 for the costs associated with the two positions.

Intervenors have also argued that an adjustment should be made for the time Horizon’s senior management spends on merger activities. This time allocation has been estimated at between 10% and 20%. In the Council’s view, “if Horizon employees are effectively providing services to the shareholders the costs of those services should be excluded from the revenue requirement” (p.10). The Board will not make an adjustment for these costs. The evidence shows that the amount of time spent on these activities will ebb and flow given the nature of these transactions. It would be difficult to determine a reasonable allocation in the circumstances. Further, although it is inappropriate for distribution customers to pay for the costs of employees dedicated to merger activity, the Board accepts that, in the Ontario LDC sector, it is appropriate and acceptable for a certain amount of distributor executive employee time to be spent on activities such as these.

[2] VECC, Argument, p. 7.

Regulatory Costs

Horizon's 2008 forecast cost for its Regulatory Services Department is $2.15 million in 2008. The 2006 and 2007 actuals were $1.52 million and $2.06 million, respectively. At the oral hearing, Horizon indicated that an amount of $625,000 was included in the 2007 trial balance representing costs for the 2008 cost of service proceeding. Horizon further clarified that it had not budgeted any outside services or legal costs in 2008 for the current application. During cross-examination Horizon noted that it had reviewed the 2008 Board Assessment costs and identified an amount of $206,000 for intervenor costs related to its 2008 EDR application that had been included in 2008. In its reply submission, Horizon acknowledged that the Board had in previous decisions allocated costs related to 2008 applications over a three year period for recovery. Accordingly, Horizon agreed to reduce regulatory costs by $137,000, representing two-thirds of intervenor costs related to the 2008 Application.

Board staff submitted that it was unclear why the 2008 costs would be higher than the 2007 costs if the costs for the 2008 application were included in 2007. Horizon replied that the regulatory burden was increasing not only for Horizon, but for intervenors as well, whose costs were passed on to distributors.

The Council disagreed with Horizon's view on increasing regulatory burden. The Council submitted that although numerous regulatory initiatives will be occurring over the next several years, Horizon's demands should be significantly less than those in 2008, a year in which it faced a full cost of service proceeding. Therefore, only one third of regulatory costs related to the present proceeding should be included in 2008 rates.

VECC estimated that 2008 regulatory costs included over $300,000 in costs pertaining to the 2008 EDR application for one-time legal, consulting and intervenor costs. VECC disagreed with Horizon that these costs are ongoing and representative of the costs of future applications because the implementation of 3rd generation IRM would reduce regulatory burden and costs. VECC concluded that only one third, or an amount of $100,000, should be included in 2008 rates. Schools argued that the overall increase in regulatory costs from 2006 to 2008 is approximately $650,000 and is largely attributed to the 2008 application process. Schools recommended that since the utility will not be required to rebase until 2014 (due to the Guelph merger), the $650,000 should be spread over the entire period, and there should be a decrease of $550,000 in the revenue requirement. Horizon responded that there was no evidentiary basis to support Schools' assertion that regulatory costs related to Horizon's 2008 application were

$650,000, nor any justification for a deviation from Board direction in other 2008 electricity rate applications of averaging regulatory costs over three years.

Horizon further argued that in keeping with Board practice it intended to update its expenditures in the Draft Rate Order to include one-third of the costs of its 2008 EDR application, which it claimed were $625,000.

Board Findings

The Board accepts Horizon's evidence that the only costs associated with its 2008 EDR application that are contained in the 2008 forecast are for intervenor costs, totaling $206,000. Horizon proposed to adjust its 2008 forecast to remove two thirds of those costs, in line with recent Board practice in other 2008 EDR applications. The Board accepts this proposal to remove $137,000 from the 2008 costs.

It remains for the Board to determine whether the balance of the forecast regulatory costs for 2008 is reasonable. After the adjustment for intervenor costs described above, the forecast for 2008 is essentially unchanged from 2007. The Board finds that the forecast is excessive under the circumstances. The costs in 2007 contain $625,000 related to the 2008 EDR application. The Board finds that the evidence does not support an ongoing requirement of that level. The Board acknowledges that there continues to be a full regulatory agenda, but Horizon will not be required to make another rebasing application for some time. If the 2008 EDR costs of $625,000 in 2007 and $206,000 in 2008 are removed from the yearly totals, the regulatory budget becomes $1.435 million in 2007, growing to $2.017 million in 2008. This represents an increase of 36% separate from considerations of the 2008 EDR application. The Board finds there is insufficient evidence to support such an increase. The Board will disallow a further $300,000 from this budget. The total disallowance from the proposed level of $2.154 million is therefore $437,000. This still provides an almost 15% increase between 2007 and 2008 (excluding the effects of the 2008 EDR costs).

The Board notes that Horizon's reply argument appeared to propose an upward adjustment to its revenue requirement to reflect a portion of the EDR costs of $625,000 which were incurred in 2007. The Board will not allow this adjustment.

Other OM&A (including Salaries and Expenses and Tree Trimming)

In its evidence, Horizon proposed an increase of $4,379,100 in salaries and expenses for 2008, which represents an increase of approximately 63% over 2006 actual.

Horizon stated that this increase was related to new hires, benefit increases, inflation-related adjustments, increased training costs and a one-time OMERS adjustment in 2006. It provided a detailed breakdown of cost increases over 2006:

- New hires (4 skilled trades) - $700,000
- 3% inflation over 2 years - $700,000
- New Hires/Benefit Increases - $2,000,000
- Executive salary increases (2 new positions) - $317,162
- Management salary increases (5 new positions) - $622,897
- General & Administrative Salary Increases - $476,451
- One time 2006 OMERS Adjustment - $700,000
- Increased training costs - $400,000

Schools, in its submission, questioned the level of increases in costs and expressed concern about the level of support Horizon had provided in its evidence for the proposed increases. Schools argued that Horizon had not demonstrated that an increase in cost recovery related to its aging workforce was necessary and submitted that the evidence in fact suggested that an aging workforce was not a significant concern for Horizon. Accordingly, Schools proposed a decrease of $1 million. Schools further argued that even after this disallowance, an increase of 21% over two years is still excessive and that an increase of 4% per annum would be more reasonable, resulting in an additional disallowance of $2 million. Schools stated that such a disallowance would encompass all adjustments for high benefit increases and excess headcount, but would be in addition to the appropriate aging workforce cost and merger cost adjustments.

In its submission, the Council supported the submissions made by Schools regarding the overall level of OM&A costs and the proposed adjustments.

Horizon identified that in the next five years, 16.9% of its employees will be eligible for retirement, and an additional 16.1% will be eligible within the next 10 years. Horizon further submitted that it was being proactive and strategic in its approach to workforce planning by using a demographic profile to identify gaps by skills and trades, and by responding to the impending shortage of professional electrical engineers and the hiring of skilled trades in apprenticeship positions. Horizon argued that it has filed detailed evidence in support of its Human Resource costs for the 2008 Test Year and requested that the Board accept its compensation costs as proposed.

Horizon budgeted $2.6 million on vegetation management in 2008, which represented a $950,000, or 37%, increase over 2007. The increase was attributed to moving to a three-year trim cycle for the entire city of Hamilton service area. Horizon had previously extended the cycles in the old City of Hamilton beyond seven years due to a manpower issue with the City of Hamilton, which was previously performing this work on Horizon's behalf. Horizon argued that the three-year cycle is an accepted industry practice in support of public and employee safety and a reliable distribution system. Horizon cited other utilities that use a three-year tree trimming cycle.

Schools submitted that the only vegetation management-related costs that Horizon should be allowed to recover from the $2.6 million budget are the $1,715,485 in actual costs for the three year cycle work in 2008. Consequently, this would require a $900,000 reduction in OM&A. Schools also suggested that the Board has the choice of also disallowing the impact of the deferral of the program in 2007, which amounts to $1.1 million.

Horizon responded that the $900,000 reduction proposed by Schools was not an out-of-period amount and it had not moved vegetation management expenses incurred in 2007 to the test year. The Company reaffirmed the importance of tree trimming to public safety and reliability and requested the Board to approve a revenue requirement that reflected its proposed plan to move to a three year tree trim cycle.

Schools submitted that absent special considerations in particular detailed line items, Horizon's total OM&A budget should be reduced between $9 million and $11.4 million for the test year. Schools derived this amount by comparing the proposed and actual cost increases since 2004 with alternative cost escalations based on various rates of inflation. Schools further submitted that the Board should establish the OM&A budget on the basis of a broad envelope rather than a detailed line item approach. Under this approach, Schools considered an amount in the range of $31 to $34 million to be reasonable.

Board Findings

The Board accepts Horizon's evidence in respect of tree trimming. Horizon has provided adequate evidence to support the move to a three-year trimming cycle and has substantiated the costs involved. Horizon has also provided substantial evidence supporting the other cost increases it is seeking related to staff additions and other cost increases. However, the Board must also consider the overall impact, or cumulative effect, of these increases. In other words, although each of the individual cost increases may be substantiated, the Board must consider whether the total cost of service results in just and reasonable rates. In order to do that, the Board must consider the overall level of increase being requested.

Horizon is seeking approval of costs in 2008 which are about 29% higher than its costs in 2006. This is a very significant increase. However, in considering the overall increase in OM&A, the effects of Smart Meters should be removed as that will continue to be tracked and accounted for separately and there can be consideration of a broader timeframe.

Horizon reported an adjusted OM&A of $41.134 million for 2008 (which removes the effect of smart meters) and compared this to the level of $32.500 million in 2004. On this basis, the increase over the period is over 26%, or the equivalent of almost 7% per year. The Board has already ordered downward adjustments of $1,087,000. This brings the adjusted 2008 costs to $40.047 million and reduces the annual increase (since 2004) to less than 6%. While these are still significant increases, the Board finds that the evidence supports the reasonableness of the forecast costs and therefore will make no further downward adjustment.

COST OF CAPITAL

The Board's guidelines for the cost of capital are set out in its *Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation of Ontario's Electricity Distributors* (the "Board Report"), dated December 20, 2006.

With the exceptions of long-term debt and short-term debt (contested by Schools), parties agreed that Horizon's proposed cost of capital was consistent with the guidelines in the Board Report.

Horizon's only long-term debt is embedded debt in the form of a Promissory Note in favour of Horizon Utilities Corporation ("HUC"), its parent company. The original Note was issued July 1, 2000 in the amount of $142 million. This Note was restated 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. This Note was restated and replaced in the outstanding amount of $116 million, due and payable July 30, 2012 bearing a fixed rate of 7%.

Horizon indicated that the 2005 Note dated February 28, 2005, was simply the 2002 Note with some non-substantive amendments and that therefore the rate of 7% referenced in the 2002 Note was appropriate. Intervenors disagreed with this view and were unanimous in their submission that the 2005 Note included substantive changes:

1. While the 2005 Note fixed the interest rate at 7%, the 2002 and earlier Notes specify the interest at the “permitted rate”. Intervenors and Board staff noted that the deemed long-term rate set by the Board in March 2008 for 2008 was 6.1%.
2. Horizon dropped the provision in the earlier Notes that the debt was payable on demand 18 months after a request for repayment.
3. The Notes prior to the February 2005 Note contained a Prepayment option of 30 days notice without any penalty.

Intervenors also noted that the 2002 Note was issued to Hamilton Hydro by HUC at 7% while HUC simultaneously issued debentures at an interest rate of 6.25%. At the oral hearing, Horizon confirmed that the effective rate of HUC’s debentures was 6.62% after taking into account issuance costs. Intervenors and Board staff questioned why Horizon was paying a higher rate (7%) than what the parent had negotiated for its debt. Furthermore, Horizon confirmed that at the time of issuing the 2005 Promissory Note, market interest rates were in the range of 5.21% to 5.26%.

The Council alleged that Horizon had not acted in the best interest of ratepayers and it was unfair and inappropriate on the part of Horizon to charge its ratepayers 7% when the actual cost to the parent was less. The Council further claimed that Horizon had an opportunity to reduce the rate in 2005 when the terms of the note were renegotiated, but Horizon chose not to do so. The Council submitted that Horizon’s characterization of the 2005 agreement at the oral hearing as “housekeeping” and the changes in the 2005 Note from the earlier agreement as “non-substantive” were not credible.

Schools submitted that, if the market rate of 5.26% was applied to the deemed debt of Horizon, the impact of this difference on revenue requirement would be an over-recovery of $3.54 million per year. Schools submitted that Horizon offered a number of explanations at the oral hearing for why it agreed to execute the 7% Note at a time that it was able to borrow at 5.26%: first, that the 2005 Note was not a new note but reflected amendments to the Note issued in July 2002; second, that the Note was entered into in consideration for the right to repay $26 million to HUC; and third, that the new Note merely represented "late housekeeping". Schools submitted that none of the reasons provided by Horizon were true.

Schools also expressed concern about the implications of the short-term interest rate given that Horizon had $24.1 million in customer deposits on which it pays an interest of 1.75%. The cost of this debt is $421,750 and Mr. Basilio, the Chief Financial Officer and Senior Vice-President of Horizon noted at the oral hearing that he had more short-term debt than required.[3] Schools noted that, under the Board's deemed capital structure Horizon seeks to recover 4.47% on $14.5 million of deemed short-term debt, plus a long-term debt rate of 7% on the balance of $9.6 million. Schools claimed that the two recoveries totaling $1,320,150 result in an over-recovery from ratepayers of $898,400 per year. Over a five year IRM period, this amounts to about $4.5 million of excess recoveries. Alternatively, if the customer deposits were treated as long-term debt, the blended rate for long-term debt would have to be reduced to account for the fact that 11.9% of Horizon's long-term debt carried an interest rate of 1.75%.

In conclusion, all intervenors submitted that Horizon should be allowed to recover a rate of 5.26% as compared to the 7% that the Applicant had asked for. Energy Probe proposed a slight variation, suggesting a rate of 5.5% that included 0.25% for issuance costs. Schools also recommended a different rate in the event the Board accepted Schools argument of treating customer deposits as part of long term debt; in such a case, Schools suggested a rate of 4.84% as the appropriate long-term debt rate.

Horizon rejected School's submission that the Board should include customer deposits as part of Horizon's short or long-term debt. Horizon cited several reasons for its position. First, the amount of prepayment could not be relied upon as a source of financial capital given the possibility that a portion of the deposits could be applied against bad debts or refunded to customers. Second, Horizon could not directly control the amount of such deposits and lastly, Horizon had no practical means of managing or hedging cash flow risk created by customer deposits so as to create a synthetic debt instrument that could be used in its capital structure. Horizon also noted that Schools had referenced an incorrect rate of 1.75% in its submission; the correct interest rate on customer deposits is variable at a rate of prime less 2%.

[3] Transcript EB-2007-0697, June 6, 2008, page 26

Horizon disagreed with intervenors' submissions and reiterated that the appropriate rate for its long-term debt was 7%. In reply argument, Horizon maintained that the interest rate in the 2000 Note was fixed at 7% subject to changes that the Board might effect with respect to recovery for rate-making purposes. Horizon submitted that, since July 2000 and even beyond 2002, electricity distributors were evolving into commercial entities and there was significant uncertainty around energy policy in Ontario. In such a scenario, it made sense to look for some flexibility with respect to repayment terms including the interest rate. However, with greater certainty in energy policy and regulation, Horizon decided to fix the rate in 2005.

Horizon maintained that all amendments between the 2000 Note and the 2005 Note were not sufficiently substantive to require re-issuance of the debt obligation at law, for financial reporting or tax purposes. Horizon submitted that the 2005 Note was a continuation, through amendment, of the original 2000 Note.

Horizon regretted that it had not provided reference to the 2005 Note in its 2006 EDR application. However, Horizon maintained that this information would have had no impact on the determination of its "deemed debt rate" in that application and hence in this application.

While Horizon submitted that there was no basis for reducing its long-term debt rate of 7%, it did propose an alternative in case the Board was not prepared to maintain the 7% debt rate. It proposed a rate of 6.62% based on two alternative methodologies: (1) The rate paid by HUC of 6.25% plus 0.37% in issuance costs for a total of 6.62%, and (2) using the rate of 7% on $116 million and 6.1% (based on the Board's 2008 deemed rate and which has been approved for other utilities in the 2008 EDR Cost of Service applications for new debt) on the remaining $87,247,725, resulting in a combined rate of 6.6137%.

Board Findings

The table below sets out the Board's conclusions regarding Horizon's deemed capital structure and cost of capital.

Board-approved 2008 Capital Structure and Cost of Capital

Capital Component	% of Total Capital Structure	Cost rate (%)
Long-Term Debt	56.0	6.10
Short-Term Debt	4.00	4.47
Equity	40.0	8.57
Total	**100.00**	**7.02**

Horizon has requested a long-term debt rate of 7% based upon the 2005 Note which Horizon claims is essentially the 2002 Note with non-substantive amendments. The Board rejects Horizon's view that this Note is not a new Note and that the Note was approved in a previous Decision.

In 2005, Horizon entered into a new financing arrangement with its parent. Horizon has characterised the 2005 arrangement as mere "housekeeping" and termed the changes between the 2002 and the 2005 agreements as "non-substantive". This is clearly not the case. The 2002 Note did not have a fixed rate of 7%, but makes reference to the "permitted rate". Horizon also dropped the provision in the earlier Notes that the debt was payable on demand 18 months after a request for repayment. The fact that it was converted from a demand note to a term note is more than a "non-substantive" change. The Board finds that the 2005 Note is a new Note that the Board has neither reviewed nor approved previously.

The intervenors have submitted that the rate of interest on Horizon's long-term debt should be 5.26% consistent with the cost of credit at the time the 2005 Note was issued. The intervenors rely upon Horizon's evidence that this rate was the market rate of interest available to Horizon at the time the 2005 Promissory Note was entered into.

While the Board has some sympathy for the intervenors' position, the Board believes that the best approach is to follow the guidelines established in the Board's Report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors. Section 2.2.1 of the report states, in part:

> For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate. When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change.

The Board believes that it is best to follow guidelines even though that rate may be above the market rate that was available to the Applicant at the time that the Note was entered into. Accordingly, the Board will use a long term debt rate of 6.1%. The Board notes that this is consistent with other Board decisions such as the Decision of this Board with respect to Oshawa PUC, May 8, 2008. Horizon shall reflect this rate for the affiliated debt in determining its revenue requirement.

PAYMENTS IN LIEU OF TAXES ("PILs")

In its evidence, Horizon used the previous 2008 income tax rate of 34.5% and the Ontario capital tax rate of 0.285% which was known at the time it submitted its application. Changes in tax legislation made by both the federal and Ontario governments have resulted in an income tax rate of 33.5% and a capital tax rate of 0.225% for 2008. In its reply submission, Horizon stated that it will use the new income tax and capital tax rates when it files its Draft Rate Order.

Horizon did not incorporate interest expense additions and deductions in the calculation of PILs. Staff submitted that if in preparing its Draft Rate Order this issue arises, Horizon should not include an interest expense difference in the determination of the PILs allowance. In its reply submission, Horizon referred to Ontario budgets, regulations and Board decisions in the discussion of interest expense and the implications in the PILs tax calculations and stated:

> Lastly, Horizon has no intention of issuing debt such that its total debt obligations would exceed the OEB deemed capital structure, which appeared to be the issue in the Halton Hills Hydro decision [EB-2007-0695]. (paragraph 244)

Board Findings

Horizon shall reflect in its Draft Rate Order the new combined income tax rate for 2008 of 33.5%, the Ontario capital tax rate of 0.225%, and the new applicable CCA class rates.

Several distributors have requested that interest expense variances be allowed in the calculation of PILs. The Board has not approved the incorporation of these differences in the PILs calculations since deemed interest is allowed for cost recovery, and the regulatory tax calculations begin with net income after the deduction of deemed interest. The Board interprets Horizon's statement at paragraph 244 to mean that Horizon will not include interest additions and deductions in its Draft Rate Order PILs calculation.

COST ALLOCATION AND RATE DESIGN

The following issues are addressed in this section:

- Line Losses
- Revenue to Cost Ratios
- Fixed Variable Split
- Transformer Ownership Allowance
- Retail Transmission Service Rates
- Credit Card Convenience Charge

Line Losses

Horizon is seeking approval of a Total Loss Factor of 1.0421 for secondary metered customers < 5,000 kW. Horizon developed its forecast loss factor for 2008 on the basis of averaging losses for the period May 1, 2002 to June 30, 2007. No intervenor objected to this proposal.

Board findings

The Board accepts Horizon's proposed total loss factor of 1.0421.

Revenue to Cost Ratios

The following table sets out the results of Horizon's cost allocation study, its proposed revenue to cost ratios and the target ranges as contained in the Board's report on *Cost Allocation for Electricity Distributors*, which was issued Board's November 28, 2007.

Revenue to Cost Ratios

Rate Class	**Cost Allocation Study** Col 1	**Application** Col 2	**Target Range** Col 3
Residential	123.6	112.4	85 – 115
GS < 50 kW	92.0	92.5	80 – 120
GS > 50 kW	72.1	86.3	80 – 180
Large Use > 5 MW	49.8	92.1	85 – 115
Street Light	15.6	23.8	70 – 120
Sentinel	34.8	91.5	70 – 120
USL	34.2	88.1	80 – 120
Back-up/Standby	51.0	65.8	n/a

VECC submitted that Horizon's approach to determining the proposed allocations leads to anomalous results. In particular VECC submitted that the proposed change in Large User rates could not increase the revenue to cost ratio from 49.8% to 92.1% as claimed by Horizon, and provided a calculation that the proposed change would yield a ratio of 57.45%. Horizon responded that its methodology was correct and that VECC's approach was in error. Horizon noted that the Large User allocated share of cost is 6.84%, or $6,487,111 based on a revenue requirement of $94,859,978, and argued that the proposed revenue is in fact 92.1% of the class revenue requirement.

All the intervenors submitted that the Streetlighting ratio should be increased by more than the proposed amount. Board staff and Schools submitted that the rates should be increased to yield a ratio of 43%, half-way to the bottom of the Board's target range of, namely 70%. The Council submitted that it should be increased to yield a ratio of 70%.

Board staff noted that the proposed rates would increase the revenue to cost ratio for Sentinel Lights from 34.8% to 91.5%, and would entail a bill increase of approximately 67%. Schools supported the proposed ratio for this class. VECC suggested a less aggressive change than proposed.

Board staff noted that the proposed rates would increase the revenue to cost ratio for Unmetered Scattered Load from 34.2% to 88.1%, and would entail a bill increase of approximately 35%. Schools supported the proposed ratio, while VECC suggested a less aggressive change than proposed. With regard to both Sentinel Lights and USL, VECC submitted that caution should be taken when moving to a ratio closer to 100% than required by the Board's policy range.

VECC and the Council submitted that, to the extent that adjustments to other classes would yield revenues higher than that proposed by Horizon, the benefit should be felt by the Residential class. The reason for this is that only this class has been proposed to have a ratio above 100%. Horizon did not agree with VECC in this regard, and pointed out that the application entailed a bill decrease for Residential customers.

Board Findings

The Board is satisfied with Horizon's explanation of its methodology and finds that the ratios in column 2 of the table are appropriate for purposes of reviewing the revenue to cost ratios for 2008. Having reviewed the record of Horizon's previous re-basing (RP-2005-0020/EB-2005-0375) along with the cost allocation study submitted by Horizon with this application, the Board has concluded that there were data errors in the cost allocation study and that the initial ratio of 49.8% should be disregarded. VECC's submission was helpful in identifying inconsistencies in the initial application, which is the information summarized in column 1.

The Board notes Horizon's proposal to bring the Sentinel and Unmetered Scattered Load classes within the Board target ranges and the large rate impacts involved. However, the Board has already acknowledged the uncertainties associated with the cost allocation work. The Board concludes that it is more appropriate for the Sentinel and Unmetered Scattered Load classes to be moved to the bottom of the target ranges, 70% and 80%, respectively, and directs Horizon to do so.

The Board concludes that the Streetlighting class should be moved closer to the Board target range. This is consistent with other recent Board decisions on this issue. The revenue to cost ratio will be 43% for Streetlighting in 2008. The Board notes that Horizon did not object to this approach. The Board further directs Horizon to move the ratio to 70% as part of its 2009 IRM application.

If additional revenue arises due to these adjustments, the benefit will be allocated to the Residential rate class because it continues to have a revenue-to-cost ratio in excess of 1.

Fixed-variable Split

Horizon proposed to maintain the fixed-variable split at previously approved levels, and noted the ongoing Board proceeding on fundamental rate design. Both staff and VECC noted that the fixed charges are higher than the range calculated in the cost allocation study. Board staff submitted that the fixed charges proposed would be consistent with Board policy. The Council supported the proposed approach.

Board staff and Schools noted that the variable rate for the GS<50 kW class is proposed to increase by a higher percentage than the fixed rate. Schools submitted that the two rates should be changed by an equal percentage. For the GS> 50 kW class, Schools submitted that Horizon's fixed rate is high relative to that of other distributors, and submitted that the rate should be left unchanged at its current amount. Horizon responded that it would be inappropriate to provide different treatment to these two classes than to the other classes, given the ongoing work in this area.

Board Findings
The Board accepts Horizon's proposals in this area. The Board notes Schools' concern regarding the GS<50 kW and GS>50 kW classes, but finds that it would be inappropriate to isolate these two classes for adjustments in light of the Board's ongoing work in this area.

Transformer Ownership Allowance
Horizon proposed to increase the allowance from $0.60 per kW to $0.73 per kW monthly. No parties opposed this proposal.

Board Findings
The Board accepts this proposal.

Retail Transmission Service Rates
Horizon undertook to provide revised Retail Transmission Service rates based on updated Board approved transmission rates. No intervenor objected to the approach.

Board Findings
The Board accepts Horizon's approach.

Credit Card Convenience Charge
Horizon proposes to implement a charge of $15 for use of a credit card as payment during a collection or disconnection visit. Horizon submitted that the 2006 Handbook provided for distributors to propose charges other than those on the standard list.

Board Findings
The Board will approve the proposed charge and notes that the charge is derived from an analysis of the costs associated with providing the service. While this departs from the general approach to specific service charges, there is no charge established for this service, and therefore a charge based on Horizon's costs is appropriate. The level of the charge may need to be revisited if this service comes to be widely offered and if a standardized charge becomes warranted.

CONSERVATION AND DEMAND MANAGEMENT ("CDM")
Horizon Utilities requested approval of $265,000 for costs relating to maintaining a small CDM department for future programs.

Horizon's evidence is that its CDM function and programs are specific to Horizon Utilities for customer education and to promote a "conservation culture" through initiatives such as community events, an education program through the local school boards, conservation champions committee, an "Ask The Expert" hotline, development of self-help conservation tools for customers and demand response strategy planning. Horizon also stated that the CDM activities are not part of the OPA-funded programs, and it is appropriate that they be funded in rates.

Board staff submitted that if the amount represents new funding for CDM programs in the 2008 revenue requirement, Horizon Utilities has not completed the filing requirements for CDM funding through distribution rates. Board staff also submitted that it was not clear if Horizon has approached the OPA for funding of the programs or the $264,623.

Schools agreed with Board staff's submission that Horizon Utilities' filing in respect to CDM costs for the Test Year is non-compliant with Board policies and submitted that the $265,000 should be disallowed. Horizon Utilities responded that it is not proposing to implement new CDM programs that are incremental to the funding previously approved by the OEB. The costs are the wages and expenses associated with three employees; Horizon has separately identified these employees and the associated costs in order to enhance transparency.

Board Findings

Horizon maintained that the costs in question are not in the nature of new CDM program costs, but are rather ongoing OM&A costs associated with customer service which are appropriately funded from distribution rates as they are not part of an OPA-funded program. The initiatives identified by Horizon are all related to customer education. The Board notes, however, that Electricity Distributors Association and the OPA have recently announced an agreement to establish an LDC Community Initiatives Fund to promote electricity conservation awareness. A similar issue arose in the Guelph Hydro Electric Systems Inc. 2008 EDR proceeding. In that decision, the Board determined that the costs in question would not be recovered through 2008 rates, but rather would be tracked in account 1508 – Other Regulatory Assets, for potential future disposition. The Board stated that, when seeking disposition:

> At that time, the Company will need to satisfy the Board that the requirements in the Board's guidelines in recovering any amounts from distribution rates have been met, including evidence that the Company could not recover its expenditures from existing or new OPA funding.[4]

The Board concludes that the same approach is appropriate in the current circumstances, as the proposed activities appear to be aligned with the intentions of the new OPA program. As a result, $265,000 will be removed from the revenue requirement. Horizon may track the expenses in account 1508 for potential future disposition, at which time the Board will examine whether the expenditures have been, or could have been, recovered through OPA funding.

Shared Savings Mechanism ("SSM") and Lost Revenue Adjustment Mechanism ("LRAM")

Horizon Utilities requested approval for an LRAM amount of $332,702 and an SSM amount of $535,374. Horizon Utilities proposed that the LRAM and SSM rate riders be combined into, and recovered through, a single distribution rate rider. Horizon Utilities has requested a three-year recovery of the amounts.

VECC submitted that there is a fundamental flaw with the allocation methodology for the SSM amounts. VECC indicated that under Horizon's proposal, the GS>50 kW and GS<50 kW class customers will receive the benefit of the CDM programs and a bill reduction due to the fact that the programs were not cost effective. VECC submitted that the resource savings from CDM programs benefit all customers and that the SSM amounts should be allocated to all customer classes on the basis of each class' distribution revenues.

Schools agreed with VECC that the SSM cost allocation was not appropriate, but it did not agree with the solution proposed by VECC. Schools recommended that the negative rate rider for GS<50 kW and GS>50 kW be removed and that the positive rate rider for the residential class be reduced by the same amount.

Horizon Utilities replied that it has not proposed a negative or credit rate rider for the GS>50 kW customer class and since program costs exceeded program benefits there is no SSM recoverable by the utility. Horizon Utilities confirmed that it would not be

[4] EB-2007-0742, *Decision*, July 31, 2008

providing a credit to the customers and the rate rider is set at zero.

Board Findings

The Board accepts Horizon's LRAM and SSM amounts and the proposed recovery. The Board notes Horizon's assurance that no negative or credit rate rider is proposed.

DEFERRAL AND VARIANCE ACCOUNTS

The following table shows the deferral and variance account balances Horizon is seeking to recover in its application.[5] The balances are as of December 31, 2006 plus interest to April 30, 2008. (The balances in parentheses denote a credit to customers.)

Deferral and Variance Accounts Proposed for Disposition

Account Number	Account Name	Balance Requested for Disposition
1508	Other Regulatory Assets	$1,932,535
1518	Retail Cost Variance Account – Retail	($75,179)
1525	Miscellaneous Deferred Debits	$83,781
1548	Retail Cost Variance Account – STR	$51,981
1550	LV Variance Account	($285,692)
1580	RSVA – Wholesale Market Service Charge	($3,039,380)
1582	RSVA – One-time Wholesale Market Service	$347,584
1584	RSVA – Retail Transmission Network Charge	($730,167)
1586	RSVA – Retail Transmission Connection Charge	($5,551,162)
1588	RSVA – Power	($107,111)
Total		**($7,372,810)**

The total amount requested for disposition is ($7,372,810) – a refund to ratepayers. Horizon originally requested disposition of these accounts over a three year period. In its reply submission, Horizon proposed to refund these amounts over two years through rate riders.

[5] The Company initially sought disposition of the balances in the 1555 and 1556 Smart Meter accounts. This proposal was subsequently revised as explained in the Smart Meter section of this Decision.

Board Staff noted that under section 78 (6.1) of the *Ontario Energy Board Act 1998*, the Board is obligated to review each quarter the balance in Account 1588, RSVA – Power. Board Staff maintained that consideration should be given on the impact of the Board's recently announced initiative of a review and disposition process for account 1588. The Board also indicated that it is considering extending this initiative to include all the RSVA and RCVA accounts.

Horizon Utilities submitted that the RSVA and RCVA accounts represented a significant dollar amount that was a credit to customers, and it was appropriate for the Board to approve the requested disposition of its December 31, 2006 audited deferral and variance account balances, including RSVAs and RCVAs, plus interest accrued to April 30, 2008.

Board staff submitted that Horizon had incorrectly used account 1508 (Other Regulatory Assets) to account for costs associated with administering rebate cheques pertaining to the Ontario Price Credit, instead of using account 1525 (Miscellaneous Deferred Debits). In its reply submission, Horizon rectified this error and used account 1525 to calculate the rate riders. There is no impact of using account 1525 instead of account 1508 on the rate riders.

Board Findings

The Board will dispose of the balances in the RSVA and RCVA accounts. The Board notes that it has announced its intention to undertake a process to look at these accounts on a generic basis. However, given the significant net credit balances in these accounts, the Board has determined that it is appropriate to refund these amounts to customers in this case. The amounts to be disposed of are to be the principal balances as of December 31, 2006 and interest forecast to April 30, 2008.

IMPLEMENTATION

Horizon's rates were declared interim on April 16, 2008. Horizon proposed that its new rates be implemented effective May 1, 2008. Schools and the Council supported Horizon's request. Horizon proposed that its rate order provide for a rate rider that will enable Horizon to recover its revenue requirement shortfall for the period between May 1, 2008 and the date new rates are implemented.

Board Findings

The Board accepts Horizon's proposal regarding new rates being made effective May 1, 2008 and the recovery of the revenue shortfall arising in the period between May 1, 2008 and the implementation of the new rates. Schools and the Council suggested that the rate rider be in effect through April 30, 2009. The Board agrees.

The Board has made findings in this Decision which change the revenue deficiency and therefore the proposed 2008 distribution rates. These are to be properly reflected in a Draft Rate Order incorporating an effective date of May 1, 2008 for the new rates.

In filing its Draft Rate Order, it is the Board's expectation that Horizon will not use a calculation of the revised revenue deficiency to reconcile the new distribution rates with the Board's findings in this Decision. Rather, the Board expects Horizon to file detailed supporting material, including all relevant calculations showing the impact of this Decision on Horizon's proposed revenue requirement, the allocation of the approved revenue requirement to the classes and the determination of the final rates. Horizon should also show detailed calculations of the revised retail transmission rates and variance account rate riders reflecting this Decision.

A Rate Order and a separate cost awards decision will be issued after the processes set out below are completed.

The Board therefore directs the following:

1. Horizon shall file with the Board, and shall also forward to all the intervenors in this proceeding, a Draft Rate Order attaching a proposed Tariff of Rates and Charges reflecting the Board's findings in this Decision, within 14 days of the date of this Decision. The Draft Rate Order shall also include customer rate impacts and detailed supporting information showing the calculation of the final rates.

2. Parties shall file any comments on the Draft Rate Order with the Board and forward to Horizon within 20 days of the date of this Decision.

3. Intervenors shall file with the Board and forward to Horizon their respective cost claims within 26 days from the date of this Decision.

4. Horizon may file with the Board and forward to the intervenors responses to any comments on its Draft Rate Order within 26 days of the date of this Decision.

5. Horizon may file with the Board and forward to intervenors any objections to the claimed costs within 40 days from the date of this Decision.

6. Intervenors may file with the Board and forward to Horizon any responses to any objections for cost claims within 47 days of the date of this Decision.

7. Horizon shall pay the Board's costs incidental to this proceeding upon receipt of the Board's invoice.

DATED at Toronto, October 3, 2008
ONTARIO ENERGY BOARD

Original Signed By

Gordon Kaiser
Presiding Member

Original Signed By

Cynthia Chaplin
Member