School Energy Coalition Interrogatory # 1

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 1

Please provide the percentage 2020 gross revenue from consulting services (including expert testimony services) of LEI broken down into the following categories of clients:

a. Regulated entities;

b. Regulatory bodies and commissions;

c. Consumer groups; and

d. Others.

Response:

The following response is provided by LEI.

LEI does not characterize its revenues in this fashion. In 2020, approximately 48% of revenues came from for profit regulated and non-regulated entities, 25% came from regulatory or policymaking bodies, 7% from market institutions, 5% from not for profit entities, and the remaining15% from other entities.

School Energy Coalition Interrogatory # 2

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 6

Please provide a copy of the discussion paper, presentation, and all other documents from LEI placed on the record in EB-2012-0340. If any were filed in confidence, please file the unredacted version in confidence in this proceeding for determination by the Board panel, and provide a redacted version in response to this interrogatory.

Response:

The following response is provided by LEI.

Please see the response to Exhibit N / Tab 6.1 / Schedule OPG-2.

School Energy Coalition Interrogatory # 3

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 8

With respect to the scope of OPG's proposal to increase its equity thickness:

a) Please confirm that OPG has proposed that the new 50% equity thickness should apply to both nuclear and hydroelectric prescribed facilities, as its cost of capital is combined, but that the application to the hydroelectric prescribed facilities would be deferred until the end of the rate freeze.

b) Please confirm that LEI's proposed 47% equity thickness is intended to be applied in the same way as in (a) above.

c) Please comment on whether, if the OEB establishes an earnings sharing mechanism or other method of protecting against overearnings from the frozen hydroelectric rates, it is the intention of LEI that the calculation of earnings for hydroelectric would include the proposed 47% equity thickness, or the 45% equity thickness underlying the current rates, or some other equity thickness.

Response:

The following response is provided by LEI.

a. Confirmed

b. Confirmed.

c. LEI's recommendation is 47% equity thickness for the 2022-2026 period for OPG's regulated assets.

School Energy Coalition Interrogatory # 4

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 5, 51

Please comment on the extent, if any, to which the standalone principle should apply if a declining perception of provincial credit support leads to a lower OPG credit rating.

Response:

The following response is provided by LEI.

Provincial credit support is one of the risk factors considered by rating agencies in assessing OPG's credit rating. As such, viewing OPG on a standalone basis (i.e., without considering provincial credit support) is likely difficult. Rating agencies seldom rate subsidiaries higher than their parents, and in turn very seldom consider a higher credit rating for sovereign entities than for the sovereign itself.

This is consistent with the following OEB finding in 2016-0152: "*...based on OPG's history since its incorporation, the credit rating agencies have not made material changes to OPG's credit ratings, with the one downgrade being linked to a downgrade in the Province's credit rating.*" Evaluation on a standalone basis is only plausible in the event that OPG has strong cash flows, a moderate capital investment program, and is not pressured to provide dividends to the province in excess of normal payout ratios. Alternatively, were a controlling interest in OPG to be sold to the private sector, a standalone rating could become more plausible.

School Energy Coalition Interrogatory # 5

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 17

Please confirm LEI's expert opinion that the business risk from the DRP has declined since EB-2016-0152. Please confirm LEI's view that this opinion is shared by the rating agencies.

Response:

The following response is provided by LEI.

LEI observes that the successful completion of the refurbishment of Unit 2, generally on time and nearly on budget, as well as the lessons learned from both Unit 2 and other CANDU refurbishments, support a lower risk profile for project execution in the subsequent units.

As such, LEI views the business risk associated with DRP is at least the same, if not lower than EB-2016-0152.

This is consistent with S&P's July 2020 rating report, which states: "*We are revising our outlook on OPG to stable from negative.... The stable outlook incorporates OPG's recently improved operating performance and our view for more stable volatile cash flows, reflecting our expectations that the company will pause on its acquisition strategy, continue to effectively manage regulatory risk, and our increased confidence that future nuclear refurbishments will be completed on time and on budget.*"[1]

[1] S&P Global Ratings. *Ontario Power Generation Inc. Outlook Revised To Stable From Negative; 'BBB+' Rating Affirmed.* July 17, 2020. Page 1. Filed as Exhibit A2 / Tab 3 / Schedule 1 / Attachment 10.

School Energy Coalition Interrogatory # 6

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 21

Please confirm LEI's expert opinion that the declining percentage of nuclear revenues (from 72% to 69%) and the declining percentage of nuclear output (from 57% to 47%), should result in reduced business risk for OPG.

Response:

The following response is provided by LEI.

LEI observes that the generation mix transition may change the composition of rate base. However, based on the simple analysis of historical production and payment amounts, compared to forecasted production and proposed payment amount, although the output falls, the revenues remain relatively stable. LEI believes that this demonstrates that business risk from the changing composition of rate base will not increase materially in the forthcoming period (i.e., 2022-2026) relative to the previous period (i.e., 2017-2021).

School Energy Coalition Interrogatory # 7

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 25-26, 29

Please confirm LEI's expert opinion that climate change will, on balance, neither increase nor decrease the business risk of OPG in any material way between now and 2027.

Response:

The following response is provided by LEI.

Confirmed.

School Energy Coalition Interrogatory # 8

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 27

Please confirm LEI's expert opinion that the risk of political intervention in Ontario energy regulation has not changed materially in the period from 1999 to date. If not confirmed, please identify any periods in which the risk of political intervention has gone up or down, and provide comments on the impact on each change on business or financial risk.

Response:

The following response is provided by LEI.

LEI cannot confirm that the risk of political intervention in Ontario energy regulation has not changed materially.

Political intervention risk discussion has been part of rating agency reports since the first rate case (i.e., EB-2007-0905), where OPG filed DBRS report from 2007 and S&P report from 2006 and 2005. The DBRS report filed in that record from November 2007 highlights political intervention as a 'challenge' and notes that "*OPG is subject to political intervention, due largely to changes in government mandates and policies, as well as limits that restrict revenues and earnings should the price of electricity rise quickly.*"[2]

Similarly, the more recent DBRS report (from April 2020) notes: "*OPG is subject to political intervention, largely because of its ownership by the Province and changes in government mandates and policies. DBRS Morningstar notes that though the Province has committed to having the Company run more autonomously, the risk of further government intervention still exists.*"[3]

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[2] DBRS. Ontario Power Generation Inc. Report Date: November 30, 2007
[3] DBRS. Ontario Power Generation Inc. Report Date: April 16, 2020. Filed as Exhibit A2 / Tab 3 / Schedule 1 / Attachment 4.

However, the focus of our report is on setting an appropriate proportion of equity in the capital structure. While we believe that the potential for political interference cannot be ignored, we also believe that there is little risk that such political interference would result in debt not being repaid.

School Energy Coalition Interrogatory # 9

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 28

Please confirm that prohibitions against strikes or lockouts by unionized employees of utilities is generally perceived by investors as reducing the business risk of utilities.

Response:

The following response is provided by LEI.

Confirmed. For example, the Government of Ontario passed Bill 67 in December 2018, which included a provision to "*prohibit and stop any strikes or lockouts between Ontario Power Generation ("OPG") and the Power Workers' Union ("PWU")*" during the bargaining round that was ongoing at the time.[4] At the time of the legislation, the PWU had given a strike notice that meant a lockout could have occurred in January of 2019.[5]

However, the risk is not eliminated. While investors do perceive that stability in workforce relations flows from the fact that the product is considered essential, for prohibitions on strikes to be meaningful governments need to be prepared to enforce them. There may be circumstances in which enforcing such prohibitions is politically challenging.

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[4] Government of Ontario website. Backgrounder: Protecting Ontario's Electricity Supply. December 17, 2018

[5] OPG. Ontario Power Generation Receives Strike Notice from Power Workers' Union. December 14, 2018.

School Energy Coalition Interrogatory # 10

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 31

Please confirm LEI's expert opinion that, at the present time, there is no reason to believe – and no evidence on which one could conclude - that the modernization of the OEB will result in any increase or decrease in business or financial risk for OPG.

Response:

The following response is provided by LEI.

LEI believes that the long term impact of OEB modernization / implementation of review recommendations is unknown, but likely minimal.

School Energy Coalition Interrogatory # 11

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 32

Please provide empirical evidence supporting the view that investors have determined expected increases in DERs constitute an increase in business or financial risk over the period 2022-2026.

Response:

The following response is provided by LEI.

LEI observes that while increase in DERs is unlikely to be a significant risk for the forthcoming application period, it is an important trend to monitor going forward.

For instance, in its methodology for regulated electric and gas utilities, Moody's states that: "*the possibility that there will be a widespread movement of electric utility customers to sever themselves from the grid is remote. However, we acknowledge that new technologies, such as the development of commercially viable fuel cells and/or distributed electric storage, could disrupt materially the central station paradigm and the credit quality of the utility sector.*"[6]

[6] Moody's Investor Service. Regulated Electric and Gas Utilities. June 23, 2017. Page 42

School Energy Coalition Interrogatory # 12

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 35, 38

Please confirm that no rating agency has stated that there has been an increase in business or financial risk for OPG since EB-2016-0152, and that the only changes in business risk assessments by the rating agencies since then have been reductions in business risk.

Response:

The following response is provided by LEI.

While no major rating agency has taken a negative rating action against OPG since 2016-0152, rating agencies have made observations associated with incremental business/financial risks of OPG. For example:

- Moody's has cited potential for incremental carbon transition risk related to acquisition of natural gas assets[7]

- S&P has discussed potential change in financial risk due to debt-funded acquisitions[8]

Note that LEI believes risks associated with non-regulated asset acquisitions should not be considered in assessing OPG's regulated equity thickness, and that ring-fencing measures should be considered.

[7] Moody's Investors Service. *Ontario Power Generation Inc.* December 4, 2019. Page 7 of 12. Filed as Exhibit A2 / Tab 3 / Schedule 1 / Attachment 5.

[8] S&P Global Ratings. *Ontario Power Generation Inc. Outlook Revised To Stable From Negative; 'BBB+' Rating Affirmed.* July 17, 2020. Filed as Exhibit A2 / Tab 3 / Schedule 1 / Attachment 11.

School Energy Coalition Interrogatory # 13

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 41

Please confirm LEI's expert opinion that, if the OEB were to maintain OPG's equity thickness at 45%, LEI's forecasts show that OPG would retain its investment-grade rating.

Response:

The following response is provided by LEI.

Not confirmed. LEI's report (on page 41) observes: "*The OEB should carefully consider the implications of approving equity thickness levels below 47%, as illustrative analysis shows higher risk associated with debt service at lower equity thickness levels. To compensate for such higher risk, rating agencies would need to continue to perceive OPG's business risk profile between strong and excellent over the application period.*"

School Energy Coalition Interrogatory # 14

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 44

Please confirm that inflationary risks are accounted for in the cost of capital through cost of debt and ROE, and are not generally considered a factor in assessing equity thickness.

Response:

The following response is provided by LEI.

LEI does not agree; while the nominal rates embedded in cost of capital calculations incorporate inflation expectations, the timing of changes to the cost of capital may not be synchronized with the way in which the regulated entity experiences inflation. While it is unlikely that inflationary conditions such as those experienced in the 1980s are imminent, during that time it was not uncommon for utilities to seek rate increases more than once a year. As LEI's report (on page 44) notes: "*[i]nflationary pressures could pose a risk to coverage ratios*", and thus, are a consideration in assessing equity thickness.

School Energy Coalition Interrogatory # 15

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 44

LEI expresses agreement with the statement "*Concentric determined that inflationary pressures pose an incremental financial risk due to OPG's fixed hydroelectric payment amount set under the price-cap incentive model*". Please provide a forecast of expected hydroelectric ROE for the period 2022-2026, and provide a sensitivity analysis to show at what level of inflation ROE can be expect to fall below the current Board-approved levels.

Response:

The following response is provided by LEI.

LEI is unable to provide a forecast for hydroelectric ROE without making significant assumptions. In addition, OPG has indicated that it does not calculate a production-specific ROE.

Further, LEI observes that OPG stated the following in the issues list hearing (on May 18, 2021): "*As you're probably aware, there is no production-specific ROE. There is only one ROE for the regulated business in its totality, and that's the basis of why it's considered as a regulated business ROE.*"[9]

[9] Ontario Energy Board. *EB-2020-0920. Transcript. Volume: Issues Day*. May 18, 2021. Page 31.

School Energy Coalition Interrogatory # 16

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 47-48

With respect to changes in utility betas:

a) Please confirm that betas are relevant to ROE, but are not generally applied as a factor in determining equity thickness.

b) Please confirm LEI's expert opinion that the current utility betas are similar to those in existence when the OEB set the ROE formula in EB-2009-0084, and that utility betas in the US and in Ontario are expected to decline between now and 2027.

c) Please confirm LEI's expert opinion that, if utility betas are considered by the OEB as a factor in assessing OPG's equity thickness, they would suggest a reduction rather than increase in equity thickness.

Response:

The following response is provided by LEI.

a. Confirmed. LEI's report (on page 48) notes: "*utility betas, beyond being a metric for perceived market risk, may be less relevant to equity thickness assessment than to the cost of equity. The determination of equity thickness should be more focused on the utility's ability to meet appropriate credit coverage ratios for debt.*"

b. Confirmed. LEI's report (on page 48) observes: "*The recent increase in US utility betas simply brings them back to the levels where they were at around the time EB-2009-0084 was promulgated.*" and *"Current betas are above historical levels, but are likely to revert to historical levels as vaccinations increase, and the economy reopens.*"

c. Not confirmed. LEI's view is that betas should not be considered in determining equity thickness, and LEI would not base a change in equity thickness on changes in betas.

School Energy Coalition Interrogatory # 17

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 51

Please confirm that, on balance, LEI does not believe that provincial/sovereign risk has increased since EB-2016-0152.

Response:

The following response is provided by LEI.

Not confirmed. The province's financial balance has deteriorated, increasing sovereign risk, though this risk remains low.

School Energy Coalition Interrogatory # 18

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 52-53

Please confirm LEI's expert opinion that, as a generation utility with a preponderance of non-GHG facilities, OPG is able to tap a larger investor group through Green Bonds, and this reduces OPG's financial risk.

Response:

The following response is provided by LEI.

LEI confirms that OPG is able to tap a larger investor group through Green Bonds, which may marginally lower its cost of debt. LEI does not believe that the availability of green bonds reduces OPG's financial risk; rather, it changes the way in which markets price that risk. LEI observes in its evidence (page 53) that "*OPG's successful issuance of large amounts of debt through its Green Bond program suggests that there are significant sources of debt financing available for the utility. In particular, investors eager for investments that meet environmental, social and governance ("ESG") criteria may be a source of this funding.*"

School Energy Coalition Interrogatory # 19

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 56-57

Please provide details of the adjustment LEI made to its recommended equity thickness to take account of the 12.18% difference in average equity thickness between Canada and the USA. Please reconcile the adjustment with the fact that "*LEI's recommended equity thickness of 47% lies close to the midpoint of [the US] range*".

Response:

The following response is provided by LEI.

LEI's recommended equity thickness of 47% considers overall changes in risk relative to the previous period, and the need to maintain an investment grade rating. The review of comparative average equity thickness between Canada and the US is only part of the overall analysis. LEI believes that a focus on Canadian equity thickness provides too narrow a sample size to be meaningful, and cannot be considered in isolation from the patterns of the underlying cash flows related to debt commitments.

School Energy Coalition Interrogatory # 20

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 60

Please explain why LEI is not recommending a reduction in equity thickness, to bring the equity thickness for OPG's zero-emitting regulated assets closer to the 26% average for Canadian zero-emitting IPPs. Please explain how LEI's answer is consistent with the quoted conclusion from DBRS that OPG's regulated credit risks would be similar to those of IPPs with contracts like those of this comparator group.

Response:

The following response is provided by LEI.

DBRS states that it "*considers assets under regulatory-styled contracts…to have similar credit risks as regulated operations because those contracts mimic the current regulatory construct under the OEB.*"[10] While this quote is intended to highlight the similarity between OPG's contracted assets to its regulated generation, LEI's recommended equity thickness takes into account a holistic risk profile analysis, and the need to maintain an investment grade rating. While LEI agrees that the equity thickness of the IPPs suggests the ability to take on greater proportions of debt in the capital stack, the magnitude of OPG's near term capital investment financing needs must be considered, along with the ability to raise debt at moderate interest rates.

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[10] DBRS Morningstar. *Ontario Power Generation Inc.* April 16, 2020. Page 4 of 20. Filed as Exhibit A2 / Tab 3 / Schedule 1 / Attachment 4.

School Energy Coalition Interrogatory # 21

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Pages 63-64

Please reconcile LEI's proposed 47% equity thickness with the trends in Great Britain and Australia, and the fact that all equity thicknesses in those jurisdictions are below that level. Please provide details of how LEI went about "adjusting UK and Australian experience for greater risk".

Response:

The following response is provided by LEI.

See response to IR # SEC-19 above with regards to the need to maintain investment grade rating. Adjusting UK and Australian experience for greater risk is related to generation being perceived as riskier than wires.

School Energy Coalition Interrogatory # 22

Issue: 6.1

Issue: Are OPG's proposed capital structure and rate of return on equity appropriate?

Interrogatory

Reference: Exhibit M / Page 70

Please describe the basis on which LEI is proposing an equity thickness for OPG that is higher than the equity thickness of any other Canadian gas or electric utility, and almost 9% greater than the average of the utilities listed in Appendix B. Please explain why the Commissioners in this case should ignore this evidence that 47% would, if approved, be an outlier in Canada.

Response:

The following response is provided by LEI.

See responses to IR# SEC-13 and IR # SEC-19 above with regards to the need to maintain investment grade rating. Utilities can have unique circumstances that impact their specific business and financial risks, and ratings, where applicable. LEI does not believe that an equity thickness of 47% for OPG would be an outlier, considering OPG's business and financial risks.