Q. Page 3-38, Footnote 89: What has been the effect on the return on equity for the Ontario utilities as a result of the Ontario Energy Board leaving the automatic adjustment formula in place?

A. The financial crisis that occurred during the 2008-2009 period resulted in most Canadian regulators abandoning the formulaic approach to determining a fair rate of return on equity for utilities. The Ontario Energy Board ("OEB") reviewed its cost of capital methodology in 2009 and determined that the formulaic approach for determining cost of capital was still necessary to be able to continue regulatory oversight of over 80 utilities in Ontario.[1]

A new formula to determine the rate of return on equity for Ontario utilities was introduced by the OEB in 2010. The new formula reflects variability between long-term Government of Canada and A-rated corporate bond yields.

The OEB reviewed and reported on the outcomes of its new cost of capital methodology in its January 14, 2016 OEB *Staff Report – Review of the Cost of Capital for Ontario's Regulated Utilities* (the "OEB Report").

Table 1 shows the effect on the return on equity resulting from the OEB's 2010 formula.

Table 1
OEB Return on Equity Formula Adjustments[2]
(2010 – 2018)

Date	Return on Equity (%)
May 2010	9.85
January 2011	9.66
March 2011	9.43
May 2011	9.58
January 2012	9.42
May 2012	9.12
January 2013	8.93
May 2013	8.98
October 2013	9.16
January 2014	9.36
May 2014	9.33
January 2015	9.30
January 2016	9.19
January 2017	8.78
January 2018	9.00

[1] The OEB's current policy on the cost of capital is detailed in the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009 (EB-2009-0084).
[2] See OEB Report, Page 5, Table 2.

The OEB Report observed that the rates of return on equity that resulted from the new formula ranged from 8.93% to 9.85% over the 2010-2015 period. *Actual* results for the Ontario utilities, particularly for electricity distributors, showed a high degree of variability.[3]

The OEB Report included a jurisdictional review of cost of capital.[4] The OEB Report indicates that allowed rates of return on equity for other Canadian regulators ranged, for the most part, between 8.5% and 9.75%. It also shows that most Canadian regulators are relying on more traditional approaches, determining the cost of capital based on evidence in individual rate applications rather than a formulaic approach. Two other regulators adopted a variation of the OEB's return on equity formula following the OEB's 2009 Cost of Capital Report – the British Columbia Utilities Commission ("BCUC") and Regie de l'energie du Quebec (the "Regie"). The BCUC formula has never operated and both the BCUC and the Regie subsequently discontinued the use of an automatic adjustment formula.[5]

Please refer to the response to Requests for Information PUB-NP-038 for Newfoundland Power's views on adoption of formulaic alternatives used to determine an appropriate rate of return on equity.

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3 A description of actual return on equity results for electricity distributors is provided on pages 13-17 of the OEB Report. On page 14, the OEB Report states that *"The data may not necessarily point to concerns with the cost of capital methodology itself but may, as noted above, reflect as much the distributors' abilities to manage the challenges and opportunities faced in terms of the regulatory regime as well as their individual and macroeconomic environmental, operational, and financial conditions."*

4 See Appendix B, page 20 of the OEB Report.

5 Both the BCUC and the Regie added a floor such that the return on equity would not be updated if the risk-free rate (the Long Canada Bond (yield) forecast) was below a pre-set value.