Volume 2: Cost of Capital: Expert Opinion of Mr. James Coyne – Return on Equity

Q. Volume 2, Cost of Capital Report, page 41, lines 9-14. Mr. Coyne states that the North American Electric Utility Proxy Group is more comparable to Newfoundland Power than the Canadian Utility Proxy Group. In Order No. P.U. 13(2013) and Order No. P.U. 18(2016) the Board decided a downward adjustment should be made to the DCF method to reflect differences in the U.S. and Canadian experience. In Mr. Coyne's opinion no such adjustment is required. Please explain all the factors the Board should consider in determining whether any such adjustment is required at this time.

A. In the past two GRA cases (2019 and 2022), the cost of capital was settled, and the Board made no specific determinations on country business risk or adjustments. The Board has previously expressed concern that there are differences in risk and associated returns between Canadian and U.S. utilities and has indicated that it has not been satisfied that the results of using U.S. data, in the form of a proxy group of companies, can be accepted without adjustment to account for these differences.

The British Columbia Utilities Commission ("BCUC") recently accepted Concentric's approach to selecting the proxy group when it determined that the use of a North American proxy group was appropriate in setting the authorized ROE for FortisBC Energy Inc. (the gas distribution utility, "FEI") and FortisBC Inc. (the electric utility, "FBC"). On pages 16-17 of Order G-236-23, issued in September 2023, the BCUC explained its reasons as follows:

> *Finally, we reject RCIA's submission for the BCUC to only use Canadian data for the Canadian proxy group because it is country and market specific. Instead, we agree with FortisBC that there is ample basis to include US data in our ROE analysis because:*
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> - *There are insufficient comparators to each of FEI and FBC in Canada to allow the BCUC to use only data pertaining to Canadian counterparts;*
> - *Both experts agree that the inclusion of US data is appropriate and both favour the use of North American proxy groups;*
> - *The BCUC's 2016 Decision used US proxy groups results, citing both increasing integration and the scarcity of Canadian publicly traded utilities; and*
> - *Other Canadian regulators (and more recently FERC) have taken a similar approach; and the extent of North American financial and capital markets integration has only increased over time.*

Concentric has used screening criteria to select a comparable risk group of U.S. companies that are primarily engaged in the provision of regulated electric utility service, like Newfoundland Power. As shown in Exhibit JMC-12, the U.S. Electric proxy group companies derive 97 percent of their regulated income and 96 percent of their regulated revenues from electric utility service, and approximately 96 percent of their regulated assets are dedicated to electric utility operations. The U.S. companies in the North

American Electric proxy group are more comparable to Newfoundland Power than the companies in the Canadian proxy group in this regard.

Exhibit JMC-13 compares the business risk for Newfoundland Power to the U.S. companies in the North American Electric Utility proxy group. As shown in that risk assessment, Newfoundland Power generally has somewhat higher business risk than the U.S. electric utilities in the North American Electric Utility proxy group. In particular, the U.S. electric utilities have numerous regulatory mechanisms, adjustment clauses, cost recovery mechanisms, and deferral/variance accounts that make them similar to Newfoundland Power in terms of business risk. These regulatory mechanisms provide comparable protection against variations in revenues and expenses, and comparable recovery of capital costs. Concentric acknowledges that Newfoundland Power has less generation risk than many U.S. companies in the North American Electric Utility proxy group, but this is offset by the risk associated with Newfoundland Power's reliance on a single source of power, which places the Company at greater risk of supply disruptions than the U.S. electric utilities in the North American proxy group.

Another important consideration is the fact that Canadian utilities are funded by an international group of investors, including U.S. investors. This is evidence that the market for equities in these companies has become a North American market, at a minimum. Supporting this view, the table below summarizes institutional investor ownership positions as a percent of total institutional holdings, by region, for each of the companies utilized in Concentric's Canadian proxy group and Fortis Inc.

Table 1: Institutional Ownership by Region[1]

Proxy Company	**Institutional Investors – % by country**		
	Canada	**U.S.**	**Other**
Algonquin Utilities and Power Company	32%	52%	16%
AltaGas Ltd.	54%	32%	14%
Canadian Utilities Ltd.	82%	13%	5%
Emera, Inc.	24%	56%	20%
Enbridge, Inc.	44%	43%	13%
Fortis Inc.	57%	26%	17%
Hydro One Limited	79%	9%	12%

In addition, while not new evidence, Concentric cites on page 41 of its report the Moody's Investors Service September 2013 report indicating that the credit rating agency changed its view of the regulatory environment in the U.S. and now believes that the U.S. regulatory environment is more favorable than it had previously thought due to increased use of cost recovery mechanisms and reduced regulatory lag. In 2018, the equity analysts

1 Source: Bloomberg Professional, as of February 20, 2024. Note that the percentages represent the institutional holdings by geographic region as a percent of total institutional holdings.

at Scotia Bank published a report in which they indicate that they no longer view U.S. utilities as more risky than Canadian utilities. Also, the Canadian and U.S. economies and capital markets are highly integrated, and Canadian-based utilities have continued to acquire U.S.-based utilities and fund their operations with debt and equity issued both in Canada and the U.S.

Further, as shown in Figure 1 of Volume 2, Concentric's *Cost of Capital* report, the average multi-stage DCF results for the U.S. Electric proxy group are approximately 80 basis points below those for Canadian regulated utilities (9.38 percent for U.S. vs. 10.17 percent for Canada). This would not support a view that the U.S. utilities are riskier than the Canadian proxy group.

In summary, Concentric believes that a North American Electric Utility proxy group can be effectively screened for purposes of estimating the cost of capital for Canadian utilities, including Newfoundland Power, without the need for a country risk adjustment. This view is supported by the comparability and supportiveness of the regulatory environments, the integration of Canadian and U.S. capital markets, and the evolution of North American business models in the utility industry.