Réponses du Transporteur et du Distributeur à la demande de renseignements numéro 1 de l'Association québécoise des consommateurs industriels d'électricité et du Conseil de l'industrie forestière du Québec (« AQCIE-CIFQ »)

Partie 2

First Topic: Concentric Evidence and Previous Testimony

Reference: Dr. Coyne's evidence page ii to page 12

Preamble:

Dr. Coyne indicates that he is a Senior Vice President of Concentric and the basis for his recommendation

Question 1:

1.2 Please confirm that previously, for example before the Alberta Utilities Commission, Dr. Coyne has filed testimony with Dr. Stephen Gaske also of Concentric and that they are both senior members of Concentric providing fair rate of return testimony

Réponse :

Confirmed.

1.3 Please confirm that Dr. Gaske filed testimony before the Regie in a recent intervention on behalf of Intragaz limited partnership (R-3807-2012) and provide copies of that testimony and indicate whether he consulted or discussed with Dr. Gaske that testimony.

Réponse :

Confirmed that Dr. Gaske filed testimony before the Régie on behalf of Intragaz, and a copy is attached. Mr. Coyne did not consult or discuss that testimony with Dr. Gaske. Please see Request 1.3, Attachment 1.

1.4 Please confirm that in his current testimony Dr. Coyne states "Concentric has estimated" (page 6), is this taken to mean that Concentric ensures that the testimony of Dr. Coyne and Dr. Gaske reflects the views of Concentric and he agrees with Dr. Gaske's Intragaz testimony.

Réponse :

Not confirmed. The authorship of this testimony and meaning of Concentric as used in the testimony is explained in the opening seven lines of the testimony:

Concentric Energy Advisors, Inc. ("Concentric") provides this testimony on behalf of Hydro-Québec under two witnesses who have collaborated in its preparation. Mr. Coyne's testimony primarily relates to the determination of the appropriate ROE and capital structure; Mr. Trogonoski's testimony primarily relates to the associated risk analysis. The words "Concentric", "we", and "our" are used interchangeably in the text.

Mr. Coyne and Mr. Trogonoski did not consult with Dr. Gaske on this testimony, and we cannot state whether or not he shares the views contained therein.

As noted in response to 1.3, Mr. Coyne has not previously reviewed or discussed Dr. Gaske's Intragaz testimony.

1.5 Please confirm that Dr. Gaske recommended an 11.50% fair ROE based on the median ROE of a proxy group of Canadian utilities ***supported by*** the DCF results from a proxy group of US utilities (page 5).

Réponse :

Cette question dépasse le cadre de la présente audience et n'est pas pertinente à l'égard de l'objet de la preuve offerte dans ce dossier par les experts Jim Coyne et John Trogonoski.

1.6 Please confirm that Dr. Gaske recommended a 50% common equity ratio for Intragaz.

Réponse :

Voir la réponse à la question 1.5.

1.7 Please confirm that the Canadian proxy group had a median return of 11.78% and the US proxy group 11.26%

Réponse :

Voir la réponse à la question 1.5.

1.8 Please confirm that Dr. Gakse's Canadian sample is the same as that used by Dr. Coyne except that Dr. Coyne also looks at Valener.

Réponse :

Voir la réponse à la question 1.5.

1.9 Please indicate why in this testimony Dr. Coyne uses the mean (average) of his sample's return estimates rather than the median as used by Dr. Gaske?

Réponse :

Voir la réponse à la question 1.5.

1.10 Please indicate why in this testimony Dr. Coyne places principal weight on the US sample estimates whereas Dr. Gaske placed primary emphasis on the Canadian sample's estimates? In particular given the relative scarcity of both storage companies and pure electric distribution and transmission companies why should the weight have shifted from Canadian proxy groups to US proxy groups within such a short period of time?

Réponse :

Voir la réponse à la question 1.5.

1.11 Please provide the Regie's ROE and capital structure decision for Intragaz

Réponse :

Voir la réponse à la question 1.5.

Second Topic: Credit rating reports

Reference: Dr. Coyne's evidence page 16-17

Preamble:

Dr. Coyne discusses the Moody's and DBRS credit rating reports.
Question 2:

2.1 Dr. Coyne mentions that Merril Lynch estimates the cost of the provincial guarantee of Hydro Quebec's debt is 50 basis points, please provide the document that contains this estimate.

Réponse :

Please see Request 2.1, Attachment 1.

2.2 Dr. Coyne mentions that Merril Lynch estimates the cost of the provincial guarantee of Hydro Quebec's debt is 50 basis points, please provide the document that contains this estimate.

Réponse :

Please see response to Request 2.1.

2.3 Dr. Coyne notes Moody's and DBRS's statements about HQ's ROE and deemed equity ratio and their impact on HQ's credit metrics, would Dr. Coyne agree that given the provincial guarantee HQ could finance with 90% debt and a lower ROE as long as it does not impact the provincial credit rating. If not why not.

Réponse :

No, Mr. Coyne does not agree with this statement. As discussed on page 20 of Concentric's ROE and risk evidence, the Régie has indicated in previous decision that the ROE for HQD and HQT should be set on a "stand-alone" basis, as if the entities were independently seeking to attract capital in the financial markets. While an equity investor might consider the credit rating, Mr. Coyne does not believe that a regulated utility would be able to attract capital in financial markets with a capital structure comprised of 90% debt and 10% common equity, nor could it attract capital with an ROE that was lower than the currently allowed ROE for HQD and HQT. In order to meet the Fair Return Standard, the ROE and deemed equity ratio must meet three standards : comparable investment standard ; financial integrity standard ; and capital attraction standard. Mr. Coyne's recommended ROE for HQD and HQT meets the Fair Return Standard.

2.4 Is Dr. Coyne aware that even if HQ were not a crown corporation but a separate company the rating agencies would still consider the importance of the utility to the province and the level of implied support? As a result they would take this into account even without a guarantee?

Réponse :

Concentric is aware of the following statement from the August 2012 Moody's report regarding this issue :

In addition to the explicit guarantee of the Province, we also believe that the Province and HQ have a high default dependence and, even without the guarantee, we would expect there to be a high probability of extraordinary support from the Province given HQ's importance to Québec's economy, its operating and financial proximity to the government, as well as its key role in the provincial government's economic development and financial strategy.

2.5 Is Dr. Coyne aware that Ontario Hydro was reorganised and is no longer a crown corporation but has been split into different parts as Ontario Business Corporation Act (OBCA) companies? Is Dr. Coyne aware that S&P takes into account the importance of the post-split Ontario Hydro companies to the province in their ratings?

Réponse :

Mr. Coyne confirms that Ontario Hydro was reorganized in 1998. The related company which Concentric included in the group of government-owned Canadian electric distribution and transmission utilities is Hydro One Networks, which is wholly owned by the Province of Ontario. Mr. Coyne has not reviewed the S&P credit report for Hydro One Networks.

2.6 Please provide a copy of Hydro One and Ontario Power Generation's latest credit rating reports from the major credit rating agencies.

Réponse :

Please see Request 2.6, Attachments 1 to 4, for OPG and Hydro One credit reports.

2.7 Please explain why in his analysis Dr. Coyne did not include a discussion of New Brunswick Power in his analysis?

Réponse :

As explained on page 25 of Concentric's evidence, we selected a group of municipal and provincial government-owned Canadian distribution and transmission utilities for the purposes of comparing the authorized ROE of HQD and HQT to those entities. There is no specific reason that New Brunswick Power was not included in this group. Concentric simply chose a broad sample of government-owned utilities. As noted in our response to Request 2.8 below, while the distribution company for New Brunswick Power does not have an authorized ROE, the transmission company's authorized ROE is 9.5 percent and its deemed equity ratio is 35 percent.

2.8 Please provide the latest allowed ROE and common equity ratio for NB Power.

Réponse :

Regarding its transmission operating company ("Transco"), New Brunswick Power reports that: "Transco is intended to collect sufficient revenues to cover its costs, and to provide a return on its equity. The return approved by the regulator for Transco is 9.5 percent (within a range from 8.5 percent to 10.5 percent), and a capital structure of 65 percent debt and 35 percent equity."[1]

Regarding its distribution operating company ("Distribution and Customer Service"), New Brunswick Power explains that: "The *Electricity Act* authorizes Distribution and Customer Service to increase its rates without the approval of the Energy and Utilities Board (EUB) as long as the increase does not exceed the greater of three per cent or the percentage change in the average consumer price index."[2] When reviewing New Brunswick Power's most recent distribution rate increase in 2010, the New Brunswick Energy and Utilities Board reiterated its position from 2008 that:

1 New Brunswick Power, Annual Report 2012-13, at 44.

2 See http://www.nbpower.com/html/en/about/regulatory/disco.html.

> **The Board finds that it is prudent for DISCO to have net income and to accumulate earnings towards its stated goal of self-sufficiency. The Board believes that the best method for determining net income is applying an allowable rate of return to equity. This, however, is not possible as no equity injection has been made by the shareholder, and DISCO has only accumulated nominal retained earnings to this point. Consequently, the Board accepts DISCO's approach of using an interest coverage ratio to set income for the test year.[3]**

As such, NB Power does not have an authorized capital structure or return on equity for its distribution business.

Third Topic: Fair Return Standard

Reference: Dr. Coyne's evidence page 17

Preamble:

Dr. Coyne discusses the fair return standard
Question 3

3.1 Please provide a copy of the Major and Priddle and indicate why the paper was written and on whose behalf.

Réponse :

Please see Request 3.1, Attachment 1.

As explained in the Introduction on page 7, the Canadian Gas Association ("CGA") asked Messrs. Major and Priddle to expand on some of the issues raised in a CGA paper regarding the importance of a "fair return" in supporting investments and the origin and evolution of the "Fair Return Standard" in Canada. The Honourable John C. Major is a former Justice of the Supreme Court of Canada, and Mr. Roland Priddle is a former Chair of the National Energy Board.

3.2 In terms of the application of the fair return standard to Hydro Quebec, please confirm that Hydro Quebec is a crown corporation and reports to the Minister of Energy and that the Regie is a branch of the provincial government.

Réponse :

Hydro-Québec is a crown corporation and does report to the Minister of Energy.

[3] New Brunswick Energy and Utilities Board, Report In the Matter of an Investigation into the necessity for the 3% increase in the New Brunswick Power Distribution and Customer Service Corporation's charges, rates and tolls which came into effect on June 1, 2010, July 12 , 2010, at 7-8.

According to the Régie's website, it is "an independent agency funded by duties and fees paid on a user basis by the regulated distributors."

It is unclear how either of these facts is relevant to the application of the Fair Return Standard to HQD or HQT.

3.3 Please indicate all instances that Dr. Coyne is aware of where Hydro Quebec has appealed to the Minister of Energy concerning a ruling by the Regie.

Réponse :

Mr. Coyne has no knowledge regarding whether Hydro-Québec has appealed to the Minister of Energy concerning a ruling by the Régie.

3.4 Please confirm the following passage taken from the Government of Quebec's web page http://www.mrn.gouv.qc.ca/english/energy/ and indicate whether Dr. Coyne judges this to be a reflection of a "stand-alone" owner or whether HQ's owner views the utility as being a critical component of Quebec's industrial policy.

Réponse :

Mr. Coyne confirms the quoted passage from the Government of Québec's web page.

Mr. Coyne does not view these issues as mutually exclusive. Mr. Coyne is aware that the Province of Québec views Hydro-Québec as a critical component of Québec's industrial policy. However, Mr. Coyne is also aware that the Régie has indicated in previous decisions that the allowed return on equity for HQD and HQT should be set on a stand-alone basis, as if the entities were independently seeking to attract capital in the financial markets.

Québec has chosen energy as a core element of its development. It is one of only a handful of societies in the world to have a plentiful supply of clean energy, and its leadership in the electricity generating field has earned international recognition; 97% of all the electricity it produces is "green" electricity!

Québec is already acknowledged as a worldwide reference in the area of hydro-electric development, and is now positioning itself as a North American leader in the wind energy sector. This is a responsible environmental choice of which it is justifiably proud!

Québec has also acquired expertise and know-how in the field of energy technology, and this will help it to develop the plentiful and varied sources of energy available throughout its vast territory.

3.5 Dr. Coyne provides the allowed ROEs for both HQD and HQT on page 21, please indicate when HQ first decided that these allowed ROEs were inadequate and when it requested that they be reviewed. That is, when was the decision made that the allowed ROEs violated the fair return standard?

Réponse :

Hydro-Québec formulait, dès 2006 dans les documents de Politique financière des Demandeurs, plusieurs commentaires quant à leur prime de risque et à leur taux de capitalisation présumé.

En effet, Hydro-Québec constatait la proportion des capitaux propres dans la composition de la structure de capital présumée du Transporteur et du Distributeur, ainsi que leur prime de risque se situaient nettement dans le bas de la fourchette des paramètres financiers accordés par les organismes réglementaires canadiens à des entreprises de services publics œuvrant dans le domaine du transport et de la distribution d'énergie.

Fourth Topic: Proxy samples

Reference: Dr. Coyne's evidence page 22-28

Preamble:

Dr. Coyne discusses his three proxy samples
Question 4

4.1 For the Canadian utility sample on page 23-4 please provide since 2001 their book value per share, earnings per share and dividend per share.

Réponse :

Concentric did not review this data in preparing its ROE analysis. Value Line reports the book value per share, earnings per share, and dividends per share for the companies it covers in Canada (i.e., Enbridge, Inc. and TransCanada Corp.)

4.2 For the US utility sample discussed on page 24 for each Value Line company initially reviewed, as well as the proxy sample finally chosen please, provide their book value per share, earnings per share and dividend per share since 2001.

Réponse :

Please see Request 4.2, Attachment 1, for the Value Line pages that contain this data.

4.3 For the Canadian power companies on page 25 and New Brunswick Power and Newfoundland Hydro please provide their common equity ratio, book value per share, earnings per share and dividend per share since 2001.

Réponse :

Concentric did not review this data in preparing its ROE analysis. We are not aware of a source that provides this information.

4.4 For the Canadian power companies on page 25 please indicate which ones are provincial power companies with a provincial monopoly equivalent to Hydro Quebec.

Réponse :

The table R-4.4 summarizes the extent to which the government-owned Canadian utilities serve their respective provinces.

Table R-4.4
Description of GOU Extent of Service

Company	*Description of Extent of Service*
BC Hydro	BC Hydro serves 95 percent of BC's population.[1]
ENMAX Corp.	ENMAX Power only provides regulated transmission and distribution of electricity in and around the city of Calgary.[2]
EPCOR Utilities	EPCOR Distribution & Transmission Inc. is responsible for the delivery of electricity to the residents of the City of Edmonton and surrounding areas.[3]
Hydro One Networks	Hydro One is the largest electric LDC in Ontario, but Ontario has several other small LDCs.[4]
Manitoba Hydro	Manitoba Hydro is the only regulated electric utility in the province of Manitoba.[5]
Saskatchewan Power	Saskatchewan Power has an exclusive franchise within the province of Saskatchewan (except for the City of Saskatoon and the City of Swift Current) to supply, transmit, and distribute electricity, as well as provide retail services to customers.[6]

[1] BC Hydro, 2011 Annual Report, at 7.
[2] ENMAX, 2012 Financial Report, at 5.
[3] See http://corp.epcor.com/about/operating-companies/pages/operating-companies.aspx.
[4] Hydro One, 2012 Annual Information form, at 18.
[5] Manitoba Public Utilities Board, 2011-12 Annual Report.
[6] Saskatchewan Power, 2012 Annual Report, at 17.

4.5 Please confirm that Enmax and Epcor are the former Calgary and Edmonton owned distribution utilities and explain why they were included in the sample since they do not have significant transmission or generation operations.

Réponse :

As indicated in the response to Question 4.4, ENMAX Power provides regulated transmission and distribution of electricity in and around the City of Calgary. As of December 31, 2011, ENMAX had distribution rates base of $750.1 million and transmission rate base of $207.0 million.[4] The City of Calgary is the sole shareholder of ENMAX.

EPCOR Distribution and Transmission, Inc. owns and operates regulated distribution and transmission assets in the City of Edmonton and surrounding areas. As of December 31, 2011, EPCOR Distribution and Transmission had net property, plant and equipment of $954 million.[5] The common shares of EPCOR are owned by the City of Edmonton.

Both companies were included in the sample of Canadian government owned utilities because they provide regulated distribution and transmission services, which are subject to rate regulation by the Alberta Utilities Commission, including setting the allowed ROE and common equity ratio.

4.6 Please confirm that when Dr. Coyne talks about credit ratings being based on business and financial risk (page 26) he is aware that for these large publicly owned power utilities it also reflects the degree of support expected from their owners and their importance to the provincial economy.

Réponse :

Mr. Coyne is aware that credit rating agencies consider the financial support available to the rated entity.

4.7 Please indicate which of the Canadian and US privately listed companies in his first two samples Dr. Coyne would regard as “too big or too important to fail” and thus automatically generate government support in the event of any problems.

4 ENMAX, 2012 Financial Report, at 20.

5 Consolidated Financial Statements of EPCOR Utilities Inc., Years ended December 31, 2011 and 2010, at 29.

Réponse :

Mr. Coyne has not assessed whether any of the companies in the first two proxy groups are "too big to fail", nor is he aware of any such measure for regulated utilities being utilized for purposes of determining the cost of capital. He uses the actual ratings of the credit rating agencies as a measure of financial risk.

4.8 Is Dr. Coyne aware that a major issue in bank regulation at present is the importance of major US banks such as Citibank and Bank America and that even without explicit government guarantees they are deemed to be too big to fail and that this implicit support is factored into their credit ratings?

Réponse :

Mr. Coyne has not researched U.S. bank regulation or bank credit ratings for this testimony.

4.9 In the case of Enbridge and TransCanada is Dr. Coyne aware that both companies are (natural gas) transmission utilities and regulated by the National Energy Board. Why would he regard these as non-regulated activities?

Réponse :

Concentric is aware that Enbridge, Inc. and TransCanada Corp. are both engaged in natural gas transmission and are regulated by the National Energy Board. As explained on pages 27-28 of Concentric's evidence, several companies in the Canadian utility proxy group have affiliates that are engaged in non-regulated activities <u>or in regulated activities other than electric distribution and transmission</u>. Enbridge, Inc. and TransCanada Corp. have substantial non-electric and/or unregulated operations which have different business risks than the regulated electric transmission and distribution business.

Fifth Topic: Board decisions on US data

Reference: Dr. Coyne's evidence page 28-34

Preamble:

Dr. Coyne discusses his three board decisions on the use of US data
Question 5

5.1 Does Dr. Coyne regard the quoted passages from the NEB, OEB and BCUC as representing a complete survey of board decisions regarding the use of US data in a Canadian market? If he answer is yes, please indicate why he has not included the latest decision by the Board of Commissioners of Newfoundland and Labrador.

Réponse :

The referenced decisions from Canadian utility regulators were provided in response to the following question on page 31 of Concentric's evidence: "Please summarize the recent orders in which Canadian regulators have accepted the use of U.S. data to estimate the cost of equity for a regulated utility in Canada." Concentric is aware that other regulatory bodies in Canada, including the Régie, have expressed specific concerns about the use of U.S. data. There is, however, substantial precedent in other jurisdictions for the use of U.S. data in Canadian markets, as evidenced by the cited decisions from the National Energy Board, the Ontario Energy Board, and the British Columbia Utilities Commission. Concentric's evidence has attempted to address the specific concerns expressed in previous decisions by the Régie about the use of U.S. data through the risk analysis.

5.2 For the BCUC in the Terasen Gas (TGI) decision referenced (page 52) please confirm the following quote from the decision:

The Commission Panel agrees with Dr Booth that "significant risk adjustments" to US utility data are required in this instance to recognize the fact that TGI possesses a full array of deferral mechanisms which give it more certainty that it will, in the short-term, earn its allowed return than the *Value Line* US natural gas LDCs enjoy. The Commission Panel notes Dr. Booth's suggestion that the risk premium required by US utilities is between 90 and 100 basis points more than utilities in Canada require may set an upper limit on the necessary adjustment. Accordingly, the Commission Panel will reduce its DCF estimate by between 50 and 100 basis points to a range of 9.0 percent to 10.0 percent, before any allowance for financing flexibility.

Réponse :

Mr. Coyne confirms the referenced quote from the BCUC decision for Terasen Gas, issued December 16, 2009. Mr. Coyne further notes that the BCUC made no such adjustment in it most recent generic cost of capital proceeding, where the BCUC relied upon both US and Canadian data in reaching its determination.

5.3 Would Dr. Coyne agree that the BCUC considered US evidence useful, but recognised that it has to be adjusted when applied to TGI? If not please explain why he would reference the BCUC decision but not the important qualification outlined in 5.2 above.

Réponse :

Yes. However, there are several important qualifications and reasons to differentiate the BCUC decision from the current proceeding in Québec. First, the BCUC decision was issued in December 2009, when the financial crisis and recession were still prominent in every investor's mind, especially in the U.S. Second, the BCUC decision states that "significant risk adjustments to US utility data are required <u>in this instance</u> to recognize that TGI possesses a full array of deferral mechanisms which give it more certainty that it will, in the short-term, earn its allowed return than the Value Line US natural gas LDCs enjoy." Concentric has presented evidence on pages 58-60, including Chart 4, which demonstrates that the operating companies within the US proxy group have generally been able to earn their allowed ROE from 2000-2011. For that reason, Concentric determined that the electric utilities in the U.S. proxy group generally operate in regulatory environments that afford timely cost recovery and a fair opportunity to earn their allowed return. As such, Concentric concluded that it is reasonable and appropriate to consider the U.S. electric utility proxy group as an appropriate benchmark for the market-based cost of equity for HQD and HQT, and that no adjustment is required to the U.S. data to account for differences in risk. As noted above in response to 5.2, the BCUC makes no such adjustment in its more recent generic cost of capital decision.

Sixth Topic: The comparability of US and Canadian data

Reference: Dr. Coyne's evidence page 34-41

Preamble:

Dr. Coyne discusses reason why he judges US and Canada to be comparable, that is, estimates can be used in Canada with minimal (no?) adjustment

Question 6

6.1 On page 39 Dr. Coyne discusses ten year bond yields in the US and Canada, please explain what Dr. Coyne understands by the term structure of interest rates or the yield curve.

Réponse :

Concentric does not discuss the term structure of interest rates or the yield curve at page 39 of the evidence. Therefore, it is not clear from AQCIE/CIFQ's question what aspects of the yield curve or the term structure of interest rates would be required.

6.2 Please provide the current three month treasury bill and the 30 year government bond yield for both the US and Canada for each month end since January 2013 to the present.

Réponse :

Concentric did not rely on the three-month Treasury bill yields, nor the 30-year government bond yields in estimating HQD's and HQT's cost of equity. Information regarding the 30-year government bond yields in Canada and the U.S. was provided to the Régie in August 2013 response to Request 1.3. Moreover, Concentric has determined that the information AQCIE/CIFQ is seeking is publicly available at the following websites:

http://www.bankofcanada.ca/rates/interest-rates/

http://www.federalreserve.gov/releases/h15/data.htm

6.3 Please confirm that the difference between the 30 year and three month government yield is called the yield spread and commonly taken to be indicative of business conditions, if not why not.

Réponse :

Concentric disagrees that the difference between the 30-year and three-month government yields is the definition of the term "yield spread". That is only one of many possible measures of what is called the yield spread. Yield spreads can be calculated across multiple investment securities that provide a yield, across varying maturities, and across differences in credit quality. The difference between three-month and 30-year government bond yields represents the differences as of any point in time of investors' expectations for numerous factors, including business conditions, between the points in time delineated by the maturation of the government securities in question.

6.4 Please confirm that currently the yield spread is higher in the US than in Canada because the US has yet to recover from the "Great Recession" and its economy is weaker than Canada's.

Réponse :

Concentric has not conducted any economic studies to analyze the underlying drivers of the differences between different maturities of U.S. and Canadian government securities. According to the National Bureau of Economic Research, the U.S. exited the last economic recession in June 2009. As such, Concentric believes it is unlikely that the economic downturn that ended four years ago is directly responsible for current bond yields.

6.5 Please confirm that with higher T Bill yields in Canada and lower long term Bond yields it is a matter of arithmetic that there is a point where they should be similar and this is currently about the ten year mark.

Réponse :

Concentric finds this request unclear.

6.6 Please confirm that if Dr. Coyne had looked at long bond yields or T Bill yields his conclusion that yields were about the same in the US and Canada would not have been true.

Réponse :

As noted in the preface to these questions, Concentric examined 10-year Treasury yields for U.S. and Canadian government securities. This examination is consistent with Concentric's understanding of the previous approach used by the Régie to determine comparability, as well as the level of the risk-free rate.

6.7 Please confirm that the non-accelerating rate of unemployment (NAIRU) in the US is regarded by the BEA as 5.2% and is significantly higher than in Canada.

Réponse :

The historical unemployment rate for Canada and the U.S. for the period from 1987-2011 is shown on Exhibit JMC-2. Concentric did not review the non-accelerating rate of unemployment in the U.S. or Canada as part of our comparison of economic conditions in the two countries.

6.8 Please indicate when both the US and Canada recovered all the jobs lost during the Great Recession.

Réponse :

First, it is unclear what time period is referred to as "the Great Recession". Moreover, Concentric has not conducted a study to catalog all the jobs lost during the recent recessionary period, nor what jobs have been created subsequent to that period. Concentric believes, however, that such information is not relevant to the determination of comparability of economic prospects, so much as the indicators followed by investors reviewed in Section VI of Mr. Coyne's and Mr. Trogonoski's ROE and risk analysis evidence.

Seventh Topic: Dr. Coyne's risk analysis

Reference: Dr. Coyne's evidence page 41-50

Preamble:

Dr. Coyne discusses the business and financial risk of his comparable firms.
Question 7

7.1 On page 44 Dr. Coyne discusses short versus ling term risk whereas HQ ignores long term risk in their discussion. Can Dr. Coyne explain why he considers long term risk relevant while HQ does not?

Réponse :

Concentric's risk analysis considered the long-term business risk of HQD and HQT because, in our view, equity investors are concerned with a company's ability to manage and offset longer-term business risks which may not be mitigated by short-term cost recovery mechanisms or variance/deferral accounts. For example, long-term trends in demand for electricity or the relative competitiveness of electricity and natural gas are important considerations for investors, but it is difficult for a utility to mitigate these potential risks through a short-term regulatory mechanism. Likewise, long-term capital spending requirements for transmission or distribution service are an important consideration for investors, but the utility has limited ability to ensure cost recovery of such projects over the life of the project.

7.2 Please indicate whether HQ agrees with Dr. Coyne's judgement (page 48) that HQD faces greater long term risk than the operating companies in the Canadian and US proxy groups due to the concentration of industrial customers.

Réponse :

Tel que mentionné à la page 27 du document HQDT-1, document 1, le Distributeur adopte et fait sienne les recommandations des experts de CEA.

7.3 Please indicate whether in Dr. Coyne's judgment HQD would be lower risk if all of HQD's customers closed down and HQD only served the commercial and residential customers that did not leave when the industries closed down.

Réponse :

As explained on pages A-22 and A-23 of Concentric's evidence, HQD faces more competitive risk due to its higher concentration of industrial customers in Québec, which makes HQD more vulnerable to risks associated with an economic downturn that could cause those industrial customers to reduce their demand for electricity, as well as risks due to economic bypass or self-generation if those customers determine those

options are more economical. As shown on Exhibit JMC-3, Schedule 2, HQD derives a considerably higher percentage of distribution revenues from industrial customers than the other electric distributors in the Canadian proxy group and U.S. proxy groups, with the exception of ATCO Electric Distribution. Consequently, Concentric concluded that HQD has higher risk than the other proxy group companies (except ATCO Distribution) on this factor.

7.4 With regard to the competitive threat from natural gas, please indicate from his review of past decisions whether Dr. Coyne judges the Regie to agree with him and has accordingly lowered the business risk assessment of Gaz Metropolitain and increased either its debt ratio or lowered its ROE to reflect the lower risk?

Réponse :

In Decision D-2011-182, issued on November 25, 2011, the Régie made the following comments about the relative competitiveness of electricity and natural gas: "The Régie also observes that the competitiveness of natural gas in relation to other energy sources has improved since 2009."[6] However, the Régie declined to change Gaz Métro's deemed equity ratio or adjust its allowed ROE on that basis, stating: "The Régie considers the company's overall risk to be higher than that of the benchmark utility, due to, among other things, the composition of its customer base and competition from electric power in Québec."[7] In making this decision, the Régie declined to adopt Dr. Booth's position, which it described as follows: "According to Dr. Booth, Gaz Métro's risk has decreased since the Régie's last decision in 2009. He argued that shale gas development is an important change which has had the effect of increasing supply, and further stated that lower natural gas prices have increased its competitiveness in relation to oil and electricity."[8]

7.5 Please provide all data that Dr. Coyne has analysed to examine the competitive position of electricity in Quebec with natural gas, fuel oil (#6) wood chips and any other energy source Dr. Coyne views as relevant for industrial, commercial and residential users.

Réponse :

Our comments on this issue are based on the Régie's decisions regarding Gaz Métro in 2011 and 2009. Concentric compares HQT and HQD to other North American utilities. Competition between electricity and other fuels, including gas, is a North American phenomenon, thus all utilities face competition from competitive fuels. The selection of an electric proxy group provides a basis for comparing HQT and HQD to companies of similar risk.

[6] Decision D-2011-182, November 25, 2011, English Translation, at 12.

[7] Decision D-2011-182, November 25, 2011, English Translation, at 13.

[8] Decision D-2011-182, November 25, 2011, English Translation, at 12.

7.6 Please indicate from the analysis in 7.5 above whether in Dr. Coyne's view this competitive position has materially changed since 2001.

Réponse :

Please see response to Request 7.5.

7.7 In terms of Concentric's US sample please indicate which companies are "state wide" utilities that are considered critical for the state's development and accordingly has a "too big to fail" implied support.

Réponse :

Concentric did not consider this factor in its risk analysis.

Eighth Topic: Dr. Coyne's financial risk analysis

Reference: Dr. Coyne's evidence page 51-64

Preamble:

Dr. Coyne discusses HQT and HQD's "higher" financial risk.
Question 8

8.1 Please confirm that financial leverage (the use of debt) magnifies underlying business risk.

Réponse :

All else being equal, for two firms of equal business risk, a firm with greater financial leverage will have greater overall risk.

8.2 Please confirm that if a utility always over earns its allowed ROE then financial leverage has been positive in magnifying the ROE. If not explain in detail why not.

Réponse :

If a utility always over-earns its allowed ROE, for example by 1% each year, regardless of its financial leverage, the firm has only over-earned by 1%. There is no "magnification" of ROE. If the question presumes that the return is measured in dollars, and not percentage terms, then the same over-earnings (in percentage terms) would be greater for a firm with more debt leverage as the equity denominator is smaller for a given level of earnings. Mr. Coyne notes, however, that ROE is calculated and determined in percentage terms so it is appropriately scaled to the amount of capital invested, so it is appropriate to consider these relationships in percentage terms.

8.3 Please provide the average over-earning of the allowed ROE by both HQT and HQD since 2001 and provide Dr. Coyne's judgement as to whether in practise the use of more debt has increased or reduced the ROE.

Réponse :

Please refer to response to Request 17.1, HQTD-3, document 1. Please refer to response to Request 8.2, above, for interpretation. The use of more or less debt has not changed the allowed or earned ROE in percentage terms, but more debt does increase the financial risk.

8.4 Please confirm or explain why Dr. Coyne disagrees with the judgement that the Regie has allowed HQT and HQD lower common equity ratios due to its judgment that both have lower business risk than the typical Canadian utility and as a result no leverage adjustment increasing the ROE is needed.

Réponse :

Mr. Coyne is not aware of the Régie's judgements regarding the relative risks of HQT and HQD in relation to "the typical Canadian utility", but he assumes that the Régie's prior decisions reflect its judgements regarding the business risk of the companies.

8.5 Please provide the full analysis for the 0.41% premium ROE for electricity generation (page 53).

Réponse :

Please see Request 8.5, Attachment 1. Data are based on rate case decisions reported by SNL Financial/Regulatory Research Associates for the period from 2004 through 2012.

8.6 Please provide the full analysis for the judgement that HQT and HQD need an additional 1.50-3.0% ROE to compensate for the additional financial "risk" that Dr. Coyne judges them to have (page 52) relative to his US proxy group.

Réponse :

Please see Request 8.6, Attachment 1.

8.7 Please confirm that the coefficient of variation as used by Dr. Coyne is the reciprocal of the average ROE divided by its variability which is commonly used as a performance measure in finance, ie., something has earned a higher ROE relative to its risk.

Réponse :

As explained on page 60 of Concentric's evidence, the coefficient of variation in Chart 5 is calculated as a ratio or percentage by dividing the standard deviation by the average ROE for each operating company. To the extent that the question is using the term "variability" to refer to the standard deviation, then Concentric confirms this statement.

8.8 Please confirm that due to 8.6 the coefficient of variation has been rejected by Canadian regulators as a risk measure. If not please provide extracts from any Canadian board decision that has endorsed the use of the coefficient of variation.

Réponse :

The only Canadian utility regulatory decision of which Concentric is aware in which a regulatory body commented on the coefficient of variation is Decision No. 2004-003 from the Alberta Energy and Utilities Board, in which the Board noted that:

> **The Board considers that volatility in historic return on capital is a direct measure of realized historic business risk. And given relative stability in the equity ratio and interest costs, variation in historic realized return on equity is also a reasonable, although indirect, measure of realized historic business risks. The Board believes that [The Canadian Association of Petroleum Producers'] expert's use of the coefficient of variation of the return on assets and of return on equity as measures of business risk has merit.[9]**

Ninth Topic: Determination of the ROE

Reference: Dr. Coyne's evidence page 64-86

Preamble:

Dr. Coyne estimates the fair ROE for HQT and HQD using risk premium models.
Question 9

9.1 Dr. Coyne uses a long term forecast of the ten year government bond rate from 2013-2018. Please indicate why Dr. Coyne judges the market to be inefficient since market participants buy long term bonds with an expectation in mind as to the path of future long term interest rates.

9 Alberta Energy and Utilities Board, Decision No. 2004-003 (Erratum), December 2, 2003.

Réponse :

Concentric does not judge the market to be inefficient. The use of forward-looking estimates of government bond yields is a matter of matching the estimate of the cost of capital to an equity investor's time horizon. If forecasts call for changes in long term bond yields, as they clearly do, it is reasonable to assume that investors would factor these forecasts into their return expectations.

9.2 Please indicate why Dr. Coyne would disagree with financial theory that the best predictor of the long term return from bonds is the current long term bond yield.

Réponse :

Please see the response to Request 9.1. There are numerous reasons why the current bond yield may not be the best predictor of long run bond returns, as the market for bonds moves in response to supply/demand for those specific instruments at one point in time. Those market conditions may change materially, and forecast expectations may deviate from current yields for those same instruments, as is the case currently. As a matter of logic, macroeconomic forecasts including bond yields would not be in demand otherwise.

9.3 Can Dr. Coyne please provide all evidence that he is aware of that economists are better predictors of future interest rates than market participants.

Réponse :

Concentric did not make the assertion that economists are better predictors of future interest rates than market participants.

9.4 Please provide the October forecast referred to on page 69 and indicate the yield on long Canada bonds at that time and currently.

Réponse :

Concentric relied upon the *Consensus Economics* estimate as of October 2012, for the estimate of the forecasted risk free rate in 2013 - 2018. Please see Request 9.4, Attachment 1. Please also see Concentric's response to Request 6.2 as to the level of interest rates, both historical and current.

9.5 Dr. Coyne confirms that both Value Line and Bloomberg adjust their betas (page 70). Please provide any evidence that Dr. Coyne is aware of those utility betas revert to 1.0 as assumed in the Value Line and Bloomberg adjustment methodology.

Réponse :

As noted in Concentric's evidence, Concentric uses the average of the market-adjusted beta estimates and industry-adjusted beta estimates for the proxy group. Concentric notes that "[u]sing an average of those two measures of Beta reflects the statistical and market practice of adjusting beta coefficients to 1.0, while also reflecting the historical practice of the Régie using an industry beta." [See Concentric Evidence at 74]. Concentric has not asserted that the proxy companies' beta coefficients revert to 1.0; rather, that market practice is to use beta coefficients that revert to 1.0.

9.6 Please provide citations from any Canadian regulator that has accepted the beta adjustment methodology used by both Value Line and Bloomberg.

Réponse :

Concentric has not researched Canadian decisions on this matter. As noted in Concentric's evidence at page 73, the Régie has previously established a range of benchmark utility beta coefficients of 0.50 to 0.60. As shown in Exhibit JMC-6, Schedule 1, Concentric uses a Beta coefficient of 0.59 in our analysis, which is consistent with the upper end of that previously accepted range.

9.7 Please provide copies of the numerous studies cited on page 71 and indicate why Dr. Coyne is relying on a 1971 study on earlier data for all stocks, rather than for a study on utility stocks.

Réponse :

Please see Request 9.7, Attachment 1 and Attachment 2. Both Value Line and Bloomberg rely on a methodology and approach similar to that developed by Blume in adjusting beta coefficients to the market mean. As such, Concentric's use of those estimates is designed to reflect the information historically and currently commonly relied upon by investors in the estimation of relative risk and relative valuation throughout the capital markets.

9.8 Please provide all information that Dr. Coyne is aware of that the future market risk premium on the stock market will exceed the historic risk premium as implied in his historical (sic) compared to the "forward" looking market risk premium on page 75.

Réponse :

Because the historical market risk premium is a function of average historical market returns and average historical government bond yields, in order for the expected market risk premium to equate to the historical average market risk premium, the difference between expected and historical market returns and government bond yields must be equal. Current expectations of a greater than historical market risk premium are a

reflection of the currently low level of government bond yields relative to historical average levels and relatively consistent levels of market return expectation. Assuming bond yields remain below the long-term historical average and that investor market return requirements remain relatively constant, forward-looking market risk premiums will exceed the historical average.

9.9 Would Dr. Coyne accept that f the judgement of the BCUC is accepted and the US DCF estimates are discounted by 0.50-1.0% then his forward looking market risk premium also has to be lowered? If not why not.

Réponse :

Mr. Coyne has developed independent estimates of the cost of capital for HQD and HQT. He is aware that in its 2009 decision, the BCUC did make an adjustment to the US DCF estimate, but he sees no evidence that the BCUC continued this practice in its most recent generic cost of capital proceeding (Order G-20-12, Generic Cost of Capital Proceeding, May 10, 2013). The BCUC weighed CAPM and DCF results with equal weight, and both estimates included US proxy groups presented by witnesses. Mr. Coyne would have no basis for "discounting" the US DCF results in this proceeding.

9.10 Please provide the evidentiary basis for the 0.75% adjustment for other models (page 77).

Réponse :

The basis for the 75 basis point adjustment to the CAPM results is explained in Concentric's testimony on pages 77 through 86, and is consistent with recent Régie decisions where the regulator also found it necessary to adjust the results of the CAPM.

Tenth Topic: Determination of the ROE

Reference: Dr. Coyne's evidence page 86-105

Preamble:

Dr. Coyne estimates the fair ROE for HQT and HQD using DCF models.
Question 10

10.1 Please indicate whether anyone has ever indicated that financial analyst opinions are not reflected in stock prices (page 91) and confirm that the question is whether the stock market uses the same expected growth rates forecast by analysts. If not why not.

Réponse :

Concentric's evidence discusses the findings of several academic researchers who have found that "analysts' earnings forecasts are indeed reflected in stock prices." (Concentric Evidence at 91). Those findings support the use of analyst earnings growth estimates in the DCF model. Concentric did not undertake an exhaustive study of what "anyone has ever indicated about financial analyst opinions".

10.2 Please indicate that the Carleton et al article cited on page 91 simply indicates that analyst forecast growth rates are better than simple extrapolation and which analysts before the Regie have ever used simple extrapolation of utility growth rates.

Réponse :

As noted on page 91 of Concentric's evidence, "Professors Carleton and Vander Weide concluded that:

> **[…] our studies affirm the superiority of analysts' forecasts over simple historical growth extrapolations in the stock price formation process. Indirectly, this finding lends support to the use of valuation models whose input includes expected growth rates."**

10.3 Please confirm that utility regulation should cause the market value of the firm's shares to approximate in the long run their book value. Otherwise the investor has earned an above fair return. If not please explain in detail why not.

Réponse :

Concentric does not agree that the investor has earned an above fair return if the market value of the firm's equity exceeds the long-term book value of equity. As a practical matter, publicly traded regulated firms commonly trade at market-to-book ratios exceeding 1.0. Because investors are aware of that fact, a change in regulatory policy to equate market and book equity values through reduction of the ROE would unfairly penalize the firm's shareholders and increase the firm's perceived market risk. No rational investor would invest in utility stocks if they believed that utility commissions would set rates in an effort to move the M/B ratio toward unity. If, for example, an investor purchased a utility stock at a M/B ratio of 1.75, that investor would incur a loss of 43.00 percent if the M/B ratio reached 100.00 percent. Such a result would certainly impede a utility's ability to attract the capital required to support its operations. Book value per share is an accounting construct, which reflects historical costs. In contrast, market value per share (i.e., the stock price) is forward-looking, and is a function of many variables, including (but not limited to) expected earnings and cash flow growth, expected payout ratios, measures of "earnings quality", the regulatory climate, the equity ratio, expected capital expenditures, and the expected return on book equity. It follows, therefore, that the Market-to-Book ratio likewise is a function of numerous variables in addition to the historical or expected return on book equity.

10.4 Please confirm that if the book value of the shares equals the market value the sv term (page 104) collapses to zero.

Réponse :

As discussed on page 104 of Concentric's evidence, "the "sv" term reflects an element of growth as the product of (1) the growth in shares outstanding, and (2) that portion of the market-to-book ratio that exceeds unity."

10.5 Please provide all data that Dr. Coyne is aware of that the long run dividend growth rate for Canadian and USutilities equals the long run GDP growth rate (page 106).

Réponse :

The multi-stage DCF analysis discussed on page 106 of Concentric's evidence assumes that over the long run, earnings will grow at the rate of long-term GDP growth. That practice is based on the financial theory that, because the DCF model projects cash flows in perpetuity, earnings growth is limited over the long-term by the level of growth of the overall economy. Concentric is aware of several regulatory jurisdictions that rely on this financial theory in estimating utility costs of capital.

10.6 Please confirm that if utilities have higher dividend yields than the market as a whole the use of GDP growth as a long run growth for utilities implies that the expected return from utilities exceeds that for the market as whole and utilities as a group are above average risk. If not why not.

Réponse :

Concentric does not agree with the premise that "if utilities have higher dividend yields than the market as a whole the use of GDP growth as a long run growth for utilities implies that the expected return from utilities exceeds that for the market as whole and utilities as a group are above average risk". Some companies with lower dividend yields grow significantly faster than GDP, and therefore have significantly higher returns and risk in comparison to utilities.

10.7 Using the dividend per share data requested in IR 4 please provide the average compound growth rate in dividend per share for all of Dr. Coyne's samples of proxy companies and for the US and Canadian GDP since 2001.

Réponse :

Concentric did not perform this analysis in the estimation of HQD's and HQT's cost of equity. Historical dividend per share and earnings growth is considered by analysts in forming their projections of earnings growth, which Concentric has relied upon in developing its DCF estimates. Cost of capital is a forward looking measure, and it is therefore appropriate to utilize forward looking inputs. This is explained on pages 89-92 in Concentric's testimony.

10.8 Using the dividend per share data provided in answer to question 4, please regress the change in the dividend per share against the GDP growth rate since 2001 for each of the firms in Dr. Coyne's proxy samples and provide all the normal regression output.

Réponse :

As explained in response to 10.7, Concentric did not calculate historic dividend per share analysis in the estimation of HQD's and HQT's cost of equity.