EB-2024-0063

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998,* S.O. 1998, c. 15 (Schedule B);

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

Compendium of Canadian Manufacturers & Exporters (CME) for the Concentric Energy Advisors, Inc. Witness Panel

Index

Tab **Document**

1. **Selections from Concentric's Report in EB-2022-0200;**

2. Selections from EGI's Evidence-EB-2022-0200;

3. Interrogatory Responses-EB-2022-0200;

4. Enbridge Gas Inc. 'A-' Rating Affirmed; Outlook Remains Negative from S&P Global, June 28, 2024;

5. Interrogatory Response-EB-2024-0200.

ENBRIDGE GAS INC.
COMMON EQUITY RATIO STUDY

OCTOBER 17, 2022

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The mean and median results for those proxy groups are provided in Figure 23 and Figure 24 respectively, below.

Figure 23: Summary of Comparative Analysis Results (Mean)[199]

Proxy Group	Gas Subsidiaries		Holding Company 2-Year Avg. Equity Ratio
	Currently Authorized Equity Ratio	2-Year Avg. Book Equity Ratio	
Canadian Operating Companies	41.70%	42.80%	N/A
Canadian Holding Companies	47.53%	55.57%	41.28%
US Operating Companies	51.40%	53.38%	N/A
US Holding Companies	53.54%	54.92%	45.79%

Figure 24: Summary of Comparative Analysis Results (Median)

Proxy Group	Gas Subsidiaries		Holding Company 2-Year Avg. Equity Ratio
	Currently Authorized Equity Ratio	2-Year Avg. Book Equity Ratio	
Canadian Operating Companies	40.50%	41.74%	N/A
Canadian Holding Companies	49.00%	54.30%	41.41%
US Operating Companies	51.00%	52.41%	N/A
US Holding Companies	53.50%	55.24%	46.38%

This evaluation of comparable regulated natural gas distribution utilities in the U.S. and Canada indicates that Enbridge Gas' current deemed equity thickness is low relative to its peer companies, despite Enbridge Gas falling in the middle of the spectrum of risk profiles. Taken together, the analyses support an equity ratio in the range of 40% to 45% for Enbridge Gas. Within that range, Concentric specifically recommends an equity ratio of no less than 42% for Enbridge Gas for the reasons discussed later in this report.

199 At the Holding Company level, authorized equity ratios are an average of the operating utilities held by the Holding Company.

SECTION 4:
CHANGES IN BUSINESS AND FINANCIAL RISKS

There are two fundamental sources of risk for any company, including regulated utilities: business risk and financial risk. Business risk for a regulated utility results from variability in cash flows and earnings that impact the ability of the utility to recover its costs including a fair return on, and of, its capital in a timely manner. These risks include operating risk and regulatory risk. Financial risk relates to a company's debt leverage and liquidity and is measured by its credit profile. Both business and financial risk have a direct bearing on a utility's cost of capital.

The cost of capital is a forward-looking concept, and utility investors tend to be long-term providers of capital. Consistent with the OEB's methodology for determining the Company's equity ratio, Concentric's analysis begins with an assessment of how the Company's business and financial risk profile has changed since the Company's previous equity thickness proceedings (i.e., 2012). To evaluate changes in Enbridge Gas' business risks, Concentric performed an independent assessment of the Company and its regulatory environment.

Our experience in assessing business and financial risks and the effect on the cost of capital in Ontario and other regulatory jurisdictions informed our review. Our additional experience advising buyers and sellers of regulated distribution utilities, including Canadian utilities, further informs our views on the investor perspective regarding the business risk of these assets. Our evaluation process included research on equity and credit analyst views regarding Enbridge Gas and the regulated gas distribution industry, relevant industry data, other publicly-available materials such as regulatory filings made by Enbridge Gas, the Company's asset management plan, financial reports, and discussions with Enbridge Gas subject matter experts.

Concentric concludes in this section that while the Company's risk level for its regulated operations remains the same in some areas of the business, the overall risk for these operations has significantly increased since 2012, primarily due to the following factors:

- The Energy Transition (described in more detail herein) began in earnest in the last five years. As equity investors and credit rating agencies widely acknowledge, it substantially affects the risk profile of North American gas distribution utilities, including Enbridge Gas.
- An uncertain economic outlook, increased competition from electricity (i.e., the Energy Transition), and the OEB's encouragement of competition from alternative gas suppliers in the Company's service territory have combined to increase the Company's volumetric risk

CAPITAL STRUCTURE

TANYA FERGUSON, VICE PRESIDENT FINANCE & BUSINESS PARTNER
RYAN SMALL, TECHNICAL MANAGER REGULATORY ACCOUNTING

1. The purpose of this evidence is to request approval of a change to the deemed equity thickness component of Enbridge Gas's capital structure.

2. The OEB last approved equity thickness levels for EGD[1] and Union[2] in the 2013 Rates proceedings for each utility. An approved common equity of 36% has been in place for each of EGD and Union since that time. With the amalgamation of EGD and Union in 2019[3], which formed Enbridge Gas, the deemed common equity ratio for Enbridge Gas remained at 36%.

3. Enbridge Gas believes that significant changes in the environment in which it operates have occurred since the time of the 2013 Rates proceedings. The OEB's current cost of capital policy indicates that capital structure should be reviewed only when there is a significant change in financial, business or corporate fundamentals. In order to determine if its risk profile has significantly changed since 2012, Enbridge Gas retained Concentric Energy Advisors Inc. (Concentric) to prepare an independent report on the reasonableness of the capital structure currently approved by the OEB. Concentric's findings are set out in a report entitled "Enbridge Gas Inc. Common Equity Ratio Study" (the Study) and provided at Attachment 1.

4. Concentric considered changes in Enbridge Gas's business and financial risk since the OEB's last assessment (i.e. 2012). In the context of its consideration of business

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[1] EB-2011-0354.
[2] EB-2011-0210.
[3] EB-2017-0306/EB-2017-0307, OEB Decision and Order, August 30, 2018.

and financial risk, Concentric concluded that Enbridge Gas's overall risk has significantly increased since 2012. As a result, Concentric concludes that the shift in risk profile warrants a reassessment of the Company's equity ratio.

5. Based on the increased risk profile of Enbridge Gas, Concentric recommends that the OEB approve an increase to the deemed equity ratio for Enbridge Gas from 36% to 42% to maintain financial strength and continued access to capital at a reasonable cost, and to manage the Energy Transition under a variety of economic and capital market conditions. As Concentric notes in the Study: "Our recommended equity ratio for Enbridge Gas in the upcoming rate setting period is consistent with the results of our analysis, which indicate that an increase in equity thickness is warranted. This is particularly important as the Company will need to maintain financial strength to continue accessing the debt and equity capital it needs to manage the Energy Transition under a variety of economic and capital market conditions, while providing safe and reliable service to its customers."

6. Enbridge Gas believes that an increase in its approved equity thickness to 42% is appropriate and supported by Concentric's findings. However, in order to manage the revenue requirement and rate impacts of the proposed change in equity thickness, along with the impacts of other proposals included within this Application, the Company proposes that the increase be phased in over the next incentive regulation term. As illustrated in Table 1, a 2% increase in equity thickness is proposed for the 2024 Test Year, with subsequent 1% increases in each of 2025 to 2028.

Table 1

Proposed Escalation of Equity Ratio

Line No.	Particulars (%)	2024	2025	2026	2027	2028
		(a)	(b)	(c)	(d)	(e)
1	Common Equity - Prior Year	36.0	38.0	39.0	40.0	41.0
2	Increase in Common Equity	2.0	1.0	1.0	1.0	1.0
3	Common Equity	38.0	39.0	40.0	41.0	42.0

7. The impact of increasing equity thickness from 36% to 38% in 2024, which is reflected in the requested test year deficiency, is an increase in revenue requirement of approximately $26.1 million, as provided at Exhibit 6, Tab 1, Schedules 1 and 2. An increase to 42% in 2024 would result in an increase in the revenue requirement of approximately $80.6 million, or an incremental $54.5 million. These revenue requirement impacts reflect the forecast cost of capital change that would occur between each level of equity thickness. As such, the increased return on equity at the 38% and 42% equity thickness levels, have been partially offset by corresponding reductions in debt financing. The $54.5 million revenue requirement variance between financing 2024 Rate Base at a 42% equity thickness level versus 38% level, is the total amount the Company is proposing to incorporate into rates through base rate adjustments in 2025 to 2028, in order to achieve the increase in equity thickness to 42% by 2028.

8. The revenue requirement impacts of changes to the 2024 equity thickness level were determined by calculating the cost of capital impacts that would result from forecast financing plan changes that would occur at each equity thickness level. As the level of equity thickness rises, the forecast level of 2024 term debt issuances

Ontario Energy Association (OEA)

Answer to Interrogatory from
Canadian Manufacturers & Exporters (CME)

INTERROGATORY

Reference:

Exhibit M2, p. 3

Question(s):

At page 3, Concentric states "Concentric's primary finding within the context of this generic cost of capital proceeding is that Ontario equity ratios across all industry segments are lower than North American industry peers and fail to meet the comparable return standard component of the Fair Return Standard."

a) Please confirm whether Concentric's view is that the fair return standard is not met as a result only of Ontario's equity ratios being lower than Concentric's deemed peer group (comparable investment standard) and not as a result of failing the capital attraction standard or the financial integrity standard.

b) To the extent that a) is not confirmed (ROE's fail multiple components of the FRS) please cite specific instances of Ontario utilities failing to attract capital on reasonable terms or being in danger of losing financial integrity, or any specific examples that Concentrics believe are likely to happen in the future.

Response:

a) Confirmed, to the extent that Ontario utilities historically have been able to attract capital on reasonable terms and financial integrity has not been a significant concern. The cost of capital, however, is a forward-looking concept, and equity ratios that do not meet the comparability standard will threaten the Ontario utilities' ability to attract capital at reasonable terms going forward. Further, as the OEB stated on page 19 of the 2009 Decision, EB-2009-0084, all three requirements or standards of the fair return standard must be met, and none ranks in priority to the others.

b) Concentric is not aware of Ontario utilities failing to attract capital or being in danger of losing their financial integrity since the 2009 Decision; Concentric is not able to answer the second part of the question because it requires speculation about the future. Given the uncertainty due to the Energy Transition and other risk factors,

Concentric cannot know if Ontario utilities will be able to attract capital and maintain financial integrity in the future, but our recommendations will place Ontario's utilities in a stronger position to do so.

Ontario Energy Association (OEA)

Answer to Interrogatory from
Canadian Manufacturers & Exporters (CME)

INTERROGATORY

Reference:

Exhibit M2, p. 132

Question(s):

At page 132 Concentric provides reasons why natural gas distributors risks are increasing.

a) Please provide a list of any differences in Concentric's risk analysis for EGI between EB-2022-0200 and this proceeding.

b) Please provide Concentric's view of the appropriateness of altering the capital structure of EGI a year after the Board selected the appropriate capital structure after having the benefit of a fulsome record, including Concentric's report, in EB-2022-0200.

Response:

a) Concentric's risk analysis for EGI in this proceeding builds on our analysis in EB-2022-0200, considers Energy Transition activities across North America since we developed our evidence in EB-2022-0200, and includes new evidence such as S&P's finding in June 2024 that Enbridge was on a negative credit outlook that "reflects the uncertainty around upcoming regulatory outcomes related to EGI's gas utility operations and the potential for increased business risk from the energy transition."

b) Concentric's analysis in this proceeding, which covers all segments of Ontario's utilities sector, indicates that a minimum equity ratio of 45.0% is appropriate for Ontario utilities. Given that the Board has opened this issue for all Ontario utilities in this proceeding, our recommendation is that the OEB increase the equity ratio for EGI from 38.0% to 45.0%.

- 28-Jun-2024 | 14:26 BRT

Enbridge Gas Inc. 'A-' Rating Affirmed; Outlook Remains Negative

- On June 3, 2024, Enbridge Inc. announced that it had completed the acquisition of Questar Gas Co. On June 18, S&P Global Ratings revised the outlook on Enbridge to stable from negative and affirmed our ratings, including the 'BBB+' issuer credit rating.
- Our outlook on Enbridge subsidiary Enbridge Gas Inc. (EGI) remains negative, and we affirmed the 'A-' issuer credit rating and 'A-2' short-term rating.
- We continue to assess EGI as having sufficient insulating measures to rate it up to one notch above its parent.
- At the same, we affirmed our 'A-' rating on EGI's senior unsecured debt and 'A-2' rating on its global commercial paper, which corresponds to an 'A-1(low)' rating on the Canadian national scale.
- The negative outlook reflects the uncertainty around upcoming regulatory outcomes related to EGI's gas utility operations and the potential for increased business risk from the energy transition.

TORONTO (S&P Global Ratings) June 28, 2024—S&P Global Ratings today took the rating actions listed above.

Our negative outlook on EGI reflects the potential for a gradual increase in its business risk given the Ontario Energy Board's (OEB) view on the future of gas local distribution companies in Ontario.
In 2022, EGI filed an application with OEB to set new rates for 2024-2028. OEB addressed this in two phases: phase 1 to primarily establish 2024 rates, and phase 2 primarily establish rates for 2025-2028. In December 2023, OEB issued an order on the phase 1 application, which included a reduced capital budget, revised depreciation rate, excluding undepreciated capital costs related to integration capital from the 2024 rate base, reduced customer revenue horizon associated with new natural gas connections for small commercial and residential developments from 40 years to zero, and determination of equity thickness at 38%. The order stated that the energy transition poses a risk and that gas assets used to serve existing and new EGI customers run the risk of

becoming stranded.

In January 2024, EGI filed a notice of motion with OEB, requesting review of certain aspects of the decision. While the outcome of this appeal is uncertain, OEB's order suggested higher operating risk for EGI. Additionally, in May 2024, the Government of Ontario passed a legislation which effectively reversed OEB's decision related to the customer revenue horizon period, allowing EGI to continue to add new customers.

OEB is scheduled to address phase 2 this year to establish the incentive rate-making mechanism. While EGI has taken adequate measures to trim costs and capital spending in 2024, the impact of OEB's regulatory decisions on EGI's business long-term is uncertain. We expect more clarity during phase 2 and notice of motion proceedings.

We continue to assess EGI's business risk profile as excellent.
This reflects the low-risk nature of the company's business, effective regulatory risk management, and large size that is partially offset by its limited regulatory diversity. Our view of OEB's regulatory framework, which we believe to be transparent, consistent, and predictable, underpins EGI's steady and consistent cash flow. Largely, we believe that regulatory support remains credit supportive, given the approval of 2024 rates and the increase of equity thickness to 38% from 36%. EGI's regulatory construct includes timely recovery of commodity costs, prudently spent capital, and operating expenses.

The company has a large customer base, serving almost all of Ontario's gas distribution network with about 3.9 million customers, most of which are residential and small business customers.

We continue to assess EGI's financial risk profile as significant.
We use our low-volatility financial benchmark table, reflecting the company's low-risk regulated gas distribution operations and effective management of regulatory risk. Our base-case scenario includes a stable regulatory environment with no material adverse regulatory decisions, annual capital spending remains elevated at about C$1.3 billion-C$1.5 billion annually through 2026, and dividend payments averaging about C$130 million annually through 2026. We expect funds from operations (FFO) to debt of 11%-13% between 2024 and 2026. Our base case also assumes a discretionary cash flow deficit over our forecast period, indicating external funding needs.

The negative outlook on EGI over the next 12 months reflects the uncertainty around upcoming regulatory outcomes related to EGI's gas utility operations and the potential for increased business risk from the energy transition. OEB believes this is underway, creating a risk of stranded assets for EGI, which could impede EGI's long-term capital spending initiatives, indicating higher business risk. Our base case assumes stand-alone FFO to debt will remain

11%-13% through 2026.

We could lower our ratings on EGI over the next 12 months if:

- Stand-alone financial measures deteriorate, including FFO to debt consistently below 10%; or
- Business risk increases from adverse regulatory developments or elevated risk concerning OEB's view of the long-term prospects for capital investment in the Ontario gas utility business.

We could affirm our ratings on EGI and revise our outlook to stable over the next 12 months if:

- EGI maintains stand-alone FFO to debt above 10%, with no increase in business risk; and
- There is a clear indication of OEB's long-term support for the Ontario gas business.

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- **Enbridge Inc. Outlook Revised To Stable From Negative On Close Of Acquisitions, Financing; Ratings Affirmed**, June 18, 2024

ENBRIDGE GAS INC.

Answer to Interrogatory from
Canadian Manufacturers & Exporters (CME)

Interrogatory

Reference:

Exhibit 4, Tab 4, Schedule 3, Attachment 4, p. 20 of 48; Exhibit 4, Tab 4, Schedule 3, Attachment 3, page 32 and 38 of 59.

Question(s):

At page 20, Schedule 1, the agreement lists the services provided pursuant to the Intercorporate Services Agreement. For Technology and Information Systems, the agreement lists, inter alia, the following services being provided: core infrastructure and operations; enterprise business applications; enterprise architecture and data; cyber security and governance, and the office of the Chief Information Officer.

At page 32 of 59 of Attachment 3, TIS costs were normalized for comparison with the peer group based on “total operating cost”.

At page 38, Guidehouse determined that EGI’s normalized TIS cost per $M in total operating cost was $61,319. Guidehouse determined that the minimum was approximately $26K, average was approximately $44K and the maximum was approximately $73K

a) Please list (on an anonymized basis) all of the comparators normalized TIS costs;

b) Please provide an explanation for why, on a normalized basis, EGI was significantly higher than the average TIS costs.

Response:

The following response was provided by Guidehouse:

a) The table below summarizes normalized TIS costs, based on $M of total operating cost for the relevant and anonymized utility comparators in CAD 2022 real dollars and CAD 2024 real dollars respectively.

Comparator Utility	Normalized TIS Cost (2022)	Normalized TIS Cost (2024)
1	Not available	Not available
2	$41,453	$41,453
3	$47,233	$47,233
4	Not available	Not available
5	Not available	Not available
6	$28,605	$36,446
7	$32,783	$31,240
8	$29,815	$29,815
9	$73,643	$69,610
10	$58,654	$65,577

b) Guidehouse did not specifically compare discrete components of Enbridge Gas TIS costs relative to comparator utilities to rationalize where Enbridge Gas falls within the band.

Guidehouse understood from Enbridge Gas that allocated TIS costs were, in general, increasing because of significant investment this period in improvements to system reliability, enhancing business systems and to ensure system security as cyber security threats continue to grow. These increases are following a relatively consistent period from 2018 to 2021 resulting from inflation at that time combined with reductions from synergies and restructuring due to merger integration. It was also noted that industry shifts towards TIS ‘as-a-service' models have also resulted in shifting costs, particularly shifts from capital intensive to OM&A in nature. These factors may be different in need or in timing relative to other utilities.

Given Enbridge Gas TIS costs fall within the range on a normalized basis relative to comparator utilities and were not assessed as the highest cost, Guidehouse did not determine it necessary to further test the incurrence of TIS costs. TIS costs are by nature lumpy and can vary from one period to another based on the investments being made to increase reliability, security, safety and overall efficiency of operations over the long term.