Coalition of Concerned Manufacturers & Businesses CANADA
Bravely Safeguarding Canadian Jobs

November 7, 2024

Nancy Marconi
Registrar
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street
Toronto ON
M4P 1E4

Dear Ms. Marconi,

RE: EB-2024-0063 Generic Cost of Capital – Submissions of CCMBC

Attached are the submissions of the Coalition of Concerned Manufacturers and Businesses of Canada (CCMBC) in the EB-2024-0063 Generic Cost of Capital proceeding.

Respectfully submitted on behalf of CCMBC.

Tom Ladanyi
Digitally signed by Tom Ladanyi
Date: 2024.11.07 16:30:15 -05'00'

Tom Ladanyi
TL Energy Regulatory Consultants Inc.

cc. Catherine Swift (CCMBC)
Parties to the Proceeding

EB-2024-0063 Generic Cost of Capital

Submissions of

the Coalition of Concerned Manufacturers and Businesses of Canada

November 7, 2024

Executive Summary

Members of CCMBC are manufacturers and businesses and the rates they pay for energy will be impacted by the outcome of this proceeding. Expert witnesses hired by the utilities recommend that the OEB increase to cost of capital to compensate them for the risks of energy transition that they may face in the future.

Increasing the cost of capital would increase the rates paid by manufacturers and businesses and they would face the risk of staying in business. Manufacturers and businesses would be forced to pre-pay utilities for unspecified energy transitions investments that they may have make at some time in the future.

CCMBC submits that there is no evidence at this time that energy transition is happening to any significant extent nor that it would increase business risk for electricity utilities. Indeed, energy transition from gas to electricity may be a boon to the business of electricity utilities and decrease their business risk. Only gas utilities may face increased risk but there is no evidence of that at this time.

CCMBC believes that the cost of capital should be reduced as recommended by Dr. Cleary, the expert witness sponsored by certain customer groups. On most of the other issues CCMBC agrees with the recommendations of Dr. Cleary or of London Economics International (LEI) sponsored by OEB Staff.

Background

The OEB annually publishes its approved cost of capital parameters on its website. The OEB last reviewed its cost of capital methodology in 2009 through its *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009 (EB-2009-0084). An OEB staff report (Staff Report) regarding a review of the cost of capital policy was published on January 14, 2016 (EB-2009-0084).

The OEB issued a notice on March 6, 2024, that it was is commencing a hearing on its own motion to consider the methodology for determining the values of the cost of capital parameters and deemed capital structure to be used to set rates for electricity transmitters, electricity distributors, natural gas utilities, and Ontario Power Generation Inc. The methodology for determining the OEB's prescribed interest rates and matters

related to the OEB's Cloud Computing Deferral Account would also be considered, including what type of interest rate, if any, should apply to this deferral account.

Following the Issues Conference of April 18, the OEB approved a list of 22 issues for the proceeding. On May 27, the OEB approved the filing of expert evidence by the following experts.

- London Economics International (LEI), sponsored by OEB Staff.[1]

- Concentric Energy Advisors (Concentric), sponsored by a group of utilities consisting of Ontario Energy Association (OEA) on behalf of the Alectra Utilities Corporation; Elexicon Energy Inc.; Enbridge Gas Inc.; Hydro One Networks Inc.; Hydro Ottawa Limited; Ontario Power Generation Inc.; Toronto Hydro-Electric System Limited; and Upper Canada Transmission 2, Inc.[2]

- Nexus Economics (Nexus), sponsored by Electricity Distributors Association (EDA).[3]

- Dr. Sean Cleary sponsored by Industrial Gas Users Association and Association of Major Power Consumers in Ontario (IGUA/AMPCO).[4]

- Reno Energy Consulting Services, LLC, sponsored Small Business Utility Alliance (SBUA) which did not file any evidence as SUBA subsequently withdrew from the proceeding.

Following the interrogatory process and the hearing was held between September 25 and October 10. The following are the submissions of CCMBC on the 22 issues.

Submissions on Issues

A. General Issues

Issue 1. Should the approach to setting cost of capital parameters and capital structure differ depending on:

a) The source of the capital (i.e., whether a utility finances its business through the capital markets or through government lending such as Infrastructure Ontario, municipal debt, etc.)?

CCMBC Submission

[1] Exhibit M1
[2] Exhibit M2
[3] Exhibit M3
[4] Exhibit M4

Sources of capital differ for Ontario utilities. Except for Hydro One, the remaining 60 electricity distributors are owned by municipalities. They do not access capital markets. Their equity and debt are financed by municipal debt. Hydro One is owned by the Province and by private investors. It does access capital markets for a portion of its financing. Ontario Power Generation (OPG) is wholly owned by the Province. It accesses capital markets for its debt. Bruce Power, Enbridge Gas, EPCOR and Upper Canada Transmission are owned by private investors, and they are financed through capital markets. Hydro One and OPG can also obtain financing from the Ontario Electricity Financial Corporation (OEFC). CCMBC submits that it makes no sense to pretend that all of these sources are identical and can be simulated by looking at US capital markets as Concentric, LEI and Nexus experts did. They treat Ontario no different than they would a US state. They did not consider a common financing method of the 60 municipally owned distributors.[5] Just because EB-2024-0063 is a generic cost of capital proceeding, it does not mean that Ontario utilities are generic utilities.

b) The different types of ownership (e.g., municipal, private, public, co-operative, not for profit, Indigenous / utility partnership, etc.)

CCMBC Submission

Ownership of utilities does matter. Many municipalities treat the utility they own no different than they treat any other municipal service. They look after its financial needs and protect it from any financial hardships. The Province similarly protects the utilities it owns, Hydro One and OPG, ensures that their financial needs are met, either directly or through OEFC. It similarly protects utilities with Indigenous ownership.[6] Privately owned utilities do not have the same level of protection. It is wrong to assume as US experts, Concentric, LEI and Nexus do that ownership does not matter.

Issue 2. What risk factors (including, but not limited to, the energy transition) should be considered, and how should these risk factors under the current and forecasted macroeconomic conditions be considered in determining the cost of capital parameters and capital structure?

CCMBC Submission

The consultants for utilities, Concentric[7] and Nexus[8] claim that transition from natural gas to electricity is the main reason for increased risk faced by Ontario utilities: distributors, transmitters and one generator.

[5] Presentation Day Tr., Pages 47-48
[6] Vol 3, pages 71-82
[7] Exhibit M2. Pages 22-23
[8] Exhibit M2, page 10

Energy transition is an Ontario government initiative. The government appears to be committed to energy transition. It even has a Minister of Energy and Electrification. If electrification was a great risk, Ontario utilities would have been lobbying the Minister to stop electrification, or at least slow it down. Or they would have mounted a publicity campaign against it. There is no evidence that utilities are opposed to electrification. In fact, their publicity campaigns fully support it and glowingly treat it as an opportunity. Therefore, one can only conclude that utilities have already discounted the claims of their consultants that energy transition is a risk to the utilities.

But even if energy transition was a risk to utilities, they expect the OEB, the government of Ontario, and the municipalities to fully insulate them from that risk.

The consultants for utilities never explained the nature of this risk. Is the risk that they would not have sufficient capacity when energy transition starts. Or is the risk that they would overexpand their systems in anticipation of energy transition that does not materialize?[9]

No consultant could provide a start date for this sudden surge in energy transition. But suppose that energy transition starts five years from now. It is unlikely to start as a sudden deluge of heat pumps or EV home chargers. It is likely to be gradual allowing time for utilities construct additional grid capacity if they need it. Unless all 61 electricity distributors are operating at peak load on every one of their feeders, many will have spare capacity and will not need to invest in additional capacity for years to come.

Increased load will generate increased revenue that will pay for that load, immediately for commercial and industrial customers whose rates do not recover all fixed costs in the fixed monthly charge and at rebasing for all customers. The revenue lag between investment and rebasing can also be accommodated by a change in the rate structure to incorporate a demand charge. It can also be dealt with through a deferral account.

Whatever increases in demand energy transition causes for utilities can be easily mitigated by increasing utility rates to pay for system expansion.[10] However, energy transition does pose risks for many commercial and industrial customers of utilities. Most of them operate in a competitive market. Increases in cost of energy that utilities are asking for to compensate them for their higher cost of capital will have to be paid by commercial and industrial customers. These customers, in most cases will not be able to increase their prices to cover increased energy costs.

Concentric recommends that the OEB compensate utilities by increasing the equity portion of capital structure and the return on equity. Nexus recommends that OEB compensate utilities by increasing the return on equity. These recommendations will increase electricity and gas rates for manufacturers and businesses in Ontario. If the OEB accepts these recommendations it will transfer the risks of energy transition from utilities to manufacturers and businesses. CCMBC submits that this would be wrong.

[9] Tr. Vol 3, pages 86-87
[10] Tr. Vol 3, page 85

Issue 3. What regulatory and rate-setting mechanisms impact utility risk, and how should these impacts be considered in determining the cost of capital parameters and capital structure?

CCMBC Submission

Unlike most other jurisdictions, Ontario has three methods of setting rates, 4th Generation IR, Custom IR, and Annual IR Index.[11] Custom IR allows utilities to design their own method of rate setting which lowers their risk of not recovering their costs. 4th Generation IR allows utilities to obtain incremental financing for major capital expenditures or programs through the ACM or ICM methods.

B. Short-Term Debt Rate

Issue 4. Should the short-term debt rate for electricity transmitters, electricity distributors, natural gas utilities, and OPG continue to be set using the same approach as set out in the OEB Report? (EB-2009-0084, *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (OEB Report), December 11, 2009, pp. iii, 55-59)

CCMBC Submission

CCMBC agrees with LEI[12] and Dr. Cleary[13] that the deemed short term debt rate for electricity transmitters and distributors which uses Bankers Acceptance (BA) rates in its derivation should be changed since BA's are being replaced with the Canadian Overnight Repo Rate Average (CORRA).

Issue 5. If no to Issue #4, how should the short-term debt rate be set?

CCMBC Submission

CCMBC agrees with LEI[14] that The CORRA should be used to replace the BA rate in the deemed short term rate methodology, and that the base CORRA be based on the average of 3-monthCORRA futures rates over the next 12 months.

[11] Exhibit K3.3, Tab 2
[12] Exhibit M1, page 79
[13] Exhibit M4, page 6
[14] Exhibit M1, page 83

C. Long-Term Debt Rate

Issue 6. Should the long-term debt rate for electricity distributors, natural gas utilities, and OPG continue to be set using the same approach as set out in the OEB Report and as set out in the Staff Report for electricity transmitters? (OEB Report, pp. 50-55, 59; EB-2009-0084, OEB Staff Report, *Review of the Cost of Capital for Ontario's Regulated Utilities* (Staff Report), January 14, 2016, p. 3 Table 1)

CCMBC Submission

CCMBC agrees with LEI[15] and Dr. Cleary[16] that the long-term debt rate should be set for all utilities including OPG using the current approach.

Issue 7. If no to Issue #6, how should the long-term debt rate be set?

CCMBC Submission

CCMBC agrees with Dr. Cleary that the deemed long term debt rate should be set as a cap for all utilities (including gas distributors and OPG) and not just electric transmitters and distributors as is current practice.[17] Rather than using forecasts for long Canada bond forecast in the existing formula, the Board should use the actual prevailing bond yields as of September 30th which produce more accurate less biased estimates of future 30-year Canada yields and has the side benefit of being significantly easier to implement.

Issue 8. How should transaction costs incurred by utilities be considered when setting the long-term debt rate?

CCMBC Submission

Transaction costs for long term debt are dependent on the utility, the size and the type of debt. A one size fits all approach would not be fair. CCMBC submits that transaction costs should be included as an OM&A cost in revenue requirement as recommended by LEI[18].

Issue 9. What are the implications of variances from the deemed capital structure (i.e., notional debt and equity) and how should they be considered in setting the cost of long-term debt?

[15] Exhibit M1, page 90
[16] Exhibit M4, page 7
[17] Exhibit M4, page 7
[18] Exhibit M1, page 96

CCMBC Submission

The status-quo approach (considering deemed capital structure regardless of the actual capital structure) should be retained as recommended by LEI[19] and Dr. Cleary.[20]

D. Return on Equity

10. What methodology should the OEB use to produce a return on equity that satisfies the Fair Return Standard (FRS)?

CCMBC Submission

In its report LEI describes the Fair Return Standard and it is reproduced here for reference.[21]

The FRS was articulated by the National Energy Board ("NEB") in its RH-2004 Phase II Decision (related to TransCanada PipeLines Cost of Capital), when it stated that three requirements must be satisfied to determine a fair and reasonable return on capital:

a) ***Comparable investment standard****: a fair or reasonable return on capital should be comparable to the return available from the application of invested capital to other enterprises of like risk;*

b) ***Financial integrity standard****: should enable the financial integrity of the regulated enterprise to be maintained; and*

c) Capital attraction standard: *should permit incremental capital to be attracted to the enterprise on reasonable terms and conditions****.***

Source: NEB. RH-2-2004. Phase II Reasons for Decision, TransCanada PipeLines Limited cost of capital. April 2005

The overall ROE must be determined solely on the basis of a company's cost of equity capital*, regardless of equity ownership, and any resulting rate increase must be an irrelevant consideration in determining the appropriate ROE for regulated utilities.*

The Federal Court of Appeal established the principle in the case TransCanada PipeLines Ltd. v. National Energy Board, 2004 FCA 149.

[19] Exhibit M1, page 101
[20] Exhibit M4, page 8
[21] Exhibit M1, LEI Report, page 38

Efficient amount of investment: *the cost of capital has to be determined to ensure that an efficient amount of investment occurs in the public interest to balance the impacts on both customers and shareholders (i.e., not so high that the Ontario consumers are disadvantaged, and not so low that the regulated utilities do not have sufficient incentive to make investments that are in the public interest).*

The decisions referenced by LEI are both related to TransCanada PipeLInes, an investor-owned utility. Its shares traded on the capital markets in Canada and the US at the time of the decisions and now trade as TC Energy. However, municipally owned utilities in Ontario are not investor-owned. Their shares do not trade on any market. CCMBC submits that the FRS that was established for investor-owned utilities should not apply to them. It should apply Enbridge Gas, Hydro One and any other Ontario utility that is investor owned. CCMBC agrees with the evidence of Dr. Cleary and LEI that the Equity Risk Premium method should be continued until the next cost of capital review. At that review the OEB should consider a benchmarking method for municipally owned utilities as discussed with Concentric.[22]

Issue 11. Are the perspectives of debt and equity investors in the utility sector relevant to the setting of cost of capital parameters and capital structure? If yes, what are the perspectives relevant to that consideration, and how should those perspectives be taken into account for setting cost of capital parameters and capital structure?

CCMBC Submission

CCMBC submits that the perspectives of debt and equity investors in the utility sector are relevant. The investors in utilities that have outside investors such as Enbridge Gas and Hydro One have a choice between investing in the utility or investing in other businesses. The cost of capital and the capital structure of an investor-owned utility should be such that investments in its securities are comparable to investments of similar risk and earnings potential available in the market. However, the only investors in municipally owned utilities are the municipalities. They do not have a choice of making other investments. They must invest the amounts required to maintain the state of good repair and the quality of service expected by the residents of the municipality, same as they are required to do for other municipal services such as sewers and watermains and roads and streets. The perspectives of municipal investors are not similar to the perspectives of outside investors. CCMBC submits that a benchmarking analysis of municipally owned utilities in Canada and the US would be appropriate.[23]

[22] Tr. Vol 3, pages 74-76
[23] Ibid.

E. Capital Structure

Issue 12. How should the capital structure be set for electricity transmitters, electricity distributors, natural gas utilities, and OPG to reflect the FRS?

CCMBC Submission

CCMBC agrees with Dr. Cleary[24] and LEI[25] that the OEB's current practice of setting a uniform ROE and adjusting the capital thickness if it determines upon application that there has been a meaningful change in business or financial risks is appropriate and that applicants should be required to include forward cash flow modeling and scenario analysis showing impact on credit metrics to support their case for adjustment of capital thickness.

Issue 13. Should the OEB take a different approach for setting the capital structure for electricity transmitters depending on whether they are a single versus multiple asset transmitter?

CCMBC Submission

CCMBC agrees with Dr. Cleary[26] that the OEB should reduce Hydro One's allowed equity ratio to 38% and should consider reducing it further to 36% over the following 2-3 years.

F. Mechanics of Implementation

Issue 14. What on-going monitoring indicators to test the reasonableness of the results generated by its cost of capital methodology should the OEB consider, including the monitoring of market conditions?

CCMBC Submission

CCMBC agrees with LEI[27] and Dr. Cleary[28] that the OEB's current practice of continuous monitoring through the review of quarterly reports adds value and should be retained.

[24] Exhibit M4, page 12
[25] Exhibit M1, page 140
[26] Exhibit KP1.4, page 33
[27] Exhibit M1, page 148
[28] Exhibit M4, page 11

Issue 15. How should the OEB regularly confirm that the FRS continues to be met and that rate-regulated entities are financially viable and have the opportunity to earn a fair, but not excessive, return?

CCMBC Submission

CCMBC agrees with LEI[29] and Dr. Cleary[30] that the OEB retain its current annual review practice. The current annual review process can be supplemented by adding annual reporting requirements for utilities to provide credit ratings, as well as details regarding new short-term and long-term debt and equity issued/borrowed during the year.

Issue 16. What should be the timing of the OEB's annual cost of capital parameters updates, including the timing, as required, of the underlying calculations?

CCMBC Submission

CCMBC agrees with Dr. Cleary[31] that the OEB maintain the status quo but consider changing to the use of October data rather than September data to update the ROE formula, if the OEB determined this change would not cause undue disruptions to its existing processes and procedures.

Issue 17. What should be the defined interval (for example, every three to five years) to review the cost of capital policy (including, but not limited to, a review of the ROE formula and the capital structure)? Should the OEB adopt trigger mechanism(s) for a review and if so, what would be the mechanisms?

CCMBC Submission

CCMBC agrees with Dr. Cleary[32] that the OEB should have regular reviews of the cost of capital policy (and allowed ROEs) at regular intervals (ideally every three years, but never more than five years). The existing OEB trigger mechanisms and procedures that are in place are reasonable and should be retained and that if the Canadian A-rated uti1ility yield spreads exceed 2%, the OEB should undertake an immediate and thorough assessment of existing capital market conditions, which could lead to a full regulatory review, depending on the results of this assessment.

[29] Exhibit M1, page 151
[30] Exhibit M4, page 11
[31] Exhibit M4, page 12
[32] Ibid.

Issue 18. How should any changes in the cost of capital parameters and/or capital structure of a utility be implemented (e.g., on a one-time basis upon rebasing or gradually over a rate term)?

CCMBC Submission

CCMBC agrees with LEI[33] and Dr. Cleary[34] that Changes in the OEB's cost of capital parameters are implemented once a utility files its cost-of-service application (i.e., upon rebasing) because it promotes predictability and stability.

Issue 19. Should changes in the cost of capital parameters and/or capital structure arising out of this proceeding (if any) be implemented for utilities that are in the middle of an approved rate term, and if so, how?

CCMBC Submission

CCMBC agrees with LEI[35] and Dr. Cleary[36] that the OEB maintain its current practice to apply any changes to cost of capital parameters and capital structure upon rebasing applications, with the changes not being applied in the middle of an approved rate term. CCMBC also agrees with LEI that the OEB should also introduce an option for parties to request implementation of such changes prior to rebasing, so long as the two-factor test is met – (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).

G. Other Issues

Issue 20. Should the prescribed interest rates applicable to DVAs and the construction work in progress (CWIP) account for electricity transmitters, electricity distributors, natural gas utilities, and OPG continue to be calculated using the current approach?

CCMBC Submission

CCMBC agrees with LEI[37] and Dr. Cleary[38] that the OEB Maintain the current approach regarding estimating the prescribed interest rate for CWIP accounts but that the interest rate for DVA should be changed.

[33] Exhibit M1, page 160
[34] Exhibit M1, page 13
[35] Exhibit M1, page 163
[36] Exhibit M4, page 13
[37] Exhibit M1, page 165
[38] Exhibit M3, page 14

Issue 21. If no to Issue #20, how should the prescribed interest rates applicable to DVAs and the CWIP account be calculated?

CCMBC Submission

CCMBC agrees with LEI[39] and Dr. Cleary[40] and that he prescribed interest rate for DVAs should be revised to align with the recommended deemed short term debt rate methodology by using CORRA as the base rate instead of the BA Rate, where the base CORRA rate is estimated as the average of 3-month CORRA futures rates over the next 12 months, and the spread added to it is determined by sampling 6-10 banks to determine the appropriate R1-low rated utility spread.

Issue 22. Should carrying charges and/or another type of rate apply to the Cloud Computing deferral account? If so, what rate should be applied?

CCMBC Submission

CCMBC believes that it remains to be proven that cloud computing will result in savings for ratepayers. There is therefore no reason to have a preferential treatment for cloud computing costs that are recorded in a deferral account. CCMBC submits that the same rate that is applied to other DVA balances should apply to cloud computing costs.

[39] Exhibit M1, page 168
[40] Exhibit M3, page 14