OEB Staff Interrogatories on Parties' Expert Evidence
Cost of Capital and Other Matters
EB-2024-0063
August 2, 2024

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M2 Evidence of Concentric Economic Advisors, Inc. (Concentric)

M2-2-OEB Staff-1

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 118

Concentric stated the following:

OPG's role as a regulated electricity generator puts the company in a unique position to meet growing demand as electrification and clean energy goals advance as part of the Energy Transition, but this will require large upfront investment and carries a wide range of risks associated with construction.

a) Please provide any examples of OPG not being able to recover large upfront capital costs, if any.

b) Please provide examples of OPG failing to recover incurred costs due to cost disallowances by the OEB.

M2-2-OEB Staff-2

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 122

Concentric stated the following:

The International Energy Agency ("IEA") reports that there is increasing evidence that cyberattacks on utilities have been growing since 2018...

a) Please elaborate on the relative risk of cyberattacks for utilities when compared to other (non-utility) sectors.

b) How do cyberattacks impact the risk of cost recovery?

M2-2-OEB Staff-3

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 128

Concentric stated the following:

On that basis and as further discussed below, we find that these Ontario electric and gas utilities have higher financial risk than the North American proxy groups.

a) Please confirm if major credit rating agencies widely share this view, and provide relevant specific examples.

M2-5-OEB Staff-4

Ref: Concentric Report, pp. 33, 138, 145, 155

Regarding the DSTDR, Concentric noted LEI's recommendation that the OEB consider the average of 3-month CORRA futures rates for the next 12-month period. LEI further recommended that the spread for a R1-low rated utility over CORRA should be applied in the short-term debt rate calculation, with the spread to be determined from an annual confidential survey of 6-10 banks.

Regarding the DSTDR, Concentric agreed with LEI's recommendation of transitioning to replacing the BA rates with CORRA rates in the deemed short-term debt rate methodology.

Concentric stated that it does not support LEI's recommendation to modify annual reporting to include results of recent credit and equity issuances. Concentric did not see the benefit of requiring utilities to file specific details regarding equity and debt issuances during each year. Concentric stated that this would be both administratively burdensome, and beyond typical reporting requirements.

Regarding the prescribed interest rates for DVAs, Concentric noted LEI's recommendation that, for DVAs, the OEB align the prescribed interest rates with LEI's proposal for the DSDTR, which is the average of 3-month CORRA futures rates for the next 12-month period plus the spread for a R1-low rated utility over CORRA, based on a confidential survey of 6-10 banks.

OEB staff notes that Bloomberg publishes the following ticker each business day, related to Canadian utilities:

BVCAUA3M BVLI Index	CAD Canada Utilities A+ A A- BVAL Yield Curve 3 Month

a) Instead of using the average of 3-month CORRA futures rates for the next 12-month period, plus conducting a confidential bank survey, what are Concentric's views on instead using the Bloomberg BVCAUA3M BVLI Index (3-month) for the DSTDR and the prescribed interest rates for DVAs, which has a spread already built in?

b) Does Concentric have any alternative views on how to derive an appropriate DSTDR and prescribed interest rate for DVAs (including an appropriate spread), without conducting bank surveys or collecting actual short-term loan data from utilities? If so, please elaborate.

c) What are Concentric's views as to whether the short-term loan data underlying the calculations should reflect three-month loans or one-year loans?

d) LEI stated on page 80 of its report that "since CORRA is an overnight risk-free rate, it has historically been slightly lower than the 3-month CDOR. Based on a Bloomberg analysis, the official recommendations from CARR suggest adding 32.138 bps to CORRA to be comparable with the 3-month CDOR. Consequently, the spreads associated with CORRA will be different from the spreads over the 3-month BA rate/CDOR."

   Does Concentric agree that if bank survey spreads over the 3-month CORRA futures rates are obtained, then the 32.138 bps would not need to be added to the rate applied to the DSTDR or prescribed interest rates? If not, please explain what spread would need to be added.

e) To obtain the average of 3-month CORRA futures rates for the next 12-month period, does Concentric agree that the data would be obtained from the following website, using settlement price data as of September 30, 2024, and derived by selecting "Futures", then "CRA"? If this is not the case, please explain.

https://www.m-x.ca/en/trading/data/historical

M2-5-OEB Staff-5

Ref: EB-2024-0063, OEB Letter and Accounting Order, July 26, 2024

On July 26, 2024, the OEB issued a letter regarding prescribed DVA interest rates and the DSTDR.

The purpose of this letter was to provide an update regarding the calculations of the above-noted prescribed interest rates for DVAs and the DSTDR, given that the three-month bankers' acceptances that underpin these calculations have been phased-out.

The OEB stated that it will set the prescribed DVA interest rates for 2024 Q4 and 2025 Q1 on a final basis, using the Canada three-month T-bill rates at the time plus a 25 basis point spread. The DVA interest rates are expected to be issued by the OEB in mid-September 2024 and mid-December 2024, respectively. The final rate will be the three-month Canada T-bill rate as at August 30, 2024 (for the 2024 Q4 DVA rate) and November 29, 2024 (for the 2025 Q1 DVA rate), plus a fixed spread of 25 basis points.

The OEB also stated that in October 2024, the DSTDR will be set by the OEB, on an interim basis for those utilities rebasing for 2025 rates, using the average of the three-month Canada T-bill rate for each business day in September 2024.[1] The bank survey from September 2023 (the prior year) will be used as the average annual spread. No bank survey will be conducted in September 2024.

The OEB also approved the establishment of a generic variance account to capture certain revenue requirement impacts related to the DSTDR.

a) Please provide Concentric's views on the OEB's approach outlined in the OEB's July 26, 2024 OEB Letter and Accounting Order, but only related to what could be used going forward, specifically using the three-month Canada T-bill rate to calculate:

[1] The DSTDR will apply to those utilities rebasing for 2025 rates, but with a decision expected in advance of the OEB's decision in the cost of capital generic proceeding.

i. Prescribed DVA interest rates for 2025 Q2 and forward, plus a 25 basis point spread
ii. The DSTDR for 2026 and forward, plus a spread using a bank survey

b) Given the elimination of the bankers' acceptance rates, does Concentric's viewpoint still remain that the CORRA rate should be used, or alternatively, please elaborate on a different methodology that should be used.

M2-7-OEB Staff-6

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 38

Concentric stated the following:

With the index constituent bonds comprising issuances rated A+, A, and A-, entities like OPG that are rated on the lower end of this spectrum would not be appropriately compensated for their cost of debt, given that each notch lower on the credit rating scale entails a higher cost of funding.

a) Please provide the basis for this claim i.e., the list of regulated utilities in Ontario and their respective credit ratings.

M2-10-OEB Staff-7

Ref: Concentric Report, pp. 95 & 98 & 100

Concentric noted that its base LCBF (3.36%) and base utility credit spread (1.371%) use data as of May 31, 2024. Concentric recommended updating these data closer to when a final decision is made in this proceeding.

Concentric stated that it used the Alberta methodology.

In "Figure 32: ERP for Proxy Group Based on Model Results", Concentric showed a long bond forecast of 3.80% and an average equity risk premium of 6.19% to calculate its recommended base ROE of 10.0%. The 6.19% is the average of 6.03%, 6.43%, and 6.10%.

a) Please provide Concentric's supporting calculations for the base LCBF (3.36%) and base utility credit spread (1.371%) in Excel format and explain.

b) Please show Concentric's supporting calculations for the long bond forecast of 3.80% in Excel format and explain.

c) Please explain why Concentric is using a LCBF of 3.36% in one instance and 3.80% in another instance.

d) At a high level, please provide Concentric's supporting calculations of the equity risk premiums shown in Figure 32 of 6.03%, 6.43%, and 6.10% in Excel format and explain.

M2-10-OEB Staff-8

Ref: Concentric Report, pp. 9 & 10 & 100

Concentric recommended an authorized base ROE of 10.0 percent.

Concentric stated that this ROE recommendation is based on the average results of the multi-stage DCF model, the CAPM using a historical market risk premium for the North American combined proxy group, and the Risk Premium model, which is the most conservative (lower) estimate of the required return.

However, "Figure 32: ERP for Proxy Group Based on Model Results", shows that the North American electric proxy group is being used, as opposed to the North American combined proxy group.

a) Please clarify which proxy group Concentric proposes to use to support its base ROE of 10.0 percent.

b) If the North American combined proxy group is being used, please explain why "Figure 1, Summary of ROE Results", shows 10.1%, instead of Concentric's recommendation of 10.0%.

c) If Concentric proposes to use the North American combined proxy group:
   i. At a high level, please provide Concentric's supporting calculations of "Figure 1, Summary of ROE Results" in Excel format and explain.
   ii. Please update Concentric's "Figure 32: ERP for Proxy Group Based on Model Results" reflecting the North American combined proxy group, provide supporting calculations in Excel format, and explain.

M2-10-OEB Staff-9

Ref: EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. ii
LEI Report, p. 16
Concentric Report, pp. 98 & 105
Nexus Report, p. 79
Dr. Cleary Report, pp. 45, 46

OEB staff has prepared the following table showing the proposed adjustment factors.

Table 1 – Adjustment Factors Used to Compute ROE

	LCBF Adjustment Factor	**Utility Bond Spread Factor**
Current OEB methodology EB-2009-0084	0.50	0.50
LEI Proposed	0.26	0.13
Concentric Proposed	0.40	0.33
Nexus Proposed	No independent formula proposed	
Dr. Cleary Proposed	0.75	0.75

While Concentric agreed with LEI that coefficients have come down since 2009, Concentric stated that its estimates indicate LEI's recommended adjustment factors are too low. Instead, Concentric recommended the OEB set adjustment factors at 0.40 for the LCBF and 0.33 for the utility credit spread, which recognizes the lower empirical relationship between ROEs and bond yields compared to previous years, while still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads.

Dr. Cleary stated that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile."

a) Concentric - please comment on Dr. Cleary's statement that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile", whereas Concentric stated that there is a "lower empirical relationship between ROEs and bond yields compared to previous years, while [Concentric's proposed adjustment factors are] still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads."

b) Please explain why Concentric's proposed adjustment factors are reasonable, when compared to the other adjustment factors presented in Table 1.

M2-10-OEB Staff-10

Ref: Concentric Report, p. 10

Concentric recommended that should OPG bring forward a proposal and evidence in its payment amounts application regarding whether and what amount of additional risk premium should be applied to its authorized ROE, and the OEB consider that proposal at its discretion as part of that proceeding.

Concentric further stated:

- The OEB has previously found that there is a heightened risk of nuclear generation relative to hydroelectric generation, which is important to consider as OPG embarks on first-of-a-kind nuclear projects in addition to refurbishing its existing nuclear units.
- The base ROE recommendation of 10.0 percent understates the ROE needed to meet the Fair Return Standard for OPG.
- There are also no direct comparators in the proxy groups analyzed by Concentric for OPG's pure-play rate-regulated generation operations.

a) Please explain whether OPG's payment amounts should be adjusted on an interim basis, based on the outcomes of the current proceeding, and then examined further in its next payments amounts proceeding.

M2-10-OEB Staff-11

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 10

Concentric stated the following:

An 8.95 percent authorized ROE would be in the bottom decile of authorized ROEs among Canadian and U.S. utilities and would not satisfy the Fair Return Standard.

a) Please provide backup data (in MS Excel) for the claim that 8.95% is in the bottom decile of authorized ROEs.

b) Please identify the decile for Concentric's recommended ROE of 10%.

c) Assuming Concentric's claim is accurate, please explain why would being in the bottom decile not satisfy FRS when other jurisdictions also fall into this decile?

d) Is Concentric suggesting that other jurisdictions in the bottom decile also failed to meet FRS?

e) Please confirm that LEI's recommended ROE of 8.95% does not include transaction/issuance costs, which LEI has recommended be considered as operating costs. If Concentric disagrees, please explain.

M2-10-OEB Staff-12

Note this interrogatory has been asked by LEI

Ref: Concentric Report, Figure 16, p. 66

Concentric presented a chart on "Value Line and Bloomberg Betas" in Figure 16 on this page.

a) Please provide the backup calculations for the derivation of the Betas provided in the Figure (in MS Excel worksheet)

b) Please provide the breakdown of raw betas, and how the raw beta was adjusted, for each company in the six proxy groups (in MS Excel worksheet).

M2-10-OEB Staff-13

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 66

Concentric stated the following:

There are two primary reasons to adjust raw betas. First, empirical studies have provided evidence that an individual company beta is more likely than not to move toward the market mean of 1.0 over time.

a) Please provide empirical evidence substantiating the appropriateness of weights (2/3 for raw beta and 1/3 for 1.0) for mature industries such as regulated utilities.

b) Concentric has cited a June 1975 study for this claim. Please provide more recent citations (since 2009) with empirical evidence.

c) Please clarify if the weights (2/3 for raw beta and 1/3 for 1.0) have been validated by market data obtained after 2009. If so, please provide backup calculations (in MS Excel). If not, please explain the rationale for utilizing these weights.

d) The factors that may push towards one include: firms that survive in the market tend to increase in size over time, become more diversified and have more assets in place, producing cash flows (Source: Aswath Damodaran):
    i. Please explain how these factors apply to regulated utilities, which are made up of mature companies.
    ii. Please provide examples of adjusted beta being determined for a sector as a whole (as opposed to determining adjusted beta for a single company).

e) In Concentric's view, do the OEB-regulated utilities have significant scope for diversification beyond their current regulated activities? Please explain.

M2-10-OEB Staff-14

Note this interrogatory has been asked by LEI

Ref: Concentric Report, Figure 17, p. 69

Concentric presented a chart on "Market Risk Premia – Canada and U.S." in Figure 17 on this page.

a) Please provide the backup calculations for the derivation of each of these numbers (in MS Excel worksheet).

M2-10-OEB Staff-15

Note this interrogatory has been asked by LEI

Ref: Concentric Report, Figure 19, p. 71

Concentric presented a chart on “Hamada Equation – Adjustment to CAPM Results in Basis Points” in Figure 19 on this page.

a) Please provide the backup calculations for the derivation of each of these numbers (in MS Excel worksheet).

M2-10-OEB Staff-16

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 71

Concentric stated the following:

It is common practice for Canadian regulators to approve an adjustment for flotation costs and financing flexibility, with 50 basis points being the norm.

a) Other than it being common practice, please provide the empirical basis (with examples of actual utility flotation costs) for recommending 50 basis points associated with floatation costs.

M2-11-OEB Staff-17

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 7

Concentric stated the following:

Concentric’s recommendations fall short of parity between Ontario and U.S. utilities, but would advance the ability of Ontario’s utilities to compete for investment capital on a comparable basis with their North American peers.

a) Please elaborate on the above statement.

b) Please provide real-world examples of Ontario utilities being unable to compete for investment capital on a comparable basis with their North American peers.

M2-12-OEB Staff-18

Ref: EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 50
LEI Report, p. 17
Concentric Report, pp. 137, 141
Nexus Report, p. 84
Dr. Cleary Report, p. 50, 54, 115, 119, 121, 127

OEB staff has prepared the following table showing the proposed equity thickness ratios.

Table 1 – Proposed Equity Thickness Ratios

	Electricity Distributors and Transmitters	Hydro One	Enbridge	OPG
Current OEB methodology EB-2009-0084	40%	40%	Case by case basis	
LEI Proposed	Use existing approach			
Concentric Proposed	45%	45%	45%	TBD in OPG's next payment amounts proceeding
Nexus Proposed	Use existing approach for electricity distributors	Not addressed		
Dr. Cleary Proposed	Use existing approach	38% and 36% over the following two to three years	36%	Not addressed

Dr. Cleary stated that his recommendation for the allowed equity ratio for Enbridge Gas Inc. remains at 36%, which was the recommendation provided in his evidence during the Enbridge Gas rebasing application in 2023.

However, Dr. Cleary acknowledged that the OEB decision was made to increase Enbridge's deemed equity ratio to 38%, primarily due to a perceived increase in energy transition risks. Dr. Cleary stated that he did not believe this increase was necessary.

Dr. Cleary stated that Enbridge earned ROEs above the allowed ROEs for 33 straight years from 1990 to 2022, and that over the entire period it earned ROEs that exceeded allowed ROEs by an annual average (median) of 1.09% (1.10%). Dr. Cleary stated that this is bottom line empirical evidence that Enbridge has low risk.

Dr. Cleary recommended that Hydro One's allowed equity ratio be reduced to 38%, and that the OEB consider reducing it further to 36% (along with Enbridge's equity ratio) over the following two to three years.

Dr. Cleary stated that Hydro One has been able to consistently earn its allowed ROEs or higher over the most recent six-year period (2018-2023). Dr. Cleary stated that this can be considered a strong indicator that Hydro One possesses low total risk.

Dr. Cleary stated that there is no reason that Hydro One's equity ratio could not be lowered to as low as 36% and still allow it to borrow and issue equity at attractive rates, as well as maintain solid credit metrics.

Concentric stated that LEI's views did not consider the unique risks of transmission development, and the extent to which they are proportionately greater for a single-asset developer lacking the diversity of revenues and cash flows of a diversified transmission (or T&D) owner in Ontario. Concentric stated that reliance on one customer, the IESO, if anything increases risk, as IESO's rules are subject to operational and government policy changes not found in a broader customer mix.

a) What are Concentric's views on Dr. Cleary's recommendations to reduce Hydro One's allowed equity ratio to 38%, and that the OEB consider reducing it further to 36% (along with Enbridge's equity ratio) over the following two to three years?

M2-12-OEB Staff-19

Ref: EDA Report, pp. 43 & 46 & 84
Dr. Cleary Report, pp. 29 & 44

Concentric Report, pp. 136 & 137

Nexus stated that “capital from US exchanges is equivalent to capital from Canadian exchanges.”

Nexus’ proposal is that the OEB retain its existing policy regarding capital structure applicable to electricity distributors for now.

Dr. Cleary stated that U.S. utilities are not reasonable comparators for Canadian utilities. In Dr. Cleary’s view, this is true because they have significantly higher business risk – partly due to their holding company structure and business holdings, partly due to operating in the U.S. and not in Canada, and partly due to the nature of their operations which entail more risk.

Concentric stated that it finds that Ontario’s regulated distribution and transmission utilities generally have comparable business risk to the companies in the North American Electric and Gas comparator groups. Concentric also concluded that Ontario’s utilities have similar financial risk to other electric and gas utilities in Canada and substantially greater financial risk than their U.S. peers due to the relatively low deemed equity ratios of 38 percent for Enbridge Gas, 40 percent for electric distribution and electric transmission, and 45 percent for OPG.

Concentric stated that an immediate move to parity with the U.S. would be abrupt. For that reason, Concentric recommended that the OEB set a minimum deemed equity ratio for Ontario utilities of 45 percent, which is at a point approximately halfway between the Ontario level and the U.S. average.

a) Concentric – please provide Concentric’s views on Dr. Cleary’s statement that U.S. utilities are not reasonable comparators for Canadian utilities.

b) Concentric – please explain why a minimum deemed equity ratio for Ontario utilities of 45 percent is appropriate, given Dr. Cleary’s statements noted above, and Nexus’ recommendation to keep the status quo.

M2-12-OEB Staff-20

Ref: Concentric Report, p. 11

Concentric recommended that the deemed equity ratio be set at a minimum of 45.0 percent for all Ontario utilities, but that each utility have the option to retain its current equity ratio and/or propose differences from the “generic” equity thickness in its rates application.

Alternatively, Concentric stated that if the OEB maintains the current deemed equity ratios of 38.0 percent for Enbridge Gas and 40.0 percent for Ontario’s electric transmission and distribution utilities, then Concentric recommended adjusting the authorized generic ROE for differences in financial leverage between the Ontario utilities and the proxy group companies.

Concentric stated that this would result in an upward adjustment of 138 to 163 basis points to Concentric’s 10.0 percent ROE recommendation, based on the North American proxy groups and the CAPM analysis using a historical market risk premium.

a) Please explain why it would be reasonable to adjust utilities’ allowed ROE, in lieu of making adjustments to utilities’ capital structures set by the OEB.

b) Please elaborate how this would be achieved in utilities’ rate proceedings.

c) If Concentric were to add 138 to 163 basis points to its 10.0% ROE recommendation, i.e., ROE of 11.38% to 11.63%, what would the decile be for the updated ROE among authorized ROEs for Canadian and U.S. utilities?

M2-12-OEB Staff-21

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 11

Concentric stated the following:

With regard to equity thickness, Concentric’s primary finding within the context of this generic cost of capital proceeding is that Ontario equity ratios across all industry segments are lower than North American industry peers and fail to meet the comparable return standard component of the Fair Return Standard.

a) Concentric has stated that the equity thickness allowed in Ontario fails to meet the comparable return standard component of the Fair Return Standard. How does Concentric reconcile this claim with the assessment of Ontario’s utilities by most credit rating agencies, e.g., Ontario being considered as “most credit supportive” by S&P Global? Please explain.

M2-12-OEB Staff-22

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p.138

Concentric stated the following:

LEI's recommendation for utilities to include forward cash flow modeling and scenario analysis showing the impact on credit metrics to support significant changes in business and/or financial risks creates a methodology that is too rigid and limiting for supporting changes that may need custom approaches in the future, and also raises confidentiality concerns.

a) Please explain how the inclusion of forward cash flow modeling and scenario analysis would lead to:
   i. a methodology that is too rigid and limiting for supporting changes;
   ii. needing custom approaches in the future; and
   iii. confidentiality concerns for the OEB (particularly as data required for forward cash flow modeling and estimating impact on credit metrics is already part of utility applications).

b) Does Concentric agree that the major rating agencies analyze utilities' own forward-looking cash flows and impact on credit metrics closely when determining their ratings (and rating changes)? If not, please explain.

c) Please confirm that forward cash flow modeling is a standard financial practice in any commercial enterprise. If Concentric disagrees, please explain.

d) Please confirm that LEI has recommended mandating forward cash flow modeling only when applying for a change in deemed equity thickness. If Concentric disagrees, please explain.

M2-14-OEB Staff-23

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p.145

Concentric stated the following:

We do not, however, see the benefit of requiring utilities to file specific details regarding equity and debt issuances during each year. This would be both administratively burdensome, and beyond typical reporting requirements.

a) LEI understands that the number of equity/debt issuances is typically in the low single digits. For example, based on S&P Capital IQ, Enbridge Gas Inc. has had eight long-term debt issuances over 5+ years since its amalgamation in 2019. Please explain how reporting on equity and debt issuances would be administratively burdensome.

b) Please estimate the steps and the amount of time needed to report information that is readily available from the company's accounting/finance functions and is limited to key details such as type of issuance (bonds, notes, commercial paper, equity, etc.) and key financial terms (maturity period, coupon rate, yield to maturity, etc.).

M2-16-OEB Staff-24

Ref: Dr. Cleary Report, p. 52
Concentric Report, p. 147

In terms of the timing of the OEB's annual cost of capital parameters updates, Dr. Cleary supported the use of October data as opposed to September data. Dr. Cleary stated that this would provide more up-to-date capital market estimates and hence improve the accuracy of the parameters used in the ROE formula which is consistent with the approach recently introduced in Alberta.

Concentric stated that it is in agreement with LEI on the annual updates to the OEB's cost of capital parameters in October, using data as of September 30th, except where forecasts are utilized. Concentric generally recommended trailing 90-day averages where historic data are utilized to avoid the inherent volatility in a single month's data.

a) Concentric - in terms of the timing of the OEB's annual cost of capital parameters update, please provide Concentric's view on using October data, as opposed to trailing 90-day average data as of September 30.

M2-18-OEB Staff-25

Ref: Concentric Report, pp. 148, 149, 150

Concentric stated that changes in the cost of capital parameters (ROE, long-term debt and short-term debt rates) should take effect for all utilities in the rate year following the OEB's decision in this proceeding (subject to any settlement agreements and each utility submitting a compliance filing demonstrating how the change would be implemented within the context of its specific IR plan), and in subsequent periods where the parameters are updated.

Concentric stated that all other elements and incentives of existing rate plans would remain in effect.

Concentric stated that it is not necessary to wait for rebasing, and any delays in implementation would not serve the public interest or meet the Fair Return Standard if the OEB determines that updated parameters are justified.

Concentric noted that depending on the magnitude of change in the deemed capital structure, the OEB may want to consider changes in capital structure implemented over a period of up to three years. This incremental approach would serve two purposes: 1) to allow the utility treasury functions to manage the transition (e.g., retiring debt and investing new equity as appropriate), and 2) to mitigate the effects of any rate impacts. Concentric stated that unlike ROE and debt rates, changes in the capital structure can require time to implement.

Concentric stated that it sees no basis for the limitations recommended in LEI's two-prong test, or a determination of "rate shock". Concentric suggested that the FRS has no provision for "rate shock", or a 100 basis point differential (i.e., LEI's noted level of deviations in the cost of capital parameters). Concentric stated that the cost of capital is a true cost that should be recognized in customer rates as soon as reasonably possible.

a) Please provide Concentric's views on how it would be practical to implement any changes in the cost of capital parameters or capital structure resulting from a decision in the current proceeding, in a utility's subsequent rate year. Also, how does Concentric propose to mitigate any regulatory burden that may result?

b) If changes in the cost of capital parameters or capital structure resulting from a decision in the current proceeding are effective and implemented in a utility's subsequent rate year, does Concentric propose that only the revenue requirement impacts of such changes should impact the subsequent rate year rate impacts? In Concentric's view, what would be the best way to implement?

c) Although Concentric stated that the cost of capital is a true cost that should be recognized in customer rates as soon as reasonably possible, how does this differ from other costs that may be incorporated into rates only at rebasing?

d) What basis point differential does Concentric suggest that should be used to implement changes to cost of capital parameters, in the event that the OEB does not approve changes related to cost of capital during a utility's rate term?

M2-21-OEB Staff-26

Ref: Concentric Report, pp. 152, 155

Concentric stated that the applicable regulatory standard with regard to the carrying cost on regulatory assets is the Fair Return Standard.

Concentric stated that the principle of a fair return applies to DVAs because utilities have committed capital to fund their deferred costs, and that commitment of capital warrants the opportunity to earn a reasonable return.

Concentric stated that for utilities to have the opportunity to earn a reasonable return, they must have the opportunity to recover the WACC. Concentric stated that to draw a line that traces one source of financing to one asset for purposes of establishing the return on DVAs would be inconsistent with the application of a WACC return to each utility's overall rate base.

a) Please provide more support on Concentric's view that the applicable regulatory standard (or DVAs) with regard to the carrying cost on regulatory assets is the Fair Return Standard, as the OEB in the past has characterized the Fair Return Standard as primarily relating to ROEs (and not primarily to WACC or regulatory assets/ DVAs).

M2-21-OEB Staff-27

Ref: Concentric Report, pp. 152 & 155 & 156

Concentric agreed with LEI's recommendation for short-term DVAs (i.e., accounts that will clear within one year), but, Concentric recommended that the OEB apply each utility's WACC to long-term DVAs.

Concentric suggested that long-term DVAs are balances that are to remain on utilities' balance sheets for more than one year.

LEI did not differentiate between short-term and long-term DVAs.

Concentric recommended that the OEB apply the WACC to CWIP, for purposes of accruing carrying costs on construction balances. Concentric noted that from an implementation perspective, this approach is not burdensome because the WACC for each utility is readily available.

Concentric stated that the OEB's current approach to carrying charges on CWIP recognizes the long-term nature of construction projects by applying a long-term cost of debt, but ignores that utilities also employ retained earnings and equity issuances to fund construction. Concentric stated that excluding the cost of equity borne by utilities during construction deprives the utilities of the opportunity to recover their full costs of financing, including the cost of equity over the life of the investment.

Concentric further stated that a long-term debt-only approach also places the Ontario utilities out of step with their U.S. and Canadian peers, placing them at a relative disadvantage in the ability to attract equity capital.

a) Please provide Concentric's views on how it would define short-term DVAs from long-term DVAs.

b) Would Concentric view all Group 1 DVAs as short-term and all Group 2 DVAs as long-term?

c) In Concentric's view, when the Group 1 DVAs are not disposed and carry more than one year's balance, do these DVAs become long-term DVAs?

d) Please provide Concentric's views on the potential increased regulatory burden on the OEB and stakeholders upon the separation of short-term DVAs from long-term DVAs.

e) Regarding Concentric's recommendations that the OEB apply each utility's WACC to long-term DVAs and CWIP, which WACC does Concentric propose to be used? For example:

i. Regarding the balances approved for disposition in IRM proceedings, is Concentric suggesting that the WACC from the utilities' last rebasing proceeding be used?
ii. Regarding the balances approved for disposition in cost-based proceedings, is Concentric suggesting that the WACC from the utilities' current cost-based proceeding be used?
iii. Regarding the balances accumulated in the CWIP account and carried forward to rate base in a cost-based proceeding, is Concentric suggesting that the WACC from the utilities' last rebasing proceeding be used?

f) Please explain further why using a debt-only approach for CWIP places Ontario utilities "at a relative disadvantage in the ability to attract equity capital."

M2-21-OEB Staff-28

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p.152

Concentric stated the following:

In addition, while utilities may use short-term debt to finance immediate needs such as capital expenditures or working capital needs, they will also refinance those borrowings with long-term financing as practical and as market circumstances afford.

a) In light of this statement, please explain the rationale for Concentric recommending WACC, instead of short-term/long-term debt rate for estimating carrying costs for DVAs?

M2-21-OEB Staff-29

Note this interrogatory has been asked by LEI

Ref: Concentric Report, p. 26

Concentric stated the following:

…other DVAs may be conceptually endorsed by the OEB, but are subject to approval on a case-by-case basis. Amounts recorded in a Group 2 account are subject to a prudence review at disposition, which can draw increased regulatory scrutiny.

a) Please explain what Concentric means by "increased regulatory scrutiny." How does it differ from the typical regulatory scrutiny for other aspects of utility applications?

M2-22-OEB Staff-30

Ref: LEI Report, pp. 173 & 174
Concentric Report, pp. 163

LEI's report stated the following recommendations:

> *…The OEB can allow the prescribed interest rate for the DVAs on the incremental operating costs. The recorded incremental operating costs and the relevant costs allowed during IRM proceedings (if any) can be treated as amortized costs of the cloud computing contract. The OEB can treat the balance unamortized portion of the cloud-based contracts (contract value minus amortized costs) as deemed capital additions to incentivize the transition to cloud-based software solutions… A deemed WACC (based on allowed capital structure, ROE, DLTDR and DSTDR, and determined as of the year of rebasing or the year of disposition, for the remaining term of the contract) for all utilities may be allowed on the deemed capital additions…*

Concentric recommends that the WACC apply to Cloud Computing deferral account carrying costs, in order to incentivize utilities to invest in beneficial cloud computing technologies.

a) Concentric - please confirm that since Concentric is proposing to apply the WACC to all long-term DVAs, Concentric proposes to record the WACC on all amounts (including operating costs) recorded in the Cloud Computing deferral account and not solely on the unamortized portion of the cloud-based contracts (as recommended by LEI). If this is not the case, please explain.

M3 Evidence of Nexus Economics LLC (Nexus)

M3-2-OEB Staff-31

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 8

Nexus stated the following:

While there are several risks facing Ontario utilities, there can be none more fundamental than the imminent energy transition, sometimes also referred to as ‘electrification’.

a) In your opinion, is energy transition a significant opportunity for electricity distributors to significantly increase the size of their rate base (thereby increasing the $ ROE earned)? If not, please explain.

b) Have any major credit rating agencies (such as S&P Global, DBRS Morningstar, and/or Moody’s) expressed concerns that Ontario utilities may be unable to recover the capital or operating costs over the next 5 years? If yes, please provide examples.

c) Please provide examples of disallowances of actual costs incurred from energy transition.

M3-2-OEB Staff-32

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 25

Nexus stated the following:

LEI has identified business and financial risks in its report. However, given the changes in industry structure occurring due to decarbonization and electrification efforts, Nexus Economics has also identified a category of risk that LEI ignores: strategic risk.

a) What specific business decisions face “strategic risk”?

b) Please explain how ‘strategic risk’ is not evaluated as part of ‘business risks’ and ‘financial risks’ as assessed by OEB as well as major rating agencies (such as S&P Global, DBRS Morningstar, and/or Moody’s).

c) Please confirm that LEI’s recommendation for Issue 2 explicitly mentions that utilities should be allowed to highlight additional risk categories in their rate applications if they consider them material.

M3-3-OEB Staff-33

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 26

Nexus stated the following:

Prior policies adopted by the OEB to facilitate policy goals and reduce the risk faced by distributors have become obstacles to adopting new goals. For example, in the past several years, the OEB adopted residential fixed distribution charges (i.e., no volumetric component of the tariff) to address the declining residential average usage problem and facilitate the adoption of DERs. However, the adoption of electrification policies would presumably reverse the trend of decreasing average usage and thus limit revenue growth to distributors.

a) Please confirm that a distributor's annual costs (or annual revenue requirement) do not vary meaningfully based on short-term variations in electricity usage, as it is mainly made up of fixed costs. If Nexus disagrees, please explain.

b) Please confirm that forecasts of consistently increasing electricity usage over the long term will lead to increased expansion of the distribution network via capital investments, leading to an increased utility rate base. If Nexus disagrees, please explain.

c) Please explain whether fixed or volumetric distribution charges are more suitable for recovering capital investments.

M3-3-OEB Staff-34

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 31

Nexus stated the following:

Many of the mechanisms referenced by LEI (e.g., Customer Choice Initiative, Broadband deferral, Getting Ontario Connected) are valuable programs but relatively immaterial. These programs have a very marginal impact on the level of risk which the distributors are exposed.

a) Please define the terms "immaterial" and "very marginal" as referenced in this extract.

b) Please confirm if Nexus intends to say whether DVAs collectively have very marginal impacts or if only the new DVAs implemented since 2006 have very marginal impacts.

M3-5-OEB Staff-35

Ref: EB-2024-0063, OEB Letter and Accounting Order, July 26, 2024

On July 26, 2024, the OEB issued a letter regarding prescribed DVA interest rates and the DSTDR.

The purpose of this letter was to provide an update regarding the calculations of the above-noted prescribed interest rates for DVAs and the DSTDR, given that the three-month bankers' acceptances that underpin these calculations have been phased-out.

The OEB stated that it will set the prescribed DVA interest rates for 2024 Q4 and 2025 Q1 on a final basis, using the Canada three-month T-bill rates at the time plus a 25 basis point spread. The DVA interest rates are expected to be issued by the OEB in mid-September 2024 and mid-December 2024, respectively. The final rate will be the three-month Canada T-bill rate as at August 30, 2024 (for the 2024 Q4 DVA rate) and November 29, 2024 (for the 2025 Q1 DVA rate), plus a fixed spread of 25 basis points.

The OEB also stated that in October 2024, the DSTDR will be set by the OEB, on an interim basis for those utilities rebasing for 2025 rates, using the average of the three-month Canada T-bill rate for each business day in September 2024.[2] The bank survey from September 2023 (the prior year) will be used as the average annual spread. No bank survey will be conducted in September 2024.

The OEB also approved the establishment of a generic variance account to capture certain revenue requirement impacts related to the DSTDR.

a) Please provide Nexus' views on the OEB's approach outlined in the OEB's July 26, 2024 OEB Letter and Accounting Order, but only related to what could be used going forward, specifically using the three-month Canada T-bill rate to calculate:

[2] The DSTDR will apply to those utilities rebasing for 2025 rates, but with a decision expected in advance of the OEB's decision in the cost of capital generic proceeding.

i. Prescribed DVA interest rates for 2025 Q2 and forward, plus a 25 basis point spread
ii. The DSTDR for 2026 and forward, plus a spread using a bank survey

M3-10-OEB Staff-36

Ref: EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. ii
LEI Report, p. 16
Concentric Report, p. 98 & 105
Nexus Report, p. 79
Dr. Cleary Report, pp. 45 and 46

OEB staff has prepared the following table showing the proposed adjustment factors.

Table 1 – Adjustment Factors Used to Compute ROE

	LCBF Adjustment Factor	**Utility Bond Spread Factor**
Current OEB methodology EB-2009-0084	0.50	0.50
LEI Proposed	0.26	0.13
Concentric Proposed	0.40	0.33
Nexus Proposed	No independent formula proposed	
Dr. Cleary Proposed	0.75	0.75

While Concentric agreed with LEI that coefficients have come down since 2009, Concentric stated that its estimates indicate LEI's recommended adjustment factors are too low. Instead, Concentric recommended the OEB set adjustment factors at 0.40 for the LCBF and 0.33 for the utility credit spread, which recognizes the lower empirical relationship between ROEs and bond yields compared to previous years, while still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads.

Dr. Cleary stated that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile."

Nexus stated that it does "not offer an independent adjustment formula."

a) Nexus – please comment on Dr. Cleary's statement that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile", whereas Concentric stated that there is a "lower empirical relationship between ROEs and bond yields compared to previous years, while [Concentric's proposed adjustment factors are] still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads."

b) Please explain why Nexus has offered criticism on LEI's suggested approach, but not offered proposed adjustment factors, as noted in Table 1.

M3-10-OEB Staff-37

Ref: Nexus Report, pp. 43 & 46
Dr. Cleary Report, pp. 29 & 44
OEA Report, p. 136

Nexus stated that "capital from US exchanges is equivalent to capital from Canadian exchanges."

Nexus further stated that "LEI errs in substituting the forecasted 30-year Canadian Treasury rate for a US rate in its specification of the CAPM."

Dr. Cleary stated that U.S. utilities are not reasonable comparators for Canadian utilities. In Dr. Cleary's view, this is true because they have significantly higher business risk – partly due to their holding company structure and business holdings, partly due to operating in the U.S. and not in Canada, and partly due to the nature of their operations which entail more risk.

Dr. Cleary also noted that Appendix B of LEI's evidence indicates that U.S. 30-year Treasury yields were used in LEI's regression, and not 30-year Government of Canada yields – "so it is not clear to me which variable was actually used."

Concentric stated that it finds that Ontario's regulated distribution and transmission utilities generally have comparable business risk to the companies in the North American Electric and Gas comparator groups. Concentric also concluded that Ontario's utilities have similar financial risk to other electric and gas utilities in Canada and substantially greater financial risk than their U.S. peers due to the relatively low deemed equity ratios of 38 percent for Enbridge Gas, 40 percent for electric distribution and electric transmission, and 45 percent for OPG.

a) Nexus – please elaborate why Nexus stated that LEI erred in using a forecasted 30-year Canadian Treasury rate in its CAPM calculations, in the context of Nexus' statement that capital from the US is equivalent to capital from Canada.

b) Please provide Nexus' views on Dr. Cleary's statement that U.S. utilities are not reasonable comparators for Canadian utilities.

M3-10-OEB Staff-38

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 5

Nexus stated the following:

This result includes 50 basis points for transaction costs associated with acquiring the equity, which is a continuation of existing OEB policy.

a) Other than the fact that this would be a continuation of existing OEB policy, please provide the empirical basis for recommending 50 basis points for transaction costs associated with acquiring equity.

M3-10-OEB Staff-39

Note this interrogatory has been asked by LEI

Ref: Nexus Report, Figure 2, p. 7

Nexus presented a chart on "Impacts of Corrections to the LEI ROE Calculation" in Figure 2 on this page.

a) Please provide the backup calculations for the derivation of each of these numbers (in MS Excel worksheet).

M3-10-OEB Staff-40

Note this interrogatory has been asked by LEI

Ref: Nexus Report, Figure 5, p. 22

Nexus presented a chart on "Authorized ROEs for Ontario and Peer Jurisdictions (Re-levered to 60:40)" in Figure 5 on this page.

a) Please provide the backup calculations for the derivation of each of these numbers (in MS Excel worksheet).

M3-10-OEB Staff-41

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 30

Nexus stated the following:

However, Nexus Economics does not agree with LEI that the regulatory environment offered in Ontario is significantly safer than its peers and, therefore, should be provided with a lower ROE.

a) Please provide a reference for this claim in LEI's report.

b) Please reconcile Nexus' view with Ontario being recently considered as "most credit supportive" by S&P Global relative to multiple other jurisdictions.[3]

M3-10-OEB Staff-42

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 38

Nexus stated the following:

We include in this Summary two tables that underscore Nexus' recommended rate of return on equity of 11.08%.

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[3] S&P Global Ratings. North American Utility Regulatory Jurisdictions: Some Notable Developments. November 10th, 2023.

a) Please confirm that, except for the ROE authorized in the state of Alaska, the recommended ROE of 11.08%, if implemented, would be the highest ROE authorized by any electricity regulator in the US and Canada since 2021. If Nexus disagrees, please explain.

M3-10-OEB Staff-43

Ref: Nexus Report, p. 40

In Table 5 - Nexus Economics Cost of Equity Results, Nexus provided a breakdown of its recommended base ROE of 11.08%.

a) At a high level, please provide Nexus' supporting calculations for the base ROE of 11.08% in Excel format and explain.

M3-10-OEB Staff-44

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 41

Nexus stated the following:

In its 2009 Report, the Board used a 50:50 weighting of interest rate changes (risk free, and risk spread). LEI computes an econometric model that revises the weights.

a) Please confirm that the 2009 report also used econometric models to determine adjustment factors of 0.5, and that the formula is not based on a 50:50 weighting of interest rate changes (risk free and risk spread). If Nexus disagrees, please explain.

M3-10-OEB Staff-45

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 42 & 45

Nexus stated the following:

We conclude that capital relevant to the Ontario electric service providers ultimately comes from a single, integrated North American capital market… We also examined the

2024 version of Aswath Damodaran's 'Country Default Spreads and Risk Premiums' and observed that both US and Canadian country risk is 0.00 percent.

a) If capital relevant to the Ontario electric service providers ultimately comes from a single, integrated North American capital market and both US and Canadian country risk is 0.00 percent, are "Canadian sovereign bonds" valid risk-free instruments for US and Canadian investors? If Nexus disagrees, please explain.

M3-10-OEB Staff-46

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 45

Nexus stated the following:

An important implication of the single capital market conclusion is that there should be no adder or subtractor to the cost of capital based on where the firms are located since these firms seek capital from the same source.

a) When evaluating whether an adder or subtractor is needed in estimating the cost of capital, other than the identified 'single market conclusion', what other considerations, if any, are important?

M3-10-OEB Staff-47

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 47

Nexus stated the following:

Third, regarding LEI's risk premium method, we input a forecasted US debt rate and a contemporary Moody's Baa bond rate into LEI's forecasting equation. We unlevered and relevered the results using the formula that is described later in this report to make the financial risk associated with the DCF and risk premium results more like that of the Ontario electric service providers.

a) Please provide the calculations for the process described above (in MS Excel worksheet).

M3-10-OEB Staff-48

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 48 & 51

Nexus stated the following:

Rather it makes evident a problem that may have been hidden when one uses only a single model, namely that there exists real-world uncertainty about investor expectations, risk aversion, and the required return on an investment which is unlikely to be captured with any confidence by any single forecasting approach… Yet, LEI is willing to accept uncritically the forecasts of interest rates by bank economists for its CAPM but it rejects totally the value of considering Discounted Cash Flow earnings forecasts of stocks made by investment analysts who plausibly work down the hall from the economists.

a) Please list the “hidden” problems that necessitate the use of multiple models.

b) Please clarify how each hidden problem will be resolved by the use of multiple models.

c) Is one of the hidden problems being resolved by considering the earnings forecasts of stocks made by investment analysts who plausibly work down the hall from the economists? If yes, please explain.

d) Does Nexus believe that investment analysts have no input in bank forecasts? Please explain.

e) Does real-world uncertainty continue to decline based on the number of forecasting approaches used, or is ‘three’ the correct number of approaches? Please explain.

f) Hypothetically, if forecasting approaches use unrealistic inputs and assumptions, does the real-world uncertainty increase or decrease with the number of forecasting approaches used? Please explain.

g) Please explain why CAPM cannot capture real-world uncertainty with reasonable beta and market risk premium inputs.

M3-10-OEB Staff-49

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 51

Nexus stated the following:

However, often both the Market Risk Premium and betas are computed using historical data, as LEI does in its analysis. The results may or may not be adjusted and the nature of the market (e.g., NYSE, S&P500) against which the stock of interest is compared may vary among applications but the essence is that the analysis is a backward-looking historical average.

a) Please confirm that historical data is one of the most (if not the most) commonly used inputs in making forward-looking forecasts. If Nexus disagrees, please explain.

b) Does Nexus believe that historical data has no bearing on forecasts? Please explain.

c) Is Blume Adjustment not backward-looking based on Nexus' definition, i.e., the 2/3 and 1/3 weights for forward-looking beta were supposedly determined by analyzing historical data, correct? If Nexus disagrees, please explain.

M3-10-OEB Staff-50

Note this interrogatory has been asked by LEI

Ref: Nexus Report, Table 7, p. 63

Nexus presented a table on "Market Risk Premium" in Table 7 on this page.

a) Please provide the backup calculations for the derivation of each of these numbers (in MS Excel worksheet).

M3-10-OEB Staff-51

Note this interrogatory has been asked by LEI

Ref: Nexus Report, Figure 8, p. 65

Nexus presented a chart on "Evolution of Dominion Energy Beta Since 2020" in Figure 8 on this page.

a) Please provide the backup MS Excel worksheet for this chart.

b) Please clarify the duration of historical data (in years) considered in the presented beta.

M3-10-OEB Staff-52

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 67

Nexus stated the following:

We also follow the practice of adjusting raw betas for mean reversion using the Blume adjustment:

$$\beta_{adj} = \beta_{raw} \times {}^{2}/_{3} + 1.00 \times {}^{1}/_{3}$$

a) Please provide empirical evidence substantiating the appropriateness of weights (2/3 and 1/3) for mature industries such as regulated utilities.

b) Nexus has cited a June 1975 study for this claim. Please provide more recent citations (since 2009) with empirical evidence.

c) Please clarify if the weights (2/3 and 1/3) have been validated by market data obtained after 2009. If so, please provide backup calculations (in MS Excel). If not, please explain the rationale for utilizing these weights.

d) The factors that may push towards one include: firms that survive in the market tend to increase in size over time, become more diversified and have more assets in place, producing cash flows (Source: Aswath Damodaran):
   i. Please explain how these factors apply to regulated utilities, which are made up of mature companies.
   ii. Please provide examples of adjusted beta being determined for a sector as a whole (as opposed to determining adjusted beta for a single company).

e) In Nexus' view, do the OEB-regulated utilities have significant scope for diversification beyond their current regulated activities? Please explain

M3-10-OEB Staff-53

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 68

Nexus stated the following:

As an independent test of reasonableness of our results, we observe that Damodaran's 2024 industry sector beta showed Utilities with a raw beta of 0.58 and a Debt-to-Equity ratio of 0.8484. Using the Hamada adjustment to unlever and relever the betas to the Deemed Debt Ratio of 1.50 and tax rate of 0.265 produces a beta of 0.71485. The overall average of our relevered (and Blume-Adjusted) betas is 0.7037 which we conclude is reasonably close to the Damodaran relevered (but otherwise unadjusted) industry beta.

a) Please provide the backup calculations (MS Excel worksheets) for determining ROE using the CAPM, DCF, and risk premium approaches.

b) Please provide the CAPM ROE value determined using a raw beta of 0.58 (assuming no change in other CAPM inputs).

c) Has Nexus unlevered and relevered the beta using the D:E ratio of each company in determining the raw beta of 0.58? If not, please explain the rationale for using 0.58?

M3-10-OEB Staff-54

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 73

Nexus stated the following:

To put the regression equation on an equal risk-adjusted footing, we unlevered the authorized ROEs using the unlevering equation discussed earlier.

a) Please provide the backup calculations (MS Excel worksheets) for the determination of the prediction equation.

M3-10-OEB Staff-55

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 4

Nexus stated the following:

The ROEs set by the OEB and proposed by LEI are nowhere near the return available from the application of invested capital to other enterprises of like risk. Neither meets the legally required FRS. They are also likely, now and over time, to result in a situation where Ontario utilities are unable to attract capital on reasonable terms.

a) Please define “like risk”, particularly in light of Ontario being recently considered as “most credit supportive” by S&P Global relative to multiple other jurisdictions.

b) Please provide an example for Ontario utilities unable to attract capital on reasonable terms “now”.

c) Please explain the basis for the claim that the current ROEs set by the OEB would over time, result in a situation where Ontario utilities are unable to attract capital on reasonable terms.

M3-11-OEB Staff-56

Ref: Nexus Report, p. 80
Concentric Report, p. 144

Nexus stated that in between the years 2015 and 2022, a sample of Ontario distributors on average did not earn their authorized returns. Nexus noted that if a distributor is not earning a return established at the FRS, it is operating at an economic loss. Nexus stated that these distributors, on average, have operated at an economic loss during each of these years.

Nexus concluded that the perspectives of equity investors are not represented by the current OEB regulatory mechanisms. Nexus recommended a more frequent (every three year) full review of the cost of equity parameters to ensure that investor perspectives are being taken into account.

Concentric noted that the opportunity to earn a fair return is based on a combination of efficiency of management, fluctuations in customer demands and macroeconomic or operational events beyond the utility's control, and the regulatory framework.

Concentric also stated that excessive (or insufficient) returns can be prevented through a combination of earnings sharing mechanisms and/or offramps tied to the allowed ROE.

a) Nexus – please explain why Nexus stated that a sample of Ontario distributors did not earn their authorized returns and that if a distributor is not earning a return established at the FRS it is operating at an economic loss, in the following context. Allowed ROEs are built into rates, but achieved or actual ROEs are generally within the control of the distributor in terms of implementing what was built into rates, subject to matters such as those that Concentric has described in its expert evidence (as noted in the above preamble).

b) Nexus – please explain why Nexus implied that more frequent OEB reviews of the cost of capital parameters would ensure that investor perspectives are being taken into account, when achieved or actual ROEs are within the control of the distributor in terms of implementing what was built into rates.

M3-11-OEB Staff-57

Note this interrogatory has been asked by LEI

Ref: Nexus Report, p. 11

Nexus stated the following:

Accordingly, LEI fails to meet the FRS in its analysis of equity holder. Indeed, LEI provides evidence in its Figure 19 that the current regulatory approach in Ontario neither meets equity investor interests nor adheres to the FRS.

a) Please confirm that Figure 19 in the LEI report only includes electricity distributors and that the average (by definition) includes distributors that over- or under-earn relative to the deemed ROE.

b) Please confirm that adding generation, transmission, and gas distribution leads to a weighted average achieved ROE typically higher than the deemed ROE (weights based on rate base). For example, Enbridge Gas and OPG earned more than the deemed ROE in 2022 (ROE of 9.45% for Enbridge Gas and 12.68% for OPG compared to the deemed ROE of 8.66%). If Nexus disagrees, please provide evidence to back up the disagreement.

M4 Evidence of Dr. Sean Cleary

M4-5-OEB Staff-58

Ref: Dr. Cleary Report, pp. 21, 22, 55

Dr. Cleary noted that his recommendation is similar to that of LEI, with two minor qualifications, and agreed that the CORRA should be used to replace the BA rate in the DSTDR methodology.

- LEI recommended extending the current practice of sampling 6 big banks to estimate the spread to a larger sample of 6-10 banks. He is fine with this suggestion, assuming that it does not lead to including less reliable estimates (i.e., from the smaller banks), nor adds unnecessary complexity to the survey process.
- LEI recommended estimating the base CORRA based on the average of 3-month CORRA futures rates over the next 12 months. Since the CORRA is linked directly to the Bank of Canada’s rate decisions, he is fine with this suggestion; although, he would also be fine with using the existing CORRA rate as of September 30th of each year as the base CORRA rate.

Dr. Cleary stated that the current annual review process can be supplemented by adding annual reporting requirements for utilities regarding new short-term and long-term debt and equity issued/borrowed during the year.

OEB staff notes that Bloomberg publishes the following ticker each business day, related to Canadian utilities:

BVCAUA3M BVLI Index	CAD Canada Utilities A+ A A- BVAL Yield Curve 3 Month

a) Instead of using the average of 3-month CORRA futures rates for the next 12-month period, plus conducting a confidential bank survey, what are Dr. Cleary's views on instead using the Bloomberg BVCAUA3M BVLI Index (3-month) for the DSTDR and the prescribed interest rates for DVAs, which has a spread already built in?

b) Does Dr. Cleary have any alternative views on how to derive an appropriate DSTDR and prescribed interest rate for DVAs (including an appropriate spread), without conducting bank surveys or collecting actual short-term loan data from utilities? If so, please elaborate.

c) What are Dr. Cleary's views as to whether the short-term loan data underlying the calculations should reflect three-month loans or one-year loans?

d) LEI stated on page 80 of its report that "since CORRA is an overnight risk-free rate, it has historically been slightly lower than the 3-month CDOR. Based on a Bloomberg analysis, the official recommendations from CARR suggest adding 32.138 bps to CORRA to be comparable with the 3-month CDOR. Consequently, the spreads associated with CORRA will be different from the spreads over the 3-month BA rate/CDOR."

   Does Dr. Cleary agree that if bank survey spreads over the 3-month CORRA futures rates are obtained, then the 32.138 bps would not need to be added to the rate applied to the DSTDR or prescribed interest rates? If not, please explain what spread would need to be added.

e) To obtain the average of 3-month CORRA futures rates for the next 12-month period, does Dr. Cleary agree that the data would be obtained from the following website, using settlement price data as of September 30, 2024, and derived by selecting "Futures", then "CRA"? If this is not the case, please explain.

   https://www.m-x.ca/en/trading/data/historical

M4-5-OEB Staff-59

Ref: EB-2024-0063, OEB Letter and Accounting Order, July 26, 2024

On July 26, 2024, the OEB issued a letter regarding prescribed DVA interest rates and the DSTDR.

The purpose of this letter was to provide an update regarding the calculations of the above-noted prescribed interest rates for DVAs and the DSTDR, given that the three-month bankers' acceptances that underpin these calculations have been phased-out.

The OEB stated that it will set the prescribed DVA interest rates for 2024 Q4 and 2025 Q1 on a final basis, using the Canada three-month T-bill rates at the time plus a 25 basis point spread. The DVA interest rates are expected to be issued by the OEB in mid-September 2024 and mid-December 2024, respectively. The final rate will be the three-month Canada T-bill rate as at August 30, 2024 (for the 2024 Q4 DVA rate) and November 29, 2024 (for the 2025 Q1 DVA rate), plus a fixed spread of 25 basis points.

The OEB also stated that in October 2024, the DSTDR will be set by the OEB, on an interim basis for those utilities rebasing for 2025 rates, using the average of the three-month Canada T-bill rate for each business day in September 2024.[4] The bank survey from September 2023 (the prior year) will be used as the average annual spread. No bank survey will be conducted in September 2024.

The OEB also approved the establishment of a generic variance account to capture certain revenue requirement impacts related to the DSTDR.

a) Please provide Dr. Cleary's views on the OEB's approach outlined in the OEB's July 26, 2024 OEB Letter and Accounting Order, but only related to what could be used going forward, specifically using the three-month Canada T-bill rate to calculate:
    i. Prescribed DVA interest rates for 2025 Q2 and forward, plus a 25 basis point spread
    ii. The DSTDR for 2026 and forward, plus a spread using a bank survey

b) Given the elimination of the bankers' acceptance rates, does Dr. Cleary's viewpoint still remain that the CORRA rate should be used, or alternatively, please elaborate on a different methodology that should be used.

M4-10-OEB Staff-60

Ref: EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. ii
LEI Report, p. 16
Concentric Report, p. 98 & 105

[4] The DSTDR will apply to those utilities rebasing for 2025 rates, but with a decision expected in advance of the OEB's decision in the cost of capital generic proceeding.

Nexus Report, p. 79
Dr. Cleary Report, pp. 45 and 46

OEB staff has prepared the following table showing the proposed adjustment factors.

Table 1 – Adjustment Factors Used to Compute ROE

	LCBF Adjustment Factor	Utility Bond Spread Factor
Current OEB methodology EB-2009-0084	0.50	0.50
LEI Proposed	0.26	0.13
Concentric Proposed	0.40	0.40
Nexus Proposed	No independent formula proposed	
Dr. Cleary Proposed	0.75	0.75

While Concentric agreed with LEI that coefficients have come down since 2009, Concentric stated that its estimates indicate LEI's recommended adjustment factors are too low. Instead, Concentric recommended the OEB set adjustment factors at 0.40 for the LCBF and 0.33 for the utility credit spread, which recognizes the lower empirical relationship between ROEs and bond yields compared to previous years, while still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads.

Dr. Cleary stated that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile."

Dr. Cleary disagreed with LEI's recommended adjustment factors. Dr. Cleary stated that the existing adjustment factors of 0.5 would be preferable.

a) Dr. Cleary - please comment on Dr. Cleary's statement that "increasing the adjustment factors makes allowed ROEs more responsive to changing market conditions than using 50% adjustment factors, but not significantly more volatile", whereas Concentric stated that there is a "lower empirical relationship between ROEs and bond yields compared to previous years, while [Concentric's proposed adjustment factors are] still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads."

b) Dr. Cleary - please explain why Dr. Cleary's proposed adjustment factors are reasonable, when compared to the other adjustment factors presented in Table 1.

c) Dr. Cleary - please confirm that Dr. Cleary would accept the status quo of 0.5, even though in one section of his evidence Dr. Cleary is proposing adjustment factors of 0.75, but in an additional section proposing the status quo of 0.5. If this is not the case, please explain.

M4-10-OEB Staff-61

Ref: Dr. Cleary Report, pp. 28 & 29

Dr. Cleary stated that he disagreed with the use of forecast yields versus using actual prevailing yields. Dr. Cleary noted that this applies to any approach taken to estimating Ke, as well as to estimating LCBF for the OEB ROE formula.

Dr. Cleary stated that LEI's MRP estimates do not consider current market conditions or investor expectations regarding future market returns (or MRPs) in the U.S. (or Canada), but simply focuses on U.S. historical evidence during relatively short time periods that reflect above average historical MRPs, and which triple weights the most recent period, thus providing a totally inflated and unrealistic MRP estimate that implies expected future long-term stock returns of 11.5%.

a) To calculate the inputs to the base ROE, please explain why in one instance Dr. Cleary states that actual data should be used (and not forecasted data), however in another instance that future expectations should be used.

M4-10-OEB Staff-62

Ref: Dr. Cleary Report, pp. 39, 40, 41, 112

Dr. Cleary stated that he weighted all three of his proposed allowed cost of equity (Ke) estimates equally, because all three methods are used in practice and provide different perspectives on Ke.

Dr. Cleary also stated that CAPM is more heavily relied upon in practice due to its conceptual advantages. Dr. Cleary further stated that CAPM is also very intuitive from the point of view of a utility cost of capital hearing.

Dr. Cleary suggested that the three methods he used to calculate his proposed allowed cost of equity (Ke) were CAPM, DCF, and BYPRP.

Ke = (1/3)(6.05 CAPM) + (1/3)(7.4 DCF) + (1/3)(7.7 BYPRP) = 7.05%

Dr. Cleary stated that he did not assign any weight to his proposed allowed cost of equity (Ke) estimate reflecting Price-to-Book (P/B) Ratios. However, Dr. Cleary discussed several proposed allowed cost of equity (Ke) estimates reflecting P/B Ratios.

a) Please explain why Dr. Cleary has weighted all three of his proposed allowed cost of equity (Ke) estimates equally, but stated that CAPM is more heavily relied upon in practice and very intuitive from the point of view of a utility cost of capital hearing.

b) Please confirm that if the CAPM method was assigned a higher weight in Dr. Cleary's proposed allowed cost of equity (Ke), Dr. Cleary's suggested allowed cost of equity (Ke) would be lower than 7.05%. If this is not the case, please explain.

c) Please explain why Dr. Cleary did not assign any weight to his proposed allowed cost of equity (Ke) estimate reflecting P/B Ratios.

d) On page 112 of Dr. Cleary's evidence, Dr. Cleary discussed several proposed allowed cost of equity (Ke) estimates reflecting P/B Ratios. If Dr. Cleary was to assign a weight to his proposed allowed cost of equity (Ke) estimate reflecting P/B Ratios, what would be the weight and what would be the resulting allowed cost of equity (Ke)? Please explain.

M4-10-OEB Staff-63

Ref: Dr. Cleary Report, pp. 28, 43, 46

Dr. Cleary is proposing the following allowed return on equity.

ROEt = 7.05% + 0.75 x (LCBFt – 3.30%) + 0.75 x (UtilBondSpreadt – 1.38%)

For the base LCBFt, Dr. Cleary stated that the actual 30-year Government of Canada yield was 3.30% as of June 5, 2024. However, OEB staff notes that based on Bank of Canada data, it was 3.28% (V39056 for 30-year government).

For the base UtilBondSpreadt, Dr. Cleary stated that the 30-yr Utility over 30-yr Government spread was 1.38% as of June 5, 2024. However, OEB staff notes that based on Bank of Canada data (V39056 for 30-year government) and Bloomberg data (BVCAUA30 BVLI Index for 30-year utility), it was 1.40%.

a) Please confirm what is the correct base LCBFt and UtilBondSpreadt and provide supporting calculations, if Dr. Cleary is proposing different numbers than that noted in the preamble by OEB staff. Please explain.

M4-10-OEB Staff-64

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p. 32 & 42

Dr. Cleary stated the following:

This effectively "triple weights" the most recent 2014-23 period, which is included in all three intervals and has an extremely high MRP estimate of 10.16% (which implies an unrealistic estimate of ERm of 13.35%, based on LEI's RF estimate of 3.19%)… It is important to recognize that overall stock market conditions have changed over the last three decades and double digit "nominal" returns are no longer the norm for stocks, given existing 2% long-run inflation expectations. In other words, long-term nominal stock returns in the 4-9% range are consistent with current long-term forecasts by market professionals (which averaged 6.1%) and with historical long-term real stock returns.

a) Please confirm that LEI has considered the MRP estimate of 10.16% to determine the high end of the ROE estimate. LEI has also provided average and low estimates for MRP.

b) Please confirm that total annual market returns (including dividends) for the S&P 500 have exceeded 13% in 44 years (out of 96 years) since 1928, i.e., annual market returns have exceeded 13% in 46% of the time since 1928. If Dr. Cleary disagrees, please explain.

c) Please confirm that total annual market returns (including dividends) for the S&P 500 have exceeded 13% in 9 years (out of 15 years) since 2009, i.e., annual market returns have exceeded 13% in 60% of the time since 2009. If Dr. Cleary disagrees, please explain.

d) Please confirm that any event that occurs 60% of the time in the last 15 years (and 46% over the last 96 years) will at least have some bearing on future expectations. If Dr. Cleary disagrees, please explain.

M4-10-OEB Staff-65

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p. 33

Dr. Cleary stated the following:

First, the use of a beta estimate (0.69) that is based solely on current beta estimates (without due consideration of historical beta estimates), is unreliable as beta estimates vary through time.

a) Please confirm that LEI has used historical data (2019-2023) to determine the beta of 0.69.

b) While historical data is a valuable input for forecasting, market conditions can change over longer periods. As such, there is a risk of overweighting the importance of historical events that happened a long time ago (say more than 30 or 50 years ago), which may result in an unrepresentative picture of the future. Does Dr. Cleary agree? If not, please explain.

M4-10-OEB Staff-66

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p. 36 & 41

Dr. Cleary stated the following:

First, the use of a beta estimate (0.69) that is based solely on current beta estimates (without due consideration of historical beta estimates), is unreliable as beta estimates vary through time.

a) Please confirm in Dr. Cleary's view that LEI has used historical data (2019-2023) to determine the beta of 0.69.

M4-10-OEB Staff-67

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p.33

Dr. Cleary stated the following:

Recognizing that four of the five Canadian utilities included in that sample are holding companies that operate in several jurisdictions that are riskier than Ontario (and Canada in general), and that also hold significant proportions of unregulated assets, it is interesting to note that the sole publicly-listed regulated operating Canadian utility (Hydro One) had a P/B ratio of 2.04 as of the end of 2023. It is further interesting to note that the average P/B ratio for the U.S. sample was greater than the Canadian average every year, ranging from 1.69 to 2.36 and averaging 2.05 over the 2017-2023 period. This is consistent with evidence provided in Section 5.1 of my evidence discussed above that shows that allowed ROEs in the U.S. are even more upward biased than those in Canada… In addition, there are data uncertainties associated with determining some of DCF input estimates for pure play regulated Canadian industries, since most of them are not publicly listed.

a) If four of the five publicly traded Canadian utilities in Dr. Cleary's sample are holding companies that operate in several jurisdictions (mainly in the US and Canada), would Dr. Cleary consider it prudent to consider a larger sample size comprising similar US and Canadian utilities, allowing for a more reasonable representation of investor expectations? If Dr. Cleary disagrees, please explain.

b) Please confirm that the P/B ratio for the broader market over the last five years (such as the S&P 500 index) was 4.94 (Source: Bloomberg), and P/B ratios ranging from 1.69 to 2.36 are well within the range of normalcy. If Dr. Cleary disagrees, please explain.

M4-10-OEB Staff-68

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p.37

Dr. Cleary stated the following:

If there is a desire or need for a “mechanical approach” to adjusting current beta estimates, simply adjust them toward the long-term average of 0.35, or even 0.45, rather than toward 1.0, as is done with published betas provided by services such as Bloomberg and Value Line… Based on historical evidence, establish a range of reasonable beta estimates with a lower bound of 0.30 and an upper bound of 0.60.

a) Please provide empirical evidence (in an MS Excel worksheet) for estimating the long-term average of 0.35, or even 0.45, and a range of reasonable beta estimates with a lower bound of 0.30 and an upper bound of 0.60.

M4-10-OEB Staff-69

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p.41

Dr. Cleary stated the following:

If we add 50 bp for flotation costs, we end up with a Ke estimate 7.7%. This is on the high side given my long-term expected market return estimate of 8% (if we add 0.50% to my raw market estimate of 7.5%).

a) Please provide the empirical basis (with examples of actual utility flotation costs) for recommending 50 basis points associated with floatation costs.

M4-10-OEB Staff-70

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p. 41 & 42

Dr. Cleary stated the following:

…CAPM is more heavily relied upon in practice due to its conceptual advantages. For example, previous studies (referenced in Section 5 of my evidence) indicate with respect to the DCF approaches to estimating Ke, they were used by:

- only 15% of U.S. CFOs - versus over 70% for CAPM;
- about 12% of Canadian CFOs - versus close to 40% for CAPM.
- Not widely used, while CAPM was used by the majority of investors.

CAPM is also very intuitive from the point of view of a utility cost of capital hearing. In particular, it has a direct relationship to financing costs (i.e., RF and MRP). The CAPM also makes a direct adjustment for the risk of utilities relative to the market, unlike DCF models, since it has a direct measure of risk (i.e., beta) included in the model. In addition, there are data uncertainties associated with determining some of DCF input estimates for pure play regulated Canadian industries, since most of them are not publicly listed.
…Based on an equal weighting of the three approaches, I determine the 1 following best estimate for allowed Ontario utility ROEs:

$$Ke = (1/3)(6.05) + (1/3)(7.4) + (1/3)(7.7) = 7.05\%.$$

a) Considering Dr. Cleary's observations regarding the clear advantages of using CAPM over the DCF methodology, please explain why the recommended ROE is not determined with only CAPM.

b) If 7.05% ROE is allowed by the OEB, please confirm that it would be the lowest allowed ROE among currently allowed ROEs for US and Canadian utilities.

M4-10-OEB Staff-71

Note this interrogatory has been asked by LEI

Ref: Dr. Sean Cleary Report, p. 45

Dr. Cleary stated the following:

In particular, Section 5.1 shows that in January 2004, the spreads between the allowed ROE and RF was 4.57%, and between ROE and A yields was 3.78%. But as of June 5, 2024, the allowed ROE-RF spread was 1.34% higher than in 2004 at 5.91% (a 29% increase), while the ROE-A yield spread was 0.75% higher at 4.53% (a 20% increase). The average ROE-RF spread during the January 2004-June 2024 period was 6.03% and the average ROE-A-yield spread was 4.61%. For illustrative purposes, as the OEB reconsiders its existing ROE formula, Figure 9 in Section 5.1 of my evidence also includes the OEB allowed ROEs that would have resulted if the OEB had used an adjustment factor of 0.75 instead of 0.5 for both terms in their ROE formula since the formula's implementation being reflected in 2010 and subsequent allowed ROEs.

a) Please provide the empirical evidence (in an MS Excel worksheet) for recommending adjustment factors of 0.75.

M4-12-OEB Staff-72

Ref: Nexus Report, pp. 43 & 46 & 84
Dr. Cleary Report, p. 29
Concentric Report, pp. 136 & 137

Nexus stated that "capital from US exchanges is equivalent to capital from Canadian exchanges."

Nexus' proposal is that the OEB retain its existing policy regarding capital structure applicable to electricity distributors for now.

Dr. Cleary stated that U.S. utilities are not reasonable comparators for Canadian utilities. In Dr. Cleary's view, this is true because they have significantly higher business risk – partly due to their holding company structure and business holdings, partly due to operating in the U.S. and not in Canada, and partly due to the nature of their operations which entail more risk.

Concentric stated that it finds that Ontario's regulated distribution and transmission utilities generally have comparable business risk to the companies in the North American Electric and Gas comparator groups. Concentric also concluded that Ontario's utilities have similar financial risk to other electric and gas utilities in Canada and substantially greater financial risk than their U.S. peers due to the relatively low deemed equity ratios of 38 percent for Enbridge Gas, 40 percent for electric distribution and electric transmission, and 45 percent for OPG.

Concentric stated that an immediate move to parity with the U.S. would be abrupt. For that reason, Concentric recommended that the OEB set a minimum deemed equity ratio for Ontario utilities of 45 percent, which is at a point approximately halfway between the Ontario level and the U.S. average.

a) Dr. Cleary - please provide Dr. Cleary's views on Nexus' statement that capital from US exchanges is equivalent to capital from Canadian exchanges.

b) Dr. Cleary - please provide Dr. Cleary's views on Concentric's statement that Ontario's regulated distribution and transmission utilities generally have comparable business risk to North American companies.

c) Dr. Cleary - please explain why likely, in Dr. Cleary's view, a minimum deemed equity ratio for Ontario utilities of 45 percent is not appropriate, despite Concentric's statements noted above, but also noting Nexus' recommendation to keep the status quo.

M4-16-OEB Staff-73

Ref: Dr. Cleary Report, p. 52
Concentric Report, p. 147

In terms of the timing of the OEB's annual cost of capital parameters updates, Dr. Cleary supported the use of October data as opposed to September data. Dr. Cleary stated that this would provide more up-to-date capital market estimates and hence improve the accuracy of the parameters used in the ROE formula which is consistent with the approach recently introduced in Alberta.

Concentric stated that it is in agreement with LEI on the annual updates to the OEB's cost of capital parameters in October, using data as of September 30th, except where forecasts are utilized. Concentric generally recommended trailing 90-day averages where historic data are utilized to avoid the inherent volatility in a single month's data.

a) Dr. Cleary - in terms of the timing of the OEB's annual cost of capital parameters update, please provide Dr. Cleary's view on using trailing 90-day average data as of September 30, as opposed to October data.

M4-17-OEB Staff-74

Ref: Dr. Cleary Report, p. 54

Dr. Cleary suggested that if the Canadian A-rated utility yield spreads exceed 2%, an immediate and thorough assessment of existing capital market conditions should be conducted by the OEB. Dr. Cleary stated that this could lead to a full regulatory review, depending on the results of this assessment. Dr. Cleary noted that a spread greater than 2% would be indicative of a period of extreme uncertainty in Canadian capital markets.

a) Please confirm that the A-rate utility yield spread noted in the preamble would be based on any point-in-time difference between the Bloomberg data (BVCAUA30 BVLI Index for 30-year utility) and Bank of Canada data (V39056 for 30-year government). If this is not the case, please explain.

b) What would Dr. Cleary's proposed "full regulatory review" entail? Please elaborate.