VIA RESS and EMAIL

August 2, 2024

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Nancy Marconi:

Re: Ontario Energy Board – Cost of Capital Review
Exhibit M1 – London Economics International LLC (LEI) Evidence
Consumers Council of Canada (CCC) Interrogatories
OEB File No. EB-2024-0063

In accordance with Procedural Order No. 1, dated March 28, 2024, please find attached CCC's interrogatories with respect to Exhibit M1 (LEI Evidence).

Yours truly,

Lawrie Gluck

Lawrie Gluck
Consultant for the Consumers Council of Canada

cc: All parties in EB-2024-0063

Ontario Energy Board Generic Proceeding

Cost of Capital Review

Exhibit M1 – LEI Evidence

Consumers Council of Canada

Interrogatories

August 2, 2024

M1-CCC-1

Ref: Ex. M1/p. 80
Ex. M4/ p. 22

a) For 2024 (or another recent year where the data is available), please provide the short-term debt rate resulting from:

   i. Option 1 (excluding the confidential survey of banks)
   ii. Option 3 (excluding the confidential survey of banks)
   iii. Option 4 (excluding the confidential survey of banks)

b) Please comment on Dr. Cleary's commentary on the use the existing CORRA rate as of September 30 of each year as the base CORRA rate. Please include in this response a discussion of the benefits/drawbacks relative to LEI's recommended option.

M1-CCC-2

Ref: Ex. M1/pp. 90-91
Ex. M4/p. 24

a) For 2024 (or another recent year where the data is available), please provide the long-term debt rate resulting from Option 1 and Option 2.

b) Please advise whether Bloomberg's BVCAUA30 index includes only Canadian utilities. If not, please explain what companies are included in that index and provide rationale supporting its use in the calculation of the utility bond spread.

c) Please comment on Dr. Cleary's recommendation to use the actual prevailing bond yields (as opposed to a forecast of bond yields) in the calculation of the long-term debt rate. Please include in this response a discussion of the benefits/drawbacks relative to LEI's recommended option.

M1-CCC-3
Ref: Ex. M1/p. 96

Please explain how LEI's recommendation to treat transaction costs as operating expenses would be operationalized from a ratemaking perspective. For example, would the utility be required to include a forecast of its test year transaction costs in its rebasing application for OEB approval?

M1-CCC-4
Ref: Ex. M1/p. 97

LEI noted that, on average, the actual debt ratio for Ontario LDCs is lower than the deemed ratio of 60%. However, the customer-weighted average debt ratios are meaningfully higher than the simple average, which indicates that the capital structure of larger utilities is closer to the deemed capital structure, while smaller utilities finance more of their rate base with equity.

a) Please confirm that in the customer-weighted debt ratio analysis, Ontario LDCs have a lower actual debt ratio than the deemed ratio.

b) Please provide any insight that LEI may have as to why the simple average actual debt ratio and customer-weighted average actual debt ratio are lower than the deemed ratio for Ontario electricity distributor.

c) Please provide any insight that LEI may have regarding why smaller LDCs finance more of their rate base with equity relative to larger LDCs.

d) Please advise whether the overall LDC trend of funding more of rate base with equity (relative to the deemed amounts) provides any insight into a LDC's shareholders' views on earning only the debt rate on, at least a portion of, its invested equity capital.

M1-CCC-5
Ref: Ex. M1/pp. 113-126

CCC acknowledges LEI's recommendation that the allowed base ROE be determined based on only the CAPM approach. However, we are also interested in understanding the other methodologies set out in LEI's report.

a) (Page 113) With respect to the ERP calculated in Figure 36, please provide rationale supporting the indexes used (comparable group column) and the period of analysis selected. As part of this response, please discuss whether longer time periods of market returns would provide any benefit to the ERP calculation.

b) (Pages 113-114) Please confirm that the determination of the updated ERP does not rely on information regarding the allowed ROEs by US regulators for electric and gas utilities. Instead, the allowed ROEs granted by US regulators is used to calculate the LCBF and utility bond spread adjustments in LEI's report.

c) Please comment on Concentric's and Nexus' use of approved returns (or, "authorized returns") for US regulated utilities to determine the risk premium in the calculation of an appropriate ROE for an Ontario regulated utility. As part of the response, please comment on the logic of using approved ROEs from other jurisdictions to determine risk premiums for Ontario utilities when those approved ROEs would have also, presumably, been underpinned by DCF, CAPM and/or Risk Premium based ROE determinations when they were initially calculated.

d) (Pages 114 and 118) Please confirm that the difference between the peer groups used for the DCF ROE calculation (Figure 37) and the calculation of betas (Figure 39) is the removal of five generation companies due to high or low annual EPS growth estimates that were unusable for the purposes of calculating DCF ROE. If so, please explain why it was appropriate to keep those companies in the peer group for the calculation of betas.

e) (Page 116) With respect to the LCBF and utility bond spread adjustment factors, at a more general level, please discuss why using either an independent or combined regression analysis to set these factors is appropriate. As part of the response, please discuss why any adjustment factor is needed and explain why simply passing through the annual change in the LCBF and utility bond spreads in the ROE formula is inappropriate.

f) (Page 117) Please confirm that in calculating a 1-year beta, the most recent year for which information is available is used. For the longer-term betas (i.e., 3 and 5-year) is it the most recent 3- and 5-year periods that are used? Please explain why the 5-year beta was selected and not a longer historical period.

g) (Page 117) Please provide an illustrative example of the beta estimation calculation (i.e., moving from raw to unlevered to re-levered betas).

h) (Page 117) Please discuss in more detail why it is necessary to calculate unlevered and re-levered betas.

i) (Page 118) Please add additional columns that provide the re-levered betas (1-, 3- and 5-year) for each peer company.

j) (Page 118) Please provide LEI's views on the differential in risk between Canadian and US utilities as expressed by the betas. Historically, do US utilities have higher betas than Canadian firms?

k) (Page 120) Please confirm that in LEI's approach to calculating the MRP there is no weighting applied to the Canadian market. If so, please explain why that is appropriate.

l) (Page 120) LEI noted that the major Canadian pension funds allocate 25% of their portfolio to the Canadian market. Please explain whether LEI is of the view that, at least some percentage of the calculation of the market returns for the MRP, should reflect Canadian returns.

   i. Please provide MRP values using a 50/50 split of US and Canadian market returns for the periods 1994-2023, 2004-2023, and 2014-2023.
   ii. Please provide MRP values using a 75/25 split of US and Canadian market returns for the periods 1994-2023, 2004-2023, and 2014-2023.

m) (Page 120) Please provide rationale supporting the use of Canadian bond rates in the calculation of RF and US market returns for the MRP.

n) (Page 121) LEI stated that, "investor expectations of the MRP may be shaped by the high US market return observed during the last 10 years. However, the current macroeconomic environment has more similarities to macroeconomic environments observed in the 1990s and 2000s."

   i. Please confirm that LEI's MRP weighting methodology operates to increase the weighting towards more recent years (i.e., 2014-2023). If so, please explain why that is appropriate in the context of the above referenced statement.

ii. Please provide revised CAPM ROE estimates where no weighting is applied in the calculation (i.e., each 10-year period is weighted equally).

iii. Please provide LEI's views on using the 1928-2023 S&P 500 total returns (Row 1 of Figure 41) for the calculation of the MRP.

o) (Page 125) Please advise whether the recommended change to the calculation of the ROE (i.e., Option 5) is intended to address a fundamental change in utility risk since the last time the OEB established the ROE for regulated utilities (2009) or are the changes more appropriately viewed as refinements to the approach for calculating the ROE?

p) Does LEI have any information with respect to the cost of capital treatment applied to publicly owned utilities in the US? How are those publicly owned utilities compensated (e.g., do they earn a return, do they recover actual debt costs, etc.)?

M1-CCC-6
Ref: Ex. M1/p. 118

For each company in each proxy group listed in Exhibit M1 at page 118, please provide a table that includes the following information (if available and as applicable):

a) Company name
b) Credit rating
c) S&P business risk rating
d) S&P financial risk rating
e) Percentage of operating income from, as applicable, electricity distribution, electricity transmission, electricity generation, natural gas operations
f) Percentage of operating income, as applicable, by operating area (i.e., electricity distribution, transmission, generation or natural gas operations) that is regulated
g) Percentage of overall operating income that is regulated
h) Beta information:
   i. Raw beta
   ii. Beta used by expert in CAPM calculation
i) The regulatory agency that regulates the company (i.e., OEB, AUC, CPUC, etc.) and the applicable rating as set out in the "Utility Regulatory Jurisdiction Assessment performed by S&P Global" (see p. 129 of Exhibit M1 – LEI Expert Report)

j) Description of ratemaking approach applied to the company. As part of this response, please include information regarding:
    i. Most prevalent form of ratemaking (e.g., cost of service, cost of service plus IRM, etc.)
    ii. Application of a forward test year approach in cost of service ratemaking
    iii. Availability of Custom IR option (which, as applied in Ontario, allows for multi-year (typically 5 years) recovery of approved capital budgets as proposed by the utility)
    iv. Availability of mechanisms that allow the recovery of incremental capital between rebasing proceedings (and a description of how those mechanisms operate)
    v. Reliance on fixed vs. variable rates (by rate class)
    vi. Availability of deferral and variance accounts for non pass-through costs and revenues (and the types of accounts that are available)
    vii. Availability of Z-factor relief (and the types of relief available through this mechanism)
    viii. Availability of off-ramp provisions when actual ROE falls below a certain threshold

M1-CCC-7
Ref: Ex. M1/p. 129

If available, please provide the "Utility Regulatory Jurisdiction Assessment performed by S&P Global" for each year 2009-2022 (or any subset of that period that is available).

M1-CCC-8
Ref: Ex. M1/p. 140
Ex. M2/p. 137

LEI's recommendation is to maintain the status quo with respect to the capital structure (i.e., no change to equity thickness in the generic proceeding and to review equity thickness at rebasing as necessary).

a) Please advise whether LEI is of the view that the overall risk faced by Ontario electricity distributors has significantly changed since 2009.
    i. If yes, why should the OEB only consider changes to the capital structure for Ontario electricity distributors at the time of each distributor's rebasing application. Does LEI agree that it would be more efficient (in the context of the number of LDCs regulated by the OEB) to consider changes to the

capital structures for all electricity distributors in the current generic proceeding.

b) Please provide LEI's views on Concentric's recommended increase to equity thickness for Ontario LDCs (from 40% to 45%).

c) If the OEB is inclined to make changes to the equity thickness for Ontario LDCs in the current proceeding (e.g., due to the large number of LDCs and the potential inefficiency in addressing equity thickness in each rebasing), please provide your directional view on whether the equity thickness for LDCs should increase or decrease.

M1-CCC-9
Ref: Ex. M1/pp. 175

LEI recommended that the OEB should employ a deemed capital additions approach, which allows deemed WACC on the unamortized portions of cloud computing contracts.

a) In the context that capital additions are placed into rate base at the time of rebasing, please explain the above cited recommendation in terms of the Cloud Computing Deferral Account (i.e., is this really a recommendation for the treatment of cloud computing costs at the time of a utilities next rebasing or is the suggestion to apply the WACC to calculate the interest on the deferral account balance)?

b) Please advise whether LEI agrees that utilities may have a capital bias across all their investment/spending decisions.

    i. If so, please explain why cloud computing (as opposed to another category of costs that are traditionally treated as an expense) should be treated differently. Does LEI agree that spending on IT is a common business expense for a utility.

M1-CCC-10
Ref: Ex. M3/p. 39

Please provide LEI's comments on the adjustments made to its calculations in Table 4 at p. 39 of Nexus' expert report.