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 M3 – Nexus Economics LLC (Nexus) 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 M3 (Nexus 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 M3 – Nexus Economics LLC Evidence

Consumers Council of Canada

Interrogatories

August 2, 2024

M3-CCC-1

Please provide, using the most recent rate base amounts available, a comparison of:

a) The total return on equity, in dollars, for the electricity distribution sector in Ontario based on Nexus' recommended ROE; and
b) The total return on equity, in dollars, for the electricity distribution sector in Ontario based on the OEB's current approach to setting the ROE.

Please provide the supporting calculation as part of the response.

M3-CCC-2
Ref: Ex. M3/pp. 8, 11, 26, 28, 32

(Page 8) Capital spending is expected to increase markedly, triggered by significant load growth, grid hardening, and cyber-security investments.

(Page 26) 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.

(Page 28) Other jurisdictions embracing carbon reduction and electrification policies have amended their regulatory mechanisms recognizing that the trajectory of capital spending may be uncertain. The absence of these policy changes in Ontario increases the risk to which distributors are exposed.

a) (Page 8) In the context that regulated distributors are allowed to recover prudently incurred capital costs, please explain why increased spending in response to climate change/electrification is a risk to distributors.

b) (Page 8) In the context of electricity distributors, please provide Nexus' view on the impact on risk of longer-term significant growth in approved rate base, which provides for larger returns on an absolute basis. Does growth in the capital asset base reduce risk overall once the costs are approved for recovery?

c) (Page 11) Does Nexus agree that the regulatory framework applied to electricity distributors is an important consideration in determining the appropriate cost of capital?

d) (Page 26) In the context of the ability for a distributor to reset its rates at rebasing (including increases to fixed charges to reflect changes to costs), please explain how the adoption of electrification policies would limit revenue growth to distributors.

e) (Page 26) Please advise whether Nexus believes that fully fixed rates or fully variable rates are riskier for a distributor.

f) (Page 28) Please describe the regulatory or ratemaking mechanisms that are not available to Ontario distributors that would address Nexus' concerns regarding the trajectory of capital spending?

g) (Page 32) What mechanism(s) is Nexus referring to that are currently unavailable in Ontario, or are provided on a more limited basis, that operate to increase Ontario LDC risks relative to its peers?

h) Please advise whether NEXUS is aware of any LDC in Ontario having difficulty attracting capital (either debt or equity).

<u>M3-CCC-3</u>
Ref: Ex. M3/p. 30

a) Please explain why Nexus believes that the k-bar methodology is “superior” to the ICM approach. As part of this response, please provide Nexus’ views on which approach provides more incremental capital funding (i.e., incremental capital provided based on historical capital with a growth factor through the k-bar or forecast incremental capital based on best available information provided through the ICM). Please also discuss whether Alberta and Massachusetts offer the availability of a Custom IR, which as applied in Ontario, allows for multi-year (typically 5 year) recovery of approved capital budgets as proposed by the utility.

<u>M3-CCC-4</u>
Ref: Ex. M3/pp. 45-46

At a general level, when Nexus discusses country risk (and notes that Canada and the US have the same risk of 0%), is this commentary only about the risk of operating in each of those countries?

<u>M3-CCC-5</u>
Ref: Ex. M3/p. 61

For each company in the proxy group listed in Exhibit M3 at page 61 (Table 6), 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

M3-CCC-6
Ref: Ex. M3/p. 67

a) Please advise whether Nexus is aware of the beta estimate for any Canadian regulated utility ever reaching 1.0.

b) Please provide Nexus' view on the differential in risk between Canadian and US utilities as expressed by the beta estimates. Historically, do US utilities have higher beta estimates than Canadian firms?

c) Please provide the revised CAPM-derived ROE result based on raw betas.

d) To understand the CAPM-derived ROE sensitivity to changes in beta estimates using Nexus' recommended approach, please provide the ROE based on:

i. A beta of 0.5
ii. A beta of 0.25

M3-CCC-7
Ref: Ex. M3/p. 72

Please explain why it is appropriate to use approved returns (or, "authorized returns") for 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.

M3-CCC-8
Ref: Ex. M3/p. 79

Please further explain Nexus' proposal regarding annual updates to the ROE on a formulaic basis. More specifically, is Nexus suggesting that there should be annual updates to the ROE or not. If there are annual updates in Nexus' proposal, please explain the formula and how the ROE would be updated each year.