EB-2024-0063

ONTARIO ENERGY BOARD

Ontario Power Generation Inc.

IN THE MATTER OF the *Ontario Energy Board Act, 1998,* S.O. 1998, c. 15, Sched. B, as amended;

AND IN THE MATTER OF a generic proceeding commenced by the Ontario Energy Board on its own motion to consider the cost of capital parameters and deemed capital structure to be used to set rates

SUBMISSIONS OF CANADIAN MANUFACTURERS & EXPORTERS ("CME")

November 7, 2024

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1.0 INTRODUCTION

1. These submissions are made on behalf of Canadian Manufacturers & Exporters ("**CME**") regarding the generic proceeding commenced by the Ontario Energy Board (the "**OEB**" or the "**Board**") on its own motion to consider the cost of capital parameters and deemed capital structure to be used to set rates.

2. CME members, which include over 400 Ontario based companies, operate energy intensive businesses. Their continued competitiveness in their respective industries is tied directly to how much energy costs them and, as a result, the increasing cost of energy in Ontario has impacted their ability to be competitive in the market compared with businesses in other jurisdictions where energy costs less. For CME and its members, the cost consequences of this proceeding are significant.

3. Pursuant to Procedural Order #1, the Board determined that it would conduct a comprehensive review of the cost of capital parameters and deemed capital structure of Ontario's electricity distributors, transmitters, Ontario Power Generation ("**OPG**") and Enbridge Gas Inc. ("**EGI**").

4. In its correspondence dated April 22, 2024, the Board accepted an issues list that included a total of twenty-two issues.

5. Board Staff commissioned a report from London Economics International ("**LEI**").[1] Intervenors also sponsored multiple expert reports. The Ontario Energy Association ("**OEA**") sponsored evidence from Concentric Energy Advisors, Inc.[2] ("**Concentric**") The Electricity Distributors Association ("**EDA**") sponsored evidence from Nexus Economics LLC ("**Nexus**").[3] The Industrial Gas Users Association ("**IGUA**") and the Association of

[1] London Economics International LLC, "*Independent expert report of the Generic Proceeding on cost of capital and other matters*", dated June 21, 2024, ("**LEI Report**").
[2] Concentric Energy Advisors "*Report prepared for the Ontario Energy Association and Coalition of Large Distributors and Ontario Power Generation*", July 19, 2024, ("**Concentric Report**").
[3] Nexus Economics "*Expert Report on the Cost of Capital and Certain Accounting Issues EB-2024-0063*", July 19, 2024, "**Nexus Report**").

Major Power Consumers of Ontario ("**AMPCO**") sponsored evidence from Dr. Sean Cleary ("**Dr. Cleary**").[4]

6. The parties participated in six days of oral hearing between September 25 to October 10, 2024.

7. Pursuant to Procedural Order #1, the Board asked parties to provide submissions on the issues set out in the issues list. These are CME's submissions, separated by issue. Where these submissions do not touch on an issue, CME takes no position on that issue.

8. The Board's task in this proceeding is to balance the legal requirements of the 'fair return standard', the practical requirements of the utilities providing services, and the interest of ratepayers/customers and the dangers of economic rents. CME submits that the Board's current cost of capital has served its regulated utilities very well. There are some areas where the Board's formula can be improved. However, as will be seen below, Ontario's utilities have regularly earned their allowed return on equity ("**ROE**"), have raised capital on reasonable terms, and have maintained their financial integrity. Ontario's utilities have also provided a return that is comparable to businesses of like risk.

9. Accordingly, CME submits that most of the changes proposed by Concentric and Nexus are unnecessary and should not be accepted by the Board. Instead, as outlined further below, the Board should accept the positions as set out by LEI and/or Dr. Cleary.

2.0 GENERAL ISSUES (ISSUES 1-3)

2.1 The Impact of the Source of Capital or Different Types of Ownership (Issue 1)

10. The first issue set out by the Board in the issues list asks whether the source of a utilities capital, such as capital markets or government lending, or the ownership type of the utility

[4] EB-2024-0063, Dr. Sean Cleary, "*2024 Review of Cost of Capital Parameters and Deemed Capital Structure*", July 19, 2024, ("the **Dr. Cleary Report**").

(municipal, private, co-operative etc.) has an impact on how the Board sets it cost of capital or capital structure.

11. In the various reports commissioned by parties, the experts either took no position on this issue,[5] or found that the Board's current practice adequately addresses these issues.[6]

12. LEI argued that the OEB already accounts for the source of capital when setting capital structure and the cost of capital. The long-term debt rates are considered based on the actual embedded debt for Enbridge Gas Inc. ("**EGI**") and Ontario Power Generation ("**OPG**").[7] For electricity distributors, the deemed long term date rate ("**DLTDR**") is a proxy or a ceiling for the debt rate depending on if the distributor has a debt rate higher than the actual cost of debt or not.[8] LEI therefore opined that the Board reviews the utilities' actual cost of debt in most instances, and therefore already implicitly accounts for the source of the funds.

13. Accordingly, CME submits that the Board's current approach sufficiently considers the source of capital and therefore no change is required from the status quo.

14. With respect to the types of ownership, the Board previously determined that it should not consider the type of ownership structure of a utility. The Board based its decision on the fact that utilities were meant to be operated as commercial entities, regardless of their underlying structure.[9]

15. The evidence in this proceeding has not demonstrated that the Board's decision needs to be changed. Accordingly, CME submits that no change is needed at this time.

[5] Nexus Report, pp. 1-2.
[6] LEI Report, p. 4.
[7] LEI Report, p. 46.
[8] LEI Report, p. 46.
[9] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 25.

2.2 Risk Factors to be Considered (Issue 2)

16. LEI, Concentric and Dr. Cleary all agreed that the risk factors that the Board should consider when determining the cost of capital parameters and capital structure are business risks and financial risks. Concentric defined each risk as follows:

    (a) Business risks results from variability in cash flows and earnings that impact the ability of the utility to recover its costs, including a fair return on and of its capital in a timely manner; and

    (b) Financial risk is related to a company's debt leverage and liquidity and is measured by its credit profile.

17. These risks have in previous cases, been found to include, *inter alia*, impacts of the energy transition.[10]

18. Nexus argued that the Board should consider another risk factor, which it called "strategic risks", which it defined as being the risk that utilities face regarding the "direction of the industry" and the investment decisions that they will have to make in the future.[11]

19. CME submits that the addition of "strategic risk" to the Board's consideration is unnecessary. The Board already takes broader considerations such as the energy transition and its impact on the industry into consideration when making cost of capital decisions.[12] This includes the present impact of risks that may not fully materialize during the rate period horizon such as the energy transition.[13]

20. The Board already has the necessary tools to address risks such as "direction of the industry" or the investment decisions that a utility may have to make through the 'business' and 'financial' risk evaluation that the Board already undertakes. "Strategic Risks" are

[10] For instance, see the Board's Decision and Order in EB-2022-0200.
[11] Nexus Report, p. 25.
[12] EB-2022-0200, Decision and Order, December 21, 2023, pp.9-23.
[13] EB-2022-0200, Decision and Order, December 21, 2023, pp.9-23.

simply those risks by another name. Accordingly, CME submits that the Board's existing approach does not need to be changed.

2.3 What Regulatory and Rate-Setting Mechanisms Impact Utility Risk (Issue 3)

21. The various experts agreed in this proceeding that regulatory mechanisms impact the level of risk to which a utility is exposed.[14] The OEB has enacted and adopted several regulatory programs and policies which impact a utilities' level of risk, including policy frameworks for residential and industrial rate design as well as distributed energy resources.

22. LEI discussed the Board's various regulatory mechanisms in its report and found that they almost universally reduced utility uncertainty, increased flexibility, or provided additional compensation for changes in risk.

23. CME agrees with LEI. This is born out by the evidence. Figure 47 of LEI's report demonstrates that S&P ranked Ontario in the top 10 jurisdictions out of 60 and found that it was a "most credit supportive" jurisdiction.[15]

24. CME agrees with LEI and Dr. Cleary that regulatory mechanisms can play a valuable role in stabilizing Ontario utilities cash flows, thereby reducing their overall business and financial risk.[16] As a result, CME submits that LEI's recommendation that that any regulatory mechanism that can significantly impact the stability of future cash flows should be considered for review as part of regulatory risks is reasonable.[17]

25. CME also agrees with LEI and Dr. Cleary that pro-active impact assessments should occur following any regulatory changes that the Board determines may have a material impact on a utilities' cost of capital.[18]

3.0 SHORT TERM DEBT RATE (ISSUES 4-5)

[14] Dr. Cleary Report, p.19; Concentric Report, p.29; Nexus Report, p.29; LEI Report, p.63-64
[15] LEI Report, p.128-129
[16] Dr. Cleary Report, p. 19
[17] LEI Report, p.74
[18] Dr. Cleary Report, p.20; LEI Report, pp.75-76

26. The Board's current methodology for calculating the Deemed Short Term Debt Rate ("**DSTDR**") and its application to utilities is as follows:[19]

    (a) The Board obtains estimates of the spread of a typical short-term loan for an R1-Low rated utility over the 3-month banker's acceptance rate from multiple Canadian banks;

    (b) The spread is obtained from up to six Canadian banks;

    (c) For electricity distributors and transmitter, the DSTDR is used to set the short term debt rate;

    (d) For OPG and EGI, the DSTDR is not used to set short term debt rates. EGI and OPG's short term debt rates are calculated using the weight average cost of their actual debt.[20] The DSTDR is instead used to true up EGI/OPG's deemed capitalization to their actual capitalization.[21]

27. The expert evidence in this case has identified 2 issues with the Board's current approach to short term debt rates. The first is that the Board's current methodology for determining the short-term debt rate does so with reference to the 3-month banker's acceptance rate from major Canadian banks for electricity distributors and transmitters.[22]

28. Canadian banks stopped issuing banker's acceptance rates as of June 2024. LEI proposed to base the short-term debt rate calculation for electricity transmitters and distributors on the Canadian Overnight Average Repo Rate ("**CORRA**") determined over the relevant forward looking 12-month period.[23] Both Concentric[24] and Dr. Cleary[25] agree with the substitution of the CORRA rate for the banker's acceptance rate.

[19] LEI Report, pp. 27, 35, 76.
[20] LEI Report p, 77.
[21] LEI Report, p. 77; Concentric Report p.33; EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 55.
[22] LEI Report, p. 27.
[23] LEI Report, p. 82.
[24] Concentric Report, p. 33.
[25] Cleary Report, p. 6.

29. Accordingly, CME submits that the Board should replace the use of the banker's acceptance rates with the CORRA rates as proposed by LEI.

30. The second issue is whether or not the DSTDR methodology (now using CORRA) should be applied as a cap to all utilities, including EGI and OPG (the "**Updated DSTAR**"). Concentric argued against the application of the Updated DSTDR methodology as a cap on EGI and OPG. Concentric argued that the actual debt rates of a utility can deviate from the deemed debt rate for reasons that are outside of the utilities' control.[26] As a result, Concentric opined that utilities could be prohibited from recovering prudently incurred costs as a result of a "rote" application of the Updated DSTDR methodology on those utilities.

31. CME submits that LEI's proposal to apply the Updated DSTAR as a cap to EGI and OPG's debt rates is reasonable. As set out in LEI's report, the short-term debt rate proposal uses R1-Low rated entities to determine the appropriate debt rate. Both EGI and OPG are rated as R1-Low utilities.[27] Accordingly, the Updated DSTDR methodology proposed by LEI should accurately track the upper limit of what OPG and EGI should face in terms of their short-term debt costs.

32. To address the concerns set out by Concentric in its report about the application of a cap, CME submits that the Board should apply the Updated DSTDR methodology as a soft cap, which can be rebutted by evidence from the utility.

33. If EGI or OPG's actual cost of debt were materially higher than the cap for reasons that were beyond its control, CME submits that the Board could require the utility to lead evidence as to the cause of its cost of debt (that it was out of its control) and the prudence of the utility in incurring it. The Board would then have the opportunity to determine

[26] Concentric Report, p. 33.
[27] LEI Report, p.83

whether the utilities' actions were appropriate and could award EGI or OPG a higher debt rate.

4.0 LONG TERM DEBT RATE (ISSUES 6-9)

4.1 The Board Should Enhance its Approach to Setting the Long-Term Debt Rate (Issues 6-7)

34. The Board currently calculates the DLTDR with reference to the Long Canadian Bond Forecast ("**LCBF**") plus the average spread between the 30-year A-rated Canadian bond yield and the 30-year Government of Canada bond yield for the three months preceding the effective date of the rate change.[28] In the same manner as the DSTDR, the DLTDR is used as a proxy for electricity distributors and transmitters who have no debt, or a ceiling for those that do have debt.

35. For EGI and OPG, the Board considers the weighted cost of actual embedded debt.[29]

36. LEI recommended two changes to the Board's methodologies:

    (a) First, LEI recommended that the Board move from the LCBF (which considers a mix of views about the 10-year GoC bond yields from several sources) to using the 30-year GoC bond yield. As CME understands it, this would remove the requirement for the calculation of spreads between the 10-year and 30-year BoC bond yields. LEI recommends that the Board use Bloomberg's BVCAUA30 BVLI Index for this purpose.[30]

    (b) LEI also recommends that the DLTDR be applied as a cap rate for EGI and OPG as well.

37. Dr. Cleary agreed with LEI's recommendation that the DLTDR be applied as a cap for EGI and OPG. However, Dr. Cleary's preferred approach to setting the DLTDR would be to use the actual prevailing bond yields as of September 30, rather than the forecast yields.

[28] LEI Report, p. 83.
[29] LEI Report, p. 84.
[30] LEI Report, p. 93.

38. With respect to the use of the forecasts suggested by LEI or actual yields, CME is persuaded that the use of actual bond yields might be preferable. However, both seem like reasonable options for the Board to consider.

39. However, CME submits that the Board should apply the DLTDR (however calculated) as a cap to EGI and OPG. As set out in LEI's report, "all OEB-regulated entities reviewed have a similar senior debt credit rating"[31] and as a result, there is no reason why a cap should be applied solely to electricity distributors and transmitters, and not EGI and OPG.

40. In a similar fashion to the Updated DSTDR methodology, CME submits that if the Board chose to apply the DLTDR as a cap to OPG and EGI, it could use them as a soft cap that the utility could rebut through evidence. In other words, it would be OPG or EGI's burden to prove that the use of long-term debt financing above the cap set out by the DLTDR was beyond their control and was a prudently incurred in the circumstances.

4.2 Transaction Costs Incurred by Utilities (Issue 8)

41. CME submits that the Board should move away from the 50-basis points adder to account for utility transaction costs.

42. As CME apprehends it, the 50-basis points adder was originally derived from mathematical calculations conducted by EGI's treasury team in 1996 where they found that flotation costs for utilities ranged between 2 and 10 percent of the gross proceeds of an issuance.[32] The average cost of 5 percent of the gross proceeds was determined as the mid point of the range.

43. An adder was then derived by calculating the impact of the payment of these additional forecast transaction costs through the DCF model to determine a basis point increase for ROE. This adder then was accepted by other jurisdictions, including the Board in its 2009

[31] LEI Report, p.93
[32] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 27.

report and has remained embedded in Ontario's cost of capital calculation since that time.[33]

44. However, CME submits that there is no evidence in this proceeding capable of supporting the position that the 50-basis point adder is the appropriate amount of money to compensate Ontario utilities for their transaction costs. In this regard, CME notes that:

(a) The mid-point of EGI 1996 estimate (5 percent of gross proceeds) actually equates to a 25-basis point adder rather than a 50-basis point adder;[34]

(b) The total cost of U.S. issuances for the preceding 10 years is significantly lower than EGI's 1996 calculations. Concentric admitted that the recent costs would be 1.75% and that costs have trended downwards for utilities where Concentric has calculated the actual cost of their issuances;[35]

(c) Concentric did not actually calculate the costs of equity issuances for Ontario utilities for its evidence in this proceeding;[36]

(d) Ontario utilities are largely not traded publicly. Accordingly, their costs of equity issuances would be significantly different than those utilities that are publicly traded;[37]

(e) Equity issuances from Ontario utilities occur infrequently, and most have not made any since 2019.[38] For instance, while Toronto Hydro had an equity injection in 2024, prior to this they have not had any equity issuances for 7 years.[39] Similarly, Hydro Ottawa, Hydro One, Elexicon Energy, Alectra, and OPG, have not had any equity issuances since 2019, a period of 5 years.[40]

[33] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. ii.
[34] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.27
[35] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 34.
[36] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 33
[37] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 35.
[38] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 21-22
[39] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.20-21
[40] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.21-22

(f) Nexus also admitted that they had simply accepted that there should be a 50-basis point adder and had not conducted any empirical analysis on whether 50-basis points was the correct amount to properly compensate Ontario utilities for their transaction costs.[41]

45. Concentric suggested that a 50-basis point adder was appropriate to provide "financial flexibility" associated with having access to equity in the market.[42] CME submits that Concentric never provided a compelling explanation of what "financial flexibility" meant in this context, or why Ontario utilities needed it.

46. Moreover, Concentric provided no evidence as to why an additional 25 basis point adder was the appropriate amount to secure "financial flexibility". CME notes that utilities operating in the United States for which Concentric has estimated the transaction costs of equity issuances do not include the adder for "financial flexibility".[43] As will be described below, this is one way among many that Canadian utilities operate with greater regulatory support and as a result, have lower risk than their U.S. peers.

47. LEI proposed that the Board remove the adder and instead allow utilities to add transaction costs as an operating expense. The actual costs incurred by a utility would therefore be tracked and the compensation provided would match the costs of the transaction. CME submits this approach is reasonable.

48. CME submits that a properly calibrated ROE 'adder' that was based in the evidence of the transaction costs faced by Ontario utilities would also be reasonable. However, there no evidence about the quantum of transaction costs of equity financing for the differently situated Ontario utilities in the recent past. Accordingly, the Board may find that it does not have an appropriate basis for determining what, if any, adder should be awarded.

[41] EB-2024-0063, Oral Hearing Transcript, Volume 5, p.51-53.
[42] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 26.
[43] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 36.

49. If the Board determines that it does not have sufficient evidence to award a properly calibrated adder, then CME submits that applying LEI's proposal regarding expensing the actual costs of equity issuances would be the most appropriate course of action.

5.0 RETURN ON EQUITY/CAPITAL STRUCTURE (ISSUES 10-13)

5.1 The Fair Return Standard (Issue 10)

50. The experts agree on both the contents of the fair return standard, and that it is a legal requirement which the Board, in setting a return on capital for the utilities that it regulates, must meet.[44] In this regard, the fair return standard is composed of:

(a) The capital attraction standard. The capital attraction standard requires that the return for the regulated entities must be sufficient to allow them to attract incremental capital on reasonable terms and conditions.[45]

(b) The financial integrity standard. The financial integrity standard requires that the return for the regulated entities must be sufficient to allow them to maintain their financial integrity on a forward-looking basis.[46]

(c) The comparable investment standard. The comparable investment standard requires that the return for the regulated entities must be sufficient to allow them to earn a "comparable" return to the returns available from other enterprises of "like risk".[47]

51. Each of the three subcomponents of the fair return standard must be met by the regulator's allowed return for its utilities in order for the fair return standard to be satisfied,[48] and none ranks in priority to the other.

[44] LEI Report, p.38; Dr. Cleary Report, p.3; Concentric Report, p.17; Nexus Report, pp.15-17.
[45] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p.18.
[46] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 17.
[47] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, pp. 18, 21.
[48] *British Columbia Electric Railway Co. Ltd. v. Public Utilities Commission of British Columbia et al* [1960] S.C.R. 837, p. 848.

52. Notwithstanding the above articulated principles, CME notes that the fair return standard is sufficiently broad that the Board must still use informed judgment and apply its discretion in the determination of a rate regulated entities costs of capital.[49]

53. Additionally, the Board articulated that a cost of capital determination made by a regulator that meets the FRS does not result in economic rent being earned by a utility; that is, it does not represent a reward or payment in excess of the opportunity cost required to attract capital for the purpose of investing in utility works for the public interest.[50] In other words, the returns earned by regulated utilities in Ontario must be sufficient to meet the three components of the fair return standard, but should not be any greater than that amount.

5.2 The Board's Current Allowed Returns and Capital Structures Meet the Capital Attraction and Financial Integrity Standards (Issue 10)

54. CME submits that the OEB's current allowed ROE's and Capital Structures meets both the capital attraction and financial integrity standard.

5.2.1 Capital Attraction Standard

55. There is no evidence in this proceeding that the ROEs allowed by the Board have ever been insufficient to allow Ontario utilities to attract capital on reasonable terms. In this regard, CME notes that:

(a) Concentric testified that it has been their observation that Ontario utilities have been able to attract sufficient capital historically to fund their operations.[51] Mr. Coyne stated during his testimony that he did not learn of any Ontario utility that has failed to attract capital on reasonable terms, nor is he aware of this being an issue raise by any of the OEA members Concentric had discussions with.[52]

[49] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 18.
[50] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, pp. 19-20.
[51] EB-2024-0063, Oral Hearing Transcript, Volume 3, p. 62.
[52] EB-2024-0063, Oral Hearing Transcript, Volume 4, p.67.

(b) During its cross examination, Nexus stated that it was unaware of any EDA members that currently have trouble attracting equity and debt capital on reasonable terms.[53]

(c) Both LEI and Dr. Cleary have opined that an allowed ROE that is lower than what is currently allowed would meet the fair return standard.[54] Implicitly therefore is the conclusion that the current, higher allowed ROEs also meet the fair return standard, including the capital attraction standard.

56. Accordingly, CME submits that the evidence before the Board demonstrates that the OEB's current allowed ROE and capital structures meet the capital attraction standard.

5.2.2 Financial Integrity Standard

57. Similarly, CME submits that there is no evidence that the Board's current allowed ROE's have ever been insufficient for an Ontario utility to maintain its financial integrity. In this regard:

(a) Concentric admitted on cross examination that the returns Ontario utilities are currently earning have been sufficient to meet the financial integrity standard;[55]

(b) As CME apprehends it, Nexus makes no claim in its report that the Board's current ROE's are insufficient to meet the financial integrity standard;

(c) Both LEI and Dr. Cleary have opined that an allowed ROE that is lower than what is currently allowed would meet the fair return standard.[56] Again there is an implicit conclusion that the current, higher allowed ROEs also meet the fair return standard, including the financial integrity standard;

(d) The Board has not had one of its regulated utilities have its financial integrity fail in the recent past.

[53] EB-2024-0063, Oral Hearing Volume 5, pp.5-7.
[54] LEI Report, p.127; EB-2024-0063, Oral Hearing Transcript, Volume 1, pp.89-90; EB-2024-0063, Oral Hearing Transcript, Volume 2, pp.174-175; Dr. Cleary Report, p.42
[55] EB-2024-0063, Oral Hearing Transcript, Volume 4, p.69; See also EB-2024-0063, Oral Hearing Transcript, Volume 6, p,189
[56] LEI Report, p.127; EB-2024-0063, Oral Hearing Transcript, Volume 1, p.89-90; EB-2024-0063, Oral Hearing Transcript, Volume 2, pp.174-175; Dr. Cleary Report, p.42

58. Accordingly, CME submits that the evidence demonstrates that the Board's current allowed ROE and capital structures are sufficient for Ontario utilities to maintain their financial integrity.

5.3 The Board's Current Allowed Returns and Capital Structure Meet the Comparable Investment Standard (Issue 10)

59. The Board articulated in its 2009 decision that when identifying comparator jurisdictions and entities for the purposes of assessing whether the return is comparable to the return available from invested capital in other enterprises of "*like risk*", the comparators need not be identical.[57] Rather, they must merely share similarities.[58]

60. As a result, there are two areas of professional judgment which need to be exercised in any evaluation of the comparable investment standard. The first is whether or not two entities are truly "like", in that they share sufficient similarities as to make the comparison of the two appropriate. The second is whether or not, based on the degree of similarity between the entities or the degree to which they are alike, the return generate by the OEB regulated entities are "comparable" to those offered by the comparator entities.

61. The evidence in this proceeding demonstrates the degree of latitude which the two aspects of professional judgment have on the analysis of the comparable return standard. The Board received four reports from qualified experts who all took different approaches to the comparisons for the comparable investment standard. They are set out at a high level below:

Expert	Comparator Group	Finding
London Economics International	Used multiple proxy groups comprising primarily of US utilities but considered approaches from jurisdictions outside North America.	The OEB'S current returns and capital structures meets the comparable investment standard.
Concentric Energy Advisors Inc.	Used multiple proxy groups, but found that their North American Electric, North	The OEB's current returns and capital structure do not

[57] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 21.
[58] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 21.

	American Gas and North American Combined groups had risk most comparable to Ontario.	meet the comparable investment standard.
Nexus Economics LLC	Used one proxy group comprising mostly of US utilities based on NAICS Codes.	The OEB's current returns and capital structure do not meet the comparable investment standard.
Dr. Cleary	Had a US and Canadian proxy identified in their report but used proxy group of only Canadian comparators for the purposes of ROE calculation.	The OEB's current returns and capital structures meets the comparable investment standard.

62. CME submits that when benchmarked against entities that are actually comparable to the OEB's regulated Ontario utilities, the current allowed ROE and capital structures are sufficient to meet the comparable investment standard.

5.3.1 Proxy Groups

63. Because the ROE is a market-based concept, the experts have used groups of companies that they consider to be comparable to Ontario's utilities to serve as a "proxy" for purposes of ROE estimation.

64. Canadian entities are, in many respects, the most comparable entities to the Ontario utilities that the Board regulates. CME submits that the Canadian proxy group approach used by Dr. Cleary has merit. However, CME also accepts that there is a broader pool of potential entities to compare with if the Board were to look outside of Canada.

65. If the Board chooses to accept comparisons to entities that are outside of Canada, it should adjust any ROE results to account for the difference in risk between Ontario entities and those operated outside of Canada. The Board previously found that it is appropriate to make adjustments to its cost of capital decisions for non-Canadian comparators. In EB-2016-0152, the Board determined that:

> The OEB accepts that the fair return standard requires that similar utilities be comparable in terms of equity thickness as well as return on equity. However, the

> jurisdiction in which utilities operate and are regulated is also a factor that must be considered…
>
> The OEB finds that an adjustment to the comparator group data should have been made by both experts to account for the substantially lower common equity ratios allowed regulated utilities in Canada."[59]

66. The Alberta Utilities Commission found the same. In its recent 2023 decision on cost of capital parameters, the AUC determined that US utilities could be used as comparators to Alberta's regulated utilities, but found that:

> "[T]he Commission retains the view expressed in the 2018 GCOC decision that a significant amount of judgment must be applied by the Commission when interpreting data from the representative utilities to establish the ROE required by investors in the Alberta utilities."[60]

67. The evidence in this proceeding demonstrated why the Board must make adjustments to comparator groups that include U.S. utilities. In this regard:

(a) Concentric admitted that the percentage of regulated versus unregulated revenues for several of the Ontario utilities it chose for their North American electric proxy group are 10-15% below what would be expected by an Ontario utility.[61] NextEra only has approximately 76.8% regulated revenue.[62]

(b) Similarly, many of the comparators chosen in Concentrics's U.S. electricity proxy group were utilities that have generation assets comprising of a significant portion of those utility's electrical assets, a feature that is not comparable to Ontario's electricity distributors and transmitters.[63] Concentric admitted during cross-examination that only 2 utilities in their U.S. electric proxy group, had no material or any generation assets comprising of the utility's electrical assets.[64]

[59] EB-2016-0152, Decision and Order, December 28, 2017, pp. 107,109.
[60] Alberta Utilities Commission, Determination of the Cost of Capital Parameters in 2024 and Beyond, October 9, 2023 at para. 104.
[61] EB-2024-0063, Oral Hearing Transcript, Volume 2, pp. 151-167.
[62] EB-2024-0063, Oral Hearing Transcript, Volume 2, p. 155.
[63] EB-2024-0063, Oral Hearing Transcript, Volume 2, pp. 156-157.
[64] EB-2024-0063, Oral Hearing Transcript, Volume 2, p.167.

(c) The types of generation owned by some of the US comparators is significantly different from any generation which occurs in Ontario. For instance, Duke Energy Corporation has a large generation fleet which includes 29% coal powered generation.[65] Ontario's power generation no longer includes coal as a fuel. As admitted by Concentric, coal powered generation has an added level of risk due to environmental legislation.[66]

(d) Concentric also admitted that it did not conduct any analysis on the comparability of Ontario utilities to the proxy group comparators in several dimensions of risks, including climate change and severe weather. Concentric admitted that:

i) Its report stated that risks such as climate change and severe weather were types of business risk, which had a "direct bearing on the utilities' cost of capital".[67]

ii) Concentric did not evaluate compare Ontario utilities to the proxy groups on dimensions of risk such as climate change and severe weather;[68]

iii) The proxy group members that have assets and operations on the west coast such as Pinnacle West Capital Corp and Northwest Nature Holding Company would have a higher risk of wildfires as compared to Ontario utilities;[69]

iv) Proxy group members that have assets or operations on the gulf coast such as NextEra Energy Corp, Duke Energy Corporation, and Southern Company have a higher risk of hurricane related damage;[70]

[65] EB-2024-0063, Oral Hearing Transcript, Volume 2 pp. 159-160.
[66] EB-2024-0063, Oral Hearing Transcript, Volume 2 p. 160.
[67] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.57.
[68] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.49.
[69] EB-2024-0063, Oral Hearing Transcript, Volume 2, p. 135; EB-2024-0063, Oral Hearing Transcript, Volume 3, p.50.
[70] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.51.

v) Proxy group members that have assets or operations on the coast, such as in Carolina or Florida have a higher risk of flooding due to climate change.[71]

68. Accordingly, there is no evidence that the proxy groups chosen by Concentric are sufficiently comparable to Ontario's regulated utilities that the Board should accept them without any adjustments made when comparing the allowed returns.

69. Nexus's report contains similar frailties with respect to their peer group selection. In this regard:

(a) Nexus did not have the most recent credit rating reports from the S&P, DBRS, and Moody's for their comparators prior to adding them in their proxy group, nor did they have any information regarding the breakdown of the annual revenue per industry segment.[72]

(b) Nexus admitted that they did not review or consider the regulatory frameworks available to the utilities that make up the operating companies they chose in their proxy group.[73]

(c) Nexus's proxy group includes entities such as Alaska Power and Telephone Company, which earns half of its revenue in the telecommunication industry. Nexus admitted that they are not aware of any Ontario utility that earns revenue through telecommunications.[74]

(d) Nexus also included Otter Tail Corporation in its proxy group, which earns most of their revenue in the manufacturing and plastic industry. Nexus admitted that it is not aware of a single Ontario utility that earns revenue in this way.[75]

[71] EB-2024-0063, Oral Hearing Transcript, Volume 3, p.51.
[72] EB-2024-0063, Oral Hearing Transcript, Volume 5, pp.12-13.
[73] EB-2024-0063, Oral Hearing Transcript, Volume 5, p.14.
[74] EB-2024-0063, Oral Hearing Transcript, Volume 5, pp.15-16.
[75] EB-2024-0063, Oral Hearing Transcript, Volume 5, pp.16-17.

(e) Nexus also included TransAlta, which does not operate in the electricity distribution business in its electric distribution proxy group. [76]

(f) Nexus included companies in their proxy group that recently filed for bankruptcy and whose credit ratings were below investment grade. Nexus admitted that they were unaware of any Ontario utility distributor filing for bankruptcy and having a below investment-grade credit rating.[77]

70. Independent evidence demonstrates that Ontario is different, and less risky than other jurisdictions. For instance, the ratings agency Fitch stated about Alectra:

> "Alectra's allowed ROE of 8.95 percent and equity capitalization of 40 percent are lower than the US averages. However, Fitch believes that they are sufficiently offset by OEB's track record of predictable regulatory support."[78]

71. Nexus conceded on cross examination that this view supported LEI's position about the relative comparability of Ontario to US jurisdictions rather than its own.[79]

72. Concentric gave evidence that:

> "[W]henever you have market data available that tells you what investors are thinking and that shows the actual decisions that they are making, I think its better to rely on that data than it is to rely on your judgment or some historical time period that may not reflect what's happening now in the current state of markets…"[80]

73. In this case, the Board does have the benefit of actual market data to determine whether or not it should apply its judgment and adjust the results of the proxy group when comparing it to Ontario utilities.

74. Betas measure the volatility or systemic risk of a security or a portfolio in comparison to the market average. A security (or group of securities) with a beta of 1.0 has volatility and risk that is the same as the market as a whole. A security (or group of securities) with a

[76] EB-2024-0063, Oral Hearing Transcript, Volume 5, p. 18.
[77] EB-2024-0063, Oral Hearing Transcript, Volume 5, pp.19-21.
[78] EB-2024-0063, Exhibit K5.1, p. 41.
[79] EB-2024-0063, Oral Hearing Transcript, Volume 5, pp.46-47.
[80] EB-2024-0063, Oral Hearing Transcript, Volume 4, p. 96.

beta of less than 1.0 have lower risk and volatility than the market as a whole. Conversely a security (or group of securities) that have a beta higher than 1.0 have greater risk or volatility than the market as a whole. The beta therefore is a direct measure of what the market thinks of a stock's volatility.

75. As set out in Dr. Cleary's report, Canadian utility betas have average somewhere between 0.2 and 0.4, and his view is that 0.35 is the best estimate.[81] In contrast, the U.S. utility betas have historically been around 0.61 (monthly) to 0.72 (weekly).[82] US utilities have historically been seen by the market as approximately twice as risky.

76. While more recently these numbers have converged, Dr. Cleary calculated that US utility betas are still 15% higher than Canadian utility betas for the 2017-2023 period.[83]

77. The market data is clear: US utilities are riskier than their Canadian counterpart. Accordingly, if the Board determines that it is appropriate to compare Ontario utilities to US utilities, CME submits that the Board should exercise "significant judgment" and adjust the ROE and/or the equity thickness downwards to achieve comparable returns between Ontario and United States utilities.

5.4 The Proper Approach to Calculating ROE (Issue 10)

78. It is not surprising, given the professional judgment required to determine a return that meets the fair return standard, that the experts in this case came to disparate conclusions about the return required to meet the fair return standard.

79. The experts recommended the following with respect to ROE:

    (a) Nexus applied the Capital Asset Pricing Model ("**CAPM**"), Discounted Cash Flow ("**DCF**") and Risk Premium methodologies to determine that the fair return on equity for Ontario's utilities should be 11.08%;[84]

[81] Dr. Cleary Report, p. 91.
[82] Dr. Cleary Report, p. 91.
[83] Dr. Cleary Report, p. 94.
[84] Nexus Report, p. 5.

(b) Concentric applied the CAPM, DSF and risk premium methodologies with respect to several proxy groups and averaged the result. Concentric determined that an ROE necessary to meet the fair return standard would be 10.0%;[85]

(c) LEI determined that the CAPM model was the best methodology to use, and found that the appropriate ROE to meet the fair return standard was 8.95% although it calculated an ROE using the other methods;[86] and

(d) Dr. Cleary conducted three cost of equity calculations, using the CAPM method, the DCF method, and the Bond Yield Plus Risk Premium Estimate method. Dr. Cleary found that the appropriate ROE that would meet the fair return standard was 7.05%.

80. CME has had the benefit of reviewing SEC's submissions on this issue and submits that SEC's proposal for a 7.58% ROE has significant merit, given the fact that it uses a better aligned proxy group, had corrected various inputs, is based on market data, and excluded the flotation costs from the ROE calculation.

81. Should the Board determine that a higher ROE is necessary, however, CME submits that the Board should make it no higher than the 8.95% recommended by LEI in its report.

82. CME's submissions on the merits of the various calculation methodologies are set out below.

5.4.1 DCF Analyses are Vulnerable to Methodological Issues

83. The DCF methodology discounts the future stream of income that a company is expected to generate, thereby reducing the future income to its present value.[87] The present value is determined with reference to two variables, the current dividend yield and the expected

[85] Concentric Report, p. 9.
[86] LEI Report, p. 16.
[87] LEI Report, p. 114.

long-run growth in the firm's earning power, as enumerated in the "earnings per share" metric.[88]

84. The DCF calculation is performed on a proxy group of companies to establish what the model indicates is the appropriate ROE for those proxy groups. The ROE for the proxy group is then compared to the ROE for the companies in question, which in this case, was Ontario's utilities, to determine whether the allowed ROE of the original companies is similar, above or below the model's ROE for the proxy group.

85. There are a number of frailties with the DCF calculation that have an impact on its results. In particular, the evidence demonstrates that DCF calculations overestimate the appropriate ROE for Ontario's utilities. In this regard:

(a) DCF calculations are conducted on a proxy group of companies. Accordingly, the results of the DCF calculation are directly impacted by the practitioner's choice of comparator companies. The DCF calculations conducted by LEI, Concentric and Nexus all include utilities from the United States. The evidence in this proceeding has indicated a significant number of ways in which the proxy companies chosen do not accurately model the characteristics and risks of Ontario utilities, which have been set out earlier in CME's submissions. As a result, the DCF calculations arrived at by LEI, Concentric and Nexus overstate the ROE necessary to meet the fair return standard.

(b) As set out by Dr. Cleary in his report, the DCF calculations can use average growth forecasts which are significantly higher than the future nominal GDP growth in Canada.[89] While it is not impossible that the utilities sector would grow at a higher rate than GDP, given that utilities are an extremely mature industry, CME submits that the likelihood of significantly higher growth is small. Dr. Cleary opines that the

[88] LEI Report, p. 114.
[89] Dr. Cleary Report, p. 30.

reason for this disconnect is that growth estimates are estimated by analysts with a vested interest in selling those utilities' securities.[90] As a result, there is an optimism bias which inappropriately inflates the expect growth thereby causing the results of the DCF model to be inappropriately high by an average of 2.84%.[91] This phenomenon has been the subject of academic literature, which bear out that there is a systemic optimism bias in these growth estimates.[92]

5.4.2 CAPM Calculations Are Also Vulnerable to Methodological Issues

86. The CAPM methodology attempts to derive the appropriate return on investment for an entity by calculating the risk-free rate of return (in other words, the return for an investment that is guaranteed and therefore has 0% risk) and adding the risk of the type of asset or entity plus the risk premium necessary for investors to invest in something that is not guaranteed. In so doing, the operator attempts to measure what the necessary return would be for an investor to invest in this particular entity instead of the risk-free asset or entity.

87. Much like the DCF methodology, the CAPM methodology has frailties depending on the data used to come up with the calculation. The evidence demonstrates that the calculations performed by many of the experts in the proceeding likely overestimate the necessary ROE as a result of these methodological issues. In this regard:

(a) Similar to the DCF calculation, the CAPM methodology also uses a proxy group to determine the "beta" or the risk of the industry more broadly. As set out above, the experts' choice of proxy groups has been shown to have significant deficiencies, as set out earlier in CME's submissions, which would overstate the requisite ROE for Ontario utilities.

[90] EB-2024-0063, Oral Hearing Transcript, Volume 6, p. 72.
[91] Dr. Cleary Report, pp. 30-31.
[92] Dr. Cleary Report, p. 30, Footnote 8.

(b) Additionally, the operator of the CAPM methodology must determine whether or not it will use raw or adjusted betas. As outlined, the beta is the relative riskiness of the entity when compared to the market. An adjusted beta is a beta that has been subject to an adjustment by the operator to make the beta conform with the belief that all entities' risk will revert towards the mean (1.0 beta value) over the long run.[93] As set out by Dr. Cleary, this hypothesis has not been born out in the evidence with respect to utility stocks, which have historically remained below the average of 1.0 beta value for many years.[94] Accordingly, the use of adjusted betas for the CAPM calculation for utility stocks simply biases the ROE results upwards.

(c) With respect to the market return premium, CME submits that Dr. Cleary has provided cogent evidence indicating that the expected market return (less the risk-free rate) is significantly lower than those estimated by other experts. Dr. Cleary found that the forecast nominal rate of return for Canada was between 4-7.2% (average 6.1%) and 5.4-7.4% (average 6.84%) for the United States.[95] When inflation is removed this leaves a 4.1% real growth rate in Canada and 4.84% real growth rate for the United States. This figure is below the historical real growth rate by approximately 1.5%. The use of historical results alone therefore overestimates the likely growth rate for mature economies like Canada in the coming years.

5.4.3 Dr. Cleary's Risk Premium Approach Should be Preferred

88. The risk premium approach attempts to estimate the appropriate ROE by calculating the yield of a determined class of bonds (or other asset) and adding a risk premium that would be required to compensate equity investors for the greater risk that they take when investing to that of debt holders.[96]

[93] Dr. Cleary Report, p. 37.
[94] Dr. Cleary Report, pp. 136-137.
[95] Dr. Cleary Report, p. 82.
[96] Concentric Report, p. 74.

89. As set out by Concentric in its report, the risk premium must be estimated.[97] Different practitioners use a number of different methods to estimate the risk premium, including both forward-looking and backward-looking data, as well data measuring different aspects of an entity. Accordingly, the results of the risk premium model are heavily dependent on the practitioner's choice of reference data.

90. Concentric and Nexus both used data on the allowed returns of various utilities as inputs to their risk premium methodologies. The use of allowed returns is problematic and biases the results of their risk premium conclusions. In other words, because Concentric and Nexus used authorized returns in their risk premium calculations, their conclusion on the appropriate ROE is higher than it should be. In this regard:

(a) The use of allowed ROEs causes a problem of circularity. Allowed ROEs are by necessity the outcome of a regulatory process. If every regulatory process calculated its own allowed ROE with reference to the allowed ROEs that already exist, then the allowed ROEs would never decrease.[98]

(b) Second, the allowed ROEs are the product of a variety of factors, which may or may not have any bearing on the market-based risk of the entities being regulated. During cross-examination, Concentric admitted that the allowed ROEs in at least some other jurisdictions in its peer group were a product of other factors outside of the entities financial data.[99] Accordingly, embedded in Concentric and Nexus' conclusion about the risk premium ROE are policy and other factors which are entirely unrelated to the underlying financial and economic data.

[97] Concentric Report, p. 74.
[98] EB-2024-0063, Presentation Day Transcript, p. 14.
[99] EB-2024-0063, Oral Hearing Transcript, Volume 2, p. 178,

91. Dr. Cleary's approach also has the benefit of using A-rated utility bond yields from the utilities themselves as the basis of the risk premium calculation, rather than either the risk free rate of return, US Government Yields, or US Bond Yields.[100]

92. CME submits that it makes intuitive sense when determining what the risk premium should be that the calculation should use the bond yields on A-rated Canadian utilities to determine the return on equity for the typical Ontario utility. Dr. Cleary has demonstrated that this approach to risk premium calculation is widely used by financial analysts and CFOs, such that it should be uncontroversial that it is a valid and appropriate methodology for the Board to employ in its ROE considerations.

5.4.4 The Board Should Set the ROE to 7.58% but No Higher than 8.95%

93. As set out earlier in these submissions, CME has reviewed SEC's submissions with respect to the appropriate ROE, and agrees that it should be carefully considered by the Board as it is reasonable and well supported by the evidence.

94. Although it is unnecessary for CME to duplicate the work completed by SEC in this respect, SEC's view that an ROE of 7.58% was derived from an average of several different methodologies with reasonable adjustments based on the evidence in this proceeding, including correcting for many of the deficiencies outlined in these submissions.

95. Should the Board determine that a higher ROE than what SEC has suggested is warranted, CME submits that it should be no higher than the 8.95% determined by LEI. While LEI's methodology suffers from some of the frailties outlined in these submissions, CME submits that it is less impacted than the analyses of Nexus or Concentric by these methodological issues, and therefore its conclusion should be preferred.

[100] EB-2024-0063, Presentation Day Transcript, pp. 96-97.

5.5 The Board Should Review the Perspectives of Both Debt and Equity Investors (Issue 11)

96. CME submits that the perspective of both debt and equity investor are valuable in setting the costs of capital parameters. The Board's current practice takes both perspectives into account and therefore it does not need to be altered.

97. CME agrees with LEI that the Board's current methodology considers equity investor perspectives as a result of using the fair return standard.[101] The fair return standard expressly requires the Board to set ROE sufficient:

(a) to be comparable to the returns an investor could get in the market from firms of like risk;

(b) for the utility to attract capital at reasonable rates; and

(c) for the utility to maintain its financial integrity.

98. Accordingly, investor perspectives are adequately canvassed in the Board's existing methodology.

99. The Board also considers the perspective of debt investors. Both the original and Updated DLTDR and the DSTDR methodologies consider the utilities' credit profiles as determined by credit ratings agencies.[102]

100. Moreover, As LEI notes, the OEB is also among the few North American regulators to annually update the cost of capital parameters to ensure they align with the current macroeconomic environment.[103]

101. Accordingly, CME submits that no change to the Board's existing methodology is required.

5.6 Equity Thickness Should Be Unchanged or Reduced (Issue 12)

[101] LEI Report, 127.
[102] LEI Report, p. 127; Dr. Cleary Report p.48.
[103] LEI Report, p. 127.

102. In addition to the allowed rate of return on equity, total return is a function of the equity thickness, which represents the proportion of financing that the Board calculates as being from equity. It is therefore the pool of financing which is eligible to earn a return on equity.

103. The experts had significantly varying opinions on the appropriate capital structures for the various entities that the Board regulates. In this regard:

(a) Nexus did not propose changes with respect to the capital structure, but instead calculated its proposed ROE on the basis of the status quo capital structure for electricity distributors;[104]

(b) Concentric proposed that the equity thickness for Ontario's utilities should be increased to 45%, regardless of their previous level.[105] Concentric also recommended that OPG should be allowed to make a separate application for a higher equity thickness;

(c) LEI found that there was no changes needed to the status quo for equity thickness;[106] and

(d) Dr. Cleary made findings with respect to specific utilities' capital structure, including recommending that EGI's equity thickness be reduced back to 36% in line with his evidence in EB-2022-0200, and that Hydro One's equity thickness be reduced to 38% immediately, with a further potential reduction to 36% in the next 2-3 years.

104. Concentrics's recommendation to increase the equity thickness for all Ontario utilities to 45% is unsupported by the evidence and should be rejected by the Board. In this regard:

(a) Concentric opined for that climate change was an issue that was taken into account by ratings agencies. Concentric cited the ratings agency S&P and stated that it had downgraded only two investor-owned utilities from 2005 to 2017, but

[104] Nexus Report, p. 84.
[105] EB-2024-0063, Oral Hearing Transcript, Volume 2, p. 126
[106] LEI Report, p. 140.

downgraded 19 utilities from 2018-2023.[107] However, Concentric admitted that in its review of downgrades since 2005, no *Ontario* utility was ever downgraded due to climate risk.[108]

(b) Concentric opined that the energy transition increased risk for both natural gas utilities as well as electricity utilities.[109] However, Concentric failed to adequately explain the interplay between the fact that customers may be leaving the natural gas system as a risk for natural gas distributors, but that there would be no corresponding decrease in risk for electricity distributors who would now have additional customers and load on the system.

(c) Concentric opined on the risks faced by OPG, including capital investments made on new technologies.[110] However, Concentric failed to grapple with how those risks interact with OPG's unique regulatory assurances of recovery. For instance, the Board determined in EB-2016-0152 that OPG's regulatory certainty was an important factor in determining its cost of capital:

> "However, in OPG's specific circumstances, there are a number of factors that substantially mitigate that risk. These include the various protections provided by O. Reg. 53/05 and the variance and deferral accounts that allow OPG the opportunity to recover substantially all their unexpected or unforeseen costs."[111]

105. Concentric compared the capital structure of Ontario's utilities to its chosen proxy groups. As outlined above, Concentric's proxy groups have significant operational and risk related differences from Ontario's utilities. Accordingly, the Board should not accept a simple comparison of capital structures between Ontario utilities and Concentric's proxy groups without a significant adjustment. For instance, as demonstrated in Concentric's own evidence, Ontario utilities' equity thickness has been consistent with that of other

[107] Concentric Report, p. 113.
[108] Exhibit N-M2-11-CME-9, pp. 1-2.
[109] Concentric Report, p. 23.
[110] Concentric Report, p. 118.
[111] EB-2016-0152, Decision and Order, December 28, 2017, p. 104.

Canadian utilities but have been below the equity thickness for US utilities by 10-15 percent for the past 15 years.[112]

106. Despite the long-standing differential in capital structures, Ontario utilities have never had difficulty raising capital on reasonable terms and have maintained strong balance sheets and stable credit metrics.

107. Accordingly, CME submits that there is no evidence that the capital structure needs to be increased to 45% as proposed by Concentric. The Board should instead review the different categories of utility and determine whether or not the equity thickness can be lowered based on the evidence tendered for each category. CME sets out its submissions on the appropriate capital structure for each category of regulated utility below.

5.6.1 Enbridge Just Had Its Cost of Capital Set Last Year

108. The Board considered EGI's capital structure as part of EB-2022-0200. In that case, the Board was presented with a full evidentiary record, which included detailed facts and analysis specific to EGI's specific risk factors, financial metrics, and changes to the regulatory and policy landscape which had occurred since its past rebasing application.

109. In that proceeding, Concentric opined that EGI's capital structure (with the related existing ROE below Concentric's current recommendation) should be 42%.[113] In this proceeding, not even twelve months later, Concentric's recommendation for EGI has increased to 45%.[114] Concentric has failed to provide a cogent rationale for why EGI's level of risk has increased at all, much less why it has changed so dramatically as to warrant an additional 3% equity thickness.

110. However, more importantly, the Board determined that EGI's equity thickness should be increased from 36% to 38%. In its decision released in late December 2023, the Board found that:

[112] Concentric Report, pp. 134-135.
[113] EB-2022-0200, Decision and Order, December 21, 2023, p.62.
[114] EB-2024-0063, Oral Hearing Transcript, Volume 2, p. 128.

> "Considering both a decrease in business risk due to amalgamation, and an increase in business risk due to the energy transition, which is partially mitigated by this Decision and Order, the OEB concludes that there is a net increase in business risk that justifies a modest increase in the deemed equity thickness. The OEB is persuaded by the analysis of LEI and its recommended 38% equity thickness. Enbridge Gas has not met the onus to establish that its ultimate requested increase to 42% is reasonable."[115]

111. The Board was also critical of the fact that EGI's evidence was that the impact of the energy transition would be small in the foreseeable future, and it failed to conduct any sort of risk analysis that might justify a further increase of its equity thickness from 38%. Accordingly, the Board ordered that EGI should conduct various analyses and return with better evidence of the risk that it might face.[116]

112. EGI has not yet conducted any of that analysis. The Board has not yet had the benefit of reviewing a more robust review of any risks that EGI may face. When asked in an interrogatory what has changed in EGI's level of risk since EB-2022-0200, Concentric responded that it "considered" energy transition activities across North America and included new evidence such as an S&P report from 2024 about EGI's credit outlook.[117]

113. As set out above, Concentric's "consideration" of energy transition activities was no different than the one it provided in EB-2022-0200, and in fact lacked the same level of specificity as it was completed for a generic proceeding rather than simply for EGI, a fact which Concentric itself admitted.[118] Moreover, the S&P report cited by Concentric also stated:

> "We continue to assess EGI's business risk profile as excellent. This reflects the low-risk nature of the company's business, effective regulatory risk management, and large size that is partially offset by its limited regulatory diversity. Our view of

[115] EB-2022-0200, Decision and Order, December 21, 2023, p. 68.
[116] EB-2022-0200, Decision and Order, December 21, 2023, pp. 67-68.
[117] EB-2024-0063, Exhibit N-M2-10-CME-12 p. 1.
[118] Concentric Report, p. 107.

> OEB's regulatory framework, which we believe to be transparent, consistent, and predictable, underpins EGI's steady and consistent cash flow. Largely, we believe that regulatory support remains credit supportive, given the approval of 2024 rates and the increase of equity thickness to 38% from 36%. EGI's regulatory construct includes timely recovery of commodity costs, prudently spent capital, and operating expenses."[119]

114. Accordingly, CME agrees with Dr. Cleary that nothing changed since the Board released its 2023 EGI Decision. There is no basis upon which the Board should increase EGI's equity thickness at all, much less the 7% suggested by Concentric.[120]

115. While CME also agrees with Dr. Cleary's recommendation that EGI's equity thickness should be reduced to 36%,[121] CME acknowledges that the Board determined that an increase to 38% in EB-2022-0200 was warranted. Accordingly, CME submits that the Board should retain EGI's 38% equity thickness.

5.6.2 OPG Should Separately Apply for Its Equity Thickness

116. OPG's equity thickness is currently set to 45%. In past cost of capital decisions, the Board has found that it can be difficult to adequately compare OPG to other utilities without the significant use of additional judgment.[122]

117. Concentric opined in this proceeding that OPG has "unique characteristics" including the fact that its regulated assets are almost all generating assets.[123] Accordingly, Concentric found that it was not possible to find comparator companies that perfectly aligned with OPG from a risk perspective.

118. CME submits that a generic proceeding is not the appropriate venue to determine OPG's equity thickness, given its unique operating profile. CME agrees with Concentric's

[119] S&P Global, Enbridge Gas Inc. 'A-' Rating Affirmed; Outlook Remains Negative, June 28, 2024, https://disclosure.spglobal.com/ratings/pt/regulatory/article/-/view/type/HTML/id/3205179
[120] EB-2024-0063, Oral Hearing Transcript, Volume 5, p.175.
[121] Dr. Cleary Report, p. 115.
[122] EB-2016-0152, Decision and Order, December 28, 2017, pp. 107-109.
[123] Concentric Report, p. 136.

suggestion that OPG should retain its current equity thickness at 45%.[124] OPG can bring forward any proposed changes to its equity thickness and fulsome supporting evidence during its next rebasing application.

5.6.3 Hydro One's Equity Thickness Should be Lowered

119. In his report, Dr. Cleary provides cogent evidence regarding why Hydro One's equity thickness should be lowered from its current 40% to at least 38% percent, with a possible reduction to 36% in 2-3 years. Dr. Cleary opined that the following factors, *inter alia*, militate for a lower equity thickness:[125]

(a) Hydro One's credit ratings have listed Hydro One as possessing excellent business risk and very low industry risk. Hydro One has maintained or upgraded its excellent credit ratings over the past 10 years;

(b) Hydro One operates in a well defined and economically prosperous region, with excellent regulatory support;

(c) Hydro One has extensive operating territory, including owning 95% of Ontario's transmission infrastructure;

(d) Ratings agencies found that Hydro One business had high barriers to entry, insulating it from pure-play competitive market challenges; and

(e) Hydro One has been able to over-earn its allowed ROE consistently since 2018 for both its distribution and transmission businesses.

120. CME agrees with Dr. Cleary's analysis and submits that the Board should reduce Hydro One's equity thickness to 38%. Upon its next rebasing application, the Board can then determine whether an additional reduction to 36% is warranted.

5.6.4 Electricity Distributors (Other than Hydro One Distribution)

[124] Concentric Report, p. 137.
[125] Dr. Cleary Report, pp. 116-121.

121. CME has had the benefit of reviewing SEC's submissions on this topic. CME agrees that electricity distributors have not had their capital structure reviewed for a significant period, and that the Board could likely lower electricity distributors' equity thickness without breaching the fair return standard based on the evidence that is already on the record in this proceeding.

122. CME also agrees that the Board should conduct a second phase of this proceeding if it determines that it requires more information in order to make a finding about the appropriate equity thickness for electricity distributors.

5.7 The OEB Should Take the Same Approach to Single or Multi-Asset Transmitters (Issue 13)

123. In their 2009 decision, the Board stated that the capital structures of transmitters will be determined on a case-by-case basis,[126] but has allowed a 40% equity thickness for all electricity transmitters since 2006, regardless of whether they are a single asset or multiple asset transmitter.

124. CME submits that the Board should not differentiate between single or multi-asset transmitters simply on that basis. However, the Board should set the capital parameters and cost of capital for specific transmitters differently where they materially depart from their peers with respect to business or financial risk.

6.0 MECHANICS OF IMPLEMENTATION (ISSUES 14-19)

6.1 Monitoring Mechanism to Test the Reasonableness of the Cost of Capital Methodology (Issue 14)

125. The OEB engages in a regular monitoring process that includes reviewing internal quarterly reports that it has prepared for internal review purposes and are not shared with the public. Together, the quarterly reports serve as a tool for OEB staff to monitor the

[126] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p.50.

reasonableness of the cost of capital parameters on an ongoing basis and ensure that the parameters continue to be aligned with prevailing macroeconomic trends.[127]

126. CME submits that the Board's current practice of continuous monitoring through the review of quarterly reports should be retained. In this regard, CME notes that the Board's current practice exceeds the monitoring done in all but one of the four jurisdiction surveyed by LEI in their report.[128]

127. CME finds merit in the submission of some experts that the Board could consider making the quarterly report public.[129] The Board has included transparency as one of its key values.[130] Transparent regulation helps all stakeholders, whether utility or ratepayer, understand the regulatory process and its outcomes. As a result, CME submits that the Board should consider whether it can make the quarterly reports public.

6.2 The Board Should Review Its Cost of Capital Policy Every 5 Years (Issue 17)

128. In its 2009 *Report of the Board* the Board determined that conducting a cost of capital policy review every five years provided an appropriate balance between the need to ensure that the formula results meet the fair return standard and maintaining regulatory efficiency and transparency. CME submits that the Board should maintain its current practice.

129. While some experts have opined that an interval as short as three years would be appropriate,[131] CME submits that this would unduly impact regulatory efficiency. For most of the utilities that the Board regulates, it does so using incentive ratemaking. The ratemaking period for these utilities are often up to five years long.

130. A three year cycle for cost of capital reviews[132] would mean that it would be possible for a utility to have its cost of capital set multiple times during an incentive ratemaking period.

[127] LEI Report, p.145.
[128] Dr. Cleary Report, p.51.
[129] Nexus Report, p.85; Concentric Report, p. 143.
[130] Ontario Energy Board, Mission and Mandate, https://www.oeb.ca/about-oeb/mission-and-mandate
[131] Nexus Report, p. 87; Cleary Report, p. 12.
[132] If coupled with Concentric's proposal to have updates implemented in the subsequent year after decision.

131. The time and cost of cost of capital reviews, couple with the potentially quick cadence of changes for utility cost of capital parameters would be both inefficient and potentially lead to customer confusion, especially when increases and decreases to the bill would not be matched by corresponding changes in service level or commodity cost.

132. Accordingly, CME submits that a five year cadence better aligns with the Board's regulatory calendar, and would offer significantly better regulatory efficiency without an appreciable increase in the ability for utilities' cost of capital to meet the fair return standard.

133. In terms of triggers mechanisms, CME apprehends that all experts are either in agreement that the trigger mechanisms and procedures that are currently available to utilities are appropriate and should be maintained or have taken no position on the issue (Nexus).[133] In the absence of any evidence demonstrating that the OEB's current trigger mechanisms are problematic, CME submits that the Board should retain the status quo.

6.3 The Board Should Implement Changes on Rebasing (Issue 18)

134. CME submit that the OEB should continue to implement changes in the cost of capital parameters and capital structures upon rebasing. The Board's current practice is consistent with the objectives of promoting predictability and stability and satisfies the fair return standard according to the reports prepared by LEI and Dr. Cleary.[134]

135. Concentric have raised concerns with the OEB's current practice and recommend that changes to cost of capital parameters should take effect for all utilities in the rate year following the OEB's decision in this proceeding.[135] Their concern relates to the fact Ontario utilities operate under rate programs with durations extending for up to 5 years or longer, and should the Board wait until rebasing before updating costs of capital parameters and/

[133] LEI Report, p.158; Concentric Report, p.147-148; Dr. Cleary Report, p.53.
[134] LEI Report, p. 160; Dr. Cleary Report, p. 54-55.
[135] Concentric Report, p.148.

or capital structures, this could create delays in implementing changes that would be necessary to meet the fair return standard.[136]

136. CME submit that Concentric's concerns are overstated as they have not demonstrated any evidence or provided any examples where the Board was unable to implement cost of capital and capital structures changes when needed to ensure that utilities are meeting the fair return standard. CME agrees with LEI that the Board ought to transition from the status quo only when associated benefits are material.[137] There is little merit in modifying aspects of the Board's practice that have worked well, and there is no evidence in Concentric's report that supports departing from the status quo.

137. Moreover, Concentric's concerns about a delay in implementing necessary cost of capital parameters and/or capital structures are addressed by LEI's recommendation that an option be introduced for parties to request implementation of such changes prior to rebasing, if the two-factor test is met.[138] CME agrees with Dr. Cleary that this approach seems reasonable.[139]

138. With respect to the review of the utility's capital structure, CME submits that the OEB can continue to review a utility's capital structure when there is a significant change in business/financial risks, and upon application by the utility or other participants.

7.0 OTHER ISSUES (ISSUES 20-22)

7.1 Prescribed Interest Rates (Issue #20)

139. Currently, the Board provides that different interest rates will apply to different categories of balances. With respect to variance and deferral accounts, the Board previously determined that the prescribed interest rate was the 3-month banker's acceptance rate plus a fixed spread of 25 basis points.[140]

[136] Concentric Report, p.148-149.
[137] LEI Report, p. 12.
[138] LEI Report, pp. 162-163.
[139] Dr. Cleary Report, p.55.
[140] LEI Report, p. 164.

140. With respect to construction work in progress ("**CWIP**"), the Board determined that the prescribed interest rate was equal to the FTSE Canada Mid Term Bond Index All Corporate Yield. The rate applied to all CWIP regardless of the length of the construction period.

141. In its report, LEI proposed to change the prescribed interest rates for DVAs. As set out previously, banks no longer provide a 3-month banker's acceptance rate.[141] It is no longer possible for the Board to calculate a prescribe interest rate on that basis. As a result, LEI proposed to use an interest rate calculated in a similar manner to the Updated DSTDR, whereby the Board would consider the average of 3-month CORRA future rates for the next 12-month period, and the spread for R1-Low rated utilities using a sample of banks.[142]

142. CME agrees that the prescribed interest rate for DVAs should be aligned with the Updated DSTDR and submits that LEI's proposal in this regard is appropriate.

143. LEI also proposed that the Board continue its current practice of using the FTSE Canada Mid Term Bond Index All Corporate yield for all construction projects, regardless of duration.[143] This proposal was supported by Dr. Cleary.[144]

144. Concentric disagreed with LEI's proposal. Concentric opined that the utility should be allowed to charge its weighted average cost of capital ("**WACC**") to construction projects, regardless of their length.

145. However, Concentric's proposal is problematic for a number of reasons. In this regard:

    (a) The Board has previously used the "used and useful" test when determining when assets should be added to rate base, and therefore when a utility is allowed to begin earning an equity return on those assets.[145] In other words, it is only once an asset is in service that ratepayers are required to pay the equity premium on a

[141] LEI Report, p. 165.
[142] LEI Report, p. 168.
[143] LEI Report, p. 168.
[144] Dr. Cleary Report, p. 56.
[145] For instance, see EB-2020-0290, Decision and Order, November 15, 2021, p. 50.

capital asset. However, under Concentric's approach, ratepayers will be paying the WACC, which includes an equity component, on assets that are not yet in service, thereby breaching the "used and useful" test;

(b) Many CWIP projects are completed within one year, meaning that many utilities use short term financing for CWIP. Allowing utilities to charge the WACC would therefore allow them to over recover the carrying cost of short-term financing and provide unwanted arbitrage opportunities.[146]

(c) It would decrease financing and regulatory efficiency for utilities that use IFRS as IFRS requires CWIP carrying charges using a debt-based rate.[147] As a result, allowing utilities to charge their WACC for the carrying cost of CWIP may require the use of two sets of books thereby increasing the administrative burden on the utility as well as the Board.

146. Accordingly, CME submits that the Board should accept LEI's proposal and maintain the status quo for CWIP carrying charges.

8.0 COSTS

147. CME requests that it be awarded 100% of its reasonably incurred costs in connection with this matter.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 7th day of November, 2024.

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[146] EB-2024-0063, Oral Hearing Transcript, Volume 4, pp. 87-88.
[147] EB-2024-0063, Oral Hearing Transcript, Volume 4, pp. 89-90.