Ontario Energy Board (Board Staff) INTERROGATORY #12 (Prefiled Evidence)

Interrogatory

At page 11, section 3.3, it is stated that a liberal expansion of service territories would result in a downgrade in the credit ratings of all distributors.

a) For Networks, why would the risk arising from approvals of service area amendments exceed the risk of losing both assets and territory under the legislation that preceded the *Energy Competition Act, 1998*?

b) How does the risk from liberal expansion of territories compare to the risk that some ratings agencies perceived as arising from the passage of Bill 210?

Response

a) Prior to the Energy Competition Act, 1998, Hydro One was part of Ontario Hydro. Ontario Hydro's debt was guaranteed by the Province, and rated the same as the Province. Such a risk would not have had an impact on the credit rating of the Province.

b) The risk from liberal expansion of territories is that it introduces competitive pressures, which are currently viewed by rating agencies to be quite limited because of the monopoly franchise. Standard and Poors recognizes in their ratings methodology that "Overall, limited competition is a significant factor in the strong business profile assessment for a typical transmission or distribution utility. Franchise monopolies are significant barriers to entry by competitors". Hydro One's current rating does not factor any potential weakness in the business profile arising from increased competition through non-exclusive franchising. Any weakening in the business profile is likely to trigger a reassessment of Hydro One's, and possibly the entire distribution industry's credit rating, leading to possible downgrade(s).

The passage of Bill 210 is viewed by Standard and Poors to be relating to regulatory risk. Standard and Poors downgraded Hydro One's credit rating to A- and placed the outlook as negative for that rating in February 2003. In their report dated March 2003, Standard and Poors notes that "The ratings on Hydro One Inc. reflect the material increase in the company's exposure to regulatory risk following political interference in the regulatory process that culminated in the December 2002 Bill 210…..". Any further negative rating action would slip Hydro One's credit rating into the BBB category. Some distribution companies have already been downgraded into BBB category as a result of increased regulatory risk perceived from the passage of Bill 210.