Nova Scotia Utility and Review Board

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Dear Mr. Willett:

M11990 – Nova Scotia Power Inc. – WACC and AFUDC Rates Application 2025

On November 28, 2024, Nova Scotia Power Inc. (NS Power) filed an application with the Nova Scotia Utility and Review Board (Board) requesting approval of its Weighted Average Cost of Capital (WACC) and Allowance for Funds Used During Construction (AFUDC) rates for 2025 and a confidentiality undertaking. On December 12, 2025, the Board issued a hearing order, establishing that this matter would be reviewed as a paper hearing. The Board approves the Confidentiality Undertaking.

Notices of intervention were received from the Small Business Advocate (SBA), the Consumer Advocate (CA) and the Industrial Group (IG) on March 18, 2024. Information Requests (IR) were filed by Board staff on January 8, 2025, and all Intervenors filed IRs on January 19, 2025, to which responses were filed by NS Power on January 30, 2025. All Intervenors filed submissions on February 13, 2025. NS Power submitted Rebuttal Evidence on March 25, 2024.

In its 2016 WACC and AFUDC rate application Decision matter M07215, the Board specified the method of calculation that should be used by NS Power each year. In the Board's decision on the 2022 General Rate Application, the Board approved an equity ratio of 40% and a return on equity of 9% for rate setting purposes. NS Power confirmed that this method was used to calculate the proposed 2025 rate of 6.66%, a decrease of 0.06 percentage points from the 6.72% rate set in

2024 under matter M11563. The remaining 60% of regulated capitalization is split between 1.5% short-term and 58.5% long-term debt. NS Power will participate in the Commercial Paper market in 2025 to access debt. NS Power noted that the low-cost debt from the Canadian Infrastructure Bank (CIB) is expected to reduce debt financing costs by about $2 million, relative to the rates for a long-term debt issuance.

CDOR vs CORRA

Refinitiv Benchmark Services Limited stopped publishing the Canadian Dollar Offer Rate (CDOR) at the end of June 2024. The CDOR was used by NS Power as part of its short-term interest rate methodology. NS Power has adopted the Term Canadian Overnight Repo Rate Average (Term CORRA) with an interest rate spread to replace the CDOR.

The Consumer Advocate (CA) suggested that the changes to forecast methodology is not entirely in keeping with the 2016 Decision M07215 because NS Power has applied the unapproved Bloomberg Outlook interest rate and has replaced the CDOR with Term CORRA. The CA highlighted that the calculated average short-term debt rate of 5.19% does not align with the quarterly rates that ranged between 3.88% and 4.47%. This higher rate is derived from forecasting interest expense by month to get an annual expense, which is then divided by the short-term debt balance. In this forecast the opening balance is much lower than the mid and late year debt estimates. The CA confirmed that this approach is the same as that approved in the 2016 Decision which supports the need for a review of the forecasting methodology.

The Industrial Group (IG) considers that NS Power's use of CORRA is in keeping with industry as it changes from CDOR. However, the IG considers that NS Power should provide a more comprehensive description of how it transitioned to Term CORRA using the credit spread adjustment in Appendix A-5 and if this change in rate has an impact on the calculation of short-term borrowing costs. In its Rebuttal Evidence, NS Power estimates the interest rate for Commercial Paper by applying a fixed spread to the benchmark rate (Term CORRA) using the current spreads it can get in the market. NS Power explained that it applied a fixed spread to Canadian Treasury Bills to forecast the cost of borrowing Commercial Paper. The forecast Term CORRA is a step in the process. Term CORRA was selected as a replacement to CDOR based on a recommendation from the Canadian Alternative Reference Rate Working Group and is in keeping with the industry transition from CDOR. NS Power further explained that it used a 1-month Term CORRA rate because it is consistent with the approved method that relied on a 1-month Banker's Acceptance (CDOR) and considers it the most fitting benchmark because NS Power mostly issues Commercial Paper for a duration of 1-month.

Bloomberg's Short-term Interest Rate

In matter M11563, NS Power requested to apply Bloomberg's Outlook 3-month interest rate to estimate short term debt rates in future debt rates in place of the approved methodology that uses forecasts of 3-month T-Bills by Canadian financial institutions. The Board's Decision in the matter stated that the burden is on NS Power to demonstrate which forecast method is more accurate.

NS Power was directed to establish this based on data over past years. As such, NS Power supplied Figure 1: Short-term Interest Rate Forecast Method Comparison and Actuals for the years 2022 to 2025. In comparison to the actual short-term interest rate neither forecast was shown to be accurate, which reflected concerns expressed by the Board in matter M07215.

In the current application, NS Power stated that the short-term debt is a small portion of its capital structure and “the impact of a difference in short-term interest rates is not significant to the forecast WACC rate.” NS Power claimed that using Bloomberg’s data improves the forecast because it used a larger sample size of short-term interest rate forecasts from various financial institutions and now it will only need to collect the data from a single source. NS Power repeated its request to adopt the Bloomberg forecast.

The CA was critical of the interest rate forecast that used data from August, considering it outdated. The CA recommended that given that forecasts have been updated “without much apparent difficulty”, a rate of 6.64% is more prudent. NS Power’s Rebuttal Evidence explained forecasts were sourced no more than four months from the data NS Power filed the application, in keeping with the Board’s direction in M11563. NS Power does not consider the forecasted interest rates in its application to be stale and noted that using more recent data would have a negligible change of 2 basis points on WACC and AFUDC.

The IG noted that Figure 1: Short-term Interest Rate Forecast Method Comparison and Actuals in the application, shows that there is not much difference between using the average of the Canadian Banks’ forecasts and the Bloomberg Outlook rate. The IG suggested that these forecasts should be monitored to ensure that the differential effect on rates is minimal.

Other Submissions

The Small Business Advocate (SBA) raised concerns about risk from credit rating agency reports provided by NS Power and the possible limited access to Commercial Paper which could affect NS Power’s ability to carry out its operations and capital spending. The SBA recommended that NS Power report to the Board and stakeholders regularly and report immediately if NS Power fails to meet its credit rating metrics in any quarter. NS Power’s Rebuttal Evidence acknowledged the importances of maintaining its credit rating in order to sustain its access to Commercial Paper. However, NS Power identified that it prepares quarterly reporting filed on System for Electronic Document Analysis and Retrieval (SEDAR) which includes confirmation of compliance with financial agreements, including maintaining a debt capitalization ratio of less than 70%, lower than the threshold set by DBRS. NS Power’s calculation of Funds From Operations (or FFO) is assessed annually. Additionally, in matter M11563, the Board directed NS Power to advise of any changes to its credit rating or other changes that materially affect its access to capital and borrowing costs. NS Power consider that these reporting requirements are sufficient for stakeholders and the Board to have a clear understanding of NS Power’s current financial situation.

Findings

The Board previously noted in matter M11563 that the difference between using the Bloomberg forecast and the approved forecasting method for short-term interest rates was negligible. Using external data could increase efficiency and by incorporating a broader range of financial institutions a more robust estimate may result. However, the Board also recognized that basing WAAC/AFUDC calculations on forecasts from the banks NS Power is likely to borrow from has merit. The Board indicated that NS Power would need to provide more information in future applications to demonstrate which methodology is more reliable. NS Power submitted a table comparing the short-term interest rate forecasts of five Canadian Banks, Bloomberg and the Actual short-term interest rates for the years 2022 to 2025. Disappointingly, neither forecast was shown to be more accurate than the other. NS Power's reasons to adopt the Bloomberg forecast did not significantly change from what it had proposed in the 2024 WACC AFUDC application.

The Board notes that the M07215 2016 WACC AFUDC Decision stated, "In future, the Board expects NSPI to develop a more accurate prediction model for the short-term debt rate". The Board will reserve its decision on the adoption of the Bloomberg forecast. NS Power is directed to continue submitting short term interest rates under the Board approved method of obtaining three-month T-Bills from Canada's five major banks and the Bloomberg Outlook 3-month T-Bills. NS Power is directed to use 4.86% for its short-term interest rate in the calculation of WACC and AFUDC. NS Power is directed to file a Compliance Filing by March 28, 2025, applying the forecast interest rate of 4.86% in its WACC and AFUDC calculation.

The Board notes that it has been ten years since the last full review of the methodology and that a broader review would be appropriate for the 2026 application. The Board considers several issues warrant a broader discussion. These include:

- potential alternative forecast methodologies for the short-term rate, the timing of available information and the ability to shorten the forecasting process;
- the use of the opening and closing debt balances to calculate the short-term interest rate, versus using monthly balances;
- other broad issues or methodologies that NS Power and Intervenors feel appropriate to discuss.

The Board is cognizant that there may not be an alternative methodology that is both more reliable and administratively easier than the current approach. However, due to the length of time since the last review, the Board directs NS Power to analyse and report on the current methodology and potential alternatives, including their reliability, ease of administration and any other advantages and disadvantages that NS Powers considers will provide a robust measure of WACC/AFUDC. This review should be included as part of the 2026 WACC and AFUDC Rates Application. If NS Power submits a General Rate Application (GRA) before it submits its 2026 WACC and AFUDC Rates Application, the review should be included as part of the GRA submission.

As in previous WACC and AFUDC applications, the Board directs NS Power to file a notification advising of any changes to its credit rating, or any other changes that materially affect access to capital and borrowing costs, and provide an assessment of any impacts this change may have on its access to capital and borrowing costs.

Yours very truly,

Bruce H. Fisher, MPA, CPA
Member

c. William Mahody, K.C. Board Counsel