Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

November 28, 2024

Ms. Nancy Marconi
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Ontario Energy Board
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Dear Ms. Marconi:

Re: Ontario Energy Board (OEB) Staff Reply Submission
Generic Proceeding – Cost of Capital and Other Matters
OEB File Number: EB-2024-0063

Please find attached OEB staff's reply submission in the above referenced proceeding, pursuant to the deadline set out in the October 15, 2024 OEB letter.

Yours truly,

Fiona O'Connell
Senior Advisor, Regulatory Accounting, Operations Decision Support

Encl.

cc: All parties in EB-2024-0063

ONTARIO ENERGY BOARD

OEB Staff Reply Submission

Generic Proceeding – Cost of Capital and Other Matters

EB-2024-0063

November 28, 2024

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Summary of OEB Staff Reply Submission

The following is OEB staff's summary of its position on the key points raised by the parties in their submissions. In general, OEB staff does not have changes in its positions. Further, OEB staff has responded to some of the key positions taken by parties.

OEB staff maintains the view we expressed in our first submission that drastic changes are not required to either the return on equity (ROE) or the deemed capital structure in order to continue meeting the Fair Return Standard.

Our middle-ground and moderate approach recognizes that the current cost of capital policy has enabled Ontario utilities to raise the capital they need. Our approach would allow for departures from the generic ROE or capital structure where the particular circumstances of a utility so require, for instance, where the utility can show that the default values would be insufficient to allow it to embark on a unique and specific capital program driven by the energy transition.

OEB staff agrees with London Economics International LLC (LEI) that there is "limited merit in modifying aspects of the methodology that have worked well".[1] One aspect of the methodology that is demonstrably not working well is the inclusion of the 50 basis point adder, which overcompensates utilities. The OEB should follow the British Columbia Utilities Commission's (BCUC) lead and eliminate it.

OEB Staff Submission

OEB staff makes the following submissions on certain issues. The organization of this submission is by topic (as opposed to by issue number). However, for each topic OEB staff has included a reference in the sub-title to the issue number.

Base Return on Equity (Issue 10)

After reading the submissions of the parties, OEB staff continues to recommend a base ROE somewhere in the range of 8.79% and 9.32%, with no flotation cost adder.

A base ROE in that range would meet the three prongs of the Fair Return Standard: it would enable utilities to continue attracting capital on reasonable terms, even during the energy transition; it would maintain their financial integrity; and it would be comparable to the approved ROE in other jurisdictions.

[1] LEI Expert Report, June 21, 2024, Revised September 23, 2024, p. 41.

Drastic Changes are Not Required to Continue Meeting the Fair Return Standard

The OEB's current cost of capital parameters, including the ROE, are working well. As Mr. Goulding of LEI said at the oral hearing, "the proof of the pudding is in the eating."[2] An ROE at the lower end of OEB staff's recommended range would represent only a modest decrease from the approved ROE for 2024 of 9.21% and the interim ROE for 2025 of 9.25%. An ROE at the higher end would represent a slight increase.

The Electricity Distributors Association (EDA) is incorrect to state that "there is no evidence either way" on whether Ontario utilities have experienced difficulty attracting capital.[3] In fact, all three experts who expressed a view on that question – only EDA's own expert did not – said that utilities have not had difficulty raising capital on reasonable terms since the OEB's current cost of policy was introduced in 2009. Concentric Energy Advisors, Inc. (Concentric) said it was "not aware of Ontario utilities failing to attract capital or being in danger of losing their financial integrity since the 2009 Decision."[4] Concentric should know – Mr. Coyne emphasized how "we work with investors every day, every month on both sides of the border, looking at investments in utilities."[5] LEI and Dr. Cleary also opined that they were unaware of utilities having trouble raising capital.[6]

The EDA is right that the Fair Return Standard is a forward-looking concept.[7] But the fact that the current policy has supported a healthy energy sector for 15 years (since the last comprehensive review conducted by the OEB in 2009) is a strong indication that drastic changes are not required. While some risks facing the sector may have increased, others (such as regulatory risk) have decreased.

The EDA proposes a base ROE (for electricity distributors only) of 11.08%.[8] That would be a 183 basis point increase from the 2025 interim ROE of 9.25%. The Ontario Energy Association (OEA) recommends 10.0%, a more modest increase, but one that is premised on raising the equity thickness for all utilities to at least 45%.[9] Several ratepayer intervenors, by contrast, recommend a sharp drop in ROE. Some of them even propose an ROE lower than the 7.05% recommended by Dr. Cleary (e.g., the Association of Major Power Consumers in Ontario (AMPCO) and Industrial Gas Users

[2] Oral Hearing Transcript, September 25, 2024, p. 66.
[3] EDA Submission, November 7, 2024, p. 41.
[4] N-M2-10-CME-1, August 22,2024.
[5] Oral Hearing Transcript, September 27, 2024, p. 150.
[6] LEI and Dr. Cleary said essentially the same thing in their reports: LEI Expert Report, June 21, 2024, Revised September 23, 2024, pp. 127-128; Dr. Cleary Expert Report, July 22, 2024, p. 47.
[7] EDA Submission, November 7, 2024, p. 41.
[8] EDA Submission, November 7, 2024, p. 57.
[9] OEA Submission, November 7, 2024, p. 5.

Association (IGUA) proposed 6.45% or 6.55%, depending on the implementation date – a drop of 270 to 280 basis points).[10]

A change of that magnitude – either upward or downward – is not required. Although AMPCO and IGUA ground their recommendation in the "common sense" proposition that the approved ROE should be lower than expected overall equity returns, which Dr. Cleary estimated at 7.5%,[11] Dr. Cleary himself conceded that a reduction in ROE to 7% could have a chilling effect among credit rating agencies.[12] Reducing the ROE to around 7% or below would also, as OEB staff noted in our first submission, make Ontario the lowest-ROE province in Canada, by a fair margin (according to Concentric, Newfoundland and Labrador is currently the lowest, at 8.50%).[13] The Consumers Council of Canada (CCC) suggests that other Canadian regulators would follow the OEB's lead.[14] But there is no way to know that for certain, in OEB staff's view, the "prisoner's dilemma" is real.[15]

At the other extreme, raising the ROE above 11% as proposed by the EDA would provide utilities with returns that are higher than necessary to meet the Fair Return Standard. The EDA is correct that the courts have said that the rate impact of meeting the Fair Return Standard is "an irrelevant consideration".[16] Still, the OEB has an obligation to ensure that consumers do not overpay. As we pointed out in our first submission, the Supreme Court has said that "the essential balance at the heart of utilities regulation" means that "utilities must be allowed, over the long run, to earn their cost of capital, no more, no less."[17]

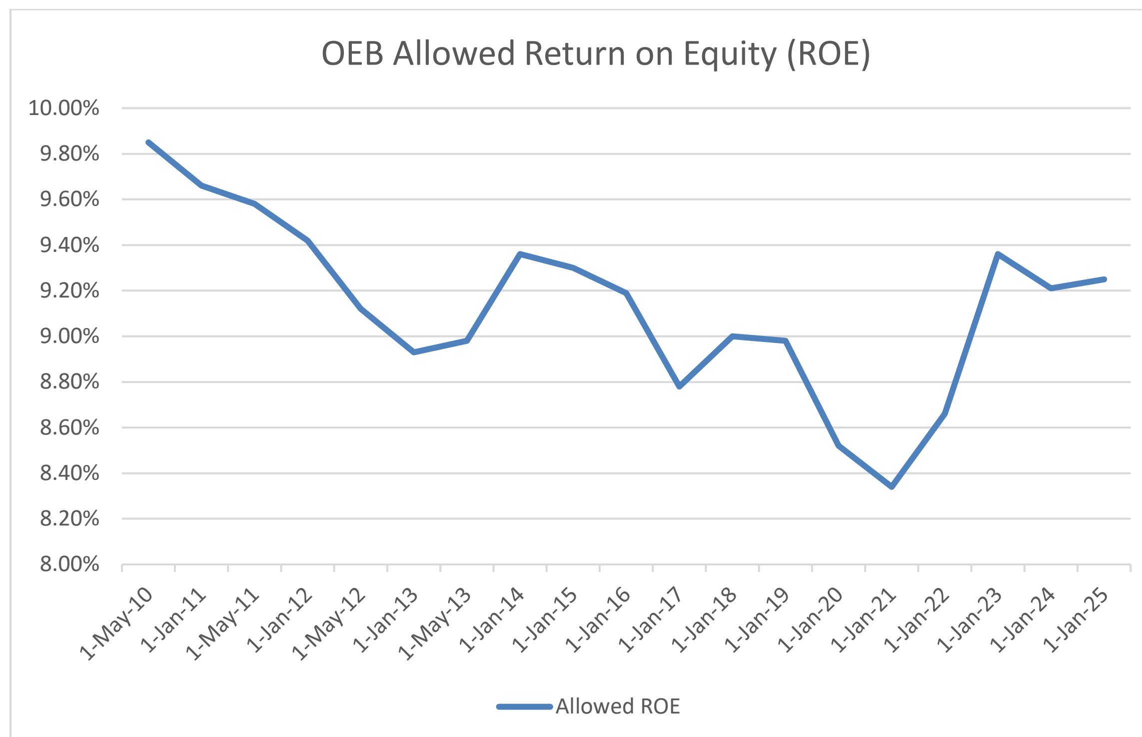
OEB staff submits that our recommended ROE range strikes the right balance, and ensures that energy is as affordable as possible for consumers while allowing utilities to attract the capital they need.

OEB staff's recommended range represents continuity and moderation. The graph below in Chart 1 shows the OEB-approved ROE since the current policy was implemented in 2010. The utilities would have the OEB raise the ROE to a level higher than it has ever been since then; some ratepayer groups would have the OEB reduce it

[10] AMPCO/IGUA Submission, November 7, 2024, p. 15.
[11] AMPCO/IGUA Submission, November 7, 2024, p. 3.
[12] Oral Hearing Transcript, October 10, 2024, p. 185
[13] OEB Staff Submission, November 7, 2024, p. 21.
[14] CCC Submission, November 7, 2024, pp. 64-65.
[15] OEB Staff Submission, November 7, 2024, p. 23.
[16] EDA Submission, November 7, 2024, p. 11, citing *TransCanada Pipelines Ltd. v. National Energy Board,* 2004 FCA 149.
[17] *Ontario (Energy Board) v. Ontario Power Generation Inc.,* 2015 SCC 44; OEB Staff Submission, November 7, 2024, p. 14

to its lowest point since then.

Chart 1 – Graph of OEB Allowed ROE



As for precisely where in the range the panel should land, OEB staff does not make a recommendation. The panel of Commissioners should exercise its judgment as to whether the current ROE is slightly too high, slightly too low, or just right. The midpoint of our proposed range is 9.06%. Adopting the interim 2025 ROE of 9.25% as the final base ROE might be easiest from an implementation perspective, as utilities who have rebased for 2025 using the interim number would not have to do any recalculations.

Use of Non-Canadian Comparators (Issues 10 and 12)

It is true that authorized returns in US jurisdictions tend to be higher than in Ontario. However, US utilities generally have higher risk than Ontario utilities. US utilities therefore require a higher return in order to attract investors. Approved ROEs have been higher in the US than in Ontario for at least 15 years, as shown in Figures 28 and 29 of Concentric's report.[18] If North American financial markets are integrated, and rational investors seek the highest risk-adjusted returns (neither of which premises OEB staff disputes), one would expect to have seen evidence of capital flight from Ontario

[18] Concentric Report, July 19, 2024, pp. 85 & 86

utilities by now. But we have not seen that, which suggests that investors are willing to accept lower returns in Ontario because the risk is lower.

Large portions of the oral hearing and the parties' written submissions were devoted to the experts' choice of comparator utilities. A common theme among the ratepayer group submissions is that the utility experts relied too much on US comparators. The utility groups say that the ratepayer expert, Dr. Cleary, inappropriately relied only on Canadian comparators, and also (perhaps somewhat inconsistently) that his Canadian sample included several companies with international footprints.

To underscore what we said in our first submission, there is no magic formula for deriving an ROE that meets the Fair Return Standard. Each of the four expert reports has its strengths and weaknesses. Triangulating between various recommendations derived through various methodologies, as the OEB did in 2009, is a sensible approach. OEB staff does not agree with the OEA that Dr. Cleary's ROE recommendation should be completely disregarded and given no weight.[19] His approach provides a needed counterbalance to the two utility experts whose results, as we said in our first submission, are skewed towards the high side.

OEB staff does not agree either with CCC, who argues that the OEB should rely solely on Dr. Cleary's "Bond Yield Plus Risk Premium" analysis because it does not incorporate authorized returns for utilities in other jurisdictions.[20] Even Dr. Cleary does not recommend using that model alone; his ROE recommendation is based on a blend of three models. Moreover, the Fair Return Standard is inherently comparative: one of the three prongs is the comparative investment standard. All four experts looked at comparative data, which is consistent with what the OEB did in 2009.

Interestingly, none of the four experts looked at comparators outside Canada and the US, even though financial markets have become globally integrated. Mr. Goulding of LEI noted at the oral hearing, "as you go out to raise equity for a utility, you know, you are going to be competing in global capital markets, the very pension funds that we talked about are invested, you know, in Australia, in the UK, in the US, we have Canadian utility investors invested in the US."[21] OMERS, for instance, has offices around the world, including London, Berlin, Singapore, Sydney and Palo Alto.[22] It might be worthwhile broadening the scope of comparators the next time the OEB reviews the cost of capital, whether in a generic proceeding or a utility-specific application.

[19] OEA Submission, November 7, 2024, p. 51.
[20] CCC Submission, November 7, 2024 p. 53.
[21] Oral Hearing Transcript, September 26, 2024, p. 44
[22] https://www.omers.com/locations.

OEB staff's recommended ROE range is in line with what other Canadian energy regulators have approved.[23] It is lower than the typical US ROE, but that is because Ontario utilities are generally lower risk than US utilities and therefore do not need to provide as high a return in order to attract capital. Moreover, as the School Energy Coalition (SEC) observed in its submission, US ROEs "are not always the product of strict financial modeling. Some are influenced by policy and other factors that the specific regulator believes are appropriate."[24]

Flotation Cost Adder (Issue 10)

The only parties who support maintaining the current 50 basis point flotation cost adder are the OEA and the EDA.[25]

OEB staff submits that neither of them has provided an explanation for why 50 basis points is the right level to compensate utilities for their equity transaction costs. The EDA acknowledges that the adder is "difficult to quantify with precision", but the only reasons it can point to for setting it at 50 basis points are that the OEB adopted 50 basis points in 2009, and some other jurisdictions also use 50 basis points.[26] As we argued in our first submission, there is no empirical basis for 50 basis points.

On a more fundamental level, OEB staff remains unpersuaded that <u>any</u> flotation cost adder is justified. We will not repeat what we said in our first submission about why it would be preferable to allow utilities to recover their actual transaction costs in a rate case. We will, however, respond to two arguments raised by the EDA.

First, the EDA says, "Addressing flotation costs otherwise than as a component of equity costs is also inconsistent with IAS 32, which provides: 'Costs of issuing or reacquiring equity instruments are accounted for as a deduction from equity.'"[27] It is not obvious to OEB staff that there is in fact an inconsistency with this International Accounting Standard; utilities can seek their own accounting advice on that. Even if it is, that would not preclude OEB staff's recommended approach. As the OEB's Accounting Procedures Handbook for Electricity Distributors explains, accounting requirements cannot dictate what is "just and reasonable":

[23] As OEB staff noted in our first submission (November 7, 2024 on p. 21), Concentric reported that the average approved ROE for electricity utilities in Canada is 9.16%; for gas utilities it is 9.23%.
[24] SEC Submission, November 7, 2024, p. 16.
[25] Also, Pollution Probe stated that "the OEB could decide to leave the 50 basis point adder in place for convenience or use a 25 basis point adder and allow utilities to come forward with evidence in their rates proceeding should they want to request approval of a higher value (i.e. the difference)": Pollution Probe Submission, November 7, 2024, p. 14.
[26] EDA Submission, November 7, 2024, pp. 38-39.
[27] *Ibid.*, p. 38.

> The methodologies used by the Board to establish just and reasonable rates have not always been the same as those used for external financial reporting purposes. The Board has and will retain the authority to establish regulatory accounting and regulatory reporting requirements. While IFRS accounting requirements are an important consideration in determining regulatory requirements, the objective of just and reasonable rates will continue to be the primary driver of such requirements.[28]

Second, the EDA asserts that "if the Board were to remove flotation costs from its authorized ROE, it would be effectively confiscating from utilities their as-yet-unrecovered past equity costs. This is because the historical 50 basis points adder reflects an amortization over infinity."[29] This ignores the fact that many Ontario utilities, which were created through the industry restructuring over 20 years ago, have never actually incurred equity transaction costs.[30] To the extent they <u>have</u> incurred transaction costs, there is every reason to believe that utilities were <u>over</u>-compensated for those costs by the excessive 50 basis point adder. Replacing the adder should be seen as a correction, not a confiscation.

Return on Equity Annual Update Formula (Issue 10)

OEB staff supports Concentric's recommendation for adjustment factors of 0.40 for the Long Canada Bond Forecast (LCBF) and 0.33 for the utility credit spread.[31] This approach recognizes the lower empirical relationship between ROEs and bond yields compared to previous years, while still maintaining the formula's sensitivity to changes in interest rates and utility credit spreads.[32] Concentric explained that the allowed ROE movements have not followed government bond yield and credit spread movements as closely as they previously have.[33]

Should the OEB not approve Concentric's adjustment factors, OEB staff would next recommend maintaining the existing adjustment factor of 0.5 for both factors as a reasonable alternative, as it is balanced between consumer and utility's interests. Also, a number of parties that supported maintaining the existing adjustment factors: CCC, SEC, and the Vulnerable Energy Consumers Coalition (VECC) stated that 0.5 is reasonable and Dr. Cleary stated that 0.5 is preferable to LEI's proposed adjustment factors.[34]

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[28] Accounting Procedures Handbook for Electricity Distributors, Article 315, p. 5.
[29] EDA Submission, November 7, 2024, p. 38.
[30] Oral Hearing Transcript, September 27, pp. 185-186.
[31] Concentric Expert Report, July 19, 2024, p. 98.
[32] Concentric Expert Report, July 19, 2024, p. 105.
[33] N-M2-10-OEB Staff-9, August 22, 2024.
[34] CCC Submission, November 7, 2024, p. 68; SEC Submission, November 7, 2024, p. 44; VECC Submission, November 8, 2024, p. 69; Dr. Cleary Expert Report, July 22, 2024, p. 45.

Ownership (Issue 1)

Energy Probe Research Foundation and the Coalition of Concerned Manufacturers and Businesses of Canada (CCMBC), who are both represented by the same consultant in this proceeding, argued that the approach to determining the cost of capital should differ depending on who owns the utility.[35] They argued in particular that municipally owned and provincially owned utilities should be treated differently than privately owned ones. That is a minority view, which was not endorsed by any of the four experts. All experts agreed, rather, that what matters is the use of funds, not the source of funds.[36] OEB staff does not see a compelling reason to depart from the OEB's current approach, enshrined in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009 (OEB Report),[37] of determining the cost of capital "regardless of ownership".[38]

Capital Structure (Issue 12 and 13)

OEB staff stands by our recommendations in our first submission in respect of capital structure, namely that:

- The deemed equity ratio for electricity distributors and transmitters should remain at 40%
- A distributor or transmitter should be permitted to apply for a tailored equity ratio when it rebases; it would need to demonstrate that its particular risk profile justifies a departure from the generic equity ratio
- The equity thickness for Ontario Power Generation Inc. (OPG) and natural gas utilities should continue to be determined on a case-by-case basis
- The equity thickness for Enbridge Gas Inc. (Enbridge Gas), which was set less than a year ago at 38%, should not be adjusted in this proceeding, nor should that for Hydro One Networks Inc. (Hydro One)

In its submission, SEC went further than Dr. Cleary (who recommended a reduction in equity thickness for Enbridge Gas and Hydro One) and suggested that the deemed ratio for all electricity distributors and transmitters be reduced from 40% to 37%, one percentage point lower than Enbridge Gas's current ratio.[39] SEC argues that, "While in the past, natural gas utilities may have been considered safer, due to changes in risk

[35] CCMBC Submission, November 7, 2024, p. 3; Energy Probe Submission, November 7, 2024, p. 4
[36] Oral Hearing Transcript, September 26, 2024, p. 101.
[37] EB-2009-0084
[38] OEB Report, p. 25.
[39] SEC Submission, November 7, 2024, p. 6.

and regulatory developments in Ontario, that is no longer the case."[40] The OEA, relying on its expert, Concentric, agrees that the natural gas sector in Ontario is now riskier than electricity,[41] but its proposed solution is to raise the minimum equity ratio for all utilities to 45% while allowing individual utilities to request a utility-specific ratio.

OEB staff does not agree with SEC that the equity ratio for electricity distributors and transmitters should be lowered in this proceeding by 300 basis points. There was simply not enough evidence to support that. None of the experts recommended an across-the-board reduction to the equity ratio for electricity distributors and transmitters, so the implications have not been fully explored. SEC offers that, "If the OEB feels that more information is required, such as a cash flow analysis as LEI suggests, then it should initiate a second phase of this proceeding to obtain that information."[42] That is certainly an option, but not one that OEB staff would support. Parties have already had ample opportunity to put forward their own expert evidence and test the evidence of the other experts.

While OEB staff acknowledged in our first submission that "it may appear somewhat incongruous for Enbridge Gas to have the lowest approved equity ratio of any Ontario utility",[43] the fact is that Enbridge Gas's equity ratio was comprehensively reviewed less than a year ago in its rebasing application (EB-2022-0200). The OEB in that case approved an increase from 36% to 38% (not the 42% that Enbridge Gas had asked for), knowing full well that 38% would still be below the deemed ratio for electricity distributors and transmitters.

SEC raises another point that OEB staff would like to respond to briefly. SEC takes issue with LEI's proposal (which OEB staff supported in our first submission) to maintain the status quo of allowing utilities to request a departure from the generic capital structure if they believe their particular circumstances require it. SEC says, "it would be up to the applicant to bring forward a proposal to adjust their capital structure when there is an increase in business and/or financial risk. This asymmetrical approach is unfair to customers. There is no requirement for a utility to seek an adjustment to their capital structure when those risks decline."[44]

OEB staff would support allowing an intervenor to recommend a utility-specific equity ratio <u>lower</u> than the generic ratio during a rebasing application. We acknowledge that it may practically be more difficult for an intervenor to advance such a position than it

[40] SEC Submission, November 7, 2024, p. 18.
[41] OEA Submission, November 7, 2024, p. 75.
[42] SEC Submission, November 7, 2024, p. 23.
[43] OEB Staff Submission, November 7, 2024, p. 35.
[44] SEC Submission, November 7, 2024, p. 23.

would be for the utility to ask for a higher ratio. Nevertheless, intervenors have access to funding under section 30 of the *Ontario Energy Board Act, 1998*, including for retaining experts. In sum, what OEB staff proposes is not asymmetrical – any party, not just the utility applicant, could request a departure from the generic equity ratio.

Also, OEB staff continues to support the short-term debt component of electricity distributors' and electricity transmitters' deemed capital structure to be 4%. This is given that there has been no evidence to the contrary, other than VECC stating that the OEB "would be hard pressed to provide a rationale for the figure of 4%".[45]

Implementation (Issues 18 and 19)

OEB staff's recommended base ROE does not depart significantly from the current approved ROE and OEB staff proposes to keep the deemed capital structure the same. Based on that, OEB staff continues to recommend that changes to the cost of capital parameters and capital structure should be implemented at rebasing, and not sooner. This approach promotes rate stability and reduced regulatory burden, and is aligned with the Fair Return Standard. OEB staff also notes that most parties recommend that any changes resulting from this proceeding should be implemented for each regulated utility at the time of rebasing. Both CCC and SEC raised the issue of the practicality of implementing the changes before the rebasing applications for more than 60 utilities in Ontario.[46]

As noted in OEB staff's submission, the revised cost of capital policy should apply to all utilities filing cost-based applications for 2025 and forward rates, with the exception being those where a decision for 2025 rates has been issued in advance of the OEB's decision in this proceeding or where parties have reached a settlement agreement on cost of capital matters and implementation.

OEB staff also notes that under the OEB's current mergers, acquisitions, amalgamations and divestitures (MAADs) policy, merged utilities may elect to defer rebasing for up to 10 years after consolidating. OEB staff notes that GrandBridge Energy Inc. is not expected to file its first post-merger rebasing application until 2032 rates; Enova Power Corp. is not expected until 2033 rates. That is not a concern for OEB staff, but we did want to highlight that under our proposed implementation approach, some utilities will continue to operate under the previously approved parameters for some time.

[45] VECC Submission November 8, 2024, p. 13.
[46] CCC Submission, November 7, 2024, p. 76; SEC Submission, November 7, 2024, p. 54.

Short Term Debt Rate (Issues 4 and 5) and Long Term Debt Rate (Issues 6, 7, 8)

OEB staff continues to support the recommendation to apply a cap on the short-term debt rate and the long-term debt rate for all utilities (and not only for electricity distributors and electricity transmitters).[47] In OEB staff's view, this allows for predictability, transparency, and fairness in approach to both consumers and utilities, given that all utilities would be subject to a cap (and not only electricity distributors and electricity transmitters). Transitioning away from the status quo has associated benefits (i.e., reduced costs passed through to ratepayers) that may prove to be material, in the event that Enbridge Gas's and OPG's actual short-term debt rates and actual long-term debt rates are significantly higher than the deemed short-term debt rate (DSTDR) and deemed long-term debt rate (DLTDR), respectively.

Regarding the short-term debt rate, the OEA noted that in its view, the status quo methodology has worked well and LEI was unable to identify any actual harm its approach tries to mitigate.[48] OEB staff is of the view that the status quo methodology might have worked well in the past, but that was generally in periods where short-term rates were lower than long-term rates, so any impacts between the DSTDR and actual short-term debt rates may be amplified in the event that the yield curve becomes inverted again (i.e., when short-term rates are higher than long-term rates).

Regarding the long-term debt rate, the OEA noted that in its view, LEI was unable to articulate, demonstrate or provide an example of the mischief (or benefit) LEI was trying to prevent (or achieve) with its recommendation to impose a cap on long-term debt rates.[49] OEB staff is of the view that the status quo methodology might have worked well in the past when the yield curve was inverted (i.e., when short-term rates are higher than long-term rates), but might not work as well in periods of a "normally" shaped yield curve (when long-term rates are higher).

Also, OEB staff continues to support the use of 12-month trailing data, despite SEC's suggestion that the OEB consider averaging yields over a range such as five days, to smooth out daily fluctuations that may be due to "noise",[50] compared to using a point-in-time actual rate (as suggested by Dr. Cleary). OEB staff is reiterating in this submission that using a trailing 12-month period would be consistent with the applicable duration of the LCBF (i.e., the 12-month period from January to December for the subsequent

[47] OEB Staff Submission, November 7, 2024, pp. 7 & 12.
[48] OEA Submission, November 7, 2024, p. 18.
[49] OEA Submission, November 7, 2024, p. 25.
[50] SEC Submission November 7, 2024, pp. 46 & 47.

year).[51]

The OEB Report states that "the deemed long-term debt rate [DLTDR] will act as a proxy or ceiling for what would be considered to be a market-based rate by the Board in certain circumstances." [52] SEC argued that the OEB should clarify its policy for its long-term debt rate by specifying that for debt with less than 30 years to maturity, the DLTDR should act as a cap or ceiling, but not as a proxy, to reflect the term of the debt.[53] OEB staff agrees with SEC on this point.

OEB staff recommends that for affiliate debt with a fixed rate, the DLTDR at the time of issuance should continue to be used as a ceiling on the rate allowed for that debt, as set out in the OEB Report.[54] OEB staff submits that the OEB should clarify that its current policy is designed to ensure utilities are borrowing at market rates, even in scenarios where a regulated utility's borrowings are done through a parent or holding company.[55]

OEB staff submits that any debt which is negotiated on a non-arms length basis (i.e., not market based debt) should be subject to a ceiling using the DLTDR at the time of issuance, to further ensure that utilities are borrowing at rates similar to market rates.[56]

Notional Debt (Issue 9)

In the OEB Staff Report, *Review of the Cost of Capital for Ontario's Regulated Utilities*, January 14, 2016, (Staff Report),[57] it was noted that the OEB had determined in a number of cases that notional debt should attract the weighted average cost of actual long-term debt rate, rather than the DLTDR issued by the OEB.[58] OEB staff notes that debt costs have generally risen in recent years, after exceptionally low rates incurred during the COVID pandemic. Therefore, the issue of notional debt and its associated impact on the long-term debt rate to be incorporated into base rates has been more acute since that time and accordingly there should be incentives for utilities to do prudent financial planning.

OEB staff agrees with SEC that there may have been inconsistent direction approved

[51] OEB Staff Submission November 7, 2024, p. 39.
[52] OEB Report, p. 53.
[53] SEC Submission November 7, 2024, p. 49.
[54] OEB Report, p. 53.
[55] VECC Submission November 8, 2024, p. 17.
[56] VECC Submission November 8, 2024, p. 18.
[57] EB-2009-0084
[58] Staff Report, January 14, 2016, p. 7.

by the OEB in the past when addressing notional debt.[59] Therefore OEB staff is of the view that a consistent approach may be decided by the OEB in this proceeding to be used going forward, specifically to clarify what type of debt rate should apply to notional debt (e.g., actual debt rate versus the DLTDR).

OEB staff agrees with VECC that ratepayers should not be at risk for utilities with significant variance between the actual and deemed capital structure and that the OEB should adjust its policy for pricing “notional” debt.[60] Ratepayers should receive the benefit of the optimum portfolio of debt. The risk in departing from the deemed structure should lie solely with the shareholder as the shareholder is responsible for a sound financial plan. Therefore, to ensure fairness in approach to consumers and utilities, OEB staff submits that notional debt should attract the lower of the weighted average cost of actual long-term debt rate and the DLTDR at the time of issuance, but only when there are material variances relating to the notional debt (i.e., with material impacts on the revenue requirement).

Monitoring (Issues 14 and 15)

OEB staff recommends that additional reporting be constrained to those things for which the review process is specified, and the eventual use of that reporting item or report is clear. This principled approach to additional reporting maintains the balance between regulatory burden and the OEB's monitoring function.

As an example, OEB staff disagrees with LEI, Concentric, Dr. Cleary and VECC,[61] that providing credit rating reports annually, or as amended, is necessary. Firstly, credit rating agency reports are not issued on a fixed schedule, nor the same schedule for the multiple entities the OEB regulates. This could leave the OEB with an incomplete picture in any given year. Further, OEB staff submits that the OEB will decide on the review cycle for the cost of capital (see issue #17) and through those subsequent reviews ensure the financial integrity component of the Fair Return Standard continues to be met. OEB staff is recommending five years for the next cost of capital review. Any credit rating agency reports can be reviewed together at that time, which allows for the review to take into account broader credit market trends and holistic performance.

[59] SEC Submission, November 7, 2024, pp. 47 & 48.
[60] VECC Submission November 8, 2024, p. 19.
[61] LEI Expert Report, June 21, 2024, Revised September 23, 2024, p. 151; Dr. Cleary Expert Report, July 22, 2024, pp. 51 & 52; Concentric Expert Report, July 19, 2024, pp. 143 & 144; VECC Submission, November 8, 2024, p. 82.

Energy Transition (Issue 2)

In its first submission, OEB staff noted that until the cost of capital policy may be reviewed again in five years, any uncertainty from the energy transition can be addressed in utilities' respective cost-based rate applications or in applications made under the OEB's *Non-Wires Solutions (NWS) Guidelines for Electricity Distributors*, March 28, 2024.[62] OEB staff also noted that outside of this proceeding there are other initiatives that address applications for energy transition investment.

OEB staff submits that facilitating NWS is beyond the scope of this current proceeding. That was addressed in the NWS Guidelines. Moreover, the OEB is conducting a consultation to advance its performance-based approach to rate regulation.[63] The objective of this initiative is to develop ways to strengthen the link between what electricity distributors earn and the achievement of outcomes consumers value, such as cost-effectiveness, reliability and customer service.

First Nations Concerns (Issues 1, 13, 20, and 21)

A joint submission was filed by the Three Fires Group Inc. (TFG), an Indigenous business corporation that represents the interests of Chippewas of Kettle and Stony Point First Nation and Minogi Corp. (Minogi). Minogi is an Indigenous business corporation that represents the interests of Mississaugas of Scugog Island First Nation. Another joint submission raising similar issues was filed by the Caldwell First Nation (CFN) and Mississaugas of the Credit First Nation (MCFN).

OEB staff would first like to respond to these parties' suggestion that there have been procedural shortcomings in this hearing, before addressing their specific proposals.

<u>The Duty to Consult Has Not Been Triggered in this Case</u>

TFG and Minogi argue that the OEB's "previous proceedings relating to the cost of capital have failed to account for the rights and entitlements of Indigenous people", and that "The current proceeding runs a high risk of repeating these errors and omissions of the past, most notably due to the silence of the four expert reports in this proceeding … on issues relating to Indigenous participation, Indigenous interests, or the impact of the matters at issue in this proceeding on Indigenous peoples."[64] They further suggest that the constitutional duty to consult has been triggered in this proceeding. CFN and MCFN

[62] EB-2024-0118, Non-Wires Solutions Guidelines for Electricity Distributors, March 28, 2024, p. 6.
[63] EB-2024-0129
[64] TFG/Minogi Submission, November 7, 2024, p. 3-4.

supported those arguments, alleging that there has been a "complete lack of engagement with First Nations by the four expert reports".[65]

OEB staff does not agree that the duty to consult has been triggered. As TFG and Minogi put it, "The duty will arise where a potential or recognized Aboriginal or treaty right may be negatively impacted by a decision."[66] But they have not pointed to any particular Aboriginal or treaty right that is engaged in this generic cost of capital proceeding, let alone how such a right might be negatively impacted. Rather, they assert broadly that "Ontario's energy sector is likely on the cusp of massive levels of development as part of Canada's broader efforts to decarbonize, which as noted will likely produce extensive development affecting Aboriginal rights, the rights of Indigenous Peoples, Indigenous lands and traditional territories, as well as the resources on those lands and territories," and that "The questions that this cost of capital proceeding addresses will have far-reaching influence on who participates in that development and consequently how the development takes place."[67]

OEB staff submits that these potential impacts are too indirect and speculative to give rise to the duty to consult. While TFG and Minogi are correct that there need not be an "immediate impact on lands and resources" for the duty to be triggered,[68] the impact must be real and identifiable. As the Saskatchewan Court of Appeal put it:

> The jurisprudence is clear: there is a meaningful threshold for triggering the duty to consult. To trigger it, actual foreseeable adverse impacts on an identified treaty or Aboriginal right or claim must flow from the impugned Crown conduct. While the test admits possible adverse impacts, there must be a direct link between the adverse impacts and the impugned Crown conduct. If adverse impacts are not possible until after a later-in-time, independent decision, then it is that later decision that triggers the duty to consult.[69]

That passage has been cited approvingly by other courts, including the Federal Court in a decision earlier this year which also noted that "speculation does not satisfy" the test for triggering the duty.[70]

This proceeding is about updating the cost of capital built into rates for regulated utilities. It is not about approving energy infrastructure – on First Nations lands or anywhere. If such infrastructure is proposed on First Nations lands, the duty may well be triggered at that time, and if it is a gas pipeline requiring leave to construct under the

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[65] CFN/MCFN Submission, November 7, 2024, p. 3.
[66] TFG/Minogi Submission, November 7, 2024, p. 25.
[67] *Ibid.*, p. 29.
[68] *Ibid.,* p. 26.
[69] *Buffalo River Dene Nation v Saskatchewan (Energy and Resources)*, 2015 SKCA 31, para. 104.
[70] *Innu Nation Inc. v. Canada (Crown-Indigenous Relations)*, 2024 FC 896, para. 132.

Ontario Energy Board Act, 1998, the OEB would have a role in discharging the duty. The duty has not been triggered in this proceeding.

The Process Has Been Open and Fair

Although the duty to consult is not at issue, there has been consultation in this case with persons having a substantial interest, including Indigenous communities. TFG, Minogi, CFN and MCFN were all approved as intervenors and granted cost eligibility.[71] They had the same opportunity to participate in the hearing as any other party. TFG and Minogi, especially, did participate fully, including by making an opening statement at the outset of the oral hearing and conducting extensive cross-examination of the witnesses. Although these parties fault the four experts for not properly considering Indigenous interests, they did not present their own evidence through an expert report, despite the availability of funding for such evidence under section 30 of the *Ontario Energy Board Act, 1998*.

In OEB staff's view, their criticism of the four experts is unfounded. The expert reports were framed around the issues on the approved issues list. The only issue that spoke directly to Indigenous matters was issue 1(b), which asked, "Should the approach to setting cost of capital parameters and capital structure differ depending on: … b) The different types of ownership (e.g., municipal, private, public, co-operative, not for profit, Indigenous / utility partnership, etc.)?"[72] LEI, Concentric and Dr. Cleary all answered that question in the negative,[73] which is consistent with the OEB Report, which said, "The Board sees no compelling reason to adopt different methods of determining the cost of capital based on ownership."[74] OEB staff agrees with the current OEB policy and the consensus view of the experts. (Nexus Economics LLC did not address the question in its expert report.[75])

It is not reasonable to expect the experts to have engaged directly with Indigenous groups in the preparation of their reports. When asked in an interrogatory why it did not do so, LEI explained, "It is neither usual nor appropriate for an independent consultant in a litigated proceeding to consult with any potential participant in drafting a report. Doing so raises the risk of perceived bias especially given that all parties have the opportunity to comment in the proceeding itself."[76] LEI elaborated in the oral hearing: "I

[71] OEB letter re Late Intervention Requests, June 26, 2024.
[72] Approved Issues List, April 22, 2024.
[73] LEI Expert Report, June 21, 2024, Revised September 23, 2024, p. 51; Concentric Expert Report, July 19, 2024, p. 20; Dr. Cleary Expert Report, July 22, 2024, p. 16.
[74] OEB Report, pp. 25 & 26.
[75] Nexus Expert Report, July 19, 2024, p. 2.
[76] N.M1-12-TFG/Minogi-1, August 22, 2024.

think we have attempted to be fair to all stakeholders. We are not here to represent any individual stakeholder. And what we have presented is consistent with academic and economic theory, and so we neither present the perspectives of individual stakeholders, nor do we try to specifically look at alternatives for one particular group."[77] OEB staff agrees with LEI. Again, the four First Nations intervenors chose not to hire their own expert. Even so, they have had an opportunity to test the evidence of the other experts and to make submissions.

The First Nations Intervenors' Specific Proposals

For all that OEB staff takes issue with the First Nations Intervenors' critique of the process, we agree to some extent with their other recommendations.

TFG and Minogi outline three specific proposals, which CFN and MCFN endorse:

1. They ask that the OEB provide for "a risk premium for single-asset transmitters in cases of Indigenous equity participation that satisfies a reasonable materiality threshold, reflecting the fact that questions relating to the capital structure for single-asset transmitters carry significant impacts for Indigenous investors, reflecting the higher levels of risk involved."[78]
2. They ask that the weighted average cost of capital (WACC) be applied to construction work in progress (CWIP) balances for large, multi-year projects and investments
3. They ask the OEB to confirm the availability of "concurrent cost recovery" (CCR) for large, multi-year projects, i.e., a mechanism to allow for recovery during construction, before the project is in service

On the first item, TFG and Minogi do not ask the OEB to approve a generic risk premium in this case. Rather, they say that "precise differentials could be proposed and supported in the context of utility-specific rates applications".[79] Such an approach is consistent with what OEB staff proposed in our first submission. OEB staff is supportive of allowing transmitters – whether they have Indigenous equity or not – to apply for a deviation from the default cost of capital parameters on a case-by-case basis. If a utility can prove that its particular risk profile demands, say, a higher ROE in order to meet the Fair Return Standard, then it should get it. To be clear, this would be consistent with current policy. The OEB indicated an openness to receiving applications for project-specific ROEs and project-specific capital structures in the *Report of the Board, The*

[77] Oral Hearing Transcript, September 25, 2024, pp. 146-147.
[78] TFG/Minogi Submission, November 7, 2024, p. 48.
[79] TFG/Minogi Submission, November 7, 2024, p. 46.

Regulatory Treatment of Infrastructure Investment in Connection with the Rate-regulated Activities of Distributors and Transmitters in Ontario (Infrastructure Investment Report).[80] That report specifically noted that "major transmission projects may involve diverse sponsors (private, public, and First Nations and Métis interests). Greater flexibility in capital structures could serve to facilitate these partnerships."[81]

OEB staff does not agree with the second proposal, for the WACC to be applied to CWIP balances, which would be a departure from the current policy of applying a (typically lower) debt-based rate. We provided reasons for maintaining the status quo in our first submission. We also found the arguments on this issue of some of the ratepayer groups, especially the Canadian Manufacturers & Exporters (CME), CCC, SEC, and VECC to be compelling. Nevertheless, OEB staff would suggest that the OEB consider exceptions to the general rule on a case-by-case basis.

The third item, CCR, is in OEB staff's view beyond the scope of this proceeding. The panel of Commissioners confirmed as much in its letter approving the late intervention of the First Nations intervenors, which cautioned: "In their request letters, under the heading 'Nature and Scope of Intended Participation', they each listed a number of matters they intend to address. While some of those are clearly covered by the Issues List, others are less clearly so. For example, neither cost recovery mechanisms nor energy planning processes are on the Issues List and therefore are not in scope" (emphasis added).[82] Incidentally, we note that the Infrastructure Investment Report largely endorsed the CCR concept: it clarified that "The Board will allow utilities to apply to include up to 100 percent of prudently incurred CWIP costs in rate base", and that it would "also allow utilities to apply to expense prudently incurred pre-commercial costs."[83]

Other Avenues for Engagement

OEB staff agrees with many of the overarching concerns raised in this proceeding by the First Nations intervenors, including the importance of addressing "financial barriers experienced by First Nations in accessing capital in Ontario for equitable participation in energy projects" and "the need for meaningful engagement with First Nations at every stage of energy policy development"[84] – all within the context of reconciliation.

[80] *Report of the Board: The Regulatory Treatment of Infrastructure Investment in connection with the Rate-regulated Activities of Distributors and Transmitters in Ontario,* January 15, 2010 (EB-2009-0152).
[81] *Ibid.,* p. 18.
[82] OEB letter re Late Intervention Requests, June 26, 2024.
[83] *Report of the Board: The Regulatory Treatment of Infrastructure Investment in connection with the Rate-regulated Activities of Distributors and Transmitters in Ontario*, January 15, 2010 (EB-2009-0152) , p. 15.
[84] CFN and MCFN Submission, November 7, 2024, pp. 4 and 9.

Nevertheless, Mr. Goulding of LEI was correct when he said, "we can't solve all public policy problems through a generic cost of capital proceeding. Right? They are extremely important matters that absolutely need to be addressed, but we can't address them all in a generic proceeding."[85] What the OEB can do in this proceeding is, firstly, to ensure the generic cost of capital parameters meet the Fair Return Standard, and secondly, to reiterate that if a utility believes it faces unique risks or challenges – including any in relation to Indigenous equity participation – then it can make its case for a more bespoke approach. The OEB has already demonstrated a receptiveness to innovative applications from Indigenous-backed utilities, such as Wataynikaneyap Power.[86]

OEB staff recognizes that there is much more that can be done beyond this proceeding. OEB staff would certainly be interested in having discussions with the four First Nations intervenors and other Indigenous groups about potential avenues for the OEB to better understand their concerns, to proactively deal with issues in advance of hearings and to better support their intervention in such hearings.

~All of which is respectfully submitted~

[85] Oral Hearing Transcript, September 25, 2024, pp. 153-154.
[86] See for instance the OEB's November 22, 2018 Decision on Wataynikaneyap Power's Application to Establish a Deferral Account and to Amend Electricity Distribution Licence (EB-2018-0267).