Ontario Energy Association ("OEA")
2024 Cost of Capital and Other Matters

Information Requests for LEI
Exhibit M1

M1-0-OEA-1

Reference:

Exhibit M1
Page 24 and Appendix D

Preamble:

LEI staff have relevant experience in cost of capital and capital structure matters, reviewing regulatory dockets and supporting regulatory staff with filing interrogatories. A selection of relevant work is provided in "Appendix D: Selected relevant LEI experience", and further information is included in the curriculum vitae for Mr. Goulding, Mr. Pinjani, and Mr. Nayak (provided separately).

In Appendix D, LEI lists the following five engagements relating to the cost of capital:

Capital structure analysis in Ontario: LEI was retained by the Ontario Energy Board ("OEB") staff as capital structure expert in respect of Ontario Power Generation ("OPG")'s 2022-2026 Payment Amounts Application (EB-2020-0290).

Testimony support to OEB in equity thickness review: In 2023, LEI was retained by the OEB Staff as capital structure expert in respect of Enbridge Gas Inc.'s application (EB-2022-0200).

Assisting in updating cost of capital and inflation parameters for the OEB: LEI has been engaged by OEB Staff (since July 2019) to provide quarterly updates on the macroeconomic conditions facing the utility sector in Ontario, and their potential impact on the cost of capital, interest, and inflation parameters.

Independent expert evidence on ROE for IRAC: LEI was retained by the legal counsel for the Prince Edward Island Regulatory and Appeals Commission ("IRAC") to provide independent expert evidence on a just and reasonable return on equity ("ROE") for the Maritime Electric Company Limited ("MECL"), associated with their General Rate Application ("GRA") for 2023-2025 [IRAC Docket: UE20946].

Independent technical consultation for a rate case involving Montana-Dakota Utilities Company: LEI was engaged by the North Dakota Public Service Commission as the outside independent technical consultant supporting the Commission's ratepayer advocacy staff in a rate case involving Montana-Dakota Utilities Company.

Question(s):

a. Have the authors of LEI's report in this proceeding been accepted as experts in these or any other proceedings on the cost of capital? If so, please identify those proceedings.

M1-0-OEA-2

Reference:

Exhibit M1
Page 38

Preamble:

Fair Return Standard ("FRS"): The FRS establishes a legal framework for setting a fair and reasonable return on capital for regulated electricity and gas utilities, as described in the text box below.

It is important to note that [*m]eeting the standard is not optional; it is a legal requirement.*

Question(s):

a. Does LEI agree that the Fair Return Standard applies to both the authorized ROE and the deemed capital structure? If not, please explain.
b. Please confirm that, in this proceeding, LEI has not performed an analysis of Ontario utility equity thicknesses to those of comparable utilities in North America. If LEI has performed such an analysis, please provide that analysis.
c. The OEB's current policy is to only adjust a utility's deemed capital structure if there has been a significant or material change in the utility's business risk since the capital structure was last reviewed by the Board. LEI recommends that this approach to evaluating capital structure be retained. Please explain how it is possible for the OEB to determine that an authorized ROE or a deemed equity ratio meets the Fair Return Standard if the Board does not also consider those authorized ROEs and/or deemed equity ratios relative to a peer group of companies that is comparable in risk to the utility for which the return is being set.

M1-0-OEA-3

Reference:

Exhibit M1
Page 42

Preamble:

LEI began with a long list comprising US states, Canadian provinces, the United Kingdom ("UK"), and Australia. As shown in Figure 9 below, after applying the five criteria listed above, LEI selected six jurisdictions for further study: Alberta, Australia, British Columbia ("BC"), California, New York ("NY"), and the United Kingdom ("UK").

Question(s):

a. For the North American jurisdictions listed in LEI's Figure 9, please provide a table showing the most recently authorized ROE and approved equity ratio for the regulated electric and gas utilities in that jurisdiction.
b. How does LEI's recommended ROE of 8.95% for Ontario's utilities compare to the authorized ROE for regulated electric and gas utilities in Alberta, British Columbia, California, and New York?
c. How do the deemed equity ratios for Ontario's utilities compare to the approved equity ratios for regulated electric and gas utilities in Alberta, British Columbia, California, and New York?

M1-3-OEA-4

Reference:

Exhibit M1
Pages 74-75

Preamble:

With respect to the major OEB regulatory mechanisms introduced since 2006, LEI believes that they have generally reduced the risks for electricity distributors:

…

The revenue stability for distributors is visible in actual revenue earned per customer (CPI adjusted) since 2015 (see blue bars in Figure 19 below). The achieved ROE (relative to deemed ROE) has also been generally stable since 2015, with the exception of 2020 which was affected by the COVID-19 pandemic (see the line in Figure 19 below).

Question(s):

a. Has LEI done any independent analysis or research on the regulatory risks of Ontario's utilities? If so, please provide that research.
b. Has LEI examined achieved ROE (relative to deemed ROE) back to 2006? If so, please provide that analysis.
c. How does LEI interpret the Customer weighted average achieved ROE minus deemed ROE being negative, ranging from approximately -0.40% down to -1.7% over the entire 2015-2022 period?
d. Does this data demonstrate, in LEI's view, a reduction in regulatory risk?

M1-5-OEA-5

Reference:

Exhibit M1
Page 83

Preamble:

With respect to the application of DSTDR, LEI recommends considering the DSTDR for all utilities, not just electricity distributors.

…

LEI recommendations – Issue 5

- The spread for a R1-low rate utility over CORRA to be determined from an annual confidential survey of banks (slightly modified from status quo vis-à-vis larger sample size of 6-10 banks and limited exclusion of outliers).

Question(s):

a. Under LEI's recommendation to apply a DSTDR cap for all utilities, would a utility be prevented from requesting and the OEB be prevented from approving a cost of debt higher than the cap if the utility demonstrates that its cost of debt is higher than the cap, for instance due to a lower credit rating and/or credit spreads that are higher than for R1-low rated utilities?

M1-7-OEA-6

Reference:

Exhibit M1
Page 93

Preamble:

With respect to the application of DLTDR, LEI recommends the modified status quo approach with DLTDR as a cap but uniformly applicable for all utilities (not just electricity distribution and transmission utilities). **All OEB-regulated entities reviewed have a similar senior debt credit rating, and there is no reason to only subject electricity distributors and transmitters to a cap.** [bold added for emphasis]

…

LEI recommendations – Issue 7

- Bloomberg's BVCAUA30 BVLI Index (12-month trailing average) is appropriate for considering the spread over LCBF for an A-rated utility.

Question(s):

a. Has LEI examined the senior debt ratings of all OEB-regulated utilities to corroborate this statement?
b. If so, please provide a table listing the senior debt ratings for each OEB-regulated utility.
c. Are all OEB-regulated utilities A-rated?
d. Is LEI aware of any other North American regulator that "caps" the cost of long-term debt?
e. If so, please provide the decisions implementing these caps.
f. Under LEI's recommendation to apply a DLTDR cap for all utilities, would a utility be prevented from requesting and the OEB be prevented from approving a cost of debt higher than the cap if the utility demonstrates that its cost of debt is higher than the cap, for instance due to a lower credit rating and/or credit spreads that are higher than for A-rated utilities?

M1-10-OEA-7

Reference:

Exhibit M1
Page 116

Preamble:

Considering the two variables simultaneously (the weighted average ROEs allowed by US regulators for electric and gas utilities as the dependent variable; 30-year GoC government bond yields and Moody's seasoned Baa corporate bond yields as independent variables) using multivariate regression analysis lowers the adjustment factors for each variable, i.e., 0.26 for the LCBF adjustment factor and 0.13 for the utility bond spread adjustment factor. The multivariate regression analysis performed by LEI had an R squared value of 0.61 which indicates that a reasonably high amount of variance in the dependent variable (allowed ROEs) has been explained by the variance in dependent variables since 2001.

Question(s):

a. Would LEI agree that an important factor in the OEB's ROE formula is that the authorized ROE should be sensitive to changes in government bond yields and the spread between government and utility bonds?
b. If the OEB were to adopt the adjustment factors recommended by LEI, does LEI believe the OEB formula would be sufficiently sensitive to changes in government bond yields and utility credit spreads? Please explain your response and provide any analysis LEI has conducted to test the sensitivity of the OEB's formula return under its proposed adjustment factors.
c. Please explain why LEI used the Moody's seasoned Baa corporate bond yield rather than the Moody's A-rated utility bond yield in its regression analysis.
d. Please confirm whether LEI used the credit spread (i.e., the spread between the 30-year GoC bond and the Moody's seasoned Baa corporate bond) or the actual Baa seasoned corporate bond yield itself in the regression analysis. If LEI did not use the credit spread, please explain why.

M1-10-OEA-8

Reference:

Exhibit M1
Page 111

Preamble:

In its summary of the BCUC's September 2023 Order in the Generic Cost of Capital Proceeding (Stage 1), LEI states:

For the CAPM, the risk-free rate is based on forecast 30-year government bond yields (LCBF for Canadian utilities in each proxy group and forecast 30-year Treasury bond yields for US utilities in each proxy group). The beta for each proxy group is calculated as the average Blume-adjusted beta estimates from Value Line and Bloomberg using five years of data.

Question(s):

a. Did LEI consider the use of Blume-adjusted beta estimates in its CAPM analysis? If not, why not?
b. Does LEI disagree with the Blume adjustment? Please explain your response.

M1-10-OEA-9

Reference:

Exhibit M1
Page 117, 118, and Figure 39

Preamble:

To estimate the beta, LEI utilized a three-step process:

(i) first, LEI used the raw beta for peer companies;
(ii) second, the raw betas were unlevered using the operating leverage of each of the peer companies (to diversify away the firm-specific unsystematic risk); and (iii) finally, the average unlevered beta of the peer group was re-levered using the OEB allowed deemed capital structure.

Question(s):

a. Please explain the source of the tax rates and debt to equity ratios used in Figure 39.
b. Did LEI use the same tax rates to both unlever and relever beta?
c. Is LEI aware of any North American regulator who has followed the procedure used in Figure 39 to estimate the cost of capital? If so, please provide the case reference(s).

M1-10-OEA-10

Reference:

Exhibit M1
Page 122

Preamble:

Notably, LEI's ERP estimate does not include 50 bps of transaction costs implicitly assumed in the 2009 ERP determination. As with LEI's recommendation for the treatment of transaction costs from debt issuances, LEI recommends considering the transaction costs associated with equity issuances as operating costs for similar reasons. Equity issuances do not happen with predictable regularity, which makes it more suitable to recover such costs as and when the utility incurs expenses.

Question(s):

a. Does LEI agree that transaction costs are not expenses that flow through the income statement? If LEI disagrees, please explain.
b. Does LEI agree that transaction costs reduce the proceeds of the securities issuances, resulting in a permanent net reduction to the common equity portion of the balance sheet? If LEI disagrees, please explain.
c. Has LEI researched whether other Canadian jurisdictions include an adjustment for flotation costs and financial flexibility? If so, please provide the results of that research.
d. If the OEB has previously included an adjustment of 50 basis points for transaction costs in the authorized ROE, why should the Board deviate from that practice in this proceeding?
e. Has LEI studied whether treating transaction costs as operating expenses is compliant with International Financial Reporting Standards ("IFRS")? If so, what were LEI's conclusions from that study?

M1-10-OEA-11

Reference:

Exhibit M1
Page 123-124, and Figure 45

Preamble:

To determine base ROE, the OEB can also consider the average ROE from different methodologies (CAPM, DCF and ERP methodologies) to reduce the overreliance on a single methodology. Although international jurisdictions reviewed by LEI rely on CAPM to determine ROE (Australia and the UK), LEI acknowledges that most North American jurisdictions consider a mix of ROE methodologies. A summary of methodologies used in other jurisdictions is shown in Figure 45 below.

Question(s):

a. Please confirm that on pages 36-37 of the OEB's 2009 Report (EB-2009-0084), the Board determined that it was appropriate to use more than one methodology to estimate the authorized ROE for Ontario's utilities.
b. Please confirm that the Alberta Utilities Commission also considered the results of multiple methodologies including the constant growth and multi-stage forms of the DCF model and the CAPM in its October 2023 decision (Decision 27084-D02-2023) in which it reset the base ROE for Alberta's electric and gas utilities.
c. If other North American jurisdictions surveyed by LEI commonly rely on multiple models to determine the authorized ROE as shown in Figure 45, and if the OEB has previously indicated that it is better to use multiple methodologies than to place reliance on the results of a single model, please explain why LEI has relied solely on the results of the CAPM in making its base ROE recommendation in this proceeding.
d. If the results of one particular model substantially diverge from the results of other commonly-employed models to estimate the authorized ROE, is that another reason to give weight to the results of multiple methodologies? Please elaborate.

M1-11-OEA-12

Reference:

Exhibit M1
Page 127-128

Preamble:

OEB is also among the few North American regulators to annually update the cost of capital parameters to ensure they align with the current macroeconomic environment. As such, LEI is not aware of OEB-regulated entities facing notable issues in attracting equity and debt capital since 2009. This is also reflected in the utility credit ratings and the regulator assessments performed by the credit rating agencies. For instance, S&P Global assesses the US and Canadian regulatory regimes based on analysis of quantitative and qualitative factors such as regulatory stability, tariff-setting procedures and design, financial stability, and regulatory independence and insulation.

Based on its assessment, S&P groups US states and Canadian provinces into 5 categories: (i) credit supportive; (ii) more credit supportive; (iii) very credit supportive; (iv) highly credit supportive; and (v) most credit supportive.

Question(s):

a. Is LEI aware of the authorized ROEs and capital structures for the utilities in the other nine jurisdictions in S&P Global's "Most Credit Supportive" category?
b. Is it LEI's view that the authorized ROEs and deemed capital structures for Ontario's utilities should be comparable to the other nine jurisdictions in this category? Please explain why or why not.

M1-11-OEA-13

Reference:

Exhibit M1
Page 134

Preamble:

LEI believes that the OEB's existing cost of capital regime (including the determination of deemed capital structure) appropriately considers investor perspectives, as market data included in the formula and risk assessment when determining the appropriate equity thickness, when considered appropriately, should reasonably reflect investors' perspectives. The OEB can slightly modify the reporting requirements to enable better monitoring of the actual utility cost of capital.

Question(s):

a. In Section 4.11, LEI mentions how credit rating agencies such as S&P Global and DBRS view the Ontario regulatory environment. Has LEI also considered the perspective of equity investors in reaching its conclusion with respect to Issue #11? If so, please explain how the perspective of equity investors was taken into account in LEI's report.
b. Has LEI undertaken any analysis comparing the authorized base ROE it is recommending for Ontario's utilities to the authorized ROEs for other North American utilities that LEI views as being comparable in business and financial risk to the Ontario utilities? If so, please provide that analysis.
c. If the answer to part (b) above is "no", please explain the basis for LEI's conclusion that its recommended ROE of 8.95% for Ontario's utilities satisfies the capital attraction standard and the comparable return standard?

M1-12-OEA-14

Reference:

Exhibit M1
Page 137

Preamble:

"FEI's independent expert endorsed FEI's proposed ratio and compared the weighted ROEs, equal to the authorized ROE multiplied by the deemed equity ratios, for FEI and companies in its proxy group. He concluded that the proposed ratio is justified by FEI's risk profile and market data."

Question(s):

a. In this proceeding, did LEI perform an analysis of the deemed equity ratios for Ontario's regulated utilities? If so, please provide that analysis.
b. In this proceeding, did LEI compare the weighted ROEs, equal to the authorized ROE multiplied by the deemed equity ratios, for Ontario utilities and companies in its proxy group.? If so, please provide that analysis.

M1-21-OEA-15

Reference:

Exhibit M1
Page 168

Preamble:

For CWIP, LEI recommends continuing the current approach of basing the prescribed interest rate on the FTSE Canada Mid Term Bond Index All Corporate yield for all construction projects, regardless of duration. LEI also recommends continuing the current CWIP accounting procedures as set out in Article 220 (p. 200) and Article 410 (p. 27-28) of the OEB's *Accounting Procedures Handbook for Electricity Distributors.*

Question(s):

a. Did LEI perform a survey of the regulatory treatment of carrying costs on CWIP in other jurisdictions? If so, please provide that survey.
b. Does LEI agree that the majority of North American regulatory jurisdictions allow for the reflection of an equity component in the return on CWIP for investor-owned utilities? Please explain your answer.