IN THE MATTER OF a consultation by the Ontario Energy Board on the Cost of Capital for Electricity Distribution Companies.

FINAL WRITTEN COMMENTS
INDUSTRIAL GAS USERS ASSOCIATION (IGUA)

Scope and Implications of this Process

1. The genesis of this proceeding was indicated as specific concern regarding the contraction by May, 2009 of the spread between the return on equity (ROE) resulting from application of the Board's current cost of capital (COC) formula for electricity distributors and the deemed long term debt rate applicable to Ontario's electricity distributors. The Board's March 16, 2009 Notice commencing the first phase of this consultation stated:

> *The Board notes that the spread between the Return on Equity and the Long-Term Debt rate has declined to a spread of 39 basis points in 2009, from a spread of 247 basis points as of the comparable date in 2008. The Board also notes the deterioration in economic and financial market conditions during 2008 and 2009. Consequently, the Board is considering whether these circumstances warrant the Board exercising its discretion to adjust any or all of the values produced by the application of its established formulaic methodology.*

2. In May, 2009 the Board's concern was that the global financial crises, and its manifestation in Canadian financial markets, might have rendered the current COC determination formula no longer robust. With a return on equity (ROE) for capital invested so close to a long term debt rate thought to reflect relatively less risk, the concern was that the ROE determined by the Board's current COC formula no longer met the "fair return standard".

3. The "fair return standard" requires that the allowed utility ROE should;

   (a) Be comparable to the return available from the application of invested capital to other enterprises of like risk;

   (b) Enable the financial integrity of the regulated enterprise to be maintained; and

(c) Permit incremental capital to be attracted to the enterprise on reasonable terms and conditions.

4. Following consideration of comments in response to the initiating notice, the Board determined that there was no immediate need to adjust the results of the current COC formula. In its June 18, 2009 Notice herein, the Board stated:

> *The Board is not persuaded that there is sufficient basis to vary, in a timely manner, the 2009 parameter values for 2009 rates. Nevertheless, the Board is satisfied that further examination of its policy regarding the cost of capital is warranted to ensure that, on a going forward basis, changing economic and financial conditions are accommodated if required.*

5. The Board thus continued this consultation process, through a Stakeholder Conference and an invitation for written submissions, in order to examine whether the Board's current approach to determining COC accommodates changing economic and financial conditions, as evidenced by the state of financial markets during 2008 and 2009[1].

6. In his opening remarks to the Stakeholder Conference the Chair reassured that *"there will be no sudden lurches in regulatory direction as a result of this consultation"*.[2] The Chair went on to underscore the importance of regulatory policy stability in this area:

> *.... we are committed to a careful approach because the capital markets expect that; they expect stability and continuity from its regulators, and so do consumers.*

7. An approach to setting COC that is based on long-term financial indicators (in this case, 30 year government of Canada bond yields and historical equity risk premium data spanning a number of business cycles) also commends avoiding sudden changes in regulatory policy to address immediate market conditions.

8. The long-term debt rate/ROE spread collapse that drove the Board's concerns and prompted this review in the first place has now largely reversed itself. The quick passage of this anomaly is yet another indicator of the wisdom of avoiding sudden changes in regulatory policy in this area.

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[1] September 21, 2009 Transcript, page 5, lines 25 to 28.
[2] September 21, 2009 Transcript, page 8, lines 3 to 5.

9. The resolution of that anomaly, however, does not of itself indicate that we are out of the fiscal crisis woods, nor that there have not been any longer term changes in financial market fundamentals. IGUA understands the current phase of this consultation to be intended to gather information on whether there have been fundamental financial market changes that commend reconsideration of aspects of the Board's current COC formula.

10. The Board last examined, comprehensively, its formulaic approach to determining COC in 2006, in preparation for implementation of its guidelines for 2nd generation electricity distribution rate setting in the first half of 2007. At that time, following a full consultation and consideration, the Board confirmed its current formula based approach to determining, and adjusting, COC. The current approach, so confirmed, has been applied to Ontario's gas distributors since 1997.

11. While the title of this proceeding relates the review of Cost of Capital for electricity distributors, the Board has indicated[3] that the results of this review may be applicable to other rate-regulated sectors. Enbridge Gas Distribution (EGD) and Union Gas Limited (Union) participated very actively in this process.

12. The Board's current COC approach relies on the derivation and application of an "equity risk premium" to a benchmark "risk free" debt rate to determine ROE, and then adjustment of the resulting ROE from year to year in accord with changes to the underlying "risk free" debt rate. This basic approach is referred to as the "equity risk premium" (or "ERP") approach.

13. Further to the Board's stated intention not to "lurch" in respect of its policy for setting COC, in setting out the issues for this second phase of the review process[4] the Board started with a conclusion. The Board's conclusion is that an ERP approach remains the most appropriate approach to determining cost of capital and that such an approach continues to meet the "fair return standard".

14. IGUA expects that the outcome of this consultation will be a refreshed Board policy, indicating whether any changes are required to the Board's current ERP methodology in

[3] August 20, 2009 OEB Letter to Robert Warren, paragraph 4.
[4] Attachment B to OEB letter to parties dated July 30, 2009, paragraph 3.

response to any changes in financial market conditions since the Board's last comprehensive review of its COC methodology in 2006.

15. IGUA appreciates that the refreshed policy will not bind Board panels which hear rate applications and render rate orders. Rather the policy will provide guidance to: a) applicants, as to how to structure their rate proposals; and b) hearing panels, as to how to structure their review and determination of COC issues. IGUA also appreciates, however, that Board policy reflects the shared views of the Board, and is generally departed from by individual hearing panels only in the face of cogent evidence that such departure is advisable in order to maintain just and reasonable rates.

16. In respect of gas distribution rates, IGUA notes that Enbridge Gas Distribution Inc. (EGD) and Union Gas Limited (Union) are both in the middle of multi-year IRM plans. Under the settlement agreements for those plans, as accepted by the Board, the percentage rate of return on equity is fixed (in EGD's case at 8.39% and in Union's case at 8.54%), and is expressly <u>not</u> subject to adjustment during the term of the plan.

17. The settlement agreements do provide, however, that in the event that a proceeding is instituted before the Board during the IRM plan term and the Board determines that a change in its ROE methodology is appropriate, then any party to the settlement may apply to the Board for determination of whether or not that change should be applied to EGD or Union during the current term of their IRM plans. Any request to change the cost of capital included in revenue requirement for EGD or Union would require an order of the Board under section 36 of the *Ontario Energy Board Act, 1998* (*OEB Act*), following a hearing pursuant to section 21 of the *OEB Act*. Pursuant the settlement agreements for determining natural gas distribution rates through 2012, determination of whether any change in the Board's policy for determining COC can and should be applied to EGD or Union rates during the term of their respective IRMs would be an issue for determination in any such hearing.

Issues Considered

18. Having set out its conclusion that the ERP method remains a sound approach for setting COC, the Board has asked for further information and views focussed in three areas of inquiry related to recent changes in financial market and economic conditions:

(a) Whether the ERP formula should itself be adjusted to adapt to any such changes.

(b) Whether the current formulaic adjustment, year over year, of the cost of capital produced by the ERP formula, continues to yield reasonable results.

(c) When, and how, should the Board exercise discretion to adjust the results of application of the ERP formula, as adjusted year over year.

19. The balance of IGUA's comments are structured in reference to these three areas of inquiry.

20. Given the breadth and volume of information brought forward in this consultation, particularly on the part of, and on behalf of, Ontario's regulated distributors, and in light of the consultative, non-adversarial, approach of a Stakeholder Conference, IGUA addresses in these comments the more general "means" by which the Board currently establishes COC, rather than any particular detailed or numerical COC proposal. IGUA believes this approach to be consistent with the Board's intention for this consultation.[5]

21. IGUA suggests that should the Board conclude that any particular ERP establishment or adjustment parameter merits a change, a subsequent opportunity to consider and comment on the specific details of such change be provided to interested stakeholders.

Should the ERP formula itself be adjusted to adapt to changes in financial market and economic conditions since the time that the ERP formula was established.

22. IGUA considers this first area of inquiry - whether the ERP formula itself should be adjusted to adapt to changes in financial market and economic conditions - to relate to the formula used to establish the initial, or "base" ROE. (The approach to year over year adjustment of the ROE is addressed in the next section of these submissions.)

[5] September 21, 2009 Transcript, page 4, lines 14 to 18.

23. Under the ERP approach, the base ROE is established by:

(a) Assembling a forecast of 30 year Canada bond yields to indicate a risk free debt rate. (This is done by using a published 10 year Consensus Forecast, and then adding a spread between 10 and 30 year bond yields derived from the difference between the published 10 year forecast and the average yields on 30 year bonds indicated by bond trading prices over the preceding month.)

(b) Deriving a utility specific risk premium based on historical risk premium relative to interest rate analysis and any applicable judgemental adjustments.

(c) Adding the derived utility specific risk premium to the determined "risk free" debt rate to derive an ROE for rate making purposes.

24. The issues that have been raised in respect of this approach to establishing the base ROE include:

(a) Is the long Canada bond yield still a sound indicator of a risk free rate? Alternatives suggested include A rated corporate bonds and utility bonds.

(b) Is a re-examination of previously established risk premiums warranted?

25. In respect of the appropriate risk free rate indicator, IGUA submits that the long Canada bond yield remains an appropriate indicator, for all the reasons that initially commended it.[6] These reasons include:

(a) The indicator is transparent and easily accessible.

(b) The basis for the indicator is a consensus forecast, which means that the forecasts from a number of respected economists are averaged and the logical result is the balancing of divergent views and the consequent reduction of forecast risk.

(c) Long Canada bonds remain liquid, and remained liquid through the recent financial crises.[7] The Canadian government has an interest in actively maintaining the supply of these benchmark instruments. It has been commented that one of the reasons that the forecast yields of corporate A bonds escalated rapidly, to previously unseen highs, during the financial crises was the withdrawal of supply of these instruments from the market as a result of the collapse of a number of large market participants.[8] Long Canada bonds have not to date been subject to such liquidity anomalies. Consequently their use as an input provides a measure of stability over even extreme business cycles.

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[6] See generally the *1997 Guidelines*.
[7] See October 6, 2009 Transcript, page 89.
[8] Professor Booth's September 2009 paper, pages 28 and 29.

(d) Long Canada bonds remain largely risk free, backed as they are by the government of Canada. Even instruments previously considered low risk - A rated corporate bonds - have proven to be subject to perceptions of risk reflected in precipitously depressed purchase prices (and thus increased yields) during the recent financial crises. The fact that long Canada bonds remain largely risk free commends their use in accord with the conceptual basis of the ERP methodology (i.e. to start with a risk free rate and then add a utility specific risk premium).

26. It has been suggested that yields on Corporate A bonds would provide a good base for an ERP based ROE determination. While such an index is relatively transparent and accessible, recent financial market events have highlighted that even Corporate A bonds are susceptible to risk (certainly more so than long Canada bonds). When high credit rated corporations like Ford and General motors suffer financial insolvency, the risk associated with even A rated corporate bonds becomes starkly apparent. The events of the past year have confirmed that Canada bonds are materially less risky than A rated corporate bonds.

27. Further, a switch from yields on less risky long Canada bonds to even A rated corporate bonds would necessitate an adjustment of the equity risk premium, given that the risk associated with the base indicator would be higher than previously.

28. It has also been suggested that utility bonds might offer a comparably risk free indicator to that offered by long Canada bonds, and one that would instinctively better track utility risk relative to the market at large.

29. This consultation has not offered the degree of detailed testing and review required to form a conclusion on whether the relationship of utility bond yields to utility business risk is more robust than that between utility risk and long Canada bonds.

30. Further, it is not clear from the "record" in this consultation what utility bond indices are readily available, and whether the companies included in these indices offer an appropriate base rate for the purposes of an ERP approach to determining ROE. It has been noted that there are few publicly traded Canadian utilities, and that the traded instruments are generally those of diversified utility holding companies, which holding companies would generally have more risk than their regulated operations *per se*.

31. While the suggestion that utility bonds might provide a useful benchmark rate has some instinctive merit, IGUA submits that further, tested analysis would be required to conclude that utility bonds would represent a better risk free rate indicator for establishing regulated ROEs than the currently used long Canada bonds. As has been observed with A rated corporate bonds, the relative volatility of utility bonds should also be examined.

32. Given the conclusion that long Canada bonds continue to be an appropriate basis for deriving utility ROE, and given that there are cogent reasons why such an approach continues to be appropriate, IGUA questions whether further analysis regarding alternative benchmark rates is warranted at this time.

33. ***In conclusion on this point, IGUA submits that yields on long Canada bonds, as determined under the Board's current COC methodology, remain an appropriate proxy for a "risk free" rate to underpin an ERP derivation of ROE.***

34. In respect of whether re-examination of the previously established utility specific risk premiums is warranted, to IGUA's view this is really a question of whether utility risks at large have changed as a result of financial market circumstances of the past few years.

35. It has been suggested that there can be no question but that business, all business, has become riskier in the past few years as a result of the recent financial crises. To IGUA's view, however, this is <u>not</u> the case for Ontario's gas distributors.

36. It appears that during this period of financial crises investors have generally viewed utilities as the least risky of all available investments (save perhaps for government instruments). Many of the experts at the Stakeholder Conference acknowledged a "flight to quality" phenomenon, with utilities being perceived by investors as providing that quality and security of investment. Utility stocks have generally done over the last few years what they're supposed to do; they have held firm.[9]

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[9] September 21, 2009 Transcript, page 91, line 15 through page 92, line 14; October 6, 2009 Transcript, page 14, lines 18 through 24.

37. The materials provided to the Stakeholder Conference by Professor Booth illustrate this "flight to quality", in the form of recent successful utility financings[10] and the relatively robust performance of utility stocks through the financial crises[11].

38. Consideration of this "flight to quality" phenomenon indicates that the business of regulated utilities has generally been insulated from the precipitous risks facing many other businesses, both large and small, during the recent financial crises. Indeed, this is intuitive when one considers the nature of economic utility regulation, which conventionally guarantees that utility revenue will recover both utility costs and a profit margin from year to year. There are few, if any, other forms of business enterprise that can claim this sort of certainty, particularly in recently troubled times.

39. IGUA also notes that there was generally little distinction made between electricity and gas distribution utilities in discussions at the Stakeholder Conference. However, when such distinctions were made, the notion of increasing utility sector risks seemed focussed more on the electricity sector than the gas sector.[12] While IGUA is of the view that all Ontario distribution utilities operate under a regulatory framework that ameliorates much of their risk, to the extent that the risk premiums of utilities at large are reconsidered, the Ontario electricity distribution sector presents more of an issue for observers than does the Ontario natural gas distribution sector.

40. ***In conclusion on this point of whether the current risk premiums for Ontario's distribution utilities require adjustment in light of recent financial market and economic conditions, IGUA submits that there is no cogent indication on the record in this process to indicate that the business risk of Ontario utilities at large has changed as a result of the recent financial crises which prompted this review.***

41. IGUA notes that utilities are always able to bring forward an application for review if they feel that their particular business risk has changed in such a way that their current ROE no longer results in a "fair return".

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[10] Professor Booth's September 2009 paper, pages 32 through 34.
[11] Professor Booth's September 2009 paper, pages 35 through 38.
[12] See September 21, 2009 Transcript, page 63 line 20 through page 65 line 7.

Whether the current formulaic adjustment, year over year, of the cost of capital produced by the ERP formula, continues to yield reasonable results.

42. IGUA considers this second area of inquiry - whether the current formulaic adjustment, year over year, of the ROE continues to yield reasonable results - to relate primarily to the continued veracity of using changes in the long Canada bond yield, year over year, to adjust previously based and adjusted ROE.

43. Earlier in these comments IGUA has endorsed continued use of the long Canada bond yield as an input to determination of the ROE. The features of the long Canada bond yield earlier considered that commend its continued use in determining an initial ROE apply equally in commending its continued use as input into the year over year ROE adjustment.

44. In addition, there is an intrinsic logic to using the same parameter to adjust ROE as was used to set the ROE in the first place.

45. Some of the discussion at the Stakeholder Conference addressed the dynamic of decreasing long Canada bond yields in the face increases in other yields and, instinctively, in business risks. Continuing to use the long Canada bond yield as the input for ROE determination has resulted in utility ROEs that are trending down, precisely when one would think that all financial risks are going up.

46. IGUA has earlier commented on the observed "flight to quality" which has resulted in utility stocks and recent utility issuances performing well relative to most other financial instruments and indicators. It would appear that during a financial crises investors with capital to park are comfortable parking that capital in low risk utility companies. Even with ROEs that trend down, there is no indication that Canadian utilities have had any difficulty attracting capital or meeting financial integrity requirements. It is logical that in an environment of hyper-risk, the low risk presented by Ontario's regulated distribution business is even more attractive to investors seeking safe haven.

47. Proponents of a change to Ontario distributors' ROE have pointed to an observed divergence since 1997 between Ontario utility ROEs and U.S. utility ROEs as indicative that the approach to adjusting Ontario utility ROEs requires adjustment.[13]

48. IGUA would first observe that this proposition really doesn't address the question of what, if any, changes are appropriate considering financial market developments since 2006. The same arguments regarding U.S./Canadian ROE comparability have been previously considered, and rejected, by this Board.

49. In any event, IGUA understands that many of the U.S. regulated utility ROEs are negotiated, and others are set in proceedings that rely on a variety of economic techniques and judgements particular to the utility and/or the regulator in question. It is therefore a complex task to tease out why U.S. regulated returns have apparently gone in one direction (up) when Canadian regulated returns have apparently gone in the other (down). In IGUA's view, the conclusion that Canadian utility returns are out of step cannot be drawn from this sort of consideration.

50. First, distinction should be made between approved returns and realized returns. IGUA's impression is that while realized returns in the U.S. often fall short of approved returns, in Canada the opposite is true.

51. Further, there are a number of differences between Canada and the U.S. that should be considered when entertaining the notion that U.S. utility ROEs present valid comparators for Canadian utility ROEs. The differences include:

(a) **Different economies and different financial markets.** From banking system integrity through currency strength and to the extent of leverage underlying consumer and corporate credit arrangements, the recent financial crises has underscored some fundamental differences between the Canadian and U.S. economies. These differences encompass growth rates and timing, business cycle patterns and timing, inflation rates, and unemployment levels.

(b) **Different approaches to financial market regulation enforcement, if not frameworks.** Our Prime Minister is widely reported to have noted that despite similar financial market regulatory structures, the United States seems to have

[13] See, for example, September 8, 2009 Concentric Energy Advisors Inc. paper prepared for EGD, Figure 1 at page 19, and associated discussion.

taken a very different approach than Canada to implementation of financial market oversight.

(c) **Different structures and approaches to regulated energy utilities.** There are significant differences between utility regulation in Canada and the U.S., including:

(i) U.S. utilities have suffered stranded investment costs and financial insolvencies, while such has not been observed in Canada to date.

(ii) U.S. utilities often go some time between rate reviews, and rate reviews are often irregular and at the instance of the regulated entity, while in Canada utility rates are generally reset annually.

(iii) In the U.S., utility ROE is often set by negotiation or the application of various economic approaches, while in Ontario and elsewhere in Canada transparent, consistent and predictable COC formulas have been applied.

(iv) Deferral and variance accounts are widely available to Canadian regulated utilities, but it is not clear that the same is true in the U.S.

(v) Ontario's electricity distributors can apply under the OEB's policies for capital expenditure adjustments during the terms of their IRM plans, and it is not clear that the same is true in the U.S.

(vi) Canadian distribution utilities pass through changes in commodity costs, and the same is not universally true in the U.S.

(vii) Depreciation rates are different in Canada and the U.S.

These, and other, material differences in regulatory frameworks between Canada and the U.S., and perhaps amongst U.S. jurisdictions themselves, yield very different regulatory risks to Canadian and U.S. utilities. There is every indication that, in general, regulatory and associated business risks facing U.S. utilities are higher than those facing Canadian utilities.[14]

52. As already noted, Canadian utilities have in fact been able to successfully attract capital on favourable terms under the current Canadian COC frameworks.

53. In light of these observations, IGUA submits that review of whether Ontario ROEs continue, year over year, to meet the "fair return standard" is more usefully focussed on the principles of the ERP establishment and adjustment methodology, and its inputs, than

[14] See also remarks by Alexandra Zvarich, Sun Life Financial, September 21, 2009 Transcript, page 51, lines 10 *et seq.*, and Moody's Global Infrastructure Finance bulletin dated August 2009, *Regulated Electric and Gas Utilities*, filed herein October 29, 2009 under cover of letter from Peter Thompson.

on attempts to apply U.S. utility indicators in a very different Canadian fiscal, business and regulatory environment.

54. The Board should assume that Ontario's gas distributor owners would, and have, also considered these differences in allocating capital as between Canadian and U.S. jurisdictions.[15]

55. It appears that most economists do. Professor Booth refers in his September 2009 paper submitted to the Stakeholder Conference to a 2008 survey of finance professors around the world. The results presented illustrate an average risk premium suggested for the U.S. of 6.3%; 90 basis points higher than the average suggested for Canada.

56. ***It is IGUA's view that there is no compelling reason to change the year over year adjustment formula for utility ROEs.***

57. A secondary issue that arose during the Stakeholder Conference regarding the formula for year over year ROE adjustment was whether the current 0.75 coefficient applied to year over year changes in long Canada bond yields to determine any required year over year change in ROE remains the appropriate coefficient. A number of experts have suggested that a 0.5 coefficient would be more appropriate.

58. In the *1997 Guidelines* the Board discussed the establishment of this coefficient.[16] The Board stated that it was persuaded that the relationship between interest rates and equity risk premiums was non-linear. The Board considered the range of adjustment coefficients determined in other Canadian jurisdictions (which ranged from 0.5 to 1.0), and found that a 0.75 coefficient was just and reasonable, *"though admittedly somewhat arbitrary"*.

59. While IGUA has assumed, as stated at the outset of these comments, that determinations of a specific numerical nature would be made following more detailed examination in a subsequent process, based on the information put forward at the Stakeholder Conference IGUA sees some merit in further consideration of adjusting downwards to 0.5 the coefficient for application of changes in long Canada bond yields to ROE. Such an

[15] For all but a very few of Ontario's electricity distributor owners, allocation of capital between entities is not an issue.
[16] *1997 Guidelines*, page 31, bottom.

adjustment might address, in some measure, any remaining concerns that long Canada bond yields are influenced in part by factors exogenous to financial markets, such as federal fiscal policy.

When, and how, should the Board exercise discretion to adjust the results of application of the ERP formula, as adjusted year over year.

60. IGUA has expressed above the understanding that the impact of Board policy on COC is to guide applicants in how they file applications, and to guide individual hearing panels in how they apply their discretion to determine COC results that will achieve the "fair return standard" and thus just and reasonable rates.

61. IGUA has also noted, and endorsed, the Board's stated views that stability and predictability in regulation in general, and in COC determinations in particular, are important.[17] Shareholders and ratepayers share an interest in predictable and stable rates, and ratemaking policies.

62. While IGUA is of the view that the Board retains discretion to adjust COC parameters despite the application of its COC formula, IGUA observes that:

(a) The financial crises that drove initiation of this discussion has, at least for now, abated, and market indicators have returned to more instinctively normal levels.

(b) Ontario's electricity distributors who are (with few exceptions) funded through their municipal owners, do not have a "capital attraction" issue, nor do they have an internal (to their municipal owners) capital allocation issue.

(c) Ontario's two major gas distributors are under IRM plans that specify COC stability through 2012. (IGUA also observes that, to date, both EGD and Union have <u>over</u> earned under their IRM plans relative to Board approved COC).

63. There is thus no need for the Board to consider altering the outcome of its current COC formula for application to determination of distribution rates.

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[17] See also comments from the Capital Markets panel, September 21, 2009 Transcript, page 75, lines 23 to 28.

64. It was noted at the Stakeholder Conference that the Board's proposed policy to address potential barriers to energy infrastructure investment in Ontario, including through the application of ROE "incentives", is an appropriate way for the Board to exercise its discretion in the area of COC, in reference to specific investment requirements.[18]

65. Beyond this more targeted discretionary adjustment of ROE, while the Board retains discretion to adjust the otherwise mechanical outcome of its COC formula, it should exercise that discretion only in exceptional circumstances.

66. There has been discussion about whether economic fundamentals are shifting permanently, or whether the fiscal events of the last year and a half have been extreme, but in the end a part of a conventional business cycle.[19] It would be entirely reasonable for the Board to continue to monitor the fiscal situation, and its potential impact on the continued veracity of the Board's COC formula, in the coming months and years.

67. ***IGUA suggests that a discretionary and reasoned adjustment to address extreme and anomalous circumstances would be a better solution, from a regulatory policy perspective, than a "lurch" (to use the Chair's words) to a new policy in response to what might be a situation of limited duration.***

68. It has been argued above that it is unnecessary, and IGUA would further suggest that it would be harmful, to abruptly adjust the Board's long-standing COC policy at this time.

Conclusion

69. COC is a controversial topic in utility regulation. There are a number of reasons for this, including:

(a) Debate about ROE, unlike debates about O&M or capital cost recovery, are about the utility bottom line. The issue when it comes to ROE is not about whether utilities are recovering their costs, which is an empirical question, rather it is about how much utility shareholders should be entitled to earn, which is more of a normative question.

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[18] September 22, 2009 Transcript, page 121, lines 13 to 24.
[19] For example, September 21, 2009 transcript, page 73 *et seq.*; [*reference Booth comments*]

(b) ROE compensates for risk, and utilities are shielded from risk by regulation. In Canada, regulated distribution utilities, and by extension their shareholders, are largely shielded from risk. The conventional notion that equity investors bear significantly greater risk than lenders is controversial when it comes to Canadian utilities.

(c) COC is a significant component of a regulated utility's revenue requirement. Further, returns attract tax, also recovered from ratepayers, magnifying the implications of changes to ROE for ratepayers.

70. While these issues have been, and continue to be, controversial, IGUA commends the Board for providing an opportunity for stakeholders with varying views on the issues to come together and exchange and explore those views in a transparent and accessible forum. Utility regulation in Ontario benefits from this approach to tough, even contentious, issues.

71. As Matthew Akman of Macquarie noted in his remarks to the Stakeholder Conference[20], the utility business is a long-cycle business, with investment decision making and implementation taking a long time. Stability, for utility investors, is key, and changes to regulatory policy in response to sudden, and perhaps passing, market environment changes is not helpful.

72. IGUA commends continuation of the Board's current approach to COC which has, and continues to, produce results in accord with the "fair return standard". All external indications regarding Ontario's distribution utilities indicate that capital is being committed, earnings are commensurate with limited risk, and financial integrity is being maintained.

73. Other regulatory practices, such as policies to remove barriers to infrastructure investment and capital recovery modules for electricity distribution infrastructure investment are available to address any utility specific, extraordinary capital requirements.

74. Ontario's gas distributors continue to earn (and generally over earn) their required returns.

[20] September 21, 2009 transcript, page 75, lines 19 *et seq.*

75. Despite financial market developments since 2006, and perhaps because of them, Ontario distribution utilities remain low risk ventures. The COC formula currently in use by the Board continues to yield results that enable attraction and retention of capital.

ALL OF WHICH IS RESPECTFULLY SUBMITTED:
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