Volume 2: Cost of Capital: Expert Opinion of James Coyne-Return on Equity

Q. If a utility is unable to obtain a particular credit rating, for example due to size, is it Mr. Coyne's judgement that the allowed ROE or capital structure should be set at an unjust or unreasonable level to obtain such a rating? In other words which is more important: setting just and reasonable rates or targeting a particular credit rating? Has Mr. Coyne ever testified on behalf of a Canadian utility that was unable to obtain an investment grade credit rating and if so, why was the rating unattainable?

A. No. The fair return standard requires that the authorized return for a regulated utility be established at a level that is just and reasonable. This Board, and others in Canada, have recognized the connection between setting a fair return and maintenance of a "sound credit rating."

> *Section 3(a)(iii) of the EPCA provides that the rates to be charged for the supply of power should provide sufficient revenue to enable the utility to earn a just and reasonable return so that it is able to achieve and maintain a sound credit rating in the financial markets of the world.*[1]

Setting a fair return involves more than targeting a particular credit rating. However, several Canadian regulators have determined that a fair return depends in part on the credit rating that will result from that return.

Mr. Coyne has testified on behalf of one Canadian utility that does not maintain an investment grade credit rating, Eastward Energy, due to its small size and access to capital from its parent company. The market for lower rated bond issues in Canada is much less liquid than the market for bonds rated A- or higher. That is one important reason why some regulators in Canada have targeted a specific credit rating as part of setting a fair return.

[1] See Order No. P.U. 18(2016), page 10.