Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 118

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

a-b) OPG's ability to recover costs as they relate to its regulated assets is reflected in decisions of the OEB, underpinned by the parameters of the prevailing legal framework, including *Ontario Regulation 53/05*. An example of a prior OEB disallowance of OPG's incurred capital costs in relation to a large capital project is for the Niagara Tunnel Project in the OEB's EB-2013-0321 decision.

Concentric also notes that the "wide range of risks associated with construction" cited in the question refers to construction of new or refurbished generating facilities, a risk that is unique to OPG as the only regulated pure-play generator. These projects can take a number of years to complete, and some of OPG's associated risks are identified throughout the Concentric Report (e.g., pp. 118-119, 124, 131-132). As further discussed in Concentric Report, Section IX, this includes OPG

needing to finance these large assets during construction, with cost recovery beginning only when the asset is in-service and generating electricity.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 122

Question(s):

Note this interrogatory has been asked by LEI

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?

Response:

a) Utilities are among the most frequently targeted sectors for cyber attacks, due to several factors:

- **Reliance on IT Systems**: Utilities rely heavily on information technology and operational technology systems. These systems are employed to operate and monitor electricity distribution, as well as the utilities financial, billing, and other business systems. The secure processing, maintenance and transmission of information is critical to a utility's operations. Both the reliance on and significance of these IT systems make utilities attractive targets for cyber criminals.

- **Critical Infrastructure and Essential Services**: Power utilities are considered critical infrastructure and provide essential services, meaning their disruption can

have widespread and severe consequences. This makes them attractive targets for cyber criminals and nation-state actors.

- **Complexity and Interconnectivity**: The power grid's complexity and its interconnectivity with other critical sectors (like water, transportation, and healthcare) increase its vulnerability. A successful attack on the power grid can cascade into other sectors and have catastrophic effects on other critical infrastructure and essential services, such as healthcare.

- **Operational Technology ("OT") Vulnerabilities**: Power utilities rely heavily on OT, which includes industrial control systems ("ICS") that manage physical processes. These systems are often older and were not designed with cyber security in mind, making them more susceptible to attacks. Growth of distributed energy systems (solar, wind, storage, etc.) further complicates securing the grid because alternative sources are rarely under the utility's control.

- **Customer Data**: utilities hold significant amount of customer data, making them an attractive target for cyberattacks.

Given the nature of utilities they are vulnerable to damage or interruption from cyberattacks, breaches or other compromises, which could result in business interruption, service disruptions, theft of intellectual property and confidential information (about customers, suppliers, counterparties and employees), additional regulatory scrutiny, litigation and reputational damage.

Cyber attacks, breaches or other compromises of electricity distribution infrastructure and technology systems could result in service disruptions and system failures, including as a result of a failure to provide electricity to customers, property damage, data corruption, and/or loss of confidential employee, supplier, counterparty or customer information. A significant breach could have a material adverse effect on the financial performance of the utility or its reputation and standing with customers, regulators and in the financial markets.

As an attractive target that supports virtually all essential services utilities are at an increased risk of cyberattacks. Further, given the support of these essential services and the significant customer data held by utilities, a cyber breach could be catastrophic.

b) **Impact of Cyber Attacks on Cost Recovery**

Cyber attacks can significantly impact the cost recovery for utilities in several ways:

1. **Direct Financial Costs**: Utilities may incur substantial costs related to detecting, investigating, containing, and recovering from cyber attacks. Utilities could be liable for replacement costs of customer owned equipment damaged due to cyber attacks. These costs can include hiring cyber security experts, replacing equipment, and implementing new security measures. It is increasingly important to consider the cost of cyber defenses in cost recovery mechanisms. These costs are a societal good and promote resilience in the critical infrastructure itself. With an increasing cyber risk profile in the North American utility infrastructure, and the criticality of supply to the other critical infrastructure sectors and residential customers it becomes increasingly incumbent upon regulators and companies to acknowledge the prudence of cybersecurity investments to avoid significant potential losses of power supply.

2. **Operational Disruptions**: Cyber attacks can lead to operational disruptions, resulting in lost revenue from unserved energy. OT and distribution assets can require significant lead time to replace. Prolonged outages can also lead to penalties and fines from regulatory bodies. Attacks that target the billing system can pose immediate risk to financial viability for electricity utilities that have minimal unregulated lines of business or alternate revenue streams. For example, disruption of billing and payments poses severe risk to a utilities cash flow and operations. Cyberattacks on generation facilities may impact generation capability (e.g. unit shutdowns). This would have a direct impact on a generators cost recovery as its ability to recover costs is output-based.

3. **Regulatory and Compliance Costs**: Following a cyber attack, utilities may face increased regulatory scrutiny and be required to comply with more stringent cyber security standards. This can lead to additional compliance costs.

4. **Insurance Premiums**: The risk of cyber attacks can lead to higher insurance premiums for utilities, further increasing operational costs.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 128

Question(s):

Note this interrogatory has been asked by LEI.

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.

Response:

a) The "basis" discussed in the referenced part of Concentric's report refers to the fact that Ontario's electric transmission and distribution utilities have similar deemed equity ratios as other electric utilities in Canada but substantially lower equity ratios than their U.S. counterparts, and that Ontario's gas distributors have somewhat lower deemed equity ratios than other gas distribution companies in Canada and substantially lower equity ratios than their U.S. peers. The major credit agencies share this view. For example, in a July 2024 Credit Opinion update, Moody's notes "[Hydro One's] relatively weak financial metrics are primarily the result of its low authorized equity layer in the capital structure (currently 40%) that is established by the OEB."[1] Further, Moody's cites the company's weak financial metrics driven by the low authorized equity capital as one of the Company's main credit challenges.

[1] Moody's Ratings, "Credit Opinion: Hydro One Inc," July 26, 2024.

According to DBRS Morningstar, the Canadian credit rating agency, Ontario regulation is generally credit supportive. DBRS has observed, however, that deemed equity ratios and authorized returns on equity are lower in Ontario than in many other North American jurisdictions. DBRS rates the regulatory environment for regulated utilities on eight criteria on a five-point scale from Excellent to Poor (i.e., Excellent, Good, Satisfactory, Below Average, and Poor). The Figure below summarizes those factors for various Ontario utilities:

| **Criteria** | **Toronto Hydro**[2] | **OPG**[3] | **Hydro One Networks**[4] | **Alectra**[5] |
|---|---|---|---|---|
| Deemed Equity | Satisfactory | Good | Satisfactory | Satisfactory |
| Allowed ROE | Satisfactory | Satisfactory | Good | Satisfactory |
| Energy Cost Recovery | Excellent | N/A | Excellent | Excellent |
| Capital and Operating Cost Recovery | Good | Good | Good | Good |
| Cost of Service vs. Incentive Rate Mechanism | Satisfactory | Satisfactory | Good | Satisfactory |
| Political Interference | Below Average | Below Average | Below Average | Below Average |
| Stranded Cost Recovery | Good | Satisfactory | Good | Good |
| Rate Freeze | Good | Below Average | Satisfactory | Satisfactory |

Similarly, in their most recent updates to their credit reports, Moody's and S&P both noted the high levels of execution risk in OPG's plan to refurbish the Darlington Nuclear

2 DBRS Morningstar, Rating Report Toronto Hydro Corporation, May 1, 2023, at 9.
3 DBRS Morningstar, Rating Report Ontario Power Generation Inc., April 30, 2024, at 14.
4 DBRS Morningstar, Rating Report Hydro One Networks, Inc., November 20, 2023, at 11.
5 DBRS Morningstar, Rating Report Alectra Inc., June 22, 2021, at 12.

Plant could pressure the company's credit quality over time.[6,7] Notably, Moody's further highlights the lack of clarity regarding OEB's regulatory support in the Company's completion of its Pickering refurbishment and small modular reactor ("SMR") reactor project.

Investors' perception of higher financial, execution, and regulatory risk signal that an investment in the utility's equity should constitute a higher return commensurate with that risk. During times of high capital spending or evolving financial conditions, the ability to attract capital at a reasonable cost is of paramount importance. Periodic regulatory reviews of established ROEs and capital structures can assist in managing a utility's ability to access the capital markets.

6 Moody's Ratings, "Rating Action: Moody's Rating affirms Ontario Power Generation ratings; outlook stable," May 29, 2024.

7 S&P Ratings Direct, "Ontario Power Generation Inc.," August 8, 2023.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Preamble:

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:

Question(s):

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

Response:

a) As discussed in Concentric's report, pages 151-156, Concentric agrees with LEI's recommendation to continue applying a short-term debt rate to short-term DVAs (i.e., accounts that will clear within one year) but recommends the Board apply each utility's WACC to long-term DVAs, consistent with corporate finance principles. Concentric views the use of the Bloomberg BVCAUA3M BVLI Index (3-month) for

the DSTDR and the prescribed interest rates for short-term DVAs as reasonable, although not necessarily preferred to the CORRA rate.

b) No. Concentric views the approaches of conducting bank surveys or collecting actual short-term loan data from utilities as the most appropriate, although there may be disclosure concerns with providing confidential information regarding short-term market transactions. As discussed in part a), however, use of the Bloomberg BVCAUA3M BVLI Index (3-month) for the DSTDR and the prescribed interest rates for short-term DVAs may also be reasonable alternatives.

c) The market is still in a transition period, making it difficult to opine on the reasonableness of one tenor versus another. Concentric has concerns that there may not be as developed a market for one-year loans as for three-month loans.

d) Agreed.

e) Agreed.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Preamble:

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.

Question(s):

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

[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.

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 Concentric's viewpoint still remain that the CORRA rate should be used, or alternatively, please elaborate on a different methodology that should be used.

Response:

a)

i. As discussed in Concentric's report, at pages 151-156, Concentric agrees with LEI's recommendation to continue to apply a short-term debt rate to short-term DVAs (i.e., accounts that will clear within one year), but recommends that the Board apply each utility's WACC to long-term DVAs, consistent with corporate finance principles. In terms of applying the three-month Canada T-Bill plus a fixed 25 basis points spread for short-term DVAs, Concentric does not recommend this approach for 2025 Q2 and forward. The T-Bill is a risk-free rate and does not reflect any credit spread that would be reflected in, for example, the CORRA rate. Further, the 25 basis points spread for utility-specific risks may not reflect current market sentiment.

ii. Concentric assumes the bank survey would be re-performed, and not continue to rely on the September 2023 survey. Concentric believes this approach would be reasonable, further assuming the bank survey sought views on the spread of utility short-term debt over the three-month Canada T-bill.

b) Yes. For those instances where a short-term rate would continue to apply (i.e., for short-term DVAs and the deemed short-term debt rate), Concentric believes it is reasonable to use the CORRA rate plus a credit spread as determined through a survey of banks.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 38

Question(s):

Note this interrogatory has been asked by LEI

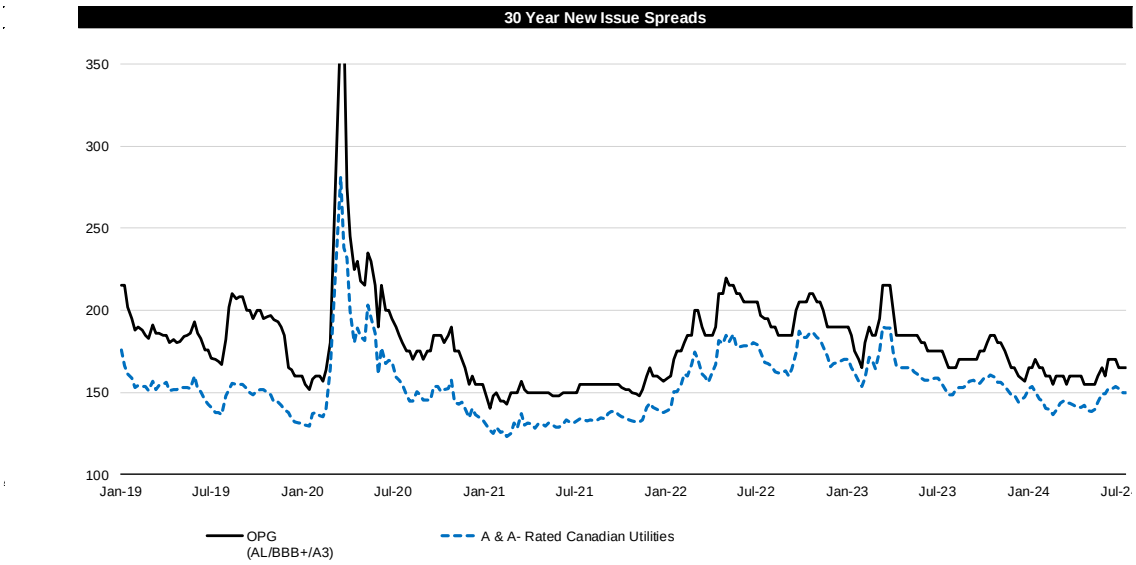
Concentric stated the following:

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.

Response:

The basis for this claim is that lower-rated borrowers face higher costs of borrowing. A utility such as OPG, which is rated A(low)/BBB+/A3 by DBRS/S&P/Moody's, has a credit rating at the lower end of the scale A+, A, A- scale. Further, OPG has higher risk generation assets, which result in bond investors requiring a higher credit spread premium when investing in OPG bonds. The difference in credit spreads between OPG and an average of Canadian A and A- rated utilities is demonstrated in the chart below.




Source: TD Bank.

Credit ratings for the regulated Ontario utilities that are included in Concentric's report, Exhibit M2, are provided in Appendix B of the report.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, pp. 95 & 98 & 100

Question(s):

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.

Response:

a) Please see OEB Staff-7(a), Attachment 1 for the base LCBF calculation and Attachment 2 for the base credit utility spread.

b) The long bond forecast of 3.80% in Figure 32 is based on the simple average of the forecast bond yield for Canada of 3.46% and for the U.S. of 4.14% as shown in Figure 15.

c) Concentric's CAPM analysis is based on the risk-free rate shown in Figure 15 of Concentric's report, Exhibit M2. This value is derived using the standard approach in most Canadian jurisdictions, which is to use the Consensus Economics' forecast of the 10-year bond yield plus the 10/30 spread to derive a 30-year bond yield forecast. Concentric used this 3.80% value in Figure 32 to compute the implied equity risk premium of its three ROE models for the Canadian Electric proxy group. However, in discussing the method for determining the LCBF in the Ontario formula, Concentric mentions two possible approaches. The first method is to use the approach described above based on the Consensus Economics' forecast of the 10-year government bond yield plus the 10/30 spread, and the second method is to use a forecast of the 30-year government bond, as was recently done by the Alberta Utilities Commission. Concentric's recommendation is to use the latter approach in setting the base LCBF in the Ontario formula.

d) The equity risk premia shown in Figure 32 were calculated by subtracting the long bond forecast of 3.80% from the results of each ROE model (Multi-Stage DCF, CAPM using historical MRP, and Risk Premium model) for the North American Combined proxy group. Please see OEB Staff-7(d), Attachment 1 for the supporting calculations in Excel.

**Canadian Risk-Free Rate**

| | Q1 2025 | Q2 2025 | Q3 2025 | Q4 2025 | Weight | |
|---|---|---|---|---|---|---|
| RBC | 3.00% | 3.05% | 3.10% | 3.15% | | |
| TD Bank | 3.45% | 3.35% | 3.25% | 3.20% | | |
| Scotia Bank | 3.50% | 3.50% | 3.50% | 3.50% | | |
| Average | | | | 3.296% | 75% | 2.472% |
| Current 30-day average yield as of May 31, 2024 | | | | 3.553% | 25% | 0.888% |
| Weighted Average Bond Yield | | | | | | **3.360%** |

Notes:

Bank forecasts as of early June 2024

Current average Canadian 30-year GOC yield from Bloomberg Professional

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Please see Exhibit N-M2-10-OEB Staff-7(a)_Attachment 2.xlsx on the OEB's RDS.

**Figure 32: ERP for Proxy Group Based on Model Results**

**Utility Equity Risk Premium Estimate**

North American Electric Proxy Group

| Model | ROE Estimate | Long Bond | Equity Risk Premium |
|---|---|---|---|
| Multi-Stage DCF | 9.83% | 3.80% | 6.03% |
| CAPM | 10.23% | 3.80% | 6.43% |
| Risk Premium | 9.90% | 3.80% | 6.10% |
| **Average** | **9.99%** | **3.80%** | **6.19%** |

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, pp. 9 & 10 & 100

Question(s):

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.

Response:

a) As shown in Figure 1 of Exhibit M2, Concentric presents the results for six proxy groups, and, because the utilities in the North American proxy groups are most representative of Ontario's utilities, we place more weight on those results. For clarification, our recommendation is not tied directly to the North American **combined** proxy group, but rather focuses on the range of results presented in Figure 1, placing more weight on the North American proxy group results that range from 10.0 percent to 10.1 percent.

b) See part a).

c) Please see part a). In addition, please see OEB Staff-8(c), Attachment 1 for the Excel version of Concentric's exhibits, which includes the summary results in Exhibit CEA-1. Concentric used the average results for the North American Electric proxy group as an example in developing Figure 32 of our report.

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Please see Exhibit N-M2-10-OEB Staff-8(c)_Attachment 1.xlsx on the OEB's RDS.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Question(s):

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.

Response:

a) Dr. Cleary's statement is formulaically correct, as the adjustment factors, by definition, sensitize the allowed ROE to changing market conditions. Concentric agrees that if the adjustment factors were to increase, the allowed ROE would become "more responsive" to changing market conditions. (For example, the current adjustment factor of 0.50 mitigates allowed ROE volatility down to 50% of the change in government bond yields and utility credit spreads, whereas an adjustment factor of 1.00 would pass on 100% of bond yield/credit spread variability to the allowed ROE.)

   However, Concentric disagrees with Dr. Cleary that the adjustment factor should increase from 0.50. Empirical evidence demonstrates that the historical relationships between allowed ROEs and government bond yields/utility credit spreads have weakened over the years, not strengthened. In other words, allowed ROE movements haven't followed government bond yield and credit spread movements as closely as they previously have. Concentric's recommendations to lower the adjustment factors from 0.50 to 0.40 (government bond yields) and from 0.50 to 0.33 (utility credit spreads) capture these trends and were based on a multivariate linear regression analysis determining the theoretical relationships or "locksteps" in which the historical series moved. In Concentric's opinion, increasing the adjustment factors makes little sense based on results of the regression analysis.

   Finally, Concentric interprets Dr. Cleary's clause of "not significantly more volatile" to mean that the difference between the current 0.50 adjustment factor and Dr. Cleary's recommended 0.75 adjustment factor is not a "significant" difference. Concentric does not opine on this wording, but notes that our recommended changes are of even smaller magnitude, just in the opposite direction.

b) Concentric recommends the OEB use its recommended adjustment factors because its analysis was based on a large sample of actual historical data, has a high degree of statistical significance, has higher confidence levels than does LEI's analysis, and maintains a more effective level of sensitivity to changes in government bond yields and utility credit spreads than does LEI's recommendation.

In Concentric's opinion, LEI's analysis produces results which won't allow the allowed ROE to be sufficiently sensitive to economic conditions. Additionally, LEI's analysis used historical data series that were highly correlated, leading to multi-collinearity issues in which outputs are unstable if presented with slight variations in input, as further expounded upon in the response to N-M2-VECC-36.2. LEI's analysis also has looser confidence intervals; for example, LEI's 0.26 government bond yield adjustment factor recommendation is wrapped in a 95% confidence interval of 0.12 – 0.40, indicating that the 0.26 is not a precise result. Conversely, Concentric's interval around its 0.40 recommendation is 0.38 – 0.42, indicating that 0.40 is a more precise result. Likewise, LEI's 0.13 credit spread adjustment factor is wrapped in a 95% confidence interval of 0.01 – 0.25, whereas Concentric's 0.33 credit spread adjustment factor is wrapped in an interval of 0.28 – 0.39.

Finally, Dr. Cleary does not provide a historical regression analysis, which is the crucial step in determining the correct adjustment factors to use, as explained in the response to N-M2-CCC-8(c).

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 10

Question(s):

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.

Response:

OPG's current payment amounts are subject to the settlement agreement as part of its EB-2020-0290 proceeding, and its payment amounts should not be adjusted in the interim.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 10

Question(s):

Note this interrogatory has been asked by LEI.

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.

Response:

a) Please see OEB Staff-11(a), Attachment 1 for the requested information.

b) Concentric's ROE recommendation of 10.0%, which is based on the average results for a North America proxy group using market data as of May 31, 2024, falls in the top decile among Canadian electric and gas utilities, but within the range of

authorized ROEs for comparable risk U.S. electric and gas utilities, which was 8.63% to 11.88% between January 1, 2023 and May 31, 2024.

c) One component of the Fair Return Standard is that the authorized return must be comparable to returns available to investors in investment with similar risk. LEI's recommended base ROE of 8.95% is lower than the average authorized ROE for other Canadian electric and gas utilities and is, in fact, at the low end of that range. Further, LEI's recommended base ROE is well below the average authorized return available to investors in U.S. electric and gas utilities and near the low end of the range. LEI has not provided any evidence that Ontario's electric and gas utilities have below-average business or financial risk compared to other North American regulated utilities. Based on our analysis using current market data and comparative returns, Concentric's view is that the LEI's recommended base ROE of 8.95% does not satisfy the Fair Return Standard for the Ontario utilities specifically.

d) No. Concentric's analysis is focused on meeting the Fair Return Standard for Ontario utilities, not on assessing whether other jurisdictions have met the Fair Return Standard. However, Newfoundland Power has a pending rate application with its regulator in which the company is requesting an increase in its authorized ROE from 8.50% to 9.85%. Newfoundland Power has a deemed common equity ratio of 45.0%, which it is requesting to maintain. Concentric's evidence in that proceeding concludes that the current authorized ROE of 8.50% does not meet the Fair Return Standard. Concentric has not evaluated the authorized ROE for Energir of 8.90%, but we do observe that it is 75 basis points lower than the authorized ROE for FortisBC Energy Inc. ("FEI") of 9.65%, which was established by the British Columbia Utilities Commission in September 2023.

e) Confirmed.

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Please see Exhibit N-M2-10-OEB Staff-11(a)_Attachment 1.xlsx on the OEB's RDS.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, Figure 16, p. 66

Question(s):

Note this interrogatory has been asked by LEI

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).

Response:

a) Please see N-M2-10-OEB Staff-12(a), Attachment 1 for the requested data. Value Line betas are taken from the summary sheet for each company; Bloomberg betas are downloaded directly from Bloomberg based on inputs of the user. No additional calculations were made to produce the betas for each utility company.

b) Please see N-M2-10-OEB Staff-12(b), Attachment 1 for the requested data. Value Line reports Blume-adjusted betas. Concentric used Value Line’s most recently reported betas for each company in the proxy group as of May 31, 2024. Bloomberg reports raw and adjusted betas. Concentric used Bloomberg’s most recently reported 5-year Blume adjusted betas for each company in the proxy group as of May 31, 2024.

   To convert an adjusted Beta to a raw Beta, Concentric used the formula:

   Raw Beta = (Adj. Beta – (1/3)) x (3/2).

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Please see Exhibit N-M2-10-OEB Staff-12(a)_Attachment 1.xlsx on the OEB's RDS.

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Please see Exhibit N-M2-10-OEB Staff-12(b)_Attachment 1.xlsx on the OEB's RDS.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 66

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

a) Betas in Concentric's CAPM analysis were adjusted using the standard Blume method. As discussed on page 67 of Exhibit M2, the Blume method was developed by Professor Marshall Blume based on his 1971 and 1975 studies of four groups of betas, ranging from a very low beta group (averaging 0.50, and similar to the utility industry) to a very high beta group (over 1.0). Dr. Blume determined that his adjustment formula best predicted the future betas for each of the four risk groups over the next seven years. In summary, the conclusion of Dr. Blume's research was that low beta firms tend to migrate toward the market mean of 1.0 over time and do in fact exceed their long-term unadjusted (or raw) averages.

b) Professor Fernandez has published a series of studies and papers on betas, considering both the practices and teaching of finance professors and the actual behavior of betas for publicly traded stocks. In these studies, published beginning in 2009 and updated most recently in 2023, Professor Fernandez compares the actual stock returns of the 30 Dow Jones Industrial companies against the returns of the S&P 500 and concludes that beta = 1.0 is a superior estimate to calculated (i.e. raw) betas for all companies except two, and Blume-adjusted betas (0.67 calculated beta + 0.33) have higher correlation than calculated betas, but adjusted betas have lower correlation than beta = 1. In other words, Fernandez's studies demonstrate that Blume adjusted betas outperform unadjusted betas, but the simple assumption of beta = 1 performs even better in terms of predicting stock returns.[1]

c) See the response and studies cited in part (b)

d) i. Regulated utilities, including those in Ontario, must continuously invest in their networks to maintain reliability and meet new and changing customer needs and regulatory requirements. These investments provide earnings growth, and over time the opportunity for some diversification of earnings, e.g., new customer services (electric distributors), alternative fuels (Enbridge, OPG), and ongoing industry consolidation within the sector.

ii. Concentric is aware of the argument that business risk, or variability of cash flows, will be similar for all companies within an industry, and that an industry beta can reduce error by using a larger sample, potentially cancelling the noise that appears in the estimation of beta for individual companies. Concentric's use of

[1] See: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1406923; and https://www.iese.edu/media/research/pdfs/DI-0825-E.pdf; and https://www.iese.edu/media/research/pdfs/DI-0822-E.pdf

North American electric and gas proxy groups, and the averaging of betas across these companies, in our view, provides the benefits of an industry beta. Concentric is not otherwise aware of the use of an industry beta in North American jurisdictions.

e) See the response to (d).i.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, Figure 17, p. 69

Question(s):

Note this interrogatory has been asked by LEI

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).

Response:

a) Please see N-M2-10-OEB Staff-14(a), Attachment 1. The attachment has four tabs, one for each calculation of the four values cited in Figure 17. The cited values are highlighted in green. The historical market risk premia for Canada and the U.S. are sourced by Kroll. The forward-looking market risk premia calculations for Canada and the U.S. are provided in the attachment as well as in Exhibits CEA-6.1 and 6.2.

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Please see Exhibit N-M2-10-OEB Staff-14(a)_Attachment 1.xlsx on the OEB's RDS.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, Figure 19, p. 71

Question(s):

Note this interrogatory has been asked by LEI

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).

Response:

a) Please see N-M2-10-OEB Staff-15(a), Attachment 1 for the requested derivation of the adjusted CAPM Results shown in Figure 19.

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Please see Exhibit N-M2-10-OEB Staff-15(a)_Attachment 1.xlsx on the OEB's RDS.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, Figure 19, p. 71

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

Flotation costs are the costs associated with the sale of new issues of common stock. These costs include out-of-pocket expenditures for preparation, filing, underwriting, and other costs of issuance of common stock, as well as price discounts and premiums. In his text, New Regulatory Finance, Dr. Roger Morin cited a 1996 study by Lee et. al., which found that the average flotation costs for regulated utilities are equal to approximately 5% of the gross proceeds of the equity issuance, with smaller issues tending to have a higher percentage.[1] This is consistent with recent research by the Enbridge Treasury team, which found that the average flotation costs for a sample of Canadian and U.S. utilities were also equal to slightly more than 5% of the gross proceeds. Based on Concentric's prior analysis of flotation costs, the empirical study cited by Dr. Morin, and the recent Enbridge analysis, our view is that flotation costs for utilities are within a range from 2% to 10%, with an average of around 5%. This can be translated into basis points of ROE by adjusting the dividend yield in the DCF model. Using this method, if f flotation costs are equal to 5% of the gross proceeds of the equity issuance, then the adjustment to ROE would be approximately 25 basis points for companies like those in Concentric's North American combined proxy group. Flotation costs at the higher end of the range (i.e., 10% of the gross proceeds), would equate to

[1] Dr. Roger A. Morin, New Regulatory Finance, Public Utilities Reports, Inc. 2006, at 323.

an approximately 45 basis points adjustment. Concentric notes that the 50 basis point adjustment approved by Canadian regulators also includes financial flexibility.
In addition to an adjustment for flotation costs, Canadian regulators in most jurisdictions including Ontario have also typically included an adjustment for financial flexibility. This adjustment provides a small cushion so that the utility may continue to raise equity in challenging capital market conditions.

According to Dr. Roger Morin, utilities need the ability to attract capital even during "market breaks" because they have an ongoing obligation to serve. For that reason, he recommends providing the utility an additional allowance for financial flexibility during difficult market conditions, as follows:

> *The flotation cost allowance of 5% allows for both the direct flotation costs and market pressure component but does not contain an explicit allowance for market break.*
>
> ***
>
> *Such an allowance is desirable, however. If negative events should occur during the time period from announcement of a public issue to actual pricing, the price could fall below book value unless a sufficient margin is maintained. Compared to non-regulated companies, utilities do not possess the same latitude and discretion in accessing capital markets in view of their obligation to serve. They must access capital markets regardless of capital market conditions. Therefore, they have limited ability to time security issuances in order to avoid an adverse market break.*[2]

[2] Dr. Roger A. Morin, New Regulatory Finance, Public Utilities Reports, Inc. 2006, at 326.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 7

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

a) As stated in Concentric's report, Exhibit M2, at 136, "Ideally, the Ontario utilities should have a deemed equity ratio at parity with their U.S. counterparts, which is approximately 50-51 percent for electric utilities and 52 percent for gas distributors." Concentric's recommended minimum equity ratio of 45% is approximately halfway between current equity ratios for Ontario distributors and transmitters and their U.S. comparators, and thus falls short of parity.

b) Concentric's view is not that Ontario utilities have been unable to compete for investment capital with North American peers, but rather that the level of equity thicknesses in Ontario does not currently meet the comparable return standard of the Fair Return Standard and is thus not providing investors a comparable risk-adjusted return. With the strengthening of the Energy Transition and the significant level of capital that will be deployed, lower risk-adjusted returns will prevent

Ontario’s utilities from competing for investment capital on a comparable basis with North American peers with stronger balance sheets.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Question(s):

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?

Response:

a) Concentric disagrees with 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 Gas Inc.'s equity ratio) over the following two to three years. Such an action by the OEB would send a negative message to the market at a time when the need to invest capital in the electric system is growing to meet policy goals related to decarbonization. Further, Dr. Cleary has provided no evidence of any *change* in Hydro One's risk level. Dr. Cleary's approach to measuring risk is narrow and focused on Hydro One's historical ability to earn its allowed return, current credit ratings and near-term credit metrics. None of these measures is indicative of an equity investor's required return, which is forward-looking and considers both near-term and long-term risks. Additionally, Dr. Cleary's review and analysis of credit rating information is unpersuasive. Dr. Cleary states (at page 119 of his report) that Hydro One's credit metrics are very strong, and that "this would continue to be the case if its equity ratio was lowered to 38%," despite the fact that a reduced equity ratio would reduce cash flows, negatively impacting credit metrics. In fact, in its November 2023 credit rating report for Hydro One, DBRS stated "[h]owever, a negative credit rating action may occur should key metrics weaken to a level that no longer supports the current credit ratings (i.e. **debt-to-capital above 60%** and cash flow-to-debt below 12.5% for a sustained period)."[1] Dr. Cleary's recommended equity ratio of 38%, decreasing over time to 36%, would bring Hydro One's debt-to-capital above 60%. Similarly, Moody's, in a June 2024 report (see the response to SEC-41(a)) indicated that Moody's 12-18 months forward assessment of Hydro One's debt ratio was 55% to 60%. Further, DBRS noted in its November 2023 credit report that Hydro One's recent credit metrics were buoyed by the effect of a recent decision on Hydro One's deferred tax asset. DBRS notes that the recovery of the deferred tax asset ended on June 30, 2023, on page 6-7. This is an indication that historical credit metrics may not represent a complete picture of forward-looking metrics. This report is filed with SEC-41(a).

[redacted]

[1] DBRS Morningstar, Hydro One Inc. Rating Report, November 20, 2023, at 1.

Furthermore, Dr. Cleary has not provided any comparable investment analysis (other than to point to one other jurisdiction, i.e., Alberta). Hydro One, of course, competes for capital in a much broader market. As such, because Dr. Cleary has not assessed changes in Hydro One's risk level, nor has he performed a comparative return analysis, his recommendation to reduce the equity ratio for Hydro One fails both steps of the OEB's historical approach to assessing equity thickness.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

EDA Report, pp. 43 & 46 & 84
Dr. Cleary Report, pp. 29 & 44
Concentric Report, pp. 136 & 137

Question(s):

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.

Response:

a) Concentric disagrees with Dr. Cleary's conclusion that U.S. utilities are not reasonable comparators for Canadian utilities. In fact, as discussed in the Concentric report (at 51-52), Exhibit M2, both the BCUC and the AUC have accepted the use of a North America proxy group comprised of utility companies in both Canada and the U.S. to set the authorized ROE for utilities under their jurisdiction. In addition, as discussed on page 50 of Concentric's report, the OEB determined in 2009 that U.S. utilities can be used as comparators to Canadian utilities for purposes of establishing the authorized ROE. Also, in September 2013, Moody's published a report in which the rating agency changed its previous view that U.S. utilities had greater regulatory risk than their peers in Canada. Moody's ultimately concluded that U.S. utilities have similar regulatory risk as Canadian utilities, noting the increased use of forecast test years in the U.S. and the adoption of adjustment clauses and cost recovery mechanisms that enhanced the timeliness of cost recovery for U.S. companies and reduced regulatory lag.

   Further, Concentric's experience suggests that equity analysts perceive the U.S. and Canada as part of an integrated North American market for capital. This is demonstrated by a March 2019 report by equity analysts at Scotiabank indicating that they view the regulatory environments in Canada and the U.S. as being similar for regulated utilities. In explaining why they expect the valuations of Canadian and U.S. utilities to converge, Scotiabank observed: "Canadian and U.S. valuations should converge. Historically, the Canadian utilities have traded at a premium to their mid-cap U.S. peers. We attribute this to the historical view that Canadian regulation was superior to U.S. regulation (***we no longer have that view***) as well as to strong earnings growth in part due to M&A. As shown in Exhibit 19, based on forward consensus estimates, the Canadian names now trade at a 3x discount."[13]

b) Concentric has included U.S. companies in our North American proxy group analysis. Our recommended 45% minimum equity thickness falls short of parity with U.S. equity ratios, which, as described in the Concentric report, at page 134, average 51% for electric companies and 52% for gas LDCs.

Nexus' proposal is that the OEB retain its existing policy regarding capital structure applicable to electricity distributors for now. However, Nexus adjusts its authorized ROE recommendation to account for differences in financial leverage. Specifically, Nexus, at page 6, stated that they adjusted their ROE results "for differences in leverage to the Deemed Debt Rate of 60 percent. In this way, we put the results on the same financial risk footing as Ontario." As such, while Nexus has not recommended a change in equity thicknesses for Ontario utilities, Nexus has accounted for Ontario's lower equity thicknesses through its leverage adjustment, which "eliminate[s] financial risk as a cause for differentiation among cost of equity estimates." Further, Nexus observes at page 84 of their report that "[f]irst, a 50:50 Debt-to-Equity ratio for regulated electric utilities is common in the US. Second, Debt ratios greater than 60 percent are fairly rare. Third, Ontario's Deemed Debt-to-Capital Ratio of 60 percent is higher than those of the Comparable states (New York and California) identified by LEI in its report. British Columbia and Alberta have Deemed Debt Ratios of 55 percent."

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 11

Question(s):

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?

Response:

a) As explained on pages 18-19 of Concentric's report, Exhibit M2, there is a relationship between the capital structure and the return on equity. The equity ratio and the equity rate of return must be considered together to determine whether the Fair Return Standard has been met. If the OEB were to determine that it wishes to maintain the current authorized equity ratios for Enbridge Gas and Ontario's electric

transmission and distribution companies in this proceeding, then it would be necessary to approve an authorized ROE greater than Concentric's 10.0% recommendation. This is because our 10.0% recommended ROE assumes that the OEB also approves our recommended equity ratio of 45.0%, at a minimum. If that recommendation is not adopted, then a higher authorized ROE is needed to compensate equity investors for the greater financial risk.

b) This would be achieved by setting the base authorized ROE at a value greater than 10.0%, using the values derived from the Hamada equation as discussed on page 11 of Concentric's report. This base authorized ROE would then be adjusted annually using the Ontario ROE formula. Under this scenario, the current deemed equity ratios would be maintained for Enbridge Gas and Ontario's electric transmission and distribution utilities until such time as the OEB determined it was appropriate to change them.

c) The updated ROE of 11.38% to 11.63% would be in the top decile among authorized ROEs for Canadian and U.S. utilities. See OEB Staff-11(a), Attachment 1.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 11

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

a) Concentric agrees that S&P Global considers Ontario as "most credit supportive," as discussed at page 123 of the Concentric report, Exhibit M2. However, a "most credit supportive" assessment by a credit rating agency is not synonymous with meeting the legal requirements of the Fair Return Standard. While the Fair Return Standard requires that the return on equity supports financial integrity and the utility's ability to attract capital on reasonable terms, it also requires that returns be comparable to returns available on investments of similar risk. The current levels of deemed equity thickness for Ontario utilities do not meet this component of the Fair Return Standard. Further, while S&P Global considers Ontario "most credit supportive," S&P has also expressed concerns specifically with the ROE formula return in Ontario, as discussed at page 123 of Concentric's report.

Furthermore, S&P's credit supportiveness assessment is not indicative of an equity investor's required return, which is forward-looking and considers both near-term and long-term risks. To that point, as discussed in the Concentric report at pages 123 and 124, UBS, an investment bank, ranks regulatory jurisdictions in the U.S. and Canada for purposes of determining whether to apply valuation discounts or premiums to the utility stocks it covers. Specifically, UBS places regulatory jurisdictions into five tiers based on the following equally weighted criteria: (1) whether commissioners are elected or appointed, (2) allowed returns relative to 10-year Treasury notes, (3) mechanisms that reduce regulatory lag, (4) rate and customer bill levels, (5) the tendency to settle or litigate rate cases, and (6) a subjective "investor friendliness" factor. UBS ranked Ontario's regulatory environment in tier three out of five (with one being the best) in a December 2023 report.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p.138

Question(s):

Note this interrogatory has been asked by LEI

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.

Response:

a) Concentric sees several issues with LEI's recommendation as applied to Ontario's utilities. First, cash flow modeling is subject to numerous assumptions and uncertainties. Treasury experts and ratings agency personnel are intimately familiar with these models and assumptions. In Concentric's experience, regulatory agencies are typically not staffed with experts who specialize in cash-flow modeling, and this would be especially burdensome for the OEB with over 60 regulated utilities. Second, the rating agencies are already performing this task and using these data as inputs to their ratings analysis. There is no need to require utilities to file another layer of reporting and cash flow modeling with the regulator. Third, cash flow modeling is but one of several perspectives that form business and financial risk and would serve as only a partial indicator of forward-looking risk that should be factored into equity ratio considerations. So, on balance, this requirement would create a regulatory burden while offering limited value in determining changes in business or financial risk.

   Further, cash flow modeling is a tool utilized by credit rating agencies to determine the ability of the company to meet its debt obligations. It is not a tool to determine the sufficiency of an equity ratio from the perspective of an equity investor. Utilities (or intervenors) recommending changes in a utility's equity ratio may base this case on a spectrum of financial and business risk assessment, including comparability to similarly situated utilities. To focus on a single metric (cash flow) would over-emphasize its importance and minimize the range of other issues relevant to that determination for each utility. In that sense, the focus on cash flow modeling is limiting and rigid and discourages the use of more comprehensive and customized approaches in individual utility cases.

   The confidentiality of cash flow analysis could be protected, so that is not an insurmountable problem.

b) Credit rating agencies use company-provided information as inputs into their own proprietary models. The opinions reached by credit rating agencies are based on their own analysis and assumptions, not simply the projections provided by the rate entities.

c) Confirmed, although the frequency, depth of analysis and timeframe covered vary.

d) Confirmed.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p.145

Question(s):

Note this interrogatory has been asked by LEI

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.).

Response:

a) Any new reporting requirement creates an administrative burden on both the filing utility and the Board. This information is provided by the utilities in financial reports and also captured by financial reporting organizations (e.g., S&P Capital IQ). We understand that the OEB has committed to a reduction of "red tape" as part of its overall business plan with the Minister of Energy[1], so we assume that further reporting requirements should be value-added. As suggested by LEI, "The OEB can use this information to monitor the credit ratings and pace of capital injections for the

[1] Ministry of Energy Letter to the Acting Chair of the OEB, November 29, 2023, p. 5.

regulated utilities on an ongoing basis, as a further test of whether the FRS continues to be met." Concentric questions whether the information required (filing debt and equity issuances during each year) would provide value to the Board in determining whether the FRS continues to be met in relation to the additional filing requirement. An additional consideration is confidentiality, in particular, the terms of short-term debt, which are not reported in the public domain.

b) The OEA utilities estimate that it would require approximately one day of time for treasury to report the requested data for long-term debt and equity issuances. Short-term debt involves a high number of transactions and would require both an investment in IT reporting software and additional personnel time, in addition to the above-mentioned (in part a) concerns for confidentiality.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Question(s):

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.

Response:

a) From a data perspective, Concentric would not have any concerns if the OEB were to use market data as of October 31 for the annual cost of capital parameters update rather than using market data as of September 30. From a timing perspective, however, the OEB should consider the administrative process after the data is available and determine if a shift to using October 31 data leaves sufficient time to make updates prior to the effective date of new rates. For example, the OEB released the cost of capital parameters for the 2024 year on October 31, 2023, with the OEB Holiday timeout period from December 16, 2023, to January 7, 2024. Should October data be used rather than September, and based on 2023 timing, the cost of capital parameters would not be available until around December 1.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, pp. 148, 149, 150

Question(s):

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 twoprong 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?

Response:

a) Concentric recommends that each utility prepare a compliance filing incorporating the results of the Board's determinations regarding the cost of capital parameters for the next effective rate year. The compliance filing would demonstrate how the changes will be implemented within the context of its specific IR plan (e.g., Custom IR or I-X plan). This is no greater regulatory burden than the annual adjustments made for changes in the inflation rate ("I"), clearing of DVA balances, and other rate changes implemented between rebasing periods.

b) Yes, Concentric recommends that only the revenue requirement changes resulting from changes in the cost of capital parameters be implemented in the subsequent rate year. Concentric's proposed implementation is outlined in response to M2-18-OEB Staff-25 (a).

c) Costs that are locked in for the duration of the rate plan, or subject to changes in "I", "Y" or "Z" factors, should not be impacted by changes in the cost of capital parameters. The difference is that changes in the cost of capital parameters are justified by updated evidence and analysis indicating that these changes are necessary to meet the Board's legal requirement to set cost of capital parameters that meet the Fair Return Standard.

d) Concentric assumes that this question refers to the second prong of LEI's recommendation that a two-factor test must be met to change cost of capital parameters prior to rebasing: (i) the utility should have more than 60% of its rate term remaining, and (ii) deviations in the cost of capital parameters should be

material (100 bps or more). (LEI Report, p. 163). Concentric's view is that 100 basis points is a substantial deviation considering its application to invested capital for Ontario's utilities. If the Board were to set such a threshold, Concentric would recommend a 25 basis point differential for debt (both short term and long term) and 50 basis points for ROE, given the relative magnitude of debt and equity costs.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, pp. 152, 155

Question(s):

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).

Response:

a) Concentric takes a broader view than only focusing on the authorized ROE when considering a fair return to investors, consistent with finance and regulatory principles. This is because the Fair Return Standard requires a focus on the cost of capital, not only the authorized ROE. This is particularly relevant in jurisdictions that use deemed capital structures and interest rates because those inputs to the ratemaking formula affect the return on equity. That is consistent with the U.S. Supreme Court's decision in *Federal Power Commission v. Hope Natural Gas Company*, where the court spoke not only to the sufficiency of the return to investors, but also the sufficiency of revenues:

*From the investor or company point of view it is important that there be **enough revenue** not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.... By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.*[1]

[1] Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944).

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, pp. 152 & 155 & 156

Question(s):

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 longterm 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."

Response:

a) The short-term/long-term distinction relies on the length of time between when costs/customer refunds are incurred/deferred and when they are recovered from customers. Concentric considers short-term DVAs to be those for which costs are deferred and cleared within one year, with long-term DVAs being those for which the period between deferral and clearance is longer than one year. On page 153, Concentric referred to short-term DVAs as those that "cleared within one year," and clarified in footnote 168 that "DVAs that clear within one year would be those that are disposed within 12 months of the deferral of costs." From a practical perspective, Concentric believes that, where available, it would also be reasonable to use the accounting definition of short-term versus long-term, whereby short-term DVAs reported on a utility's balance sheet generally represent amounts to be cleared within 12 months of the balance sheet date and long-term DVAs generally represent amounts to be disposed of beyond one year.

b) Concentric's recommendation is based on regulatory and corporate finance principles, and the application of the WACC to DVAs is most consistent with those principles, regardless of the type or timing of the deferral. Concentric recognizes,

however, that the timeframe over which a regulatory asset is accumulated and recovered is a historical consideration by the Board in assigning an appropriate carrying cost, and, as such, Concentric recommended that short-term DVAs be applied the prescribed interest rate. As such, Concentric's definition of short-term vs. long-term is not reliant on whether a DVA is a Group 1 or a Group 2 DVA.

Concentric recognizes, however, that for practical purposes few, if any, DVAs are accrued and recovered within one year. As such, under Concentric's recommendation, most, if not all DVAs would accrue carrying charges at the WACC, which would be most consistent with corporate finance and regulatory principles, as discussed in Concentric's report.

If the OEB, however, were to determine that it is appropriate to distinguish between DVAs that accrue carrying charges at the WACC versus at the prescribed interest rate, applying the prescribed interest rate to Group 1 DVAs and the WACC to Group 2 DVAs would provide a reasonable approximation of the short-term versus long-term distinction that Concentric has drawn in its report, and thus represent a reasonable alternative to Concentric's proposal. That approach, while not wholly consistent with the principles Concentric discussed in our report, would reflect better alignment with those principles as compared to the status quo.

c) See the response to part b).

d) Concentric does not believe there will be increased regulatory burden because under the status quo, utilities regularly update DVA carrying charge accruals based on changes in prescribed interest rates, changes in deferral balances, regulatory approvals or modifications, etc. Applying a different carrying charge rate to one set of DVAs versus another would only impact the inputting of the appropriate rate when determining the carrying charge amounts on that account. Both the prescribed interest rate and utility-specific WACC rates are readily available and auditable.

e) Concentric proposes that the most recently-approved WACC be used for calculating carrying charges on long-term DVAs and CWIP, and, when the WACC changes (whether through rebasing or in cost-based proceedings), that updated WACC be applied on a going-forward basis for future accruals, similar to the approach used for changes in prescribed interest rates.

f) Using a debt-only approach for CWIP places Ontario utilities at a relative disadvantage in the ability to attract equity capital because a debt-only approach puts Ontario utilities out of step with their U.S. and Canadian peers, with whom Ontario utilities compete for capital. Since a debt-only approach results in Ontario utilities not recovering their full costs of financing construction, jurisdictions that allow the accrual of financing costs at the WACC provide the opportunity to earn their actual cost of capital for financing these functions.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p.152

Question(s):

Note this interrogatory has been asked by LEI

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?

Response:

a) Concentric's recommendation reflects the fact that utilities are not financed solely with debt (whether short or long-term), but also fund their businesses (including the deferral of expenses) with equity.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

Concentric Report, p. 26

Question(s):

Note this interrogatory has been asked by LEI

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?

Response:

a) Increased regulatory scrutiny refers to the detailed reviews that can occur in a prudence review. A Group 1 DVA, which is not subject to a prudence review, would not face the same level of regulatory scrutiny.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Ontario Energy Board Staff (OEB Staff)

INTERROGATORY

Reference:

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

Question(s):

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.

Response:

a) Confirmed. Concentric agrees with LEI's recommendation to allow a deemed WACC on the unamortized portion of cloud-based contracts, but disagrees with LEI's recommendation to continue the use of the prescribed interest rate to long-term DVAs (whether reflective of O&M costs related to cloud computing contracts or other costs).