VIA RESS and EMAIL

August 2, 2024

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Nancy Marconi:

Re: Ontario Energy Board – Cost of Capital Review
Exhibit M4 – Dr. Sean Cleary (Cleary) Evidence
Consumers Council of Canada (CCC) Interrogatories
OEB File No. EB-2024-0063

In accordance with Procedural Order No. 1, dated March 28, 2024, please find attached CCC's interrogatories with respect to Exhibit M4 (Cleary Evidence).

Yours truly,

Lawrie Gluck

Lawrie Gluck
Consultant for the Consumers Council of Canada

cc: All parties in EB-2024-0063

Ontario Energy Board Generic Proceeding

Cost of Capital Review

Exhibit M4 – Dr. Sean Cleary Evidence

Consumers Council of Canada

Interrogatories

August 2, 2024

M4-CCC-1
Ref: Ex. M4/p. 18
Ex. M2/p. 137

a) Please provide your view on Concentric's recommended increase to equity thickness for all Ontario utilities to a minimum of 45% as part of the current generic proceeding.

b) If the OEB is inclined to make changes to the equity thickness for Ontario LDCs in the current proceeding (e.g., due to the large number of LDCs and the potential inefficiency in addressing equity thickness in each rebasing), please provide your directional view on whether the equity thickness for LDCs should increase or decrease.

M4-CCC-2
Ref: Ex. M4/pp. 29, 35

a) With respect to the determination of ROE based on the DCF and CAPM methodologies, if the OEB is inclined to include US utilities in the peer group, do you have any suggestions on how that can be operationalized in a manner that recognizes the significantly lower risk of Canadian utilities? For example, can weightings towards Canadian utilities or incremental adjustments to betas be applied in the DCF and CAPM methodologies?

b) Please further describe the US estimates by Kroll. In what context are those estimates developed and do they have any usefulness for the CAPM calculation

in the context of the OEB potentially preferring to include US data as part of the determination of the ROE.

M4-CCC-3
Ref: Ex. M2/p.74
Ex. M3/p. 72

Concentric noted that, for our Risk Premium analyses, we have relied on authorized returns from a large sample of U.S. electric utilities and U.S. gas distribution companies. In addition, we have conducted a Risk Premium analysis based on authorized returns for Canadian electric and gas utility companies since 2000. Nexus appears to apply a similar methodology that relies on authorized returns for U.S. electric and gas distribution companies.

Please comment on Concentric's and Nexus' use of approved returns (or, "authorized returns") for US regulated utilities to determine the risk premium in the calculation of an appropriate ROE for an Ontario regulated utility. As part of the response, please comment on the logic of using approved ROEs from other jurisdictions to determine risk premiums for Ontario utilities when those approved ROEs would have also, presumably, been underpinned by DCF, CAPM and/or Risk Premium based ROE determinations when they were initially calculated.

M4-CCC-4
Ref: Ex. M4/pp. 35, 46, 76

(Page 35) Allowed ROEs in Canada have not declined in line with reductions in government and utility bond yields, and hence are providing Ontario (and other Canadian and U.S.) utilities "excess compensation" in terms of allowed ROEs relative to their actual market-determined cost of equity.

(Page 46) I recommend an adjustment factor of 0.75 for both factors, which maintains the relationship, is more responsive to changing market conditions, and will still reduce year-to-year fluctuations in allowed ROEs relative to a weighting of 1.0.

(Page 76) A large part of this can be explained by the fact that allowed ROEs "tend to exhibit considerable stickiness around focal 'odometer' points." Consistent with the evidence for Ontario and Alberta discussed above, the authors note that "awarded ROE spreads over risk free treasuries have progressively *widened* significantly since 2005, even though systematic risk in the utilities industry has *fallen continuously* during the same time period."

a) Please further discuss why ROEs have not declined in line with government and utility bond yields. Is this related to the fact that, under the current ROE formulaic annual update, only a portion of the change in bond yields are passed through to the allowed ROE? Are there other reasons?

b) Please provide your view on applying no adjustment factor (i.e., passing through the entirety of changes to bond yields) in the ROE annual update formula. Is there a reason that you prefer to reduce the impact of annual changes in bond yields on the allowed ROE (i.e., 0.75 adjustment factor)?

c) Please further comment on the reasons for the cited "stickiness" of ROEs. As part of the response, please discuss whether regulators' general inclination to benchmark against other regulators, is part of the reason for that stickiness.

M4-CCC-5
Ref: Ex. M4/p. 91
Ex. M2/pp. 66-67

(Exhibit M2, Pages 66-67) Concentric stated that there are two primary reasons to adjust raw betas. First, empirical studies have provided evidence that an individual company beta is more likely than not to move toward the market mean of 1.0 over time. Second, adjusting beta serves a statistical purpose.

Please provide your views on Concentric's rationale for using adjusted betas in its analysis. As part of this response, please comment on the studies (Blume, 1975 and 1979 (footnote 77), and Morin (footnote 78)) that Concentric relies on to support its view and the applicability of those studies to the regulated utility sector.

M4-CCC-6
Ref: Ex. M4/p. 94

Beyond US utility beta estimates being higher than Canadian utility beta estimates, please provide a discussion of the reasons for the difference in risk between Canadian and US utilities.

M4-CCC-7
Ref: Ex. M4/pp. 93, 101, 107

a) With respect to the use of peer groups in your study (as set out in Tables 8, 10 (which shows an average based on the peer companies set out in Appendix J), and the unlabeled table on p. 107), please confirm or correct the following understanding:

   i. For the CAPM calculation, the Canadian and US peer groups are not directly used but inform the potential accuracy of the beta of 0.45 that is applied.

   ii. For the DCF calculation, Panel A (Canadian Sample) is used to determine the DCF-derived ROE.

   iii. For the BYPRP calculation, Fortis Alberta, Fortis BC, Canadian Utilities, Enbridge Gas and Hydro One, are used to determine the appropriate average bond yield.

b) Please advise whether the peer groups are used in any other calculation beyond what is discussed in part (a) of this question.

c) Please explain the reason for the difference in the companies included in Panel A (Canadian Sample) and the group of companies used in the BYPRP calculation.

d) For Panel A (Canadian Sample), please provide a table that includes the following information (if available):

   i. Company name
   ii. Credit rating
   iii. S&P business risk rating
   iv. S&P financial risk rating
   v. Percentage of operating income from, as applicable, electricity distribution, electricity transmission, electricity generation, natural gas operations
   vi. Percentage of operating income, as applicable, by operating area (i.e., electricity distribution, transmission, generation or natural gas operations) that is regulated
   vii. Percentage of overall operating income that is regulated
   viii. The regulatory agency that regulates the company (i.e., OEB, AUC, etc.) and the applicable rating as set out in the “Utility Regulatory Jurisdiction Assessment performed by S&P Global” (see p. 129 of Exhibit M1 – LEI Expert Report)
   ix. Description of ratemaking approach applied to the company. As part of this response, please include information regarding:

i. Most prevalent form of ratemaking (e.g., cost of service, cost of service plus IRM, etc.)
ii. Application of a forward test year approach in cost of service ratemaking
iii. Availability of Custom IR option (which, as applied in Ontario, allows for multi-year (typically 5 years) recovery of approved capital budgets as proposed by the utility)
iv. Availability of mechanisms that allow the recovery of incremental capital between rebasing proceedings (and a description of how those mechanisms operate)
v. Reliance on fixed vs. variable rates (by rate class)
vi. Availability of deferral and variance accounts for non pass-through costs and revenues (and the types of accounts that are available)
vii. Availability of Z-factor relief (and the types of relief available through this mechanism)
viii. Availability of off-ramp provisions when actual ROE falls below a certain threshold

M4-CCC-8
Ref: Ex. M4/p. 113

Please provide your views on the appropriateness of lowering the weighting applied to the DCF approach in your calculation of the recommended average ROE (which is based on a simple average of three separate approaches).

M4-CCC-9
Ref: Ex. M4/pp. 117-118

In the context that regulated electric utilities are allowed to recover prudently incurred costs, please provide your views on whether increased spending in response to climate change/electrification increases or decreases risk. As part of this response, please discuss whether long-term significant growth in approved rate base, which provides for larger returns on an absolute basis, increases or decreases risk for electricity utilities.