PUBLIC INTEREST ADVOCACY CENTRE
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August 2, 2024 **VIA E-MAIL**

Ms. Nancy Marconi
Registrar (registrar@oeb.ca)
Ontario Energy Board
Toronto, ON

Dear Ms. Marconi:

Re: EB-2024-0063 Generic Cost of Capital Proceeding
Interrogatories of the Vulnerable Energy Consumers Coalition (VECC)
to London Economics International LLC (LEI) Exhibit M1 – Board Staff

Please find attached the revised interrogatories of VECC in the above-noted proceeding. We have also directed a copy of the same to the Applicant.

Yours truly,

Mark C. Garner Digitally signed by Mark C. Garner
Date: 2024.08.02 16:50:54 -04'00'

Mark Garner
Consultants for VECC/PIAC

Email copy:
Fiona O'Connell, OEB Staff
fiona.oconnell@oeb.ca

REQUESTOR NAME	**VECC**
TO:	**OEB STAFF / LONDON ECONOMICS INTERNATIONAL (LEI) EXHIBIT M1**
DATE:	**AUGUST 2, 2024**
CASE NO:	**EB-2024-0063**
APPLICATION NAME	**GENERIC COST OF CAPITAL PROCEEDING**

1.0 Reference: M1: LEI Report, page 12

Preamble: The Report states:
"*LEI has devised five overarching principles to evaluate its potential alternatives (derived from OEB's mission and mandate, and its existing principles related to cost of capital and accounting) and arrived at its recommended approach*."

One of LEI's five principles is:
"*Transitioning away from the status quo only if the associated benefits are material as there is limited merit in modifying aspects of the methodology that have worked well*"

1.1 With respect to the second reference, please identify those aspects of the status quo (i.e., the methodology) that LEI considers to "have worked well" and, in each case, explain why.

2.0 Reference: M1: LEI Report, pages 27-28 and 84

Preamble: The Report states (page 27):
"*For natural gas distributors, and OPG's prescribed rate-regulated baseload generation, the long-term debt rates are considered based on the weighted cost of actual embedded debt.*
For electricity distributors and transmitters, the OEB's stated policy is to primarily rely on embedded or actual cost for existing long-term debt instruments, albeit with DLTDR acting as a proxy (if the distributor has no debt) or a ceiling (if the actual rate is higher than DLTDR).
The OEB utilizes the long-term debt rate for 56% of the capital structure for electricity distributors and transmitters." (page 27)
And
"*For natural gas distributors and OPG's prescribed rate-regulated baseload generation, the short-term debt rates are considered based on the weighted cost of actual embedded debt. The short-term debt is used for an unfunded portion to true-up the deemed capitalization to the utility's actual capitalization and is typically a small fraction of total capitalization for rate-setting purposes*." (page 28)

At page 84 the Report outlines the use of the DLTDR when an electric distribution utility has no debt or the debt is held by an affiliate.

2.1 For electricity distributors and transmitters, if the actual embedded debt is less than 56% of the capital structure, what does the OEB use as the long-term debt

rate for the that portion of the rate base that is deemed to be financed by long-term debt? Please provide the relevant references supporting LEI's understanding of the OEB's current approach.

2.2 For electricity distributors and transmitters, what role (if any) does the DLTDR currently play in determining the regulated rate for long term debt if the debt is not held by an affiliate?

3.0 Reference: M1: LEI Report, page 28

Preamble: The Report states:
"*For natural gas distributors and OPG's prescribed rate-regulated baseload generation, the short-term debt rates are considered based on the weighted cost of actual embedded debt. The short-term debt is used for an unfunded portion to true-up the deemed capitalization to the utility's actual capitalization and is typically a small fraction of total capitalization for rate-setting purposes.*
The OEB utilizes the DSTDR for 4% of the capital structure for electricity distributors and transmitters." (emphasis added\0

3.1 For natural gas distributors and OPG's prescribed rate-regulated baseload generation what "actual embedded debt" is used in the determination of the "weighted cost of actual embedded debt" (e.g., is it just short-term embedded debt and, if so, how is short-term defined?).

3.2 For natural gas distributors and OPG's prescribed rate-regulated baseload generation, is the short-term debt used for the entire unfunded deemed debt portion of the capital structure?

3.2.1 If not, for what unfunded portion is it used and what rate is applicable to the balance of the unfunded deemed debt portion of the capital structure?

4.0 Reference: M1: LEI Report, pages 28-29 and 54

Preamble: The Report states:
"*The OEB's guidelines assume that the base capital structure will remain relatively constant over time, and requires undertaking a full reassessment of a utility's capital structure only in the event of significant changes in the company's business and/or financial risk.*
The OEB set the deemed capital structure at 60% debt and 40% equity for all electricity distributors and transmitters in 2006." (page 28)
And
"*EPCOR Natural Gas' equity thickness of 40% has remained unchanged since 2006.*
Since 2006, the OEB has reassessed the capital structure for the following regulated utilities: OPG in 2008, 2014 and 2017, Enbridge Gas Distribution Inc. in 2007 and 2013, Union Gas Limited in 2006 and 2012, and Enbridge Gas in 2023, following applications from these utilities/intervenors. Only two of the eight reassessments have led to a change in equity ratio (for OPG in 2014 and Enbridge Gas in 2023". (page 29)
And

"*As such, the OEB typically assesses the major risk factors following a utility's application for a change in equity thickness. The most recent assessments for electricity distributors were performed in 2006 (2006 report), Enbridge Gas in 2023 (EB-2022-0200), and OPG in 2017 (EB-2016-0152*)." (page 54)

4.1 Please confirm that in assessing whether there has been a significant change in one of the regulated entities business and/or financial risk the relevant point of reference would be:
- For electricity distributors and transmitters, changes since 2006;
- For EPCOR Natural Gas, changes since 2006;
- For OPG, changes since 2017; and
- For Enbridge, changes since 2023.

4.2 If not confirmed, for each such utility please explain why not and what LEI considers to be the appropriate historical reference point for assessing whether significant changes in the company's business and/or financial risk have occurred.

5.0 Reference: M1: LEI Report, page 30

Preamble: The Report states:
"*Prior to the cloud computing accounting order, the OEB did not distinguish the accounting treatment for cloud computing related operating/capital expenses and general operating/capital expenses. To compensate for the additional risks and benefits (if any) associated with the change in methodology, the OEB aims to determine in this Generic Proceeding what type of interest rate, if any, is warranted for the above deferral account*."

5.1 What "change in methodology" is the LEI Report referring to?

6.0 Reference: M1: LEI Report, page 38

Preamble: The Report states:
"*LEI has closely considered several underlying principles and objectives formulating recommendations in this report. These include:*
• Cost of capital principles adopted by the OEB;
• Regulatory accounting principles adopted by the OEB; and
• OEB's mission and mandate.
LEI then synthesized five guiding principles consistent with this source material."

6.1 It is noted that LEI makes no reference to having considered the OEB's statutory objectives as set out in the OEB Act, Section 1 (1). Please explain why.

6.2 Please indicate if/how LEIs five guiding principles align with the OEB's statutory objectives.

7.0 Reference: M1: LEI Report, page 38

Preamble: The Report cites as one of the OEB's key regulatory principles with respect to determining the cost of capital:
"*The overall ROE must be determined solely on the basis of a company's cost of equity capital, regardless of equity ownership, and any resulting rate increase must be an irrelevant consideration in determining the appropriate ROE for regulated utilities*." (emphasis added)

7.1 Please clarify how LEI has interpreted this principle (e.g., does it mean that the ROE for a utility should consider a company's actual cost equity (regardless of the impact the nature of its equity ownership has on its actual cost of equity?).

8.0 Reference: M1: LEI Report, page 37

Preamble: The Report states:

"*The design of the IRM is tailored to accommodate approved material incremental capital expenses, but not incremental operating (or O&M) expenses. Regulated utilities can earn an ROE on their rate base (which is primarily made up of capitalized assets in use) but cannot earn a return on their operating expenses. As such, the current IRM design incentivizes utilities to make in-house infrastructure investments for their computing and storage needs, rather than opting for a cloud computing service (as it is categorized as an O&M expense). The cloud computing costs cannot be amortized over a longer time horizon, despite the long-term benefits of switching to this model*."

8.1 What distinguishes cloud computing costs from any other utility investment where there can be a substitution as between carrying out the responsibility as an operating costs (e.g. system maintenance) and a capital cost (e.g. system capital investment? In other words, do utilities have a general incentive to under spend in operating areas and overspend (or substitute) for capital spending? If so what impact if any does this have on setting an appropriate cost of capital?

9.0 Reference: M1: LEI Report, page 44

Preamble: The Report states:
"*However, while the energy transition is bringing dramatic changes to the sector as a whole, the focus when considering cost of capital implications is not whether and how fast the industry is changing but whether, for regulated businesses, the volatility of net cash flows is changing or there is an increased risk of inability to attract capital or recover associated investments. Neither appears likely in the forthcoming regulatory period. This is because the pace of change remains measured, and regulated utilities can use various regulatory mechanisms such as DVAs, Z factor, I factor, and off-ramp mechanisms to manage net cash flow volatility (if any).*

By design, regulated entities face less risk than competitive businesses. Existing regulatory mechanisms address load fluctuations, capital recovery, and unforeseen events, whether caused by energy transition or not. Given that ratemaking processes directly deal with these issues and equity thickness is the lever used to address differences between regulated sectors (see Section 4.2.4 wherein LEI has recommended adjusting equity thickness as the appropriate lever for addressing material changes in risk profile), LEI does not believe energy transition issues are a large driver in reviewing the process of setting the cost of capital."

9.1 With respect to the above statement, what does LEI consider to be the "forthcoming regulatory period".

9.2 Does LEI agree that energy transition will have significantly different impacts on Ontario's natural gas distributors as opposed to its electricity transmitters and distributors? If not, why not?

9.3 Please outline what financial or business risks LEI considered that energy transition could introduce for natural gas distributors and how existing regulatory mechanisms will serve to address/mitigate them.

9.4 Please outline what financial or business risks LEI considered that energy transition could introduce for electricity transmitters and distributors and how existing regulatory mechanisms will serve to address/mitigate them.

9.5 Please outline what financial or business risks LEI considered that energy transition could introduce for OPG's regulated activities and how existing regulatory mechanisms will serve to address/mitigate them.

9.6 In the case of Ontario's electricity transmitters & distributors and OPG, does energy transition serve, in any way, to reduce the financial and/or business risks of these entities?

9.6.1 If yes, how?

9.6.2 If not, why not?

10.0 Reference: M1: LEI Report, page 45

Preamble: The Report states:
"*The sources of capital are typically equity and/or debt. Debt funding can come from banks, corporate bonds, or public lending institutions (such as Infrastructure Ontario). Loans received directly by the government or its own controlled agency/development bank often have favourable rates relative to financing obtained from commercial banks and bond issuances. Issue 1a relates to whether the source of capital should matter for OEB when setting the cost of capital and capital structure methodologies*."

10.1 Does LEI agree that another source of debt funding could be from an affiliate or the parent company of the utility?

11.0 Reference: M1: LEI Report, page 48

Figure 11. Summary of the jurisdictional review (treatment of public debt in cost of debt determination)

Jurisdiction	Source of funding
Alberta	The cost of debt is based on actual costs determined by the market, not set by the AUC
Australia	The AER sets the benchmark return on debt using a 10-year simple trailing average of the BBB+ corporate bond yield from third-party providers, which is not based on the source of funding
UK	Ofgem sets the benchmark cost of debt reflecting a notional efficient operator who is not systematically under- or over- compensated for the cost, which does not consider the source of funding

11.1 While LEI describes different ways of setting cost of long term debt as outlined in Figure 11 it provides no description of what material difference (if any) results from employing these different methodologies. Does LEI have any insight into the variation of results found when employing these different methods?

12.0 Reference: M1: LEI Report, pages 46 and 51

Preamble: The Report states:
"*Given that the OEB considers the actual long-term debt rates in most cases, its current methodology already implicitly considers the impacts of different funding sources*." (page 46)
And
"*In 2009 (EB-2009-0084), the OEB determined that the ownership structure of a utility should not be a relevant factor when determining the cost of capital*." (page 46)
And
"*With regards to consideration of ownership type, LEI agrees with the OEB's 2009 report that a utility's ownership structure should not be a relevant consideration in determining its cost of capital parameters. As noted by the OEB, despite differences in ownership structures, all OEB-regulated entities operate as commercial/corporate entities*." (page 51)

12.1 Does LEI agree that a utilities ownership can impact the sources it has available for debt financing (e.g., municipally-owned electricity distribution utilities have access to lending from Infrastructure Ontario)? Can ownership affect the cost of debt for a utility? For example, might full or partial public ownership of utility have an impact on the terms that a lender is willing to offer?

12.1.1 Please provide any analysis that LEI aware of which shows the cost of difference between debt raised by publicly owned corporations and privately owned companies.

12.1.2 If actual debt rates are used by the OEB in determining the cost of capital parameters and if the cost of that debt can be impacted by ownership than isn't ownership a relevant factor in determining the cost capital for an OEB regulated utility?

13.0 Reference: M1: LEI Report, pages 50-51 and 52

Preamble: The Report states:
"*Considering ownership type as a risk factor: If the OEB believes that the type of ownership significantly changes the risk profile of a utility:*
a. for electricity distributors, the OEB can group the utilities based on risk profiles (with ownership type as one of the key considerations), and determine a slightly different capital structure for each group; and
b. for all other utilities, the OEB may consider ownership type as one of the risk factors in future assessments of capital structure (as part of the rebasing proceedings)." (pages 50-51)
And
"*As such, regulated utilities within a particular sector face very similar risks, given:*
• the composition of their rate bases is similar, i.e., the type of physical assets owned does not vary significantly. As such, electric distributors are commonly grouped as peer utilities when determining the appropriate rate of return; and
• they operate in the same regulatory environment. For instance, all Ontario electric distributors' rates are governed by the same OEB regulations and principles, allowing them equal opportunities to recoup their operating costs." (page 52)

13.1 In LEI's view, does government ownership (either municipal, provincial or First Nations) change a utility's political risk and therefore its overall business risk profile?

13.1.1 If not, why not?

13.1.2 If yes, how and why?

14.0 Reference: M1: LEI Report, pages 54-55, 56-60 and 61

Preamble: At pages 54-55 the Report identifies the following as business risk factors: i) Energy Transition, ii) Volumetric Risk, iii) Operational Risk; iv) Regulatory Risk and v) Policy Risk.

At pages 56-60, the Report identifies the business risk factors considered by other jurisdictions (i.e., Alberta, Australia and British Columbia).

The Report states (page 61):
"*In addition to the business risks and financial risks considered by the OEB in recent applications (see Section 4.2.1), the OEB can review additional risk factors considered in other jurisdictions, such as explicitly considering macroeconomic risk factors (inflation, interest rates, etc.), and energy/commodity price risk. <u>One may argue that these risks are subsumed under existing risk categories</u>. Major macroeconomic risk factors and energy price risk (which LEI views as "affordability risk") ultimately relate to regulatory risk, i.e., the availability of appropriate regulatory mechanisms to mitigate such risks. Examples include the composition of the I factor to mitigate inflation risk, allowed ROE/DLTDR*

to mitigate interest rate risk, and variance accounts to mitigate the energy price volatility risk." (emphasis added)
And
"*The major risk factors considered in other jurisdictions are similar to the ones considered in OEB proceedings. They can be grouped under the risk factors assessed by the OEB in recent equity thickness applications. LEI believes that the review of existing risk factors listed in Section 4.2.1, considering the current and forecasted macroeconomic conditions, are sufficient to determine the cost of capital parameters and capital structure (however, LEI believes that energy transition risk is primarily a policy risk and may be grouped as such). The key business risk factors include volumetric risk, operational risk, regulatory risk and policy risk (including energy transition risk*)." (emphasis added)

14.1 Do the five business risk factors set out on pages 54-55 represent: i) LEI's assessment of the business risk factors the OEB has used in recent proceedings or ii) LEI's view as to what the relevant business risk factors that should be considered?

14.1.1 If the former, please provide the relevant references to support this assessment.

14.2 Please provide a schedule that sets out the five business risk factors identified in the Report (page 54-55) and then, for each of the three jurisdictions, indicate which of the business factors utilized in that jurisdiction are subsumed by each of the business risk factors identified in the Report.

14.2.1 Please identify any of the business factors utilized by one of the other three jurisdictions that LEI is not readily able to assign/align with its proposed five business risk factors.

15.0 Reference: M1: LEI Report, pages 61 and 54 / pages 105-

Preamble: The Report describes the status quo with respect to assessing business/financial risks and the need to adjust utilities' capital structure as follows:
"the OEB currently undertakes a full reassessment of a utility's capital structure in the event of significant changes in the company's business and/or financial risk." (page 61)

The Report states:
"*As such, the OEB typically assesses the major risk factors following a utility's application for a change in equity thickness. The most recent assessments for electricity distributors were performed in 2006 (2006 report), Enbridge Gas in 2023 (EB-2022-0200), and OPG in 2017 (EB-2016-0152)*." (page 54)

15.1 In LEI's view what specific risks are addressed through the derivation of a return on equity (using whatever methodology chosen,(i.e. CAPM, Comparable earnings, DCF etc..) and what risks are addressed through the capital structure deemed by the Board?

15.2 In LEI's view is it methodologically correct calculate a regulated return on equity for electricity distributors, electricity transmitters, electricity generators and natural gas utilities based on (i) the same methodology (i.e. CAPM, comparable earnings etc.) and (ii) using combined utility data (i.e., using both natural gas utility data and various electricity utility data to in the applied model).m

15.3 To LEI knowledge has the OEB since 2006, on its own initiative, undertaken any assessment as to whether the business/financial risks facing electricity transmitters or distributors have changed significantly enough to warrant a review of their capital structures?

15.3.1 If yes, please provide the relevant references and outcomes.

16.0 Reference: M1: LEI Report, pages 54, 61-62 and 75

Preamble: The Report describes the status quo approach of the OEB with respect to determining the capital structure of utilities as follows:
"*However, per its stated policy, it undertakes a full reassessment of a utility's capital structure in the event of significant changes in the company's business and/or financial risk.*
As such, the OEB typically assesses the major risk factors following a utility's application for a change in equity thickness." (page 54 – emphasis added)

The Report subsequently states:
"Furthermore, as the OEB highlights in its capital structure policy, most risk factors tend to be stable over time. As such, considering their impacts at pre-defined intervals (as described in Section 4.2.3) is inefficient and unnecessary. LEI recommends that the OEB's current policy (reviewing business/financial risk factors if there is a significant change from the status quo) be retained. Furthermore, LEI believes that adjusting the allowed /deemed equity thickness remains the appropriate lever to address material changes in the utility risk profile." (pages 61-62 – emphasis added)

The Report also states:
"*LEI recommends impact assessments for major regulatory changes at the time of introduction i.e., before the changes goes into effect (similar to the UK example) in addition to the status quo*." (page 75)

At page 158 the Report states:
"*Consistent with the OEB's existing policy, the OEB should commit to reviewing the cost of capital policy every five years*."

16.1 Based on the discussion on pages 54 and 61-61, LEI's proposal appears to be that, apart from impact assessments when major regulatory policy changes are introduced (per page 75), the OEB rely solely on applications by the utilities it regulates as the basis for determining whether or not financial/business risks have significantly changed enough that an adjustment to their capital structure is warranted. Please clarify if this is the intent behind the discussion set out on these pages.

16.1.1 If yes, does LEI consider it reasonable to assume that utilities will in those situations where their financial/business risks have changed such that they are significantly more favourable (i.e. lower) than previously assessed file applications for changes in their capital structure (e.g., reductions in their equity thickness)?

16.2 The referenced quote from pages 61-62 appears to reject reviewing utilities' risks and capital structure at regular intervals. However, at page 158 the Report states that the OEB should commit to reviewing the cost of capital policy every five years. Please reconcile.

17.0 Reference: M1: LEI Report, page 62

Preamble: One of LEI's recommendations regarding Issue 2 is that:
"*The current policy of considering the impact of risk factors when there is a significant change in business/financial risks is a reasonable approach, which LEI recommends be retained*."

17.1 In preparation of its Report, did LEI undertake an assessment or form any opinions as to whether there has been a significant change in the business/financial risk faced by electricity distributors since 2006 (or whatever date LEI considers the OEB to have undertaken its last formal assessment of such risk)?

17.1.1 If yes, please provide.

17.1.2 If not, why not?

17.2 In preparation of its Report, did LEI undertake an assessment or form any opinions as to whether there has been a significant change in the business/financial risk faced by OPG since 2017 (or whatever date LEI considers the OEB to have undertaken its last formal assessment of such risk)?

17.2.1 If yes, please provide.

17.2.2 If not, why not?

17.3 In preparation of its Report, did LEI undertake an assessment or form any opinions as to whether there has been a significant change in the business/financial risk faced by Enbridge since 2023 or EPCOR Natural Gas since 2006 (or whatever date LEI considers the OEB to have undertaken its last formal assessments of such risks associated with each utility)?

17.3.1 If yes, please provide.

17.3.2 If not, why not?

18.0 Reference: M1: LEI Report, page 63 – 70 and 74

Preamble: At page 63 the Report identifies five major OEB regulatory/policy changes enacted since 2006 that affect electricity distributors and/or transmitters. These policies are then discussed individually on pages 64 to 70. At page 64 the Report states:
"*While each of these represented new policies, in almost all cases the impact was to either reduce uncertainty, increase flexibility, or provide compensation for changes in risks*."

At page 74 the Report states:
"*With respect to the major OEB regulatory mechanisms introduced since 2006, LEI believes that they have generally reduced the risks for electricity distributors*"

18.1 For each of the identified policies please provide LEI's assessment as to whether it: i) reduces uncertainty, ii) increases flexibility and/or provides compensation for changes in risk.

18.2 For each of the identified new polices please comment on whether LEI considers the policy as: i) reducing uncertainties that existed in 2006 (as opposed to addressing just new uncertainties) and/or ii) providing compensation for risks that existed in 2006 (as opposed to just addressing new risks).

18.3 It is noted that the list of policies enacted since 2006 that affect distributors does not include either: i) the Incremental Capital Module (ICM) introduced in the Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors issued in July 2008 or ii) the Advanced Capital Module (ACM) introduced in the Report of the Board - New Policy Options for the Funding of Capital Investments in September 2014. Does LEI consider these new regulatory mechanisms as impacting the business risk faced by electricity distribution utilities?

18.3.1 If not, why not?

18.3.2 If yes, why were these policies not included in LEI's assessment?

18.3.3 If yes, do these policy changes serve to reduce uncertainty, increase flexibility, and/or provide compensation for changes in risks?

18.3.4 If yes, does LEI consider these new polices as i) reducing uncertainties that existed in 2006 (as opposed to addressing just new uncertainties) and/or ii) providing compensation for risks that existed in 2006 (as opposed to just addressing new risks).

19.0 Reference: M1: LEI Report, page 67-68

19.1 LEI makes the observation that changing rate design to increase the recovery of distribution cost via a fixed rate component, as compared to a volumetric charge, reduces volumetric risk. The Report also notes that predictability of cash flow is considered by utility debt rater agencies. What study has LEI done in order to understand the magnitude of the risk adjustment resulting from the actual

electricity rate design changes to greater fixed rate recovery and the proposed changes of Enbridge Gas. Would the change in the proportion of distribution revenues recovered from fixed rates as compared to variable rates provide any insight as to the change in risk?

20.0 Reference: M1: LEI Report, pages 74 and 75

Preamble: The Report states (page 74):
"*With respect to alternate ways of considering the risk factors, the OEB may adopt one of the three options below*:
1. Status quo: The OEB considers regulatory risks whenever it assesses potential change in business/financial risks following an application from the utility/intervenors."
And
"*As such, LEI recommends that any regulatory mechanism that can significantly impact the stability of future cash flows must be considered for review as part of regulatory risks*."

The Report also states (page 75):
"*LEI recommends impact assessments for major regulatory changes at the time of introduction i.e., before the changes goes into effect (similar to the UK example) in addition to the status quo. This will enable the OEB to proactively increase/decrease the deemed equity thickness if warranted following material regulatory changes. As such, LEI recommends reviewing business /financial risks for electricity distributors at the time of major regulatory changes and adjusting the allowed equity thickness accordingly based on the review's outcome*."

20.1 Does LEI consider the regulatory policy changes enacted since 2006 as having a significant impact on the business or financial risks of electricity distributors and/or transmitters?

20.1.1 If not, why not?

20.1.2 If yes, how are these risks impacted (i.e., do the policies significantly increase or significantly decrease business and/or financial risk)?

20.2 Overall, in LEI's view, have the business (including regulatory) risks and financial risks faced by electricity transmitters and distributors changed sufficiently since 2006 to warrant change in the capital structure (i.e., equity thickness) for either electricity transmitters or distributors?

20.2.1 If not, why not?

20.2.2 If yes, what changes would LEI recommend and why?

20.3 Since 2006 have there been regulatory policy changes applicable to natural gas distributors that have significantly impacted EPCOR Natural Gas' business and/or financial risks?

20.3.1 If yes, what are they?

20.3.2 If yes, how are these risks impacted (i.e., do the policies significantly increase or significantly decrease business and/or financial risk)?

20.4 Overall, in LEI's view, have the business (including regulatory) risks and financial risks faced by EPCOR Natural Gas changed sufficiently since 2006 to warrant change in the capital structure (i.e., equity thickness) for EPCOR?

20.4.1 If not, why not?

20.4.2 If yes, what changes would LEI recommend and why?

20.5 Since 2017 have there been regulatory policy changes applicable to OPG that have significantly impacted its business and/or financial risk?

20.5.1 If yes, what are they?

20.5.2 If yes, how are these risks impacted (i.e., do the policies significantly increase or significantly decrease business and/or financial risk)?

20.6 Overall, in LEI's view, have the business (including regulatory) risks and financial risks faced by OPG changed sufficiently since 2017 to warrant change in the capital structure (i.e., equity thickness) for OPG?

20.6.1 If not, why not?

20.6.2 If yes, what changes would LEI recommend and why?

20.7 Since 2023 have there been regulatory policy changes applicable to Enbridge Gas that have significantly impacted its business and/or financial risk?

20.7.1 If yes, what are they?

20.7.2 If yes, how are these risks impacted (i.e., do the policies significantly increase or significantly decrease business and/or financial risk)?

20.8 Overall, in LEI's view, have the business (including regulatory) risks and financial risks faced by Enbridge Gas changed sufficiently since 2023 to warrant change in the capital structure (i.e., equity thickness) for OPG?

20.8.1 If not, why not?

20.8.2 If yes, what changes would LEI recommend and why?

21.0 Reference: M1: LEI Report, pages 77 and 79-83

Preamble: The Report states (page 77):
"*For electricity distributors and electricity transmitters, the DSTDR is used to set short-term debt rates.*
For natural gas distributors and OPG, the DSTDR is not used to set short-term debt rates. Short-term debt is used for an unfunded portion to true-up the deemed capitalization to the utility's actual capitalization (the

portion is generally small).7 In rate applications, natural gas distributors and OPG provide forecasts of short-term debt rates based on their actual debt portfolio."

The Report states (pages 79-80):
"*LEI has identified the following four alternatives for determining DSTDR (pages :*
1. CORRA as a reference rate plus spread determination based on a confidential survey of banks;
2. CORRA as a reference rate (similar to #1) plus spread determination based on a survey of regulated utilities;
3. Current 3-month CORRA futures rate plus spread determination based on #1; and
4. Average of 3-month CORRA futures rates for the next 12-month period plus spread determination based on #1."

The Report subsequently provides LEI's recommendations (page 83):
"• For reference rate, LEI recommends considering the average of 3-month CORRA futures rates for the next 12-month period.
• The spread for a R1-low rated utility over CORRA to be determined from an annual confidential survey of banks (slightly modified from status quo vis-à-vis larger sample size of 6-10 banks and limited exclusion of outliers).
• DSTDR to be applied as a cap for all utilities."

21.1 Is LEI recommending that the DSTDR continue to be used to set the short-term rates for electricity distributors and transmitters and, if not, how will the short-term rates be set for these entities?

21.2 Is LEI recommending that for natural gas distributors and OPG the utilities forecasts of short-term debt rates based on their actual debt portfolio be used to set the short-term borrowing rates, subject to a cap equivalent to the DSTDR?

21.3 Based on recent data available please provide the following:
- The current value for CORRA,
- The current 3-month CORRA futures rate, and
- Average of 3-month CORRA futures rates for the next 12-month period.

21.4 Does LEI anticipate that the spread for a R1-low rated utility over CORRA will vary depending on the values of CORRA (all else being equal)?

21.4.1 If not, why not?

21.4.2 If yes, why is it appropriate to use the same spread for Alternatives 3 and 4 as established for Alternative 1?

22.0 Reference: M1: LEI Report, page 77

Preamble: "*Some regulators will exclude short-term debt with the view that it is temporary and will eventually be replaced with long-term capital*."

22.1 Why is the above noted methodology that is used by some regulators not superior or at least equivalent to the Board's policy of providing a short-term debt component and associated cost rate in its deemed capital structure?

23.0 Reference: M1: LEI Report, page 89

Preamble: The Report states:
"*The 30-year maturity period considered for LCBF is similar to that of most long-term bonds issued by utilities in Ontario. LEI analyzed the current debt maturity profile for Enbridge Gas, OPG, Hydro One Limited, Toronto Hydro Corporation, Alectra Inc., and Hydro Ottawa Holding Inc. The average maturity period is ~21 years. As the GoC does not issue a 20-year bond, a 30-year GoC bond yield is the most appropriate indicator to consider for estimating the LCBF/risk-free rate.*
The 30-year A-rated Utility Bond Yield Spread (utility series C29530Y published by Bloomberg) is also consistent with the senior debt rating of most OEB-regulated entities. However, Bloomberg has ceased updating the utility series (C29530Y) as of February 2024. LEI, in consultation with the OEB Staff, has identified Bloomberg's alternative BVCAUA30 BVLI Index. LEI compared the two indices over the May 2023-January 2024 period and found no meaningful difference between the two indices. As such, the switch to the BVCAUA30 BVLI Index does not impact the calculation of DLTDR and ROE under the current methodology."

23.1 It is noted that it is the larger electricity distribution utilities that LEI referenced for its analysis of the debt maturity period for utilities in Ontario. Has LEI analyzed the debt maturity period for smaller electricity distributors in Ontario?

23.1.1 If yes, what were the results?

23.1.2 If not, why not?

23.2 Given the average maturity period is 21 years, why wouldn't it be more appropriate to use the average of the 10-year GOC and 30-year GOC rates?

23.3 Please provide internet link for where Bloomberg's BVCAUA30 BVLI Index can be accessed.

23.4 What does Bloomberg's BVCAUA30 BVLI Index measure and how, in terms of definition, does it differ from Bloomberg's utility series (C29530Y)?

23.5 Does Bloomberg publish an index similar to the BVCAUA30 BVLI Index, but based on a 10 year period?

23.6 Please provide the comparative analysis performed by LEI with respect to the C29530Y index versus the BVCAUA30 BVLI Index which indicates that there was “no meaningful difference between the two indices”.

24.0 Reference: M1: LEI Report, pages 89 and 92 – 93

Preamble: The Report states (page 89, Footnote #237):
“*The monthly Consensus Forecasts survey report (dated April 8th, 2024) provides 10-year GoC bond yield forecasts from the Economist Intelligence Unit, Economap, BMO Capital Markets, University of Toronto, Scotia Economics, CIBC Capital Markets, Institute for Fiscal Studies, Desjardins, Toronto Dominion Bank, Informetrica, Royal Bank of Canada, Conference Board of Canada, National Bank of Canada, Citigroup, and Oxford Economics*.”

The Report states (pages 92-93):
“*LEI recommends considering reputable publicly available sources for 30-year bond forecasts for LCBF/risk-free rate*.”
And
“*Bloomberg's BVCAUA30 BVLI Index continues to be appropriate for considering the spread over LCBF for a 30-year A-rated utility, as there is no comparable publicly available index available for substitution (but 12-month trailing average, instead of one month)*.”

24.1 For which of the sources used by Consensus Forecasts is the forecast data for the 30-year LCBF/risk-free rate “publicly available” such that it could be used per LEI recommendation?

24.1.1 Are these the sources LEI is recommending the OEB used for the 30-year bond forecasts for LCBF/risk-free rate?

24.1.2 If not, which sources is LEI recommending be used?

24.1.3 Please provide a revised version of Figure 26 that incorporates all of these sources.

24.2 Does LEI recommend simply using an average of the forecasts from all the recommended publicly available sources or should outliers (on both the high and low side) be excluded to avoid skewing the results?

24.3 Do the publicly available sources that LEI recommends be used for forecasts of the GoC 30-year bond yield also provide forecasts for US 30-year bond yields?

24.3.1 If yes, please provide a revised version of Figure 26 that includes the forecasts for 2024 and 2025 for US Government 30-year bonds.

25.0 Reference: M1: LEI Report, pages 84 and 93

Preamble: At page 84 the Report sets out how the DLTDR is used in the case of electricity transmitters and distributors.

The Report states (page 93):

"*With respect to the application of DLTDR, LEI recommends the modified status quo approach with DLTDR as a cap but uniformly applicable for all utilities (not just electricity distribution and transmission utilities). All OEB-regulated entities reviewed have a similar senior debt credit rating, and there is no reason to only subject electricity distributors and transmitters to a cap*."

25.1 Please outline LEI understanding as to whether or not, for electricity transmitters and distributors, the DLTDR is used as a cap in those situations where there is actual debt held by a non-affiliate and the debt is at a fixed rates and not callable.

25.2 Please clarify whether, in such situations, LEI is proposing that the DLTDR at the time of issuance be used as a cap for the applicable debt rate for all OEB-regulated utilities.

26.0 Reference: M1: LEI Report, pages 93

Preamble: The Report states:
"*The OEB currently does not consider transaction/financing costs associated with obtaining debt when determining the DLTDR/DSTDR. The utilities reviewed by LEI record the transaction costs as interest expense, amortizing them using the effective interest rate method over the term of the related debt instrument*."

26.1 Please describe what LEI means by the "effective interest rate method".

26.2 Do all transmitters and distributors treat transaction/financing costs associated with obtaining debt as an interest expense and amortize them over the term of the debt instrument?

26.3 Do the interest rates referenced/requested by transmitters and distributors in their cost of service rate applications include the amortization of the transaction/financing costs associated with obtaining the related debt?

27.0 Reference: M1: LEI Report, pages 95-96

Preamble: The Report states:
"*For instance, in EB-2022-0200 (Exhibit 5), Enbridge Gas has claimed account maintenance and admin fees (upfront fees paid to credit facility agent(s) and lenders) and standby fees (compensation charges for undrawn credit facility amounts) under financing charges*."

27.1 Were the any of the account maintenance& admin fees and standby fees claimed by Enbridge Gas related to long-term debt or just related to short-term debt?

28.0 Reference: M1: LEI Report, page 96

Preamble: The Report states:
"*Based on the reasons discussed in alternative #3 above (i.e., irregularity in frequency and amount of debt issuance), LEI believes that considering transaction costs as operating expenses is the most reasonable approach. Consistent with the principles outlined by LEI in Section 3.1,*

this approach is also fairer to consumers because there is less likelihood of higher cost allowances for utilities, i.e., more than the actual transaction costs incurred by utilities. As such, LEI believes that the benefits to consumers justify the transition away from the status-quo."

28.1 Please explain more fully why Alternative #3 means there is less likelihood of higher cost allowances for utilities than Alternative #1 (status quo), since Alternative #1 involves the amortization of the actual costs incurred.

28.2 Please explain why Alternative #3 is fairer from an intergenerational perspective.

29.0 Reference: M1: LEI Report, page 89

Figure 24. Summary of the jurisdictional review (long-term debt determination)

Jurisdiction	Approach to determining allowed cost of debt	Description
Australia	Formulaic	• Simple average of a benchmark debt portfolio with a credit rating of BBB+ for existing NSPs • On-the-day cost of debt as at end of December 2022 for new NSPs
California	Case by case	Based on actual or embedded costs of long-term debt
New York	Case by case	Based on actual or embedded costs of long-term debt
United Kingdom	Formulaic	• Indexation of the cost of debt allowance using the yield of the iBoxx GBP Utilities 10yr+ index • Addition of additional costs of borrowing and infrequent issuer premium • Calibration of the index • Deflation to CPIH real yields

29.1 LEI recommends the Board continue with its current methodology for DLTDR which uses an embedded cost of debt. While the calculation of the different methodologies are explained in detail no analysis is provided as to the merits of employing what appear to be two different regulatory philosophies – one using embedded (actual) debt and the other calculating a "debt cost proxy" via a formulaic approach. What are the advantages and disadvantages of these two methods and why is one method to be preferred over the other?

30.0 Reference: M1: LEI Report, pages 90- 101

Preamble: The Report states:
"*LEI recommends continuation of the status-quo approach (considering deemed capital structure regardless of the actual capital structure*)."

30.1 Where a utility's actual long-term debt is less than that provided in its deemed capital structure, what is LEI's recommendation as to how the debt rate that should be calculated for the notional component of long-term?

30.2 If a utility's actual long-term debt is greater than the approved deemed structure how should the regulatory cost of long-term debt be calculated?

30.3 If actual long or medium debt is to be used to calculate the weighted cost of long-term debt at what point of divergence of actual to deemed capital structure become problematic. For example, smaller utilities may have very little debt and

as such one or two issuances become the proxy for the entire deemed structure. Does setting debt based on actual debt that might represent less than 50% of the deemed structure remain reasonable? Conversely, if a utility is over leveraged as compared to the deemed structure what is the argument for allowing potentially high cost debt in the portfolio be allowed to be used in the calculation of the deemed amount?

30.4 Should any adjustment be made if using actual long-term debt rates is the actual debt is not long-term but rather of a medium term (e.g. 5-10 years)?

31.0 Reference: M1: LEI Report, pages 102–103

Preamble: The Report states:
"*The ERP submitted by the above participants is shown in Figure 30 below. The OEB considered the low end of the ERP submitted by the participants*."

31.1 With respect to Figure 30, for each of those instances where the values varied between low, medium and high, please explain what the basis for the low values was.

32.0 Reference: M1: LEI Report, page 103 (Figure 31)

32.1 Please confirm (or otherwise explain) that Dr. Vander Weide's calculated value for the LCBF adjustment factor was 0.55 (and not -0.55).

33.0 Reference: M1: LEI report, pages 105-108

Preamble: The Report states (page 107):
"*The AUC considered results generated from the three models and determined the forecast ERP to be 5.9% and the resulting base ROE to be 9.0%."*

33.1 For purposes of applying the formula in Figure 33 what is the base year?

33.2 If the base year is not 2024, what was the ROE approved by the AUC for 2024?

34.0 Reference: M1: LEI Report, pages 110-112

34.1 What is the currently approved ROE and equity thickness for each of FEI and FBC?

35.0 Reference: M1:LEI Report, page 110

Preamble "*The BCUC uses a benchmark methodology where it designates a Benchmark Utility and sets the cost of capital parameters of the Benchmark Utility, and then uses the Benchmark Utility as a reference to set the cost of capital parameters of other regulated utilities by adjusting various risk factors. FortisBC Energy Inc. ("FEI") has been selected as the Benchmark Utility for natural gas utilities, while FortisBC Inc. ("FBC") has been selected as the Benchmark Utility for electric utilities*."

35.1 What are the various risk factors employed in BCUC' Benchmark Utility methodology which are used to adjust cost of capital parameters for the non-FEI utilities? How are these risk factors employed with respect to adjustments to capital structure and return on equity.

35.2 Why would a benchmark approach not be preferable in Ontario where the Board regulates various types of utilities both in function (natural gas, electricity transmission and distribution, and electricity production) and in size (some of the smallest utilities in Canada and the largest)?

36.0 Reference: M1: LEI Report, pages 113-114

Preamble: The Report describes Alternative #1 for the ROE methodology as follows:
"*Status quo with updated values for base ROE (using ERP approach), base LCBF, base utility bond spreads, and adjustment factors based on current data*."
And
"*The base LCBF using March 2024 data is 3.15%. As such, the base ROE is 8.65% (3.15% + 5.50%) using the existing methodology*."

36.1 With respect to Figure 36, how was the average bond yield value calculated for each of the two periods: i) 2001-2024 and ii) 2021-2024 and is it just coincidence that the values are the same (i.e., 3.37%)?

36.2 In EB-2009-0084 did Dr. Vander Weide use historical premiums observed between 30-year GoC bond yields and both: i) returns from the S&P/TSX composite index (total returns, including dividend returns) and ii) from the BMO equal weight utilities index ETF to determine the base ROE for the ERP approach?

36.3 With respect to Figure 36, please provide a revised version with two additional rows: i) Use the S&P/TSX composite (total return) index results for the period 2010 to 2024 and ii) Use the BMO equal weight utilities index ETF results for the period 2001-2024.
Note: If the BMO equal weight utilities index ETF does not have values back to 2001, please provide two rows where: i) the first provides the BMO equal weight utilities index ETF results from its starting year to 2024 and ii) second provides the S&P/TSX composite (total return) index results based on the same period.

36.4 Is 2024 the "base year" for the calculated base ROE of 8.65%?

36.4.1 If not why not and what is the associated base year?

36.5 With respect to Alternative #1, please set out the formula that would be used to calculate the ROE in future years.

37.0 Reference: M1: LEI Expert Evidence, pages 113-115
M2: Concentric Report, pages 46-48

Preamble: The LEI Report describes Alternative #2 for the ROE methodology as follows:
"*Same as #1 but determining base ROE with the discounted cash flow ("DCF") approach instead of the ERP approach*".

At pages 114-115 the LEI Report describes how the peer companies were chosen for purpose of the DCF approach.

At pages 46-48 the Concentric Evidence sets out it proposed Canadian proxy group, US electric proxy group and US gas proxy group.

37.1 While not mentioned on page 114, was one of the selection criteria used by LEI a requirement that the company be paying dividends?

37.2 Please explain why LEI's selection criteria did not include the requirement (similar to that used by the BCUC per page 110) that the company have an investment grade credit rating?

37.3 For each of the utilities included in Concentric's Canadian proxy group and which was not included in either LEI's generation, wires or gas distribution proxy groups (i.e., Canadian Utilities, Emera and Fortis), please explain why.

37.4 For each of the utilities included in Concentric's US electric proxy group and which was not included in either LEI's generation or wires proxy groups, please explain why.

38.0 Reference: M1: LEI Report, page 115
M3: NEXUS Report, page 69
M2:Concentric Report, page 58

Preamble: The NEXUS Report sets out the formula for calculating the DCF ROE as:

$$k_e=d_0(1+g)/P+g$$

In contrast, instead of $k_e=d_0(1+g)/P$, the Concentric Report uses the following as the dividend yield component in the formula:

$$Y = D_0(1+0.5g)/P_0$$

38.1 With respect to Figure 37, please explain more fully how the Dividend Yield (Apr 2023 - Mar 2024) value for each company was determined (i.e., how was the annual dividend value calculated over the April 2023 – March 2024 period and why this approach was used) and how the stock price used in the denominator was determined (e.g., over what period was it averaged and why this period was selected)?

38.2 With respect to Figure 37, please provide the actual equity thickness for each of the companies listed and the resulting average equity thickness for each of the three groupings.

38.3 Please provide the formula used by LEI to calculate the DCF ROE using: i) the Dividend Yield and ii) the 2024-2026 annual EPS growth estimate.

38.3.1 To the extent LEI approach differs from that used by NEXUS or Concentric, please explain why the approach used by LEI is appropriate.

39.0 Reference: M1: LEI Report, pages 111 and 115-116

39.1 At page 111 the Report indicates that there are various sources for the dividend growth rates. What was the basis for the growth rates used by LEI in Figure 37 and why?

39.2 At page 111 the Report makes reference to the three-stage DCF model. For purposes of calculating the DCF ROEs for each company (Figure 37), did LEI use a three-stage DCF model? Alternatively, was a single stage or two-stage DCF model used?

39.2.1 If a single-stage DCF model was used, please provide LEI's rationale for adopting this approach.

39.2.2 If a two or three-stage DCF model was used please indicate the length of time assumed for each stage and the basis for the growth rates used in each stage.

39.3 At page 116 the Report states: "This approach resulted in a weighted average DCF ROE of 10.77% (as presented in Figure 38 below)." Is 2024 the base/reference year for the calculated DCF ROE of 10.77%?

39.3.1 If not, why not and what is the associated base/reference year?

40.0 Reference: M1: LEI Report, page 116

Preamble: The Report states:
"*Considering the two variables simultaneously (the weighted average ROEs allowed by US regulators for electric and gas utilities as the dependent variable; 30-year GoC government bond yields and Moody's seasoned Baa corporate bond yields as independent variables) using multivariate regression analysis lowers the adjustment factors for each variable, i.e., 0.26 for the LCBF adjustment factor and 0.13 for the utility bond spread adjustment factor*." (page 116 – emphasis added)

At page 188 (Figure 69) LEI provides the actual regression results and lists US 30-year Treasury bonds as one of the independent variables.

40.1 At page 116 the Report indicates that 30-year GoC government bond yields were used as one of the independent variables. However, in Figure 69, the independent variable is indicated to be US 30-year Treasury bonds. Please reconcile and indicate which government's bonds were used in the regression analysis.

40.2 Using LEI's regression equation, the current Moody's seasoned Baa corporate bond yields and the current yields for the appropriate government's 30-year bond what is the resulting ROE?

40.3 If US 30-year Treasury bonds were used as the independent variable, please re-estimate the equation using 30-year GoC government bond yields instead and provide the results.

40.3.1 Using this revised equation, the current Moody's seasoned Baa corporate bond yields and the current 30-year GoC government bond yields what is the resulting ROE

41.0 Reference: M1: LEI Report, pages 111, 113 and 117-119
M2: CONCENTRIC Report, pages 66 and 83

Preamble: The LEI Report (page 113) describes Alternative #4 for the ROE methodology as follows:
"*Determination of base ROE using CAPM and adjustment of ROE using CAPM formula parameters*"

The Concentric Report states:
"*LEI's CAPM analysis relies on raw, unadjusted betas calculated using daily return data for the past five years. LEI then adjusts these betas for differences in financial leverage between Ontario's utilities and the companies in LEI's various proxy groups. We do not agree with LEI's approach to beta, and in particular the use of raw betas, as discussed below in our response to LEI." (page 66)*
And
"With regard to beta, Concentric believes it is appropriate and consistent with empirical financial research to use Blume adjusted betas rather than raw betas for the reasons discussed earlier in our Report." (page 83)

41.1 At page 111 the Report makes reference to average Blume-adjusted beta estimates from Value Line and Bloomberg using five years of data. Please confirm that, per Concentric's Report, LEI did not use Blume adjusted beta estimates.

41.1.1 If confirm, please explain why LEI considers it appropriate to use raw, unadjusted betas versus Blume adjusted betas for purposes of the CAPM.

41.2 Please explain more fully why it is necessary to re-lever the betas.

41.3 Please provide a sample calculation illustrating how the raw betas are un-levered and then re-levered.

41.4 Please provide revised versions of Figures 40 and 41 based on the un-levered betas.

41.5 For purposes of its ROE analysis based on CAPM LEI relies on the re-levered 5-yr betas (Figure 40). However, the relative 5-year betas for electricity transmission/distribution and generation (0.67 and 0.64 respectively) suggest that electricity transmission/distribution requires a higher adjustment for risk than generation. Is this result, consistent with LEI's understanding as to the relative

business and financial risks faced by electricity generation vs. electricity transmission/distribution?

41.5.1 If not, why is it appropriate to rely on the 5-year betas?

42.0 Reference: M1: LEI Report, pages 115 and 118

42.1 Please explain why Figure 39 (which derives the beta values for electricity generation, wires (electricity transmission/distribution) and gas transmission/distribution for purposes of the CAPM) includes as peers, companies that are not used as peers in Figure 37 (for purposes of the DCF model).

42.2 Please re-do Figures 39, 40 and 41 using only those companies included in Figure 37 for purposes of determining the beta values.

43.0 Reference: M1: LEI Report, pages 119-122

Preamble: The Report states:
"*For reasons provided in Section 4.7.2, LEI recommends considering publicly available reputable sources (such as average forecasts from major Canadian banks) for 30-year bond forecasts for LCBF/risk-free rate. As presented earlier in Figure 26, this approach results in the average forecast yield for 2025 to be 3.19%*." (page 119)

The Report also states:
"*Under this approach, the OEB may update the risk-free rate/LCBF annually. However, the beta and MRP are more stable and can be updated after five years. For instance, the US MRP recommended by Kroll (formerly Duff & Phelps) has ranged between 5% and 6% since 2008 (Kroll has updated the recommended MRP 33 times during this period).*
Alternatively, the OEB can update the LCBF and ERP annually, using the same beta for five years." (page 122)

43.1 Please provide the forecast LBCF yield for 2024 based on actuals for Q1 and the forecasts for Q2 – Q4.

43.2 Please confirm that the CAPM ROE values set out in Figure 41 are for a base year of 2025.

43.2.1 If not confirmed, please explain why given the risk free rate (3.19%) is based on a LCBF for 2025.

43.3 With respect to Figure 41, please provide the results for a seventh option where the MRP is calculated as "1928-2023 S&P 500 total returns - US 30-year treasury bond yields".

43.4 With respect to the alternatives set out on page 122 for setting the ROE for subsequent years, under the second alternative (last sentence in referenced quote) would the value for the MRP be updated annually?

43.4.1 If so, would the most recent 10-year, 20-year and 30-year US MRP values be calculated and then averaged?

44.0 Reference: M1: LEI Report, pages 122-123

Preamble: The Report describes Alternative #5 as follows:
"*Determination of base ROE using CAPM, with ROE updated annually using adjustment factors determined in #3."*
"Using the base LCBF of 3.19% (see Figure 41) and the base utility bond spread determined as of March 2024 (see Figure 44 below), the Annual ROE formula (for year "t") will be as follows:
$ROE_t = 8.95\% + 0.26 \times (LCBF_t - 3.19\%) + 0.13 \times (UtilBondSpread_t - 1.385\%)$*"*

44.1 What is the assumed base year for the formulae?

44.2 All of the values used in the formulae do not appear to reflect the same base year" as: i) the 8.95% and the 3.19% are based on 2025 whereas ii) the UtilBondSpread is based on 2024 data. Please reconcile.

45.0 Reference: M1: LEI Report, pages 123-124

Preamble: The Report describes Alternative #6 as follows:
"*Determination of an average base ROE from CAPM, ERP and DCF methodologies, with annual updating of ROE based on #3*" (page 123)
And
"*This results in a base ROE of 9.46%, which is an average of 8.95% (CAPM approach), 10.77% (DCF approach), and 8.65% (ERP approach). The ROE can be updated annually based on the formula described in alternative #5*." (page 124)

45.1 All of the values referenced from page 124 do not appear to reflect the same base year as: i) the ERP result (8.65%) and the DCF result (10.77%) both appear to use 2024 as the base year (per pages 113 and 115 respectively) while ii) the CAPM result (8.95%) appears to use 2025 as the base year (per page 119). Please reconcile.

46.0 Reference: M1: LEI Report, pages 125-127

Preamble: The Report states:
"*LEI recommends using CAPM to determine the base ROE (average estimate of 8.95%, low estimate of 8.23%, and a high estimate of 10.22%), as it meets the FRS.*
The ROE can be updated annually using the adjustment factors (0.26 for LCBF and 0.13 for utility bond spread) determined simultaneously with multivariate regression analysis (as opposed to independent determination in 2009)."

46.1 For purposes of applying the annual adjustment is the base year associated with LEI's recommended 8.95% 2024 or 2025?

47.0 Reference: M1: LEI Report, pages 135-136

Preamble: The Report states (page 135):
"*The AUC is required to determine a fair return on the deemed equity component of invested capital (i.e. the deemed equity ratio) to satisfy the FRS. It adjusts deemed equity ratios to recognize risk differentials among utilities that have a uniform approved ROE*."

47.1 What is the current range of deemed equity for those utilities regulated by the AUC in each of the following categories: i) electricity generation; ii) wires (electricity transmission/distribution) and iii) gas transmission/distribution?

48.0 Reference: M1:LEI Report, pages 134-

48.1 Is LEI recommending both "unique" financial and business risk be considered in considered in adjusting capital structures for individual utilities?

48.2 What business risks and financial risks which should be considered in adjusting capital structure and that are not already captured in the methodology that establishes the return on equity or are incorporated in the debt costs incurred?

49.0 Reference: M1: LEI Report pages 138

Figure 50. Deemed capital structure allowed to electricity distributors in Ontario from 1999 to 2006

Rate base	Deemed capital structure		Deemed debt rate
	Debt	Equity	
> $1.0 billion	65%	35%	5.8%
$250 million - $1.0 billion	60%	40%	5.9%
$100 million - $250 million	55%	45%	6.0%
< $100 million	50%	50%	6.25%

Source: OEB. Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors. December 20th, 2006. Page 4.

49.1 Does LEI agree that a utility's rate base or customer size could affect business or financial risk?

49.2 Does LEI believe that utility size (by number of customers or rate base) may affect a utility's cost of debt?

49.3 If an electricity or natural gas distributor is heavily reliant upon a very small number of large customers (as may occur in rural towns) how should this be addressed in either the setting of equity returns or capital structure (or at all)?

49.4 LEI notes that the Board moved away from variation of capital structure for electric distributors in order to encourage (or at least not discourage) utility consolidation. Why is this not a violation of the principle articulated by LEI that utility ownership should not influence cost of capital determination?

49.5 Why is not a violation of the fair return standard if the regulator acknowledges a difference in risk among utilities but then ignores that difference in order to achieve a different policy outcome?

49.6 What jurisdiction and legislative authority does the Ontario Energy Board rely upon which would allow it to prioritize utility consolidation over the fair return standard?

49.7 The Board regulates a small gas utility (EPCOR). Given the Board's stated policy on consolidation was generally in respect to electricity distributors should the OEB consider varying capital structure adjustment for small gas utilities?

50.0 Reference: M1: LEI Report, pages 138-140

Preamble: The Report states:
"*LEI believes the OEB's status quo approach, with one modification, is sound, administratively efficient, and meets the FRS.362 Alternative #2 (setting capital structure using rating agency benchmarks) has merits, but the benefits from changing the status quo approach are not material. However, the OEB should mandate forward-looking cash flow analysis with scenarios for utilities (or participants) within the status quo approach (as part of financial risk analysis) when requesting a change in equity thickness*." (pages 138-139 – emphasis added)
And
"*LEI recommendation - Issue 12*
• *The OEB's current approach of revising the capital structure upon application if warranted due to increase in business/financial risks is a reasonable practice, as OEB has noted that risks rarely change meaningfully in a short period of time.*
• *LEI believes that the existing approach meets the FRS.*
• *Applicants should be required to include forward cash flow modeling and scenario analysis showing impact on credit metrics to support their case*." (page 140)

50.1 Please confirm that the "one modification" recommended by LEI is that "the OEB should mandate forward-looking cash flow analysis with scenarios for utilities (or participants) within the status quo approach (as part of financial risk analysis) when requesting a change in equity thickness."

50.1.1 If confirmed, how far forward (i.e., number of years) should the cash flow analysis look?

50.1.2 In assessing a utility's forward-looking cash flow analysis how should the OEB assess the reasonableness/appropriateness of future forecasts for O&M expense and capital expenditures?

51.0 Reference: M1: LEI Report, page 144

Preamble: The Report states:
"Transmitters (big and small) cannot diversify customer risk or economic risk but are likely insulated from volume risk based on their tariff structure."

51.1 Please explain why LEI considers that transmitters are "likely insulated from volume risk based on their tariff structure."

52.0 Reference: M1: LEI Report, pages 144-145

Preamble: The Report states:
"*LEI has been retained by the OEB to prepare these quarterly reports since 2019. These quarterly reports comprise of two key analytical components:*

- *first, the quarterly reports use updated data to recalculate the cost of capital parameters, which are then compared to the values published as part of the OEB's annual cost of capital updates; and*
- *simultaneously, the quarterly reports incorporate a review of the current macroeconomic outlook on a global, North American, and provincial scale, including key macroeconomic developments that have unfolded in the previous quarter*."

52.1 Do the quarterly reports incorporate a review of recent changes in federal policy and/or legislation or OEB policies/procedures that would impact the business/financial risks faced by OEB-regulated utilities?

52.1.1 In LEI's view should such changes be considered in the OEB's ongoing monitoring of the cost of capital parameters/values? If not, why not?

53.0 Reference: M1: LEI Report, page 148

Preamble: The Report states:
"*Ongoing monitoring of the cost of capital parameters enables the OEB to ensure the FRS continues to be met. It is also simple to administer – even though monitoring takes place fairly frequently (each quarter), the quarterly reports need only be prepared for internal review purposes. Finally, continuing with the status quo provides confidence to all stakeholders regarding the durability of the monitoring approach*."
And
"*LEI recommendations – Issue 14*
Consistent with the OEB's existing policy, OEB staff should continue to monitor the cost of capital parameters and test their reasonableness in the context of prevailing macroeconomic conditions on a quarterly basis, through reports prepared for internal review purposes only."

53.1 Does LEI consider it important that stakeholders have confidence in the OEB's monitoring processes and its responsiveness to changes identified through such monitoring?

53.1.1 If not, why not?

53.1.2 If yes, please explain how only reporting the results internally provides all stakeholders with confidence regarding the effectiveness of the OEB's monitoring.

54.0 Reference: M1: LEI Report, pages 148 and 151

Preamble: The Report states:
"*As described by the OEB, "each time a formulaic approach is used to calculate an allowed ROE, it must generate a number that meets the Fair Return Standard, as determined by the OEB using its experience and informed judgment." For example, as part of the 2024 annual cost of capital update letter, the OEB determined that the formula-generated "cost of capital parameter values … and the relationships between them, [are] reasonable and representative of market conditions at this time. For this reason, the OEB concludes that the numerical results from the formulaic methodologies meet the Fair Return Standard.""* (page 148)
And
"*LEI recommendations – Issue 15*
The OEB should continue to annually confirm that the FRS is being met, as it currently does through its cost of capital update letters. In addition, the OEB should direct utilities, as part of the annual reporting requirements, to provide credit ratings and details regarding new short-term and long-term debt and equity issued/borrowed during the year. The OEB can use this information to monitor the credit ratings and pace of capital injections for the regulated utilities on an ongoing basis, as a further test of whether the FRS continues to be met." (page 151)

54.1 In LEI's view is it sufficient, for purposes of maintaining stakeholder confidence in the process, for the OEB to simply state/confirm in its annual cost of capital update letter that it has determined that the formula-generated "cost of capital parameter values … and the relationships between them, [are] reasonable and representative of market conditions at this time" or should it provide details supporting such assessments?

55.0 Reference: M1: LEI Report, page 153

Preamble: The Report states:
"*The OEB's 2009 decision established the process of periodically reviewing the cost of capital policy every five years. This five-year interval was found to "provide an appropriate balance between the need to ensure that the formula-generated return on equity continues to meet the Fair Return Standard and the objective of maintaining regulatory efficiency and transparency." Following the 2009 decision, the OEB subsequently commenced a review on schedule in 2014. This review culminated in a 2016 report by OEB Staff, which concluded that the cost of capital methodology continued to "work as intended", such that "movement in the parameters [had] followed macroeconomic trends and activity, and [had] not resulted in excessive or anomalous volatility." Since the 2016 report no other comprehensive reviews of the formulaic cost of capital policy have been conducted by the OEB, until the current GCOC proceeding.*" (page 153)
And

"*LEI recommendations – Issue 17*
Consistent with the OEB's existing policy, the OEB should commit to reviewing the cost of capital policy every five years. The OEB should also maintain the existing trigger mechanisms, including allowing utilities to apply for different cost of capital parameters during their individual rate hearings, as well as triggering a regulatory review through the off-ramp mechanism (which may or may not include a review of the cost of capital parameters and/or capital structure). In the event that a regulatory review is triggered, the utility and/or intervenors should be allowed to submit evidence for the OEB's consideration regarding the extent to which the cost of capital parameters and/or capital structure caused or contributed to triggering the off-ramp. The OEB can then exercise its own judgement (based on the evidence presented) as to whether the cost of capital parameters and/or capital structure are to be included in the regulatory review." (page 158 – emphasis added)

55.1 Please confirm that neither utilities nor intervenors were allowed to submit either expert evidence or submissions/comments as part of the 2014-2016 review process.

55.2 In LEI's view should utilities and intervenors be allowed to submit expert evidence and/or comments as part of the cost of capital policy review LEI recommends should occur every five years?

56.0 Reference: M1: LEI Report, page 160

Preamble: The Report states:
"LEI's recommendation to retain the status quo is consistent with the principles outlined in Section 3.1, particularly promoting the objectives of predictability and stability. With respect to the review of the utility's capital structure, the OEB can continue to do so when there is a significant change in business/financial risks, and upon application by the utility or other participants (see LEI recommendation in Issue 2/Section 4.2.4)."
(emphasis added)
And
"*LEI recommendations – Issue 18*
Consistent with the OEB's existing policy, the OEB should continue to implement changes in the cost of capital parameters and capital structure upon rebasing."

56.1 The highlighted portion of the first reference appears to suggest that a utility's capital structure can be changed upon (successful) application by the utility even between rebasing applications whereas the second reference suggests it would only be changed upon rebasing. Please reconcile.

57.0 Reference: M1: LEI Report, page 163

Preamble: The Report states:
"*LEI recommendations – Issue 19*
Consistent with the OEB's existing policy, the OEB should continue to implement changes in the cost of capital parameters and capital structure upon rebasing. However, to ensure the FRS continues to be met, the

OEB should also introduce an option for parties to request implementation of such changes prior to rebasing, so long as the two-factor test is met – (i) the utility should have more than 60% of its rate term remaining, and (ii) deviations in the cost of capital parameters should be material (100 bps or more)."

57.1 Please explain how the 100 bps materiality threshold applies in the case of a change in capital structure (e.g., would a change from an equity thickness of 40% to 41% be considered a 100 bps change?).

57.2 How is the 100 bps materiality threshold to be applied if both the ROE and equity thickness are changed but neither change meets the 100 bps threshold?

57.3 How is the 100 bps materiality threshold to be applied if the ROE is increased but the equity thickness decreased (or vice-versa)?

58.0 Reference: M1: LEI Report, pages 174-175

Preamble: The Report states:
"*LEI believes that cloud computing is less risky compared to in-house investments, however, a deemed WACC is necessary as a means of aligning incentives for utilities to transition to cloud computing solutions*." (page 174)
And
"LEI recommends that the OEB employ a deemed capital additions approach (Alternative #2 in Section 4.22.3) to increase utility flexibility and align incentives with customers." (page 175)

58.1 If the move to cloud computing solutions is less risky compared to the traditional in-house investments, is this an additional factor that should be taken into account when assessing the change in the business risk faced by OEB-regulated utilities and the need to adjust their capital structure?

58.2 Please explain how adopting Alternative #2 "aligns incentives with customers".

59.0 Reference: M3: NEXUS Report, pages 5-7; 38-39; 40-41 and pages 47-53

Preamble: At pages 5-7 the NEXUS Report identifies three points of disagreement with LEI's approach to and recommendation regarding ROE. These points are further explained at pages 38-39; 40-41 and 47-53.

59.1 Does LEI agree with the points made by NEXUS?

59.1.1 If yes, how does this impact LEI's recommendations?

59.1.2 If not, why not?

60.0 Reference: M3: NEXUS Report, pages 57-58 and 78-79

Preamble: At the referenced pages NEXUS comments on LEI's application of the risk premium approach and the use of its results for purposes of making annual adjustments the ROE.

60.1 Does LEI agree with the points made by NEXUS?

60.1.1 If yes, how does this impact LEI's recommendations?

60.1.2 If not, why not?

61.0 Reference: M3: NEXUS Report, pages 62-64

Preamble: "*In order to determine the MRP value for input in to the CAPM based on forward-looking data, NEXUS used the DCF method and estimated the input for earning growth ("g") using "the so-called br formula*".

61.1 Please provide LEI's views on NEXUs' use of the DCF method and, more specifically the "so-called *br* formula" to estimate the growth factor input to the formula to determine a forward-looking MRP value.

62.0 Reference: M2: CONCENTRIC Report, pages 45-50

62.1 Please provide LEI's views on the appropriateness of the five proxy groups established by Concentric and the screening criteria used by Concentric to determine the companies to be included in each proxy group for purposes of determining the cost of capital parameters for Ontario's regulated utilities.

63.0 Reference: M1: LEI Report, page 120
M2: CONCENTRIC Report, page 69

Preamble: The LEI Report states:
"Regarding the historical period to consider when determining the appropriate MRP, LEI prefers longer term averages (at least 10 years) as year over year MRP tends to be volatile (see Figure 42 below)."

The Concentric Report states:
"In Canada, the historical MRP is based on return data from 1919-2023, while in the U.S., the historical MRP is calculated using return data from 1926-2023."

63.1 Given LEI's stated preference for using longer term averages when determining MRP, why didn't LEI use even longer time frames such as those used by Concentric?

64.0 Reference: M1: LEI Report, pages 144-145

Preamble: The Report states (page 144): "*As described by OEB Staff, "macroeconomic conditions and their impact on cost of capital are monitored throughout the year, and any major changes could trigger an updated calculation."378 This ongoing monitoring process is conducted through quarterly reports that are prepared for internal review purposes only and thus are not released publicly. LEI has been retained by the OEB to prepare these quarterly reports since 2019."*

64.1 Subject to receiving the OEB's consent, please provide a copy of one of LEI's quarterly reports

64.2 If the appropriate consent is not provided, please provide a more detailed description of the actual items/issues covered by the report than that set out on page 145.

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