# Recent Developments in the Cost of Capital for Canadian Utilities

**January 28, 2014**

Over the better part of the past decade, regulators in Canada have struggled with the issue of whether evidence on U.S. utility cost of capital should be determinative for Canadian utilities. Concentric Energy Advisors, Inc. has studied this issue, and presented evidence before several Canadian utility regulators concluding that it was reasonable and appropriate to place weight on the results of carefully-selected U.S. proxy companies. Recently, two credit rating agencies have published reports shedding light on the contentious issue of whether the regulatory environments in Canada and the United States are, in fact, comparable.

Specifically, in September 2013, *Moody's Investors Service* released a report regarding what it described as the rating agency's "evolving view of US utility regulation."[1] In that report, *Moody's* indicated that they "propose to generally adopt a more favorable view of the relative credit supportiveness of the U.S. utility regulatory environment" given the "increased prevalence of automatic cost recovery provisions, reduced regulatory lag, and generally fair and open relationships between utilities and regulators." *Moody's* ultimately concludes: "Our revised view that the regulatory environment and timely recovery of costs is in most cases more reliable than we previously believed is expected to lead to a one notch upgrade of most regulated utilities in the U.S., with some exceptions."

Similarly, *DBRS* published a report in October 2013 comparing the regulatory frameworks for utilities in Canada and the U.S.[2] *DBRS* ranks each Canadian province and U.S. state on ten factors to assess the regulatory environment. Based on Concentric's analysis of the ten *DBRS* ranking factors by jurisdiction, the regulatory frameworks in the U.S. are generally more favorable from an investment perspective than those in Canada. Concentric's view that comparisons between regulated utilities in the two countries are reasonable and appropriate, and that risk adjustments to comparable U.S. companies are not necessary is supported by these rankings. The *DBRS* report also observes that "regulation north of the border has evolved and developed at a much slower pace than that in the United States." Further, *DBRS* notes that "many utilities in Canada are wholly owned by their respective provincial governments, which often faces challenges in striking a balance between commercial interest and political passion," and that "rate case proceedings are similar in both Canada and the United States" while "the rise of consumer advocacy in both countries has introduced a new level of complexity in the rate making process."

Concentric has taken the position that U.S. proxy groups provide a solid foundation of market data that can be appropriately utilized to determine investor return requirements for utilities in Canada. Supporting risk analysis, at the operating company level, can be provided that allows for rigorous comparisons of business, regulatory and financial risks between Canadian and U.S. companies. As financial markets and economies in Canada and the U.S. become increasingly integrated, and as rating agencies recognize that the regulatory frameworks in the two countries are indeed comparable, Concentric believes that the arguments supporting the use of U.S. data and proxy groups have become even more compelling.

For more information, or to obtain copies of Concentric's recently launched ROE Newsletter or recent testimony we have provided on this topic, please contact:

**Jim Coyne**
Senior Vice President
jcoyne@ceadvisors.com
508-263-6255

**John Trogonoski**
Senior Project Manager
jtrogonoski@ceadvisors.com
508-263-6258

**www.ceadvisors.com**

1 Moody's Investors Service, "Proposed Refinements to the Regulated Utilities Rating Methodology and our Evolving View of US Utility Regulation," September 23, 2013.

2 DBRS, "Industry Study: The Regulatory Framework for Utilities: Canada vs. the United States, a Rating Agency Perspective," October 2013.