November 7, 2024

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

Dear Ms. Marconi,

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

Attached are the submissions of Energy Probe Research Foundation (Energy Probe) in the EB-2024-0063 Generic Cost of Capital proceeding.

Respectfully submitted on behalf of Energy Probe.

Tom Ladanyi

Digitally signed by Tom Ladanyi
Date: 2024.11.07 16:36:16 -05'00'

Tom Ladanyi
TL Energy Regulatory Consultants Inc.

cc. Patricia Adams (Energy Probe)
Parties to the Proceeding

EB-2024-0063

Generic Cost of Capital

Submissions of Energy Probe

November 7, 2024

Executive Summary

This purpose of this proceeding is to determine the cost of capital for setting rates of Ontario utilities. According to the experts hired by the utilities, the OEB should increase the cost of capital because of increased risks of energy transition, climate change and cybersecurity that utilities will be facing.

Energy Probe believes that there is no indication that energy transition from fossil fuels to electricity is proceeding at any significant level at the present time or will proceed in the near future. When and if it does, it will result in greater volume of business and greater earnings for electricity utilities and will likely decrease their business risk.

Transition from natural gas to electricity is currently not having any significant impact on gas distributors. Based on evidence in recent gas proceedings, additions of new gas customers are far greater than the number of customers leaving the gas system. The recent Provincial government decision overturning the EB-2022-0200 OEB decision, indicates that the government is protecting Enbridge Gas from potential impacts of energy transition.

In the past the OEB has allowed utilities full recovery of all costs of dealing with severe weather attributed to climate change, such as the ice storm. There is no indication that the OEB would deny such recoveries in the future. Response to climate change will provide Ontario utilities with justification for increased capital spending to mitigate the effects of severe weather events. These expenditures will result in greater equity returns.

Similarly, there is no indication that the OEB would deny recovery of costs for cybersecurity or not approve investments in cybersecurity software. Indeed, like climate change, cybersecurity will allow utilities to justify increased capital spending that will result in greater equity returns.

In summary, energy transition, climate change and cybersecurity will not increase business risk for Ontario utilities. They will, in fact, provide many of them with an opportunity for increased earnings. Rather than justifying increased costs of capital, energy transition, climate change and cyber security justify decreased cost of capital, they justify decreasing cost of capital. Energy Probe agrees with Dr. Cleary that the cost of capital should be reduced.

Another reason why the cost of capital should be reduced is the OEB decision in the EB-2023-0148 proceeding dealing with the Getting Ontario Connected Variance Account[1]. In that decision the OEB agreed to protect utilities from the business risk due to legislative change. Energy Probe submits that utilities are compensated for business risk caused by legislative change through equity thickness and the return on equity approved by the OEB. This decision overcompensated utilities for business risk.

Regulatory Background

On March 6, 2024 the OEB issued a notice 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 will also be considered, including what type of interest rate, if any, should apply to this deferral account.

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). [2]

Following the Issues Conference of April 18, the OEB approved the issues list consisting of 22 issues for the proceeding.[3]

Expert Evidence

On May 27, the OEB approved the filing of expert evidence by the following parties.

- OEB Staff - London Economics International (LEI).
- 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 – Concentric Energy Advisors
- Electricity Distributors Association (EDA) – Nexus Economics

[1] Decision and Order, EB-2023-0148, Getting Ontario Connected Variance Account, October 31, 2023
[2] OEB EB-2024-0063 Notice
[3] OEB Generic Proceeding – Cost of Capital and Other Matters Cancellation of April 23, 2024, Issues Day and Approved Issues List, April 22, 2024

- Industrial Gas Users Association and Association of Major Power Consumers in Ontario (IGUA/AMPCO) – Dr. Sean Cleary of Queen's University

- Small Business Utility Alliance (SBUA) – Reno Energy Consulting Services, LLC . The SUBA subsequently withdrew from the proceeding and did not file expert evidence.

It should be noted that Dr. Cleary was the only Canadian expert. Following the interrogatory process and the hearing was held between September 25 and October 10. The table below is a summary of major recommendations by experts compared to the current OEB parameters.

Consultant	**Current OEB**	**LEI**	**Concentric**	**Nexus**	**Dr. Cleary**
Sponsor		OEB Staff	OEA	EDA	IGUA/AMPCO
ROE	8.95%	8.95%	10%	11.08%	7.05%
Equity Thickness	EGI 38% Electrics 40% OPG 45%	No change	All 45%	No change	36%
Models	CAPM	CAPM	Multiple	Multiple	Multiple
Flotation or issuance cost	50 bps in cost of capital	In revenue requirement	50 bps in cost of capital	50 bps in cost of capital	50 bps in cost of capital
Proxy Group		28 North American companies	25 North American companies	46 North American companies	5 Canadian companies
Exhibit		M1	M2	M3	M4

Energy Probe Submissions

There are 22 issues in this proceeding. The following are Energy Probe's submissions on certain issues. On the remaining issues, Energy Probe agrees with the submissions of CCMBC since both Energy Probe and CCMBC were represented by the same consultant.

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.)?

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

Energy Probe Submission

Energy Probe believes that the approach to setting cost of capital parameters and capital structure should differ depending on the source of funds and ownership. The OEB regulates 61 electricity distributors, 8 electricity transmitters, 2 gas distributors and 1 electricity generator.[4] No other jurisdiction in North America has as may distributors.[5] Of the Ontario distributors, 60 electricity distributors are owned by municipalities, and one electricity distributor is partially owned by the Province, while the electricity generator is wholly owned by the Province. The two gas distributors are owned by private investors.

Source of capital does matter. For example, none of the municipally owned distributors access capital markets. The US based consultants, LEI, Concentric and Nexus claim that the source of capital does not matter as Concentric explains in the following interrogatory response.[6]

> *"Ontario's utilities are owned by a combination of private and public investors. As outlined in Concentric's report, Exhibit M2, practically speaking, if the Board were to find the source of funds was determinative, the Board would be required to distinguish between the cost of equity from different investors, and the sources of potential investment are numerous. Rather, the most appropriate way to measure the cost of capital is to analyze current market data for a proxy group of companies with comparable business and financial risk as Ontario's regulated utilities. This is consistent with the economic principle of the "opportunity cost" of capital where the investor (including municipal governments) invest capital where the returns are comparable to those in alternative investments. In order to attract funds from other municipal functions (schools, water, safety), the returns must be sufficient for these governments to divert funds to utility service."*

Energy Probe disagrees with the above opinion by Concentric. Concentric assumes that municipalities have a choice of investing capital in the stock market or of investing it in their own distribution utility. There is no evidence that Ontario municipalities have ever done that or would even be allowed to do it. The "opportunity cost" does not exist for them.

The 60 municipally owned distributors do not have outside equity investors. None issue equity securities, and none incur equity flotation or issuance costs. Their equity is held by their municipal owners. Their financing is different than the financing of investor-owned utilities as pointed out by Commissioner Anderson. [7]

[4] Exhibit K3.3, Tab 1
[5] Tr. Vol.3, page 66
[6] Exhibit N-M2-1-EP-7, and Exhibit K3.3, Tab 3
[7] Tr. Presentation Day, Page 48

MS. ANDERSON: So, you didn't really consider the perspective of a promissory note from a municipal related party? You didn't analyze that perspective?

MR. DANE: Not specifically. I think our point here is more generally applicable regardless of the source of the debt, is that the deployment of that debt is into companies of certain levels of risk. And even at -- whether it's from a municipal or from a public market, they still have to analyze the risks of the entity and would demand similar returns based on those risks.

Even though there are municipally owned utilities in the US none of the US based experts included them in their analysis of peer groups. This was confirmed by Mr. Coyne[8] of Concentric

MR. LADANYI: Thank you, very much. I might follow up on that later; I will have to look it up. But let's move on, because I am kind of concerned that we are kind of losing time.

So if we can go to -- and you have it on the screen already. It's an interrogatory that I asked on behalf of Energy Probe Research Foundation. And I am quoting in the preamble from your evidence:

> *"Assuming that the investors in Ontario's utilities businesses have comparable investment alternatives, the determinative factor is the use of funds."*

And my question was:

> *"Considering that most Ontario utilities are owned by a municipality or the province, why does Concentric believe that investors have comparable investment alternatives?"*

And if I can just read parts of your response, you say that:

> *"Ontario's utilities are owned by a combination of private and public investors. As outlined in Concentric's report, Exhibit M2, practically speaking, if the Board were to find the source of funds was determinative, the Board would be required to distinguish between the cost of equity from different investors, and the sources of potential investment are numerous.*
>
> *"Rather, the most appropriate way to measure sure the cost of capital is to analyze current market data for a proxy group of companies with comparable business and financial risk as Ontario's regulated utilities."*

Now I have looked at your proxy group, and I don't see any municipally owned or government-owned utilities. And can you answer why you did not include any of those? There are some in the US that are municipally owned. Now why didn't you include any of those?

MR. COYNE: The primary reason is that they are not publicly traded because they are municipally owned. So therefore, they don't provide the capital market information that would be required to estimate the cost of capital.

And you are correct that there are many municipal-owned utilities in the United States that are owned at the government level, the state level and the municipal level.

And the same is true there, that in the US, we don't include them in our proxy group analysis for the cost of capital, because they don't have the -- they don't go to public markets to raise equity capital, and therefore, they wouldn't inform our analysis.

[8] Tr. Vol. 3, pages 74-76

MR. LADANYI: So there is no way -- the reason why you haven't included them because you say there is no information, it's too hard to get the information. But wouldn't it be very useful for the Board to know exactly what, you know, how these entities are being financed, what is their risk? I mean, I was thinking for example of some large ones like Los Angeles Department of Water and Power or the Sacramento Municipal Utility District, there's no information about them that you can use or find?

MR. COYNE: Well, there's certainly lots of information on those organizations, pertaining to how they are capitalized, what their debt costs are, and how they obtain financing. But it's not -- it's not public market information that pertains to equity markets. And, if our goal here is to determine the cost of equity, we rely on public market information, and that only involves investor-owned utilities that are trading securities in those public markets.

If the Board wanted to delve into that further and look at municipal financing specifically, then I would suggest a benchmarking study or something of that nature, that it could look at those issues specifically for that segment of the industry.

It would have been possible to compare municipally owned utilities in the US with municipally owned utilities in Ontario by benchmarking but Concentric did not do that because it would have been harder to do than comparing Ontario utilities to US investor-owned utilities. Mr. Zarumba of Nexus[9] also confirmed that Nexus would have found it harder to do that.

MR. LADANYI: ...So does California's public utility commission set electricity rates for Los Angeles Department of Water and Power, which is the electricity distributor in Los Angeles?

MR. ZARUMBA: No, LADWP has a separate entity set up by the city council which provides oversight.

MR. LADANYI: So essentially it's regulated by the city council, more or less?

MR. ZARUMBA: That is correct. That's fair, fair characterization.

MR. LADANYI: How about Sacramento Municipal Utility District?

MR. ZARUMBA: I don't know. I've never had any interaction with SMUD.

MR. LADANYI: Nothing with SMUD. How about -- maybe I'm going too far afield -- East Bay Municipal Utility District? Don't know what it is. That would be in Oakland.

MR. ZARUMBA: I know of East Bay, but I have never worked for them or had interaction, so I could not give you a fair statement.

MR. LADANYI: So none of these distributors, municipally-owned distributors, are in your peer group; are they?

MR. ZARUMBA: No, municipal utilities operate very differently than investor-owned utilities in the United States. In the model that Ontario has adopted with the municipally owned utilities, really they treat them like an investor-owned utility would be treated in the US, by and large.

You know, starting with the way they calculate the revenue requirement, where they do a "return on" and a "return of" type of calculation. And in the case of Ontario during rebasing.

In the case of a municipal utility in the US, they use a cash flow model. They adopt a different set of accounting roles. In the US, an investor-owned utility would adopt generally accepted accounting principles. A municipal utility would adopt generally -- governmentally accepted accounting principles -- I don't -- I have that acronym wrong. I'll get it during the break, I'll look it up and get you the correct one. It uses a cash flow model. So instead of a

[9] Tr. Vol 5, pages 113-115

return on and a return of, it is a cash flow to support the utility, and to maintain at least minimum bond covenant coverage ratios.

So it's different. And different than what an MEU would do in the US, and different than what you do in Ontario.

Mr. Zarumba of Nexus[10] and Mr. Coyne[11] of Concentric explained that it would have been possible to compare municipally owned Ontario utilities with municipally owned utilities in the US by benchmarking.

Municipalities that own electricity distributors have always looked after their financial needs. The municipally owned distributors have not raised debt or equity capital in US markets.[12]

MR. LADANYI: Okay, very good. Are you aware of any instance where a municipally owned Ontario utility was not able to obtain debt financing?

MR. COYNE: We haven't researched that issue, but I am not aware of a case where that has happened.

MR. LADANYI: Would you agree with me that municipally owned Ontario utilities have obtained debt financing in the past from Canadian banks at most favourable rates?

MR. COYNE: Well, there are two aspects to your question; have they raised capital from Canadian banks? My presumption is yes. But in terms of most favourable rates, I couldn't say that. You would have to compare their access to debt financing to others that were obtaining similar financing to determine if they had achieved most favourable rates or not.

When we do that work, we do a benchmarking analysis of others that were raising debt in the same markets, to try to reach that conclusion. We certainly haven't done that here.

MR. LADANYI: Would you agree with me that municipalities that own distribution utilities are financial protectors of those utilities?

MR. COYNE: It depends on how they are structured. I would say in a typical circumstance, if they backstop the utility with their own balance sheet and their own obligations, then you could say yes, they are financially obligated, as the utility is obligated as a backstop to their financial obligations.

That could be different if they are set up as an arm's length electric utility, where there -- where the debt is based -- the debt security is based on the revenues of the utility and only the revenues of the utility. So it does vary.

Even in the case where it is based on the revenues of the utility, it is oftentimes but not always the case that lenders and credit rating agencies will look to -- will look upstream and make an assumption that the city or municipality would be there if the utility got into trouble. But that's an assumption as opposed to a guarantee.[13]

Provincially owned utilities or partially provincially owned utilities benefit from their provincial ownership and the mandate of the Ontario Electricity Financial Corporation (OEFC).[14]

[10] Tr. Vol 5, page 115
[11] Tr. Vol. 3, pages 75-76
[12] Exhibit N-M2-10-AMPCO/IGUA-5
[13] Tr. Vol.3, pages 70-72
[14] Exhibit K3.3, Tab 3

MR. LADANYI: Now, let's turn to provincially owned utilities. Please turn to tab 4 of my compendium, and it is just on the next page. Can we have it on the screen, please? All right, thank you. It's a page from the website of the Ontario Electricity Financial Corporation or OEFC. Are you aware of the existence of the OEFC?

MR. COYNE: Yes.

MR. LADANYI: And the mandate of the OEFC is described on the page, and I want to draw your attention to the fourth bullet, which -- can you scroll up? You can see the fourth bullet. It says: "Providing financial assistance to the successor corporations of Ontario Hydro."

MR. COYNE: We see that.

MR. LADANYI: And you agree with me that Ontario Power Generation and Hydro One are successor corporations of Ontario Hydro?

MR. COYNE: Yes.

MR. LADANYI: Would you agree with me, then, the Ontario government through the OEFC is a financial protector of Hydro One and Ontario Power Generation?

MR. COYNE: I wouldn't use the words "financial protector." The way it works in financial markets is whether or not the government is viewed as being a credit backstop to the obligations, as I said earlier, to these corporations.

The word "financial protector" would not enter into it. But are they serving as a financial backstop for some of their financial obligations through the OEFC? If that is your question, the answer is yes.

MR. LADANYI: Yes, I -- perhaps "protector" is too strong a word. "Backstop" will be fine.

MR. COYNE: Yes.

Enbridge Gas, even though it is not owned by the Province, has enjoyed its protection.

MR. LADANYI: Thank you. Now, let's turn to Enbridge. Are you aware that the Ontario government overturned part of the Enbridge EP-2022-0400 decision that deals with the revenue horizon for customer attachment?

MR. COYNE: That is my understanding, yes.

MR. LADANYI: So, did that decision by the government increase or decrease the business risk of Enbridge Gas?

MR. COYNE: We had that discussion the other day and our answer to that was that we didn't have a view that it was a -- I think we made two points we didn't -- it wasn't our view that it made a material impact in Enbridge's risk, but we also noted that after that, after that, this went to Bill 165.

The net result was that they were put on negative credit watch by Standard & Poor's because of the uncertainty in the mind of the credit rating agency with regard to energy transition in Ontario and what it would mean for the company. And I think there's probably two facts at play there, one is the uncertainty around energy transition and Standard & Poor's also gives Ontario -- notes in Ontario that political activity or, as they call it, political interference is stronger here than it is in some other provinces. I think this is another sign that the energy sector in Ontario is one that is actively scrutinized by the government and, at times, creates uncertainty regarding its operating environment.

MR. LADANYI: But the government decision was positive for Enbridge, so did this decision not signal to the financial markets that the Ontario government would protect Enbridge from risks of energy transition?

MR. COYNE: Standard & Poor's didn't view it that way they viewed it as creating uncertainty with regards to the company's future around energy transition. So, we don't have a different view of it than that, and as you recall our testimony in the calculation of Enbridge was that energy transition is -- does represent a new and significant risk for the company. And we don't see Bill 165 as changing the fundamental nature of the future of energy markets in North America and in Ontario around an energy -- a gas distributor. It creates more uncertainty regarding the company's future.

Energy Probe submits that Ontario electricity distributors that are owned by municipalities are protected from business risk by the municipalities that own them. The Province of Ontario protects the utilities it owns wholly or partially, OPG and Hydro One, through the Ontario Electricity Financial Corporation or directly. Even an investor-owned utility, Enbridge Gas, enjoys the protection of the Province.

There are municipally owned utilities in the US similar to the 60 municipally owned electricity distributors in Ontario but none of the cost of capital experts included them in their peer groups because it would have been hard to do. It was much easier to compare municipally owned Ontario utilities with investor-owned US utilities and that is what Concentric, LEI and Nexus did. The fact that this type of comparison was accepted by the OEB in the past does not make it right. Energy Probe believes that this omission is a major deficiency of the evidence in this proceeding. Energy Probe submits that the OEB in its decision should ask that parties filing peer group evidence in the next cost of capital review include municipally owned utilities in other jurisdictions.

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?

Energy Probe Submission

Energy transition was identified by consultants for OEA and EDA as the greatest risk facing Ontario utilities to justify their arguments for higher ROE. But is energy transition such a great risk? According to the EDA consultants there is a risk that gas customers will suddenly convert from gas heating to electric heating using heat pumps and electricity distributors would not have sufficient capacity to accommodate them. There are currently 3.8 million gas customers in Ontario. That means that there are about 3.8 million gas furnaces, gas boilers and gas water heaters and more are being added each year. It would take decades to replace these appliances with electric appliances or with hydrogen fired appliances as Enbridge proposes. Individual homeowners would need to pay for the replacement of these appliances. Energy Probe believes

that Enbridge may have to provide natural gas to customers who cannot convert to other forms of energy for decades to come.

Enbridge has about 3.8 million gas customers in Ontario. It does not seem likely that all 3.8 million customers would suddenly convert their home heating from gas to electricity. Vast majority, if not all, of the 3.8 million heat pumps would likely have to be imported from China. The manufacturing of these heat pumps, their shipment to Ontario, and their installation in 3.8 million basements, if it ever happens, would not be sudden. It would take decades, not years.

At Presentation Day LEI explained that energy transition is not a large risk. [15]

"Moving to the next slide. This slide presents a few overarching messages that LEI believes are important to state upfront. First, risk is a function of timing and likelihood of recovery. As such, while energy transition is in process, there is no evidence that energy transition impacts either timing or recovery of cash flows for the regulator utilities, particularly in the upcoming regulatory period. That is 2025 to 2029. Second, there is no evidence that OEB regulated utilities have been unable to raise capital on reasonable terms."

LEI witness Mr. Goulding confirmed that during the hearing. [16]

MR. SMITH: Right. Okay, let me make sure that I understand your evidence in relation to energy transition. I don't think we have to be long on this, but if we turn to the compendium at page 167. And, at the bottom of this page, you have set out the impact of the energy transition on the cost of capital. Do you see that?

MR. GOULDING: section 3.2.2, "Impact of the Energy Transition on the Cost of Capital."

MR. SMITH: Yes. And it proceeds for the next three paragraphs. But as I understand your evidence, your view is that energy transition issues are not a large driver in reviewing the process of setting the cost of capital, and that's because, at least in the near term, they are not affecting cash flows.

MR. GOULDING: That's correct. But I would add that this is in the context of the generic proceeding. Overall, I would want to see evidence that the energy transition was changing, making more volatile the cash flows and profits of the regulated utilities and calling into question the recovery of their investments.

And on a general basis, within the next five years, I don't believe that to be the case.

Energy Probe agrees with Mr. Goulding of LEI. Many people are overestimating the energy transition risk as it relates to electricity distributors. It is unlikely that Ontario distributors and the OEB would be caught by surprise as was pointed out in this question by Commissioner Sardana to Mr. Zarumba of Nexus.

[15] Tr. Presentation Day, pages 4 and 5
[16] Tr. Vol. 1, pages 90-95

MR. SARDANA: Okay, thank you. And that's actually somewhat of a decent segue into my final question, which is -- and you have made mention of this many times in reference to the energy transition, that there's a lot of planning that has to go on.

One of the things that the OEB has done in the last 10 or more years is, you know, utilities are required to file a distribution system plan. Most utilities that I have worked on have planning as a continuous activity. They spend a lot of time looking at their system, planning for the future. Why wouldn't you think that has already started in planning for the energy transition?

I would say to you: Most utilities, most LDCs in this province, are well ahead of the curve. I would hope they are well ahead of the curve in what's coming. Would you not agree with that?

MR. ZARUMBA: Yes. If they are planning, that's very good. I think that's necessary. The issue is we have identified that there is going to be this change in the behaviour of the industry, at least as what the official numbers from the IESO are. And I think those are -- no forecast is perfect, but that is the best information we have right now.

This is a change from what we have seen in the past, and that general -- that is going to introduce risk. This is a, you know, this is -- I call it a once-in-a-generation change in the industry, like we saw in the '90s with the retail and wholesale competition, like I saw at the very beginning of my career almost 40 years ago dealing with regulatory issues stemming from the expansion of nuclear generation.[17]

Concentric has identified that apart from energy transition, Ontario utilities face other risks, climate change and cybersecurity. Energy Probe submits that climate change is a long-term risk and not one that would affect the near-term operations of Ontario utilities. However, if in response to climate change utilities need to make capital investments, that will actually increase utility earnings which would be a reduction in risk.

Cybersecurity is a current risk that is primarily dealt with current OM&A expenditures. Many distributors have transferred their IT to a cloud provider and are no longer making significant capital investments in IT assets. Therefore, their ability to deal with cybersecurity risks will not be affected by ROE or equity thickness.

Energy transition from natural gas to electricity will have different impacts on gas distributors than on electricity distributors. However, there is no evidence that this transition is happening in Ontario to any significant extent and when it happens it may actually be a boon to electricity distributors as explained by Dr. Cleary in answers to questions from Mr. Rubenstein, SEC counsel. [18]

MR. RUBENSTEIN: So back -- now, CCC-9 is up on the screen here, just to repeat the context. You were asked -- you discuss -- as I mentioned to you, there has been a lot of discussion about electrification and energy transition increasing utility risk as opposed to it being a positive outcome and that the increasing risk required an increase in the compensation through the ROE or the capital structure.

[17] Tr.Vol.5, pages 147-148
[18] Tr. Vol. 5, pages 179-180

And you were asked about this in certain IRs, and, well, they all point to CCC-9. And it seems to me you take a different tact than Concentric and Nexus. And maybe you can help me understand your view of the -- about the risk caused by energy transition and electrification as it relates to electricity distributors and transmitters.

DR. CLEARY: Yes. So the fact of the matter is the transition means we are going to need more electricity, significantly more. This creates a risk only if there's evidence that the companies aren't able to plan adequately for it and attract capital to go into those investments. I think it's a problem that most companies would like to have, that is to say: Hey, your sales are going to grow 30 percent or 40 percent or whatever the number is over the next 10 to 20 years.

I don't think companies are going to say: Oh, wow, that really puts us at risk.

Yes, it changes things. You have to raise more capital. You have to do more planning. You have to think about different approaches to your operation. But, at the end, these are well-run companies that we are talking about, and those are nice opportunities to have. So I always think of risk and opportunities as the opposite sides of the coin, right, so there is that.

The fact that energy transition can result in greater earnings was also confirmed by Mr. Dane of Concentric [19]on two occasions. [20]

MR. DANE: Yes, that's part of the attraction for investors. And that's part of the utilities' business, is attracting capital. And so they would necessarily need to present this information to its investors.

MR. RUBENSTEIN: And if the energy transition is a reason for the increased capital, that's also good for investors?

MR. DANE: Can you repeat that question?

MR. RUBENSTEIN: Let me phrase it a different way: If the increased capital expenditures are in part due to the energy transition, that's also good for investors? It's increasing the rate base, increasing the dividend. Correct?

MR. DANE: I would agree that can contribute to increases in rate base and dividends. I think what we are studying here is the return required by investors on that capital. And so the focus is not so much on the absolute level of increase or the absolute level of profits, but rather the return that investors are going to require.

But if energy transition places greater demand for capacity on Ontario electricity distributors in the future, it is likely that many will have adequate spare capacity to deal with the increased load without the need for new investments for many years. as discussed by the consultant representing Energy Probe and CCMBC with Mr. Coyne of Concentric. [21]

MR. LADANYI: Your evidence is that Ontario electricity and gas distribution utilities will need to raise large amounts of capital in the future for capital expenditures needed for energy transition; is that right?

MR. COYNE: Yes.

[19] Tr.Vol.2 pages 128-134
[20] Tr.Vol.2, pages 121-127
[21] Tr.Vol.3 pages 82-90

MR. LADANYI: Let's look at electricity distributors first. Is your evidence that energy transition will create load growth and the electricity distributor will need to make investments to meet this increased load?

MR. COYNE: That's fair, yes.

MR. LADANYI: Would you agree with me that some of the 61 electricity distributors in Ontario may have sufficient spare capacity that they would not need to make any investment?

MR. COYNE: We don't know that to be the case, we haven't researched -- when you say spare capacity, do you mean spare distribution capacity? I assume.

MR. LADANYI: Right, that's what I mean.

MR. COYNE: We have not researched whether or not the 61 distributors have spare distribution capacity and can accommodate load growth. But even if they didn't have spare capacity, there are new requirements for the industry that aren't load dependent regarding system hardening, and cyber security, and things of that nature. So, even an electric utility with static or negative load growth can still have new capital requirements. But we have not researched the issue of capacity as in your question.

MR. LADANYI: But you'd accept that of the 61 distributors it would be totally impossible for all of them to be operating at peak capacity, i.e. that currently they have absolutely no spare capacity, the whole system would -- it's illogical so they must have some spare capacity?

MR. COYNE: It's an industry standard, you know, the old, the old standard is, you know, an outage of one day in every ten years is how you set out an N1 or N2 requirement to set up your system. And so, the standard for the industry would not be to have them operating at capacity that would not be customary.

If some electricity distributors need to make investments in additional capacity, it is not clear why such investments would be more risky than any of their other investments for load growth unless the distributors over expand the distribution system and the load growth does not materialize and the OEB disallows the addition of capital additions to rate base. Energy Probe is not aware of any such OEB disallowance.

MR. LADANYI: So, there is a risk as I understand that, for example, distributors will over-expand the system in expectation of increased load from energy transition but the load will not materialize; sort of, like, build it and they will not come?

MR. COYNE: That is one of the risks because, you know, as we look at the future of the power industry there are, there is a fair amount of emphasis on non-wires alternatives, for example, or distributed resources. And, you know, it was the case under central planning for an electric utility that you could plan on the next need for your 600 megawatt generating unit, you knew where to put it, you could anticipate load growth that looked like GDP, and it was a very different planning environment. So, now you don't know if they are going to be your customers or belong to a competitor that will be invited to come into the industry. And you don't know if your customers are going to have electric charging cars or not, will they be used on the system to offset other generation? So, the levels of -- the levels of alternatives around these scenarios are laid out by the IESO in its planning document and by the government in its planning document, and it portrays a very wide range of uncertainty. So, I think those are key differences.

MR. LADANYI: Do you think there is a risk that the OEB might disallow some investments if they are under-used in the future? I am talking about electricity distribution systems.

MR. COYNE: We haven't examined that possibility per se.

When and if energy transition happens, there should be an increase in electricity use per customer. There has been no indication of that in recent OEB electricity distribution proceedings. Under the current straight fixed variable (SFV) rate design for residential rates the increase in use per customer will not result in greater earnings for distributors unless they make capital investments to accommodate increased loads. However, this can be mitigated by changing the rate design to straight fixed variable with demand (SFVD) as was explained by Mr. Zarumba of Nexus.[22]

MR. LADANYI: Very good. And now you think there is an increase in use per customer or you're expecting it to happen sometime in the future? Because I must tell you that I have been involved in a number of recent applications by distributors in Ontario and there has been no increase in the use per customer, and maybe it's completely off, maybe whatever is happening with heat pumps and EVs is completely offset by, let's say, use of more efficient appliances by the customer in better washers, driers, fridges, whatever, but there's been no indication so far of any increased use per customer.

MR. ZARUMBA: We expect it in the future, but that's based upon the forecast from the IESO which we are feeling is the best information available.

MR. LADANYI: So, the future has not started yet. When do you expect this future to start?

MR. ZARUMBA: Well, we filed the projections. The issue becomes when do the distributors have to start planning for the future. And it's my opinion, about five years. As I mentioned earlier, there is a planning cycle that needs to occur, there is an equipment procurement cycle that needs to occur, and basically the acquisition of employees with the proper credentials, the proper human resource. So, you know, we are in 2024 right now, I think if we start seeing things in 2029 we essentially start tomorrow morning.

MR. LADANYI: So, would the revenue per customer increase if the load per customer increases?

MR. ZARUMBA: No.

MR. LADANYI: Really?

MR. ZARUMBA: Excuse me, I am sorry. I misspoke. The revenue per customer with the current revenue -- the current residential rate design is based on a per customer, so if the load per customer increases, but the revenue per customer will not increase because it is all based on the number of customers. Does that answer your question?

MR. LADANYI: Well, you're saying is it because of the fixed variable rate structure; is that what you're talking about?

MR. ZARUMBA: Yes.

MR. LADANYI: But the energy usage per customer would increase?

MR. ZARUMBA: Energy usage will increase but revenues would not.

[22] Tr.Vol. 5, pages 119-122

MR. LADANYI: So, we have a different rate structure actually, any investments required for increased load for energy transition would actually be covered off with higher revenues; wouldn't they?

MR. ZARUMBA: I don't think I agree with you. Because what would happen is that the revenue per customer would only increase by the I minus -- if they are under the IRM, by the I minus X each year. So, it's quite possible that you would have a load increase significantly higher. This was a discussion that occurred when the fixed variable pricing was analyzed back in the early 2010s. There was discussion of potentially having a demand charge, which was -- had to be rejected because it was one of the constraints that was faced was the meters that had just been acquired by -- that had been spec'd by the province did not have a demand reading that was revenue quality.

However, we are now looking at the next generation meters in the not to distant future that we would think would not suffer that same shortcoming. But right now there would be a problem if you load increases, which would require new capital investments, because the change in the revenues would not keep up with the revenue requirement to support the incremental capex.

MR. LADANYI: So, if I understand what you're saying is if we had the appropriate rate structure or rate design, there would be either no risk or much reduced risk from energy transition?

MR. ZARUMBA: I think the issue is I don't want to get into the "ifs", but I think some place we can agree is that the regulatory mechanisms need to be reviewed again. So I think we are on the same page there, I just don't want to go to the next pages, but what are the solutions.

In questioning by Ms. Stothart, counsel for EDA, Dr. Cleary explained the need for financing energy transition investments is not urgent. [23]

MS. STOTHART: Well, in the sense -- we're all talking about, you know, this transition that's coming, and this urgent need to finance the electricity grid expansion. And in order to do that, you realize that utility companies can't just start building, for example in five years, when that demand arrives, right, they have to start building sooner than that, it's a fairly urgent requirement?

DR. CLEARY: I think we're talking -- it is definitely urgent, from the nature of this report, that we start doing that. As to is it urgent that Ontario utilities have to go out tomorrow and raise a lot of capital for this? I would say that depends, I don't see that. I think it will roll in over the next few years, depending on how they move towards this is transition. I don't think it's urgent in the sense that they're going to be out there raising buckets of extra money over the next year. I think it will happen quite consistently over the next three years. And maybe there will be a tipping point, where they need a whole -- a whole bunch at once, but I don't think we're at that tipping point just yet. We're at the point where they have to start planning for it and are dealing -- you know, potentially need more capital.

[23] Tr.Vol.6, pages 61-69

Energy transition will create greater earnings opportunities for electricity distributors as explained by Dr. Cleary. [24]

MR. RUBENSTEIN: So back -- now, CCC-9 is up on the screen here, just to repeat the context. You were asked -- you discuss -- as I mentioned to you, there has been a lot of discussion about electrification and energy transition increasing utility risk as opposed to it being a positive outcome and that the increasing risk required an increase in the compensation through the ROE or the capital structure.

And you were asked about this in certain IRs, and, well, they all point to CCC-9. And it seems to me you take a different tact than Concentric and Nexus. And maybe you can help me understand your view of the -- about the risk caused by energy transition and electrification as it relates to electricity distributors and transmitters.

DR. CLEARY: Yes. So the fact of the matter is the transition means we are going to need more electricity, significantly more. This creates a risk only if there's evidence that the companies aren't able to plan adequately for it and attract capital to go into those investments. I think it's a problem that most companies would like to have, that is to say: Hey, your sales are going to grow 30 percent or 40 percent or whatever the number is over the next 10 to 20 years.

I don't think companies are going to say: Oh, wow, that really puts us at risk.

Yes, it changes things. You have to raise more capital. You have to do more planning. You have to think about different approaches to your operation. But, at the end, these are well-run companies that we are talking about, and those are nice opportunities to have. So I always think of risk and opportunities as the opposite sides of the coin, right, so there is that.

In summary there is no indication that energy transition from fossil fuels to electricity is proceeding at any significant level at the present time or will in the near future. When and if it does, it will result in greater volume of business and greater earnings for electricity utilities and will likely decrease their business risk.

Transition from natural gas to electricity is currently not having any significant impact on gas distributors. Based on evidence in recent gas proceedings, additions of new gas customers are far greater than the number of customers leaving the gas system. Recent Provincial government decision overturning the EB-2022-0200 OEB decision, indicates that the government is protecting Enbridge Gas from potential impacts of energy transition.

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?

Energy Probe Submission

Ontario distributors have a choice of three rate setting mechanisms.[25] A distributor can choose a mechanism that suits its needs. In particular, a distributor can propose a Custom IR mechanism that can be designed to reduce its risk. The OEB has approved such risk reducing Custom IR rate

[24] Tr.Vol.5, pages 179-180
[25] Exhibit K3.3, Tab 2

setting mechanisms for Hydro One, Enbridge and Toronto Hydro. No other jurisdictions offer similar options for risk reduction. Moreover, LEI believes that OEB rate setting policies reviewed since 2006 have slightly reduced the risks for electricity distributors.[26] Energy Probe believes that this would justify reducing the cost of capital rather than increasing it.

Another reason why the cost of capital should be reduced is the OEB decision in the EB-2023-0148 proceeding dealing with the Getting Ontario Connected Variance Account. In that proceeding utilities requested approvals to set up variance accounts to record incremental costs of locates because of legislative change. They expect to be able to recover incremental costs from ratepayers in the future. In its decision[27] the OEB granted their requests reducing business risk of the utilities. Energy Probe submits that utilities are compensated for business risk caused by legislative change through equity thickness and the return on equity approved by the OEB. This decision overcompensated utilities for business risk.

Issues 4 to 22.

Energy Probe Submissions on Issues 4 to 22

Energy Probe and the Coalition of Concerned Manufacturers and Businesses of Canada are represented by the same consultant. It agrees with the submissions of CCMBC on Issues 4 to 22. sues and to avoid duplication is not filing its own submissions on those issues.

[26] Exhibit M1, Issue#3, page 14
[27] Decision and Order, EB-2023-0148, Getting Ontario Connected Variance Account, October 31, 2023