VIA RESS and EMAIL

November 28, 2024

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

Dear Nancy Marconi:

Re: Ontario Energy Board
Generic Proceeding on Cost of Capital
Consumers Council of Canada (CCC) Reply Submission
OEB File No. EB-2024-0063

In accordance with the OEB's letter, dated October 15, 2024, please find attached CCC's reply submission for the Generic Proceeding on Cost of Capital.

Yours truly,

Lawrie Gluck

Lawrie Gluck
Consultant for the Consumers Council of Canada

cc: All parties in EB-2024-0063

Ontario Energy Board Generic Proceeding

Cost of Capital Review

EB-2024-0063

Consumers Council of Canada Reply Submission

November 28, 2024

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1. Introduction

On March 6, 2024, the Ontario Energy Board (OEB) initiated a generic proceeding on its own motion to consider the cost of capital parameters and deemed capital structure to be used to set rates for electricity transmitters, electricity distributors, natural gas utilities, and rate-regulated electricity generators.

The OEB received four expert reports in the current proceeding as follows:

- London Economics International LLC (LEI) – OEB staff
- Concentric Energy Advisors (Concentric) – Coalition of Large Distributors (CLD+)
- Nexus Economics (Nexus) – Electricity Distributors Association (EDA)
- Dr. Sean Cleary (Dr. Cleary) – Industrial Gas Users Association (IGUA) and Association of Major Power Consumers in Ontario (AMPCO)

The OEB provided the opportunity for discovery regarding the expert evidence through written interrogatories and a six-day oral hearing. Submissions from all parties participating in the proceeding were filed on November 7, 2024.

This is the Consumers Council of Canada's (CCC) reply submission. We do not intend to repeat, in detail, our argument filed on November 7, 2024. Instead, we continue to rely on the positions and argument already submitted.

Our position continues to be that the OEB should establish the base return on equity (ROE) for Ontario's electricity distributors and transmitters at 7.1% (which excludes transaction costs). CCC reiterates that a 7.1% base ROE is below the expected average Canadian market return (i.e., 7.5%), which properly reflects that Ontario's electricity distributors and transmitters have lower risk than the market on average. The equity thickness for electricity distributors and transmitters should be maintained at 40% in the context that the ROE and capital structure is set only for the electricity distribution and transmission sectors in the current proceeding. For Enbridge Gas Inc. (Enbridge Gas) and Ontario Power Generation (OPG), the ROE and capital structure should be established separately in their respective rebasing proceedings.

CCC will take this opportunity to respond to certain arguments made by the other parties in the proceeding related to: (i) the base ROE and the capital structure; (ii) the annual ROE

adjustment formula; and (iii) Indigenous ownership of rate-regulated energy infrastructure projects.[1]

2. Return on Equity and Capital Structure

In the sub-sections that follow, CCC responds to the arguments of the Electricity Distributors Association (EDA), the Ontario Energy Association (OEA) and OEB staff with respect to issues related to the establishment of the base ROE and the capital structure. CCC disagrees with all three of these parties regarding the appropriate base ROE that the OEB should establish in the current proceeding and has other concerns with each of these parties' positions.

2.1. The Status Quo

In support of its position that the OEB should establish the base ROE in the range of 8.78% to 9.32%, OEB staff notes that this is "in line with the status quo, which has worked well."[2] OEB staff elaborates that the current ROE is working as intended as there is no evidence that Ontario utilities are currently failing to attract capital on reasonable terms, let alone that their financial integrity is compromised.[3]

The EDA and the OEA argued that many of the key determinations made by the OEB in its 2009 Cost of Capital Report were correct and the OEB, in the determination of the base ROE in the current proceeding, should continue using: (a) U.S. market data and U.S. peer companies; (b) multiple methodologies/approaches; and (c) a 50-basis point adder for equity-related transaction costs.[4]

CCC disagrees with OEB staff, the EDA and the OEA with respect to the continuation of the status quo. We will discuss each of these parties proposed base ROEs later in the reply submission. First, however, we believe that it is important to recognize the context of the 2009 Cost of Capital proceeding and reiterate that the status quo has resulted in the payment of economic rent by ratepayers.

[1] CCC has no further comments with respect to ROE implementation timing and monitoring, deemed short-term debt rates, deemed long-term debt rates, and the appropriate interest rate to apply to deferral and variance accounts (including the Cloud Computing Deferral Account) and maintains its position as set out in its November 7, 2024 submission.
[2] OEB Staff Submission, p. 20.
[3] OEB Staff Submission, p. 20.
[4] EDA Submission, p. 8; and OEA Submission, pp. 31, 36, 45-46.

In the 2009 Cost of Capital Report, the OEB stated the following:

> "On March 16, 2009, the Board initiated a consultation process to help it to determine whether current economic and financial market conditions warrant an adjustment to any of the cost of capital parameter values (i.e., the ROE, long-term debt rate, and/or short-term debt rate) set out in the Board's February 24, 2009 letter. The consultation was initiated, in part, by (i) the fact that the difference between the cost of equity and the cost of long-term debt values determined by the Board for the 2009 Cost of Service Applications was only 39 basis points (8.01% and 7.62%), versus a difference of 247 basis points in 2008; and (ii) concern that the Board did not have a sufficiently robust approach within which to exercise its discretion to adjust any or all of the values produced by the application of the methodology. The Board indicated that the objective of the consultation was to test whether the values produced, and the relationships among them, are reasonable in the current economic and financial market conditions, and to allow the Board to determine if, when and how to make any appropriate adjustments to any of the values."[5]

From the above passage, it clear that the main impetus for the 2009 Cost of Capital proceeding was that the OEB was concerned that the 2009 ROE resulting from its established formula was too low. The reason for this concern was that the ROE was only 39 basis points higher than the deemed long-term debt rate (DLTDR) in 2009. This compared to a differential of 247 basis points between the ROE and the DLTDR in 2008.[6]

CCC submits that this is not the same circumstance that is faced by the OEB in the current generic proceeding on cost of capital. Based on the OEB's 2024 cost of capital parameters (which was the time that this proceeding was launched), the difference between the DLTDR and the ROE was 463 basis points.[7] In 2010, when the OEB's 2009 Cost of Capital decision was implemented, the difference between the DLTDR and the ROE was 398 basis points.[8] Therefore, the spread between DLTDR and the ROE is wider today relative to the last time that the OEB reset the base ROE.

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[5] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 7.

[6] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, Appendix A. In 2009, before the OEB's 2009 Cost of Capital Report was issued, the OEB's annual ROE adjustment formula adjusted the ROE only for changes in the Government of Canada bond yield (the Long Canada Bond Forecast (LCBF)). As the spread between the utility bond yield (as reflected by the DLTDR) and the LCBF was growing, this was not captured in the formula and resulted in the situation where the cost of utility debt and the ROE were very similar. The current formula, as established in 2009 now captures changes to both the LCBF and utility bond yields to avoid this problem occurring again (and CCC supports with some modifications the continuation of a formula that reflects changes to both the LCBF and utility bond yields).

[7] Cost of Capital Parameter Updates | Ontario Energy Board. This reflects a 2024 ROE of 9.21% and a 2024 DLTDR of 4.58% (i.e., 9.21%-4.58% = 4.63%).

[8] Cost of Capital Parameter Updates | Ontario Energy Board. This reflects a 2010 ROE of 9.85% and a 2024 DLTDR of 5.87% (i.e., 9.85%-5.87% = 3.98%).

As noted in OEB staff's argument, the OEB's 2009 Cost of Capital Report does not, anywhere, include an explicit statement that a ROE that is set too high is a problem (or results in economic rent).[9] While the OEB did speak to establishing an ROE that results in "efficient" investment[10], the omission of an explicit statement regarding the problems with setting the ROE too high is telling. The OEB was very concerned in 2009 that the ROE was lower than necessary to fulfill the fair return standard, and it set out on a path to rectify that concern. CCC submits that it was in the context of a very narrow differential (39 basis points) between the ROE and the DLTDR (and the OEB's overall concern that the ROE was lower than necessary to fulfill the fair return standard) that the OEB made its findings to use U.S. market data, average all the experts estimates and accept a 50 basis point transaction adder in the determination of a new base ROE for 2009.

As CCC has already argued in detail, and will not repeat again here, the result of the OEB's approach in 2009 was the establishment of a base ROE that was set above the level necessary to meet the fair return standard.[11] The continuation of the status quo with a heavy reliance on U.S. data and U.S. proxies in the OEB's final determination of the 2025 base ROE will result in the same outcome – an ROE higher than is necessary to meet the fair return standard and the associated payment of economic rent by ratepayers to utilities.

CCC further submits that OEB staff's position that the "current ROE is working as intended"[12] is not based on any analysis with respect to whether the current ROE is above the level necessary to fulfill the fair return standard. OEB staff's position is based on the fact that Ontario utilities are not having difficulty attracting capital on reasonable terms. As discussed in our November 7, 2024 submission, all this implies is that the ROE is not too low.[13] As a hypothetical, if the current ROE was 20%, OEB staff's analysis would come to the same conclusion – the status quo is working – as there would similarly not be any problems attracting capital. There are clear signs that the status quo ROE is already too high (i.e., price-to-book ratio analysis, proposals for excessive capital spending, etc.)[14] and is resulting in the payment of economic rent to utilities.

[9] OEB Staff Submission, p. 14. OEB staff notes that the OEB did not explicitly set out a principle that "a return that exceeds what is required to meet Fair Return Standard amounts to economic rent."
[10] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, pp. 15, 21, 31.
[11] CCC Submission, pp. 8-12.
[12] OEB Staff Submission, p. 20.
[13] CCC Submission, p. 9.
[14] CCC Submission, pp. 8-11.

2.2. Multiple Models and the Averaging of Model Results

The EDA stated that there is no principled reason to depart from the OEB's approach in 2009 of considering all three methodological outcomes (i.e., DCF, CAPM, and Risk Premium), recognizing that all methodologies have flaws in modelling reality but together they average to a better representation of the correct ROE.[15] The OEA stated that the use of multiple models creates the most robust analysis.[16]

OEB staff proposed that the OEB establish the base ROE by averaging the results of all of the experts' approaches similar to the approach the OEB applied in its 2009 Cost of Capital Report.[17]

CCC submits that the derivation of the base ROE based on averaging only Nexus's estimation approaches as proposed by the EDA, averaging only Concentric's estimation approaches as proposed by the OEA, or averaging all experts' estimation approaches as proposed by OEB staff does not result in a reasonable ROE for Ontario's electricity distributors and transmitters.

As discussed in detail in CCC's November 7, 2024 submission[18], both Nexus' and Concentric's estimation approaches are incorrectly specified (and rely heavily on a comparison to "peer" companies that are not actually comparable to Ontario's distributors and transmitters). CCC also has significant concerns with LEI's estimation approach.[19] The result is that the ROE estimated from each of these experts' approaches is significantly higher than necessary to meet the fair return standard. Therefore, developing an average ROE that is premised on these same models (where each establishes a base ROE that is too high) does not lead to a better ROE estimate.

OEB staff stated that it is neither necessary nor advisable for the OEB to pick one of the four expert recommendations in this case, or to make a finding on which methodology (e.g., CAPM, DCF or ERP) or which inputs are superior.[20] On that basis, OEB staff proposed an averaging of all experts' recommended ROEs. OEB staff acknowledged that "it might be

[15] EDA Submission, pp. 1-2.
[16] OEA Submission, p. 35.
[17] OEB Staff Submission, p. 17.
[18] See CCC Submission pp. 41-44 for further details regarding the problems with Nexus' estimation approaches and pp. 32-41 for further details regarding the problems with Concentric's estimation approaches.
[19] CCC Submission, pp. 45-48.
[20] OEB Staff Submission, p. 17.

argued that this type of triangulation is not grounded in principle – it essentially accepts each recommendation at face value without picking one."[21]

CCC submits that for the OEB to apply no judgment with respect to the model outputs of the various experts and to simply weight them equally in determining the final base ROE calls into question the purpose of this entire proceeding. The OEB, on its own motion, launched this generic proceeding on cost of capital. It received four expert reports, has the benefit of responses to interrogatories and responses to questions at the oral hearing, and has heard argument from numerous parties. The result is that the OEB has the benefit of a significant record before it regarding the merits (and, in some cases, the lack thereof) associated with the various estimates put forward by the experts. To not use that record and "blindly" accept an average of the results of the estimation approaches, means that the OEB is implicitly accepting every problematic model input (i.e., proxy groups comprised of companies that are not similar to Ontario's electricity distributors and transmitters, excessively high growth rates, excessively high estimates of future market returns, very high betas, etc.) in its determination of the appropriate base ROE. OEB staff's suggested approach also generally mirrors the approach that the OEB took in 2009 and will perpetuate the status quo payment of economic rent by ratepayers.

The OEB is the economic regulator of Ontario's energy sector, it has significant expertise on cost of capital matters, and it should apply that expertise in its final determination regarding the appropriate base ROE in this proceeding (including a consideration of the merits of the various estimates).

In addition, OEB staff's argument to use an average of all the experts' base ROE estimates is in direct contradiction to the arguments that it makes regarding certain model specifications and results. For example, OEB staff appears to believe that:

- Blume adjusted betas are inappropriate[22]
- Legitimate questions have been raised regarding Concentric's and Nexus' choice of comparators[23]
- Dr. Cleary's proxy group is too small[24]

[21] OEB Staff Submission, pp. 19-20.
[22] OEB Staff Submission, p. 22.
[23] OEB Staff Submission, p. 22.
[24] OEB Staff Submission, p. 23.

- Dr. Cleary makes a compelling point that a 7% return looks good if the expected market return is 7.5%.[25]

OEB staff then retreats from these positions by noting that it "does not mean to suggest that there is a single, ideal methodology for calculating the ROE – that the OEB should declare, for instance, that Concentric was wrong to include Duke Energy or Alliant Energy in its comparator group. The point, rather, is that the utility experts made certain methodological choices that supported a higher ROE, and the ratepayer expert made certain methodological choices that supported a lower ROE.[26] CCC submits for the OEB to accept OEB staff's position that an average of all model outputs is reasonable would result in the OEB overlooking the problems, and the noted compelling perspective of Dr. Cleary (regarding average market returns of 7.5%)[27], that OEB staff, itself, has regarding the evidence before the OEB in the current proceeding.

CCC does, generally, agree with OEB staff's statement that there is no precise number that is the "correct" ROE and there is no "magic formula" for deriving it.[28] CCC also agrees with the Hope decision, as referenced in the OEB's 2009 Cost of Capital Report, that, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method which is controlling…"[29]

CCC submits that OEB staff, however, has taken this concept to the extreme conclusion that all ROE estimates provided in the current proceeding should be treated equally. Certainly, the most important determination that the OEB will make in this proceeding is establishing an appropriate base ROE. CCC submits the OEB will not land at a reasonable result by applying an average to all experts estimates when the estimates of Concentric, Nexus and LEI are higher than is necessary to meet the fair return standard.

CCC submits, as it argued in detail in its November 7, 2024 submission[30], that a base ROE of 7.1%, which is aligned with Dr. Cleary's BYPRP, is a reasonable result for Ontario's very low-risk electricity distributors and transmitters. It avoids the use of problematic proxy groups (as there are so few reasonably comparable companies to Ontario's electricity distributors and transmitters). It uses market-derived information to provide a reasonable

[25] OEB Staff Submission, p. 23.
[26] OEB Staff Submission, p. 23.
[27] OEB Staff Submission, p. 23.
[28] OEB Staff Submission, p. 16.
[29] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 29; and Federal Power Commission v. Hope Natural Gas 320 U.S. 591 (1944). p. 602.
[30] CCC Submission, pp. 48-54.

estimate of these utilities' cost of debt. And most importantly, it appropriately results in a base ROE that is below the expected Canadian market return of 7.5%.

2.3. The Alignment of Ontario's Cost of Capital with Other Jurisdictions

The EDA and OEB staff have each made arguments that suggest that the OEB must set the ROE for Ontario's electricity distributors (EDA) and more generally Ontario's utilities (OEB staff) in alignment with other jurisdictions.[31] Similarly, the OEA argues that the equity thickness for Ontario's electricity distributors and transmitters and Enbridge Gas should be established based on a comparison to other jurisdictions.[32]

The EDA stated that only Nexus' and Concentric's proposed ROEs meet the comparable investment branch of the fair return standard. The EDA goes on to analyze the current OEB-approved ROE relative to U.S. and Canadian jurisdictions. The EDA stated that establishing the base ROE at 11.08% would make the authorized ROE for Ontario utilities comparable to those available in other jurisdictions.[33]

OEB staff stated that its proposed range of 8.79% to 9.32% would keep Ontario returns in line with what other Canadian utilities can earn. OEB staff noted that the average approved ROE for electricity utilities in Canada is 9.16% (with a range from 8.50% in Newfoundland and Labrador to 9.65% in BC). For natural gas utilities the average is 9.23% (with a range from 8.90% for Energir to 10.65% for Eastward Energy).[34]

The OEA stated that as the deemed equity thickness for Ontario utilities is lower than U.S. peers it does not meet the fair return standard.[35]

CCC reiterates, as was set out in more detail in its November 7, 2024 submission, that establishing the base ROE and equity thickness on the basis of comparisons to other jurisdictions is a circular exercise and not appropriate.[36]

AMPCO & IGUA, in its submission, provided compelling argument with respect to the circularity of establishing the ROE and capital structure by reference to other

[31] EDA Submission, p. 33; and OEB Staff Submission, pp. 21, 23.
[32] OEA Submission, pp. 72-76.
[33] EDA Submission, p. 33.
[34] OEB Staff Submission, p. 21.
[35] OEA Submission, p. 75.
[36] CCC Submission, p. 64.

jurisdictions.[37] AMPCO & IGUA stated that "caution is also warranted in judging a fair ROE or equity thickness for one utility based on what a regulator in another jurisdiction has been persuaded is a fair ROE or equity thickness for a utility there. There is a certain circularity to such comparisons, in particular when experts led by utilities habitually argue for significant cost of capital parameter increases."[38]

OEB staff stated that accepting Dr. Cleary's proposed ROE would make Ontario the lowest-ROE province in Canada, by a fair margin. OEB staff acknowledged that Dr. Cleary may be right that approved ROEs tend to be too high throughout North America and that there is a certain "circularity" in looking at what other regulators have done, but that is not something that the OEB can cure on its own. OEB staff stated that regulators are in a "prisoner's dilemma." OEB staff further argued that unilaterally reducing the ROE – even if backed by sound theory – makes it harder to meet the comparable investment test.[39]

As we did in our November 7, 2024 submission, CCC acknowledges that moving first and reducing the ROE below those set by other regulators is difficult.[40] However, the OEB has a full evidentiary record that highlights that Ontario's electricity distributors and transmitters have a very low risk profile relative to the market average (and to the utilities in the experts proxy groups).[41] The OEB has compelling evidence from Dr. Cleary regarding the expected market return (i.e., 7.5%).[42] Therefore, the ROE for low-risk Ontario electricity distributors and transmitters is properly set below the expected average market return. The OEB should consider these facts as they relate to the appropriate base ROE. If the outcome is the establishment of an ROE that is lower than the ROEs set in other jurisdictions, that is simply the result of the OEB applying its judgement to the evidence filed in this proceeding and ensuring that it sets rates that are just and reasonable for Ontario's electricity distributors and transmitters.

2.4. The Applicability of U.S. Capital Markets and U.S. Proxy Companies

The OEA and the EDA, in support of using U.S. market data and U.S. proxy groups in the determination of the base ROE, stated that the Canadian and U.S. capital markets are highly integrated, and Ontario's utilities compete for capital with their U.S. counterparts.[43]

[37] AMPCO & IGUA Submission, pp. 11-13.
[38] AMPCO & IGUA Submission, p. 11.
[39] OEB Staff Submission, p. 23.
[40] CCC Submission, p. 64.
[41] CCC Submission, pp. 17-28.
[42] Exhibit M4, p. 83.
[43] OEA Submission, pp. 29-30; and EDA Submission, p. 28.

We do not intend to repeat our previous arguments in detail here. However, given the importance of this issue in terms of CCC's view that U.S. peer companies and U.S. market returns are not relevant to the determination of the base ROE for Ontario's electricity distributors and transmitters, we have provided a brief summary below.

- U.S. utilities have significantly higher risk than Ontario's rate-regulated electricity distributors and transmitters.
- Canadian investors have a significant home bias.
    - The eight major pension funds in Canada (informally known as the Maple 8) allocate approximately 25% of their portfolio to domestic Canadian investments.
    - Canadian investors (including institutions) had a domestic allocation to Canadian equities of over 40% in 2020.
- The shareholders of Ontario distributors are municipalities, which have an even more pronounced home bias relative to the general population of Canadian investors.
- U.S. bond yields have been higher than Canada bond yields for several years, and this is still the case.
- Hydro One recently offered $1.2 billion of medium-term notes only in Canada.
- Ontario's municipally owned distributors cannot accept non-municipal capital in any material amount without incurring a significant departure tax and the U.S. capital market is completely irrelevant to these companies.[44]

OEB staff noted that, while Concentric stated that many of the Canadian investors they work with (e.g., pension funds) have been investing in US utilities, and that there has been a steady outflow of capital from Canada investing in US utilities, no one has demonstrated that such cross-border investment has left Ontario utilities unable to raise the capital they need on reasonable terms. In other words, there is no evidence that investment in US utilities has come at the expense of Ontario utilities.[45]

CCC submits that these facts imply that the predominant use of U.S. market data and U.S. comparators by Concentric, Nexus and LEI result in recommended ROEs that are not relevant to Ontario's electricity distributors and transmitters.[46]

[44] CCC Submission, pp. 30-32.
[45] OEB Staff Submission, pp. 20-21.
[46] CCC Submission, p. 58.

2.5. The OEA's and EDA's Proposed Base ROEs

The OEA proposed a base ROE of 10% for Ontario's electricity distributors and transmitters and gas distributors. The ROE was calculated based on an average of the results of Concentric's Discounted Cash Flow (DCF), Capital Asset Pricing Mechanism (CAPM) and Risk Premium approaches.[47] The proposed 10.0% base ROE includes an adder for equity-related transaction costs.[48]

The EDA proposed a base ROE of 11.08% for Ontario's electricity distributors. The ROE was calculated based on a weighted average of the results of Nexus' DCF, CAPM and Risk Premium approaches.[49] The proposed 11.08% base ROE includes a 50 basis point adder for equity-related transaction costs.

We will not repeat our significant concerns with Concentric's and Nexus' estimation approaches again. However, as a brief summary, Concentric's and Nexus's estimation approaches should be disregarded due to the following specifications that are not reasonable:

- Proxy Group
    - Comprised of 80% U.S. Firms (Concentric – North American Electric) and 88% U.S. Firms (Nexus)
    - Includes U.S. holding companies, vertically integrated utilities, and companies with significant unregulated operations (Concentric and Nexus)

- DCF
    - Using Single-stage DCF only (Nexus)
    - Applies growth rates much higher than nominal GDP growth based on optimistic analyst estimates (Concentric and Nexus)

- CAPM
    - Includes 30-year U.S. and Canadian treasury bond yields (Concentric) and only U.S. treasury bond yields (Nexus) as the risk-free rate
    - Uses adjusted betas (Concentric and Nexus)
    - Applies growth rates much higher than nominal GDP growth (Nexus)

[47] OEA Submission, p. 57.
[48] OEA Submission, p. 29.
[49] EDA Submission, p. 15.

- Risk Premium
    - Relies on U.S. authorized returns[50] (Concentric and Nexus)

OEB staff also appears to be concerned with Concentric's and Nexus' choice of comparators and the use of Blume adjusted betas.[51]

CCC responds directly to some of the arguments that the OEA and EDA made in support of their recommended base ROEs below.

Risk-free Rate

The EDA noted that Nexus selected U.S. treasury bonds for its risk-free rate used in is CAPM approach.[52] Concentric's risk-free rate is a combination of a 30-year Canadian government bond yield and a 30-year U.S. treasury bond yield.[53]

The EDA stated that Nexus used a U.S. treasury bond as its risk-free rate to ensure internal consistency in the CAPM methodology. Nexus further explained that to do otherwise and use a Canadian treasury bond rate, where U.S. data had been used elsewhere in the model, would be "an apples and oranges error." The EDA further stated that from a principled standpoint, a U.S. risk-free rate may be used in an integrated North American market, since the law of one price says that within a market, the same good has but a single price regardless of the buyer. The long-term overlap of the two countries' risk-free rates indicates that, over time, any current differences are transient and will converge.[54]

CCC notes that Nexus' risk-free rate (based on the 30-year U.S. treasury bond yield) used in its CAPM approach is 4.06%. The 30-year Government of Canada bond yield at the time that Nexus did its analysis was 3.19%.[55] There is a material difference between these two yields. CCC submits that there is no basis to use a U.S. treasury bond yield as the risk-free rate. The risk-free rate that is applicable to Canadian investors is the Government of

[50] See CCC Submission pp. 32-41 for further details regarding the problems with Concentric's estimation approaches and pp. 41-44 for further details regarding the problems with Nexus' estimation approaches.
[51] OEB Staff Submission, p. 22.
[52] EDA Submission, p. 22.
[53] Exhibit M2, p. 9.
[54] EDA Submission, p. 22.
[55] Exhibit M1, p. 120. Based on LEI's approach for forecasting the Government of Canada bond yield.

Canada bond yield (LCBF). The 30-year Government of Canada bond yield is used in the annual ROE adjustment formula and as part of the DLTDR as the risk-free rate.[56]

CCC also notes that the Alberta Utilities Commission (AUC) uses the 30-year Government of Canada bond yield in determining the base equity risk premium, as a measure of the risk-free rate in the CAPM model used to estimate the base (or notional) ROE, and as part of the annual adjustment formula.[57]

In terms of Nexus' position that it had to use the U.S. treasury bond yield within its CAPM methodology, CCC submits that this highlights that the model is so heavily biased towards U.S. data that using the appropriate risk-free rate for Canadian investors results in the model being internally inconsistent. This calls into question the usefulness of Nexus' CAPM model not the appropriate risk-free rate to be used in Ontario. CCC notes that the AUC made a similar determination regarding the use of risk-free rates in the CAPM that are different from the 30-year Government of Canada bond yield. More specifically, the AUC stated that in assessing the results of the estimation models, the AUC is mindful of its concerns regarding "CAPM results using a forecast risk-free rate that differs significantly from the 3.10 percent rate the Commission found reasonable in Section 6.3."[58] CCC notes the 3.10% rate referenced in the citation above is the 30-year Government of Canada bond yield that the AUC used as the risk-free rate in 2024.[59]

Adjusted Betas

The OEA submitted that there are two reasons to adjust raw betas. First, empirical studies show that an individual company beta is more likely than not to move toward the market mean of 1.0 over time. Second, adjusting beta serves a statistical purpose. Because betas are statistically estimated and have associated error terms, betas below the market average of 1.0 tend to have negative error terms and underestimate future returns. Consequently, it is necessary to adjust forecasted betas toward 1.0 to improve forecasts.[60] The EDA made similar arguments.[61]

[56] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, Appendix B and C. Specifically, the OEB states that "the ROE and the deemed long-term debt rates are based on the same forecast of the risk-free rate."
[57] Alberta Utilities Commission, Decision 27084-D02-2023, October 9, 2023, p. 22.
[58] Alberta Utilities Commission, Decision 27084-D02-2023, October 9, 2023, p. 38.
[59] Alberta Utilities Commission, Decision 27084-D02-2023, October 9, 2023, p. 22.
[60] OEA Submission, p. 42.
[61] EDA Submission, pp. 20-21.

CCC notes that both LEI and Dr. Cleary disagree with the use of adjusted betas. Both LEI and Dr. Cleary stated that there is no empirical evidence that the beta for regulated utilities move towards 1.0 over the long-term.[62] Dr. Cleary cited a number of recent studies that show that utility betas do not have a tendency to move towards 1.0. For example, Dr. Cleary cited a 2022 article by Thomas Sikes that notes "[i]t is undeniable based on Figure IV that the Value Line Adjustment is inappropriate. Clearly, utility betas have been consistently below 1.0…"[63]

As noted in the Vulnerable Energy Consumers Coalition's (VECC) submission, the Blume Adjustment (which is used to adjust betas) was developed in the 1970's. When asked about more recent studies supporting the Blume Adjustment, Concentric referred to a 2023 study by Professor Fernandez. VECC noted that Professor Fernandez study only involved 30 Dow Jones Industrial companies, which are not comparable to regulated entities. As a result, VECC stated that it does not view the more recent study results as convincing support for the Blume adjustment.[64] CCC agrees.

Single Stage DCF and Investment Analysts' Forecasts of Market Expectations

The EDA noted that Nexus performed a single-stage DCF analysis. While Nexus acknowledged that other regulators have in some cases preferred a modified single-stage or multi-stage DCF model to include the effects of a lower long-term growth rate, any theoretical benefits of this approach are mitigated by its implementation challenges. The EDA noted that multi-stage DCF models requires the analyst to determine the timing and glide path from first-period growth to terminal growth. It also requires the analyst to determine a second terminal growth rate. Every instance of analyst intervention creates a new opportunity for engineered results or errors.[65]

CCC submits that Nexus' decision to use a single-stage DCF is itself an opportunity for engineered results. Directionally, the use of a multi-stage DCF is going to result in a lower output (i.e., a lower ROE) as the growth rates level off in the later periods used in the model. Nexus made the choice to use a model that was always going to result in a higher estimated ROE.

[62] Exhibit N-M1-0-SEC-3; and Exhibit N-M4-CCC-5.
[63] Exhibit M4, p. 136; and Exhibit M4, Attachment AF, Thomas Sikes, Regulated Inequity, January 2022.
[64] VECC Submission, p. 51.
[65] EDA Submission, pp. 23-24.

The EDA also stated that the claim that analysts' forecasts of market expectations are overly optimistic does not reflect relatively recent rules governing investment recommendations. The EDA referenced Rule 2241 of the Financial Industry Regulatory Authority (FINRA), which requires that the pay of an analyst who issues reports must be reviewed annually by a committee, which must evaluate the quality of the analyst's research and the correlation between the research analyst's recommendations and the performance of the recommended securities. In other words, analysts are graded on their performance. The EDA stated that this rule mitigates against the concern that analysts are overly optimistic. The EDA further stated that analyst forecasts are reliable and the concerns regarding their forecasts are out of date.[66]

Dr. Cleary was asked about the introduction of the FINRA rule at the oral hearing. In response, Dr. Cleary stated that these analysts, even after the introduction of the FINRA rule, are still forecasting growth rates that are excessive. In addition, he referenced that the sell-side analysts continue to suggest that the majority of assets are worth purchasing at any given time.[67] CCC submits that the optimism of the sell-side analyst forecasts continues to hold true and the use of these forecasts results in the excessive growth rates used by Nexus (and Concentric).

CCC also notes that the AUC was concerned about the use of growth rates that exceed long-term nominal GDP growth (which is true of Nexus' and Concentric's growth rates) in its 2024 cost of capital decision.[68]

2.6. OEB Staff's Proposed Base ROE Range

OEB staff stated that the OEB, in 2009, determined the base ROE by averaging the five expert recommendations. It gave equal weight to all five. OEB staff submitted that a broadly similar approach would be appropriate in this proceeding. Based on this approach, OEB staff proposed that the OEB should set the ROE between the range of 8.79% and 9.32% based on averages of the experts recommended ROEs (excluding the transaction cost adder). The 8.79% ROE is an average of all the experts' proposals (with the utility experts' results averaged together prior to being added to the overall average). The 9.32% ROE is an

[66] EDA Submission p.24 -26.
[67] Oral hearing Transcripts, Vol. 6, pp. 72-73, 77-78. More specifically, Dr. Cleary stated that these analysts are recommending approximately 65% buys, 30% holds, and 5% sells.
[68] Alberta Utilities Commission, Decision 27084-D02-2023, October 9, 2023, p. 38.

average of all the experts' proposals (with no adjustment to reflect that there are two utility experts participating in the proceeding).[69]

As noted previously, CCC strongly disagrees with the establishment of the ROE based on an average of the results of the various experts estimates. However, in order to be of assistance to the OEB, CCC has reviewed the derivation of OEB staff's average ROEs of 8.79% and 9.32%. CCC submits that some adjustments to OEB staff's approach would be appropriate if the OEB were seeking to apply an approach similar to the approach that it used in 2009.

Generally, the OEB's approach in 2009 was to average all the experts' estimated ROE (as reflected by an implied equity risk premium (ERP) figure) at the "low-end" of the range provided by a given expert.[70] The average ERP was added to the LCBF to establish the 2009 base ROE (i.e., 5.5% (average ERP) + 4.25% (LCBF) = 9.75%).[71] OEB staff acknowledges this in its submission[72] but did not apply this approach in developing its ROE averages. If the OEB decides to apply an approach similar to the approach that it did 15 years ago, it is unclear why the OEB would not again use the low-end of the experts' estimates (where available[73]).

OEB staff also used the original base ROE estimates (as opposed to the updated figures that were filed in response to undertakings at the oral hearing). OEB staff noted that the revised numbers have not been tested by way of interrogatory or cross-examination and the differences were generally negligible.[74] CCC submits that the updates provided by the experts were simply to reflect the most up-to-date information that is available regarding the Canadian and U.S. government bond yields and utility bond yields (and calculated in the same manner as the experts did when they calculated their estimates in their original evidence). It is unclear what level of testing is required regarding these changes given that OEB staff's proposed approach, and the OEB's 2009 approach, averages all the estimation approaches and is indifferent to the methodology used to derive the updated figures. CCC

[69] OEB Staff Submission, p. 19.
[70] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 38.
[71] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, pp. 37-38.
[72] OEB Staff Submission, p. 17, footnote 78.
[73] CCC notes that in 2009 some experts did, and others did not, provide low, medium and high estimates, which is the same situation as in the current proceeding.
[74] OEB Staff Submission, p. 19.

submits that if the OEB intends to apply an average of all the estimates to derive a base ROE for 2025, it is best to use the most up-to-date information available.

Finally, OEB staff uses a base ROE figure of 11.51% for Concentric (which is the mid-point between 11.38% and 11.63%). OEB staff stated that "Concentric's recommendation of 10.00% was tied to its recommendation to increase the deemed equity ratios. Concentric explained that if the deemed equity ratios were to remain at current levels, a higher ROE would be needed to meet the Fair Return Standard, somewhere between 11.38% and 11.63%, depending on the type of utility."[75] CCC submits that applying this leverage adjustment to Concentric's base ROE is not necessary in OEB's staff's proposed averaging approach.

While CCC agrees that the equity thickness and ROE are connected[76], Concentric does not calculate its overall recommended base ROE of 10% in a manner that considers the capital structure. More specifically, Concentric stated that it applied the Hamada equation to its CAPM model to illustrate the impact of differences in financial leverage between the North American proxy group operating companies and the Ontario utilities "to analyze the effect of financial leverage on returns, but our ROE recommendation is based in part on CAPM results that are not adjusted for such differences in leverage."[77] The values shown in Concentric's report are illustrative adjustments to only the CAPM model related to leverage differences between the proxy group used in its CAPM model and Ontario's utilities. CCC submits that the Hamada-adjusted CAPM estimate does not reflect an alternative proposal by Concentric to increase its overall recommended base ROE of 10%, which is based on an average of all three models, to 11.51% in the circumstance that the OEB does not accept Concentric's proposal to increase the equity thickness for all utilities to a minimum of 45%.

On the basis of the changes discussed above, the following tables provide revised figures based on: (a) an average of the recommended ROEs (excluding the transaction cost adder); and (b) an average of the implied ERPs (excluding the transaction cost adder). We have used the risk-free rates that are used in each of the experts' recommended base ROEs to

[75] OEB Staff Submission, p. 18.
[76] CCC argues that the ROE and equity thickness should be established together for only electricity distributors and transmitters in the current proceeding with the ROE and equity thickness for Enbridge Gas and OPG established in their respective rebasing applications.
[77] Exhibit M2, p. 71.

determine the implied ERP and then added CCC's proposed risk-free rate, which is based on the 30-year Government of Canada bond yield, to determine the base ROE.[78]

Average ROEs

ROE - Post-Hearing Updated Figures	Low	Mid	High
Concentric[79]	9.57%	9.57%	9.57%
Nexus[80]	9.83%	10.55%	11.28%
LEI[81]	8.16%	8.88%	10.15%
Dr. Cleary[82]	6.45%	6.45%	6.45%
Average	**8.50%**	8.86%	9.36%
Average (w/ Utility Expert Averaged)	**8.10%**	8.46%	9.01%

[78] CCC Submission, pp. 29, 58. In our November 7, 2024 submission, we showed the implied ERPs resulting from each experts recommended base ROE using LEI's proposed risk-free rate (i.e., the 30-year Government of Canada bond yield). This was provided to allow for comparison of implied ERPs amongst the experts (using a common risk-free rate) and relative to the 2009 implied ERP. We also highlighted the implied ERPs resulting from Concentric's and Nexus's recommendation using the risk-free rates that were applied by these experts (see footnotes 107, 108, 247 and 248). Concentric's and Nexus' risk-free rates are higher than the 30-year Government of Canada bond yield (as they each use U.S. treasury bonds to differing extents). Therefore, the implied ERPs for these two experts are different depending on whether you use the LCBF as the risk-free rate or the risk-free rates that they applied (i.e., U.S. treasury bond yields for Nexus and a combination of U.S. and Canada government bond yields for Concentric). If the OEB is inclined to use an implied ERP approach it appears that it would be appropriate to remove the risk-free rate that was used by the experts in deriving their recommendations to determine the implied ERP and then add the LCBF (assuming the OEB agrees that the LCBF is the appropriate risk-free rate) to determine the base ROE estimate.

[79] Undertaking J4.8. The North American Combined Proxy Group average result, as updated, is 9.9%. Removing the transaction cost adder of 0.33% (as the adder is only applied to two of Concentric's three models) results in a 9.57% base ROE.

[80] Undertaking J5.2. Nexus noted that based on its update, the base ROE estimates would reduce by 2.6 basis points relative to its original report. CCC has reduced the original estimates by 2.6 basis points and removed the transaction cost adder of 0.5%.

[81] Undertaking J2.2. LEI's figures already do not include a transaction cost adder. Therefore, no further adjustment was applied.

[82] Undertaking J5.3. This reflects the removal of the transaction cost adder of 0.5%.

Average Implied ERP (Derived by Removing Experts' Risk-Free Rates) + 30-Year Government of Canada Bond Yield (as the Risk-Free Rate to be Added Back)

ERP - Post-Hearing Updated Figures	Low	Mid	High
Concentric[83]	5.78%	5.78%	5.78%
Nexus[84]	5.77%	6.49%	7.22%
LEI[85]	5.03%	5.75%	7.02%
Dr. Cleary[86]	3.32%	3.32%	3.32%
Risk-Free Rate (LCBF)[87]	3.13%	3.13%	3.13%
Average (ERP + Risk-Free Rate (LCBF))	**8.11%**	8.47%	8.97%
Average (ERP + Risk-Free Rate (LCBF) (w/ Utility Expert Averaged)	**7.84%**	8.20%	8.74%

Based on the above calculations, if the OEB were to use an average based on the low-end of the ROE estimates from each expert, the bottom of the range would be 8.10% (applying an average of the experts' recommendations (with the utility experts' recommendations first averaged together)) and the top end of the range would be 8.50% (using a simple average of the experts' recommendations).

Alternatively, if the OEB sought to use an implied ERP approach, the bottom of the range would be 7.84% (applying an average of the experts' recommendations as reflected by an implied ERP (with the utility experts' recommendations first averaged together)) and the top end of the range would be 8.11% (using a simple average of the experts' recommendations as reflected by an implied ERP).

CCC submits that, if the OEB were inclined to undertake an averaging approach as suggested by OEB staff, the utility experts' recommendations should be averaged together

[83] Undertaking J4.8, Attachment 1. Concentric updated the risk-free rate to 3.79% (average of US and Canadian government bond yields). Therefore, the implied ERP is 5.76% (i.e., 9.57% (updated base ROE excluding transaction costs) minus 3.79% risk-free rate).
[84] Undertaking J5.2; and Exhibit M3, p. 39. Nexus' risk-free rate is 4.06% based on the 30-year U.S. treasury bond yield (and was unchanged in its post-hearing update). Therefore, the implied ERP for the low-estimate is 5.77% (i.e., 9.83% (updated base low-estimate ROE excluding transaction costs) minus 4.06% risk-free rate).
[85] Undertaking J2.2. LEI updated the risk-free rate to 3.13% (30-year Government of Canada bond yield). Therefore, the implied ERP for the low-estimate is 5.03% (i.e., 8.16% (updated base low-estimate ROE) minus 3.13% risk-free rate).
[86] Undertaking J5.3. Dr. Cleary updated the risk-free rate to 3.13% (30-year Government of Canada bond yield). Therefore, the implied ERP is 3.32% (i.e., 6.45% (updated base ROE estimate excluding transaction costs) minus 3.13% risk-free rate).
[87] The risk-free rate based on the 30-year Government of Canada bond yield (LCBF) is 3.13% as shown in Undertaking J2.2 and J5.3. While LEI and Dr. Cleary use different approaches to determine the 30-year Government of Canada bond yield, both experts end up with the same figure (3.13%) for 2025.

first before averaging the rest of the recommended ROEs. This would reflect a more equitable balance of the experts' recommendations.

2.7. Transaction Costs

The OEA and the EDA support the continued inclusion of a 50 basis point adder for flotation costs and financial flexibility.[88]

The EDA stated that flotation costs should be recoverable as part of the authorized ROE as these costs are properly included in a deemed cost of capital.[89] The OEA stated that it is common practice for Canadian regulators to approve an adjustment for flotation costs and financial flexibility, with 50 basis points being the norm.[90]

The OEA further stated that these flotation and financial flexibility costs include actual out-of-pocket expenditures for preparation, filing, underwriting, legal and other costs of issuance of common equity. The adjustment also includes the costs of financial flexibility which ensure that there is an adequate cushion to raise equity in challenging capital market conditions.[91]

The EDA stated that LEI's proposed approach (i.e., allowing recovery of only actual equity-related transaction costs) is inappropriate as unlike every other aspect of cost captured by the cost of capital, it compensates the utility for flotation costs as an actual cost and not part of an opportunity cost of the marginal investor, no matter who that investor may be.[92]

CCC agrees with OEB staff, and other intervenors, that there is no justification for the 50 basis point equity-related transaction cost adder to be included in the base ROE. We agree with OEB staff's position that very few Ontario utilities depend (or have ever depended) on the public equity markets. We also agree with OEB staff's analysis that highlights that Hydro One earned around $4.8 million from the flotation cost adder in 2023 even though it had not issued public equity since at least 2019 and does not plan to do so through 2027. Therefore, we agree with OEB staff's conclusion that a 50 basis point adder operates to overcompensate utilities and "it is difficult to justify such an outcome with the

[88] OEA Submission, p. 45; and EDA Submission, p. 35.
[89] EDA Submission, p. 35.
[90] OEA Submission, p. 45.
[91] OEA Submission, p. 46.
[92] EDA Submission, pp. 36-37.

fundamental premise, stressed by Concentric, that "the cost of equity is a true cost of service"[93]."[94]

The EDA further stated that if the OEB were to remove flotation costs from the OEB-approved 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.[95] CCC submits that, as noted above, the 50 basis points adder has been overcompensating utilities since its introduction (and certainly over the past 15 years) as there are nearly no actual equity-related transaction costs incurred by Ontario's rate-regulated utilities. Therefore, there are no "unrecovered past equity costs" that are remaining to be recovered.

CCC submits that the OEB should establish a generic deferral account that will come into effect at the time of each utilities next rebasing, which will allow the utilities to record actual transaction costs associated with equity issuances. There is no need to forecast these costs at the time of the rebasing, the deferral account should operate to record the actual transaction costs for disposition at the time of the next rebasing after the amount is recorded (based on there being no transaction costs included in rates). This will ensure that only actual equity issuance-related transaction costs are recovered by utilities.[96]

2.8. The Risk Profile of Ontario's Rate-regulated Utilities and the Capital Structure

As set out in its November 7, 2024 submission, CCC does not believe that it is appropriate to continue to set a single average ROE for all Ontario rate-regulated utilities and use the equity thickness as the lever to reflect risk differences between sectors as the OEB has done historically. CCC submits that an ROE of 7.1% with an equity thickness of 40% (i.e., an unchanged equity thickness) for Ontario's electricity distributors and transmitters will fulfill the fair return standard.[97]

The OEA is the only party in the proceeding to propose that changes to the equity thickness for Ontario's rate-regulated utilities be made in the current proceeding. The OEA proposed that the OEB set a minimum deemed equity ratio for Ontario utilities of 45%. The OEA

[93] Oral Hearing Transcript, Volume 4, p. 44.
[94] OEB Staff Submission, pp. 24-25.
[95] EDA Submission, p. 38.
[96] CCC Submission, p. 56.
[97] CCC Submission, p. 68. CCC submitted that the ROEs for Enbridge Gas and OPG should be established separately in each of their respective future rebasing applications.

stated that this equity ratio would reflect progress towards parity among North American peers and allow Ontario's utilities to compete for both debt and equity capital on a more favorable basis.[98]

With respect to business risks, the OEA stated that, with the exception of OPG, the business risk profiles of its North American proxy groups reflect similar risk to the Ontario electric and gas utilities. The OEA supported its conclusion with reference to the regulatory mechanisms that are available to the companies its peer group (i.e., use of infrastructure recovery mechanisms, availability of DVAs, and the use of decoupling mechanisms).[99]

CCC submits that Concentric did not do the necessary analysis to know how the various mechanisms in the other jurisdictions actually operate (and whether they are more, or less, favourable than Ontario's regulatory framework).[100] The OEA makes the statement that "several of the Ontario utilities are exposed to fluctuations in throughput due to changes in load or loss of customers, while more than 60 percent of the North American proxy group utilities are protected from volumetric risk through decoupling mechanisms."[101] CCC submits that when looking more closely at how decoupling is defined in the report that underpins Concentric's analysis[102], Ontario's electricity distributors, due to the application of a fully fixed rate design for residential customers, have a much greater level of protection than 89% of the operating companies in Concentric's North American electric peer group.[103]

As supported in detail in our November 7, 2024 submission,[104] the changes to regulatory policy and the OEB's proactive approach to regulation de-risked utilities over the past 15 years. Ontario's distributors and transmitters have more protection than ever with respect to the recovery of costs during ratemaking terms (e.g., ability to recover forecast capital costs (Custom IR, Incremental Capital Module/Advanced Capital Module), ability to recover numerous categories of non-forecast costs or cost variances on forecast costs (Deferral and Variance account expansion), move to fixed charges for residential customers, etc.). Regulatory lag has also been significantly decreased (through changes to Uniform Transmission Rate policy, billing practices, etc.). In addition, S&P Global, in its assessment of U.S. and Canadian regulatory regimes in 2023 classified Ontario as a "most

[98] OEA Submission, p. 76.
[99] OEA Submission, pp. 66-67.
[100] CCC Submission, p. 35; and Oral Hearing Transcripts, Vol. 4, pp. 42-43.
[101] OEA Submission, p. 67.
[102] Undertaking J4.4.
[103] CCC Submission, p. 36.
[104] CCC Submission, pp. 17-22.

credit supportive" jurisdiction.[105] This statement from S&P Global highlights that Ontario's regulatory framework is considered highly favourable to utilities relative to other jurisdictions. Therefore, CCC submits that the OEA's view that the regulatory risk faced by Ontario's rate-regulated utilities is similar to the risks faced by Concentric's proxy group is not accurate.

The OEA also raised energy transition and grid modernization as key risk factors for electric distribution utilities. The OEA stated that the energy transition creates risk related to forecasting, technological changes, performance expectations (both reliability and resilience), changing business models, and unanticipated capital expenditures.[106] Similarly, the EDA stated that the increase in demand and associated capital requirements related to the energy transition carries strategic risk.[107] CCC submits that demand growth is properly considered an opportunity for electricity distributors and transmitters. Ontario's electricity distributors and transmitters have the ability to recover all prudently incurred costs. In addition, in terms of any lag with respect to cost recovery, the OEB has already made available regulatory mechanisms for the recovery of capital costs on a forecast basis.

With respect to electric transmitters, the OEA stated that key risk factors relate to supply chain constraints, project development and permitting, the incurrence of large capital deferrals upon which only a debt return is accrued as a carrying charge under the current regulatory framework, operating across a large province with the potential for harsh weather conditions, and the forecasting of volumes.[108] CCC submits that the OEB's regulatory framework mitigates these risks. This is supported by LEI, which stated that the OEB's existing regulatory mechanisms address load fluctuations, capital recovery, and unforeseen events, whether caused by energy transition or not.[109]

Overall, in the context of the current regulatory framework applied to Ontario's distributors and transmitters, along with the OEB's proactive approach to regulation, CCC submits that that the overall business risk (including energy transition and the other business risks raised by the OEA) has decreased for these companies since 2009 and is lower than the companies included in Concentric's, and the other experts', proxy groups.

[105] S&P Global Ratings, North American Utility Regulatory Jurisdictions: Some Notable Developments, November 10, 2023.
[106] OEA Submission, pp. 67-68.
[107] EDA Submission, p. 13.
[108] OEA Submission, p. 69.
[109] Exhibit M1, p. 44.

CCC notes that the OEA's primary rationale supporting its proposed increase in the deemed equity thickness is by way of reference to U.S. utilities. The OEA stated that "Concentric expresses that Ontario deemed equity thicknesses, by being lower across the board than their U.S. peers, do not meet the Fair Return Standard."[110] The OEA further stated that Ontario rate-regulated utilities have similar deemed equity ratios as other utilities in Canada but substantially lower equity ratios than their U.S. counterparts. On that basis, the OEA concluded that Ontario's rate-regulated utilities have greater financial risk than the peers in their proxy groups.[111]

As discussed in detail in our November 7, 2024 submission, the comparison to U.S. utilities is unfounded. As noted by Dr. Cleary, U.S. utilities are not reasonable comparators for Canadian utilities. U.S. utilities have significantly higher risk due to their holding company structure (and related holdings) and due to the nature of their operations. Dr. Cleary also highlights that historical U.S. utility beta estimates, which are an indicator of risk, over a long period of time are significantly higher than Canadian beta estimates.[112]

CCC notes that OEB staff seems to agree with this view based on its statement that, "the only reasonable inference is that, generally, US utilities are not actually comparable in risk to Ontario utilities. Investors are willing to accept lower returns in Ontario because the risk is lower."[113]

Further, CCC submits that all electricity distributors and transmitters, for which ratings are available, have very high credit ratings, even with the lower equity ratios relative to U.S. companies, which highlights the strong financial position these companies are currently in (and are expected to be in going forward).[114] In addition, as SEC noted in its submission[115], a recent Fitch credit rating report found that Alectra Utilities' lower allowed ROE (8.95%) and equity ratio (40%) were "sufficiently offset by the OEB's track record of predictable regulatory support."[116]

Overall, determining the financial risk of Ontario's utilities in reference to U.S. utilities is inappropriate and does not reflect how these companies are viewed by investors or credit rating agencies. The evidence is that all electricity distributors and transmitters have very

[110] OEA Submission, p. 75.
[111] OEA Submission, p. 67.
[112] Exhibit M4, p. 29.
[113] OEB Staff Submission, p. 21.
[114] Exhibit N-M2-CCC-9.
[115] SEC Submission, p. 15.
[116] Fitch Affirms Alectra's IDR at 'A-'; Outlook Stable (Attachment to M3-10-SEC-72) (K5.1, p. 41).

high credit ratings and no utility in Ontario has had any issues with attracting capital or financial integrity.[117]

For these reasons, on the basis of the business and financial risks that are faced by Ontario's rate-regulated utilities currently and the inappropriateness of comparing these utilities to U.S. utilities, there is no basis to increase the equity thickness as proposed by the OEA.

In fact, if the OEB is inclined to continue setting a single average ROE for all rate-regulated utilities in Ontario and using the capital structure as the basis to reflect differences in risks between sectors, then the capital structure for electricity distributors and transmitters should be reduced to 36% in the current proceeding.

The OEA noted that historically, the OEB's risk ranking of Ontario utilities places Enbridge Gas at the low end of the risk spectrum and OPG at the high end, with electricity distributors and transmitters in the middle. Based on the current risks faced by the various segments in the Ontario energy sector, the OEA, itself, acknowledged that due to the "acute risks to the natural gas distribution segment caused by the Energy Transition, Concentric finds natural gas distribution to be riskier than electric distribution operations."[118] CCC agrees that electricity distributors, and we add electricity transmitters[119], have lower risk than natural gas distributors now due to the energy transition.

As discussed previously, given that there is no merit in the OEA's proposal to increase the deemed equity thickness for all rate-regulated utilities to 45% to move closer to parity with U.S. utilities, the appropriate point of reference for the sector-by-sector risking ranking is Enbridge Gas's current equity thickness of 38%.

Enbridge Gas's current equity thickness of 38% was established less than a year ago in Enbridge Gas's 2024 rebasing proceeding (as part of a comprehensive review of the risks faced by the company in the context of energy transition). In that proceeding, the OEB increased Enbridge Gas's equity thickness from 36% to 38% in consideration of "both a decrease in business risk due to amalgamation, and an increase in business risk due to the

[117] CCC Submission, pp. 26-27.
[118] OEA Submission, p. 75.
[119] See Exhibit M1, p. 14, LEI stated that "the risk profile of electricity transmitters is similar, if not lower than that of electricity distributors."

energy transition…"[120] CCC submits that there is no basis to change Enbridge Gas's equity thickness in the current proceeding given the recent findings by the OEB and no change to the risk faced by Enbridge Gas since that decision was rendered.

The OEA stated that subsequent to the OEB's decision in respect of Enbridge Gas's 2024 rebasing application, Enbridge Gas was placed on a negative outlook by S&P Global in an update dated June 28, 2024. [121] The OEA appears to use this credit report update as support that the financial risk of Enbridge Gas increased after the OEB's decision was issued last year. CCC notes that Enbridge Gas was initially placed on a negative outlook by S&P Global in September 2023 as "we revised our outlook on Ontario-based Enbridge Gas Inc. (EGI) to negative from stable following our recent outlook revision to negative from stable on its parent, Enbridge Inc. (Enbridge)."[122] S&P Global's initial placement of Enbridge Gas on a negative outlook was based on its downgrade to Enbridge Inc. due to its acquisition of three U.S. regulated gas utilities.[123] With respect to the Enbridge Gas "negative outlook" finding from S&P Global in the July 28, 2024 report (as cited by the OEA), it was simply maintaining that previous negative outlook as described above. The S&P Global reports states "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." Therefore, this does not reflect an increase in risk, it is simply reflecting no change from the previous credit reports.

CCC also supports SEC's submission, which sets out that Enbridge Gas's risk, if anything, has decreased as a result of the passage of Bill 165, which was strongly endorsed by the company and is indicative of government support for natural gas. SEC also noted that this was followed up in late October with the release of the government's energy vision document which discussed the "need for an economically viable natural gas network to support a gradual energy transition, to attract industrial investment, to drive economic growth, to maintain customer choice and ensure overall energy system resiliency, reliability and affordability"[124].[125]

For these reasons, CCC submits that there is no evidence that the risk of Enbridge Gas has increased since the OEB's 2024 rebasing decision in December 2023. Therefore, the appropriate reference point is an equity thickness of 38% for Enbridge Gas. Based on the

[120] EB-2022-0200, Decision and Order, December 21, 2023, p. 68.
[121] OEA Submission, p. 72.
[122] Exhibit N-M2-10-SEC-41, Attachment 1, p. 116.
[123] Exhibit N-M2-10-SEC-41, Attachment 1, p. 116.
[124] Ontario's Affordable Energy Future: The Pressing Case for More Power | ontario.ca
[125] SEC Submission, p. 26.

OEA's own submission natural gas distribution is riskier than electricity distribution,[126] the sector ranking should have electricity distribution (and transmission[127]) at the bottom of the ranking. On this basis, if the OEB plans to continue to set a single average ROE for all rate-regulated utilities, CCC submits that a reduction of the equity thickness to 36% for electricity distributors and transmitters follows the rationale that electricity distributors and transmitters have lower risk than natural gas distributors. With respect to OPG, the OEB should review the appropriate equity thickness at its next rebasing application to determine where it falls in the sector-by-sector risk ranking.

2.9. CCC's Proposed Base ROE and Capital Structure

CCC submits, as it did in its November 7, 2024 submission, that the base ROE for electricity distributors and transmitters should be set at 7.1%, which aligns with Dr. Cleary's BYPRP estimate (removing the transaction cost adder). CCC submits that transaction costs should not be included in the base ROE for the reasons previously discussed. Further, CCC submits that the equity thickness for electricity distributors and transmitters should be maintained at 40% assuming the ROE is set at 7.1% and the OEB does not continue its approach of establishing a single ROE for all rate-regulated utilities (and using the capital structure to differentiate between the risks faced by each sector in Ontario).[128]

CCC's position is that a 7.1% base ROE is appropriate as it properly falls below the expected Canadian market return. Dr. Cleary's detailed analysis of historical and forecast Canadian market returns provides the OEB with an accurate estimate of the long-term average expected Canadian market return of 7.5% upon which it should evaluate the appropriate base ROE for electricity distributors and transmitters. Therefore, establishing the base ROE for Ontario's electricity distributors and transmitters below (i.e., 7.1%) the expected Canadian market return (i.e., 7.5%) properly reflects that these firms are lower risk than the market.[129] We also agree with the argument of AMPCO & IGUA that a range of reasonableness for the Ontario regulated utilities is "properly defined by a reasonably derived expected overall market return at the upper end…"[130] Establishing the base ROE for low-risk rate-regulated utilities that is higher than the expected Canadian market return cannot be correct. There is no basis for low-risk electricity distribution and transmission

[126] OEA Submission, p. 75.
[127] See Exhibit M1, p. 14, LEI stated that "the risk profile of electricity transmitters is similar, if not lower than that of electricity distributors."
[128] CCC Submission, pp. 56-57.
[129] CCC Submission, p. 61.
[130] AMPCO & IGUA Submission, p. 20.

companies to be providing returns that are above the market average.[131] We note that OEB staff acknowledged that it is a "compelling point that a 7% return looks good if the expected market return is 7.5%."[132]

As discussed in detail in its November 7, 2024 submission, CCC premises its position that it is appropriate to use the BYPRP approach to derive the base ROE because there are so few truly comparable publicly traded proxy companies to Ontario's electricity distributors and transmitters.[133] Therefore, you cannot use the estimation approaches as applied by Concentric (DCF and CAPM), Nexus (DCF and CAPM), LEI (CAPM) and Dr. Cleary (DCF)) as they require proxy company specific financial information to operationalize. We also submitted that the risk premium approaches applied by Concentric and Nexus that measure the relationship between authorized ROEs (largely in the U.S.) and historical bond yields, have no relevance to the establishment of a base ROE in Ontario. Therefore, these estimation approaches should not be used by the OEB in its determination.[134]

This left two estimation approaches that could be applied while avoiding the use of specific proxy company information in the derivation of the base ROE. The first approach is Dr. Cleary's version of the CAPM, which uses long-term historical average betas and a consideration of more current raw betas for Canadian utilities (as opposed to betas derived from individual companies in the experts' proxy groups). The second approach is the Bond Yield Plus Risk Premium approach, which adds a risk premium to the current Canadian A-rated utility long-term bond yield. The BYPRP approach does not directly input any individual company's financial information in the model.

CCC submitted that the BYPRP is preferable. The BYPRP allows the OEB to establish the base ROE using the best available market information that is actually relevant to Ontario's electricity distributors and transmitters – their cost of debt. The BYPRP uses the A-rated Canadian utility bond index as the proxy for these company's cost of debt. All experts that commented on the appropriate deemed long-term cost of debt (DLTDR) for Ontario's rate-regulated utilities agreed that it should be based on the Government of Canada 30-year bond yield (LCBF/risk-free rate) plus the spread to the A-rated Canadian utility bond

[131] CCC Submission, p. 61.
[132] OEB Staff Submission, p. 23.
[133] See CCC Submission for analysis of the proxy groups used by Concentric (pp. 32-37) Nexus (pp. 41-42), LEI (pp. 45-46) and Dr. Cleary (pp. 48-49).
[134] CCC Submission pp. 39-41, 44.

index.[135] Therefore, the starting point for the BYPRP reflects a consensus by the experts on Ontario's utilities' deemed cost of debt.

After establishing the appropriate cost of debt that is relevant to Ontario's distributors and transmitters, a premium is added to reflect that equity is riskier than debt. Dr. Cleary recommended a risk premium of 2.5% in the context that Ontario's electricity distributors and transmitters are some of the least risky companies and therefore, the risk premium should be set towards the bottom of the range of risk premiums (2%-5%).[136]

The OEA and EDA argued that the BYPRP is subjective and suggest that Dr. Cleary's methodology is premised on an example from a test problem contained in a CFA textbook.[137] More specifically, the OEA stated that, with respect to the BYPRP analysis, Dr. Cleary simply asserts that an appropriate range is 2-5%. Then he simply asserts that 3.5% is commonly used for average risk companies and because Canadian utilities are "low risk" the best estimate is 2.5%. The OEA also stated that the only support Dr. Cleary cites in his expert report for this analysis is an excerpt from the CFA Curriculum where "a risk premium of 2.75% is added to cost of IBM's debt" and "[c]learly IBM is riskier than a regulated A-rated utility, so 2.5% is very reasonable by comparison.[138]

CCC reiterates that Dr. Cleary provided evidence supporting the typical range of risk premium adders of 2%-5% applied by financial professionals. He stated that based on his own experience with using the BYPRP approach and also observing numerous estimates provided by analysts based on such approach, a risk premium in the range of 2% to 5% is added to a company's existing bond yields, with 3.5% being applied for average risk companies. Dr. Cleary stated that this is basic practice for finance professionals. Dr. Cleary noted that he has seen the 2% to 5% range used in countless analyst reports that he has directly reviewed over the years. He further references a number of corporate finance textbooks and readings used in the CFA and CPA programs that discuss the range of risk premiums to be used in the BYPRP model.[139] CCC submits that Dr. Cleary's risk premium is properly estimated using a common approach applied by financial professionals (as supported by corporate finance literature). The OEA and EDA are incorrect that his risk premium estimate is based on a "test problem."

[135] Exhibit M1, pp. 92-93; Exhibit M2, p. 38; and Exhibit M4, p. 22. We note that there is some debate about exactly how to forecast the LCBF and utility bond spread but all experts agree that the DLTDR is equivalent to the A-rated utility bond yield (i.e., LCBF + Utility Bond Spread).
[136] CCC Submission, p. 61.
[137] EDA Submission, p. 56; and OEA Submission p. 48.
[138] OEA Submission p. 48.
[139] CCC Submission, p. 41; and Exhibit N-M4-EDA-5.

We also reiterate that the BYPRP approach is no more subjective than the approaches put forward by the other experts in this proceeding. Every estimation approach before the OEB in the current proceeding required the expert to apply their judgement at every step of model specification. And as discussed in our November 7, 2024 submission, the specifications made by the other experts are highly problematic for application in determining an appropriate base ROE for Ontario's electricity distributors and transmitters.[140]

The OEA also stated Dr. Cleary's recommendations have never been accepted by other regulators.[141] CCC notes that the OEB has not accepted Concentric's recommendations. In Enbridge Gas's 2024 rebasing, Concentric recommended that the equity thickness should be increased to 42% and the OEB approved an equity thickness of 38%. Similarly, in OPG's 2022 rebasing, Concentric recommended an equity thickness of 50% and the OEB approved an equity thickness of 45%.[142] The OEB also did not accept Concentric's recommendation in the 2009 Cost of Capital proceeding.[143] In addition, Concentric's recommended ROEs are typically significantly higher than what was approved by regulators in other jurisdictions.[144]

Overall, CCC submits that a base ROE established at 7.1% for electricity distributors and transmitters, which aligns with Dr. Cleary's BYPRP estimate (removing the transaction cost adder), is appropriate. It is properly below the expected average market return of 7.5%, uses the best available market information that is applicable to Ontario's electricity distributors and transmitters (i.e., their cost of debt) and was derived based on empirically informed judgement. We also note that the risk premium applied in any given cost of capital proceeding can be adjusted, as necessary, to reflect prevailing market conditions and any changes to the risks faced by Ontario's electricity distributors and transmitters.

As we noted previously, CCC acknowledges that reducing the ROE below those set by other regulators is difficult.[145] However, OEB staff's argument regarding the "prisoners dilemma"

[140] See CCC Submission for further details regarding the problems with Concentric's (pp. 32-41) Nexus' (pp. 41-44) and LEI's (pp. 45-48) estimation approaches.
[141] OEA Submission, p. 51.
[142] Exhibit N-M2-0-SEC-31, Attachment 1.
[143] Ontario Energy Board, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009, p. 38.
[144] Exhibit N-M2-0-SEC-31, Attachment 1.
[145] CCC Submission, p. 64.

and related call for inaction (i.e., perpetuating the status quo)[146] is unfortunate. If every regulator simply looks at other regulators and says we cannot reduce the ROE unless another regulator reduces the ROE first, then ratepayers will be stuck paying economic rent in perpetuity. We believe that the OEB should provide leadership in the regulatory community on this matter. The OEB does not wait to see how other regulators are addressing various ratemaking matters before doing what it believes is right. This is no different.

As we noted in our November 7, 2024 submission, CCC believes that a base ROE of 7.1% meets the fair return standard for Ontario regulated electricity distributors and transmitters. However, if the OEB is concerned with a change of this magnitude all at once, it should start reducing the ROE in the current proceeding and monitor the impact that it has on utilities.[147]

3. Annual ROE Adjustment Formula

CCC's preferred annual ROE adjustment formula (inclusive of its proposed base ROE, initial LCBF and initial utility bond spread) is as follows: ROE = 7.10% + 0.75 x (LCBF – 3.13%) + 0.75 x (UtilBondSpread – 1.39%).[148]

We reiterate that the LCBF and utility bond spread should be established on the basis of current yield information available on September 30 each year for the reasons discussed in its November 7, 2024 submission.[149]

With respect to the adjustment factors, the OEA and OEB staff argued that the LCBF adjustment factor should be 0.4 and the utility bond spread should be 0.33.[150] Both parties argued that these adjustment factors recognize that the relationship between ROEs and government bond yields has weakened slightly over the past fifteen years, while still maintaining the formula's ability to be sufficiently sensitive to changes in interest rates and utility credit spreads.[151]

[146] OEB Staff Submission, p. 23.
[147] CCC provided an alternative reduction to the base ROE at p. 65 of its November 7, 2024 submission.
[148] CCC Submission, p. 68.
[149] CCC Submission, p. 66.
[150] OEA Submission, p. 65; and OEB Staff Submission, p. 28.
[151] OEA Submission, p. 65; and OEB Staff Submission, p. 28.

As we argued in our November 7, 2024 submission, Concentric's regression analysis used to determine the adjustment factors relies on U.S. authorized ROEs and U.S. treasury bond yields (which are not relevant to the OEB's adjustment formula) and the goodness of fit is low.[152]

CCC notes that Dr. Cleary's evidence highlights that the approved ROE in Ontario as adjusted each year using the OEB-approved 0.50 adjustment factor has resulted in the approved ROEs being well in excess of the utilities' cost of equity (as the spread between the allowed ROE and the risk-free rate & utility bond yield has widened over time).[153] This implies that the adjustment factor is not passing-through enough of the change in bond yields to the ROE. On that basis, CCC continues to support an increase to the adjustment factor (as opposed to a decrease).

If the OEB is concerned with the 0.75 adjustment factor applied to the LCBF and the utility bond spread as set out in Dr. Cleary's formula, maintaining the existing adjustment factor of 0.5 is the most reasonable of the potential alternatives.

4. Indigenous Ownership of Rate-Regulated Energy Infrastructure Projects

CCC agrees with the submission of Three Fires Group (TFG) and Minogi Corporation (Minogi) that supporting Indigenous economic opportunity is an integral aspect of economic reconciliation, an expanding legal requirement, an integral aspect of the public interest, and an essential component of Ontario's ability to navigate the energy transition successfully.[154] However, CCC does not believe that the OEB should approve TFG and Minogi's three proposals in the current proceeding as they go beyond setting generic cost of capital parameters for Ontario's utilities (which is the purpose of the current proceeding) and instead reflect important policy questions that require careful consideration.

The first proposal is that the OEB should "provide 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."[155]

[152] CCC Submission, p. 67.
[153] Exhibit M4, p. 74.
[154] TFG and Minogi Submission, p. 4.
[155] TFG and Minogi Submission, p. 48.

The second proposal is that the OEB should adopt a weighted average cost of capital (WACC) applicable to construction work in progress (CWIP) balances for large, multi-year projects and investments, that better reflects the full participation costs for investors, particularly Indigenous investors who typically do not have access to large pools of capital and must borrow the necessary funds.[156]

The third proposal is that the OEB should confirm: (i) the availability of concurrent cost recovery (CCR) for large, multi-year projects, subject to application to the OEB in the specific circumstances of the case; and (ii) that CCR will be made available in circumstances where doing so will mitigate obstacles to investment involving cost for an Indigenous applicant.[157]

CCC submits that none of these proposals should be accepted on a generic basis applicable to all rate-regulated infrastructure projects.

CCC submits that there is no basis for an increased risk premium for single-asset transmitters to be applied on a generic basis in the current proceeding. As we noted in our November 7, 2024 submission, the regulatory framework (and ratemaking structure with the socialization of demand risk) results in similar risks faced by single-asset and multi-asset transmission companies. In addition, the single-asset transmitters operating in Ontario are relatively new and are operating newer assets (which are lower risk) than multiple asset transmitters.[158] Therefore, if the OEB were to set a different risk premium for single-asset transmitters, it should be lower (not higher) due to the newer vintage of the assets operated by these companies.

CCC also submits that it is inappropriate to apply the WACC to CWIP balances on a generic basis. As we noted in our November 7, 2024 submission, the application of WACC to CWIP will result in the capitalization of the return component on assets that will eventually form part of rate base, which is generally not appropriate.

To facilitate Indigenous economic opportunity, which CCC believes is a very important policy goal, the OEB should consider Indigenous ownership of rate-regulated energy infrastructure in a generic proceeding or consultation. This proceeding, or consultation, for example, could seek to establish OEB policy with respect to the appropriate financing costs applicable to CWIP in the circumstance that the expected financing costs to be

[156] TFG and Minogi Submission, p. 48.
[157] TFG and Minogi Submission, p. 48-49.
[158] CCC Submission, p. 69.

incurred by an Indigenous shareholder during the construction phase of a project are higher than the deemed rate, and in the absence of relief, the Indigenous investors would be unable to participate in the project.

The OEB should also advise that, at any time (including before any policy consultation or hearing regarding Indigenous ownership of rate-regulated energy infrastructure projects is undertaken), the proponents of Indigenous-owned energy infrastructure projects may file proposals for differential risk premiums, the application of a different interest rate to CWIP or the application of a CCR mechanism in leave to construct or rates applications before the OEB related to specific projects. The OEB should review the evidence in those cases to determine whether the application of any of these mechanisms is appropriate based on the merits of the evidence filed.

~ All of which is respectfully submitted ~