FORTIS BC™

Diane Roy
Vice President, Regulatory Affairs

Gas Regulatory Affairs Correspondence
Email: gas.regulatory.affairs@fortisbc.com

Electric Regulatory Affairs Correspondence
Email: electricity.regulatory.affairs@fortisbc.com

FortisBC
16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (604) 576-7349
Cell: (604) 908-2790
Fax: (604) 576-7074
www.fortisbc.com

October 13, 2020

British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC
V6Z 2N3

Attention: Ms. Marija Tresoglavic, Acting Commission Secretary

Dear Ms. Tresoglavic:

Re: FortisBC Inc. (FBC)

Project No. 1599119

Annual Review for 2020 and 2021 Rates (Application)

Response to the Industrial Customer Group (ICG) Exhibit C4-3

FBC writes in response to the request from ICG that FBC respond to ICG information request (IR) No. 1 question 8, consisting of a series of IRs related to FBC's cost of capital (Exhibit C4-3). FBC declined to respond to ICG IR1 8 as FBC's cost of capital is outside of the scope of this proceeding. ICG argues that cost of capital is within scope because it submits that the British Columbia Utilities Commission (BCUC) is required to assess FBC's cost of capital every time it sets rates and that the onus is on FBC to justify in this proceeding that FBC's approved cost of capital continues to remain appropriate for 2020 and 2021. ICG further asserts that, in order to conclude that there should be no change to FBC's cost of capital since Order G-129-16, the BCUC must conclude that there has been no change in the financial markets since October 2015. FBC disagrees. As discussed below:

1. FBC's reliance on past BCUC orders approving its cost of capital is consistent with past practice before the BCUC.

2. This proceeding is designed to be a relatively abbreviated and efficient process, and is not an appropriate forum in which to assess FBC's cost of capital.

3. The BCUC's approved cost of capital orders can remain valid despite changes in financial markets.

4. This is not an appropriate time to initiate a cost of capital proceeding due to the ongoing uncertainty caused by the COVID-19 pandemic.

FBC's Application is Consistent with Past Practice

Consistent with past practice, in this Annual Review, FBC has applied for rates using its approved capital structure and return on equity (ROE). Specifically, FBC relies on Order G-47-14, in which the BCUC determined that it was appropriate for FBC to receive a 40 basis points (bps) premium over the benchmark utility's ROE, and Order G-129-16, in which the BCUC determined that FortisBC Energy Inc. (FEI) would continue to serve as the benchmark utility and directed that FEI's ROE would remain at 8.75 percent. In addition, in Order G-129-16, the BCUC suspended the use of an automated adjustment mechanism formula indefinitely. It is reasonable for FBC to rely on these valid BCUC orders that have set its capital structure and ROE.

ICG argues that cost of capital is in scope because "Order G-129-16 and Order G-47-14 do not make any determinations that reference 2020 or 2021."[1] However, Orders G-129-16 and Order G-47-14 set FBC's capital structure and ROE until the BCUC orders otherwise and, therefore, do not need to reference 2020 or 2021 or any other year. This is consistent with the BCUC's regular practice, in which the cost of capital is considered in separate proceedings designed for that purpose, and revenue requirements and rates are set based on the capital structure and ROE approved at the time. The ICG and other stakeholders had an opportunity to participate in the past cost of capital proceedings and will have the opportunity to participate in future cost of capital proceedings. This proceeding, however, is not designed for that purpose and should remain focused on the scope of matters needed to set rates for 2020 and 2021 as outlined in FBC's approvals sought.

This Proceeding is not the Appropriate Forum to Assess FBC's Cost of Capital

ICG argues that the onus is on FBC to justify all elements of the revenue requirements[2] and ICG IR1 8 is relevant to whether Order G-47-14 and Order G-129-16 should be relied upon to determine the cost of capital in this proceeding.[3] FBC of course assumes the burden of proof to justify its proposed rates. However, FBC is entitled to rely on existing and valid BCUC Orders that have already approved aspects of its costs, including its capital structure and ROE. As is customary, in this Annual Review, FBC is only seeking those approvals necessary that, when in the context of other approvals already granted, are sufficient to set rates for 2020 and 2021. Other existing approvals include BCUC Orders granting approval of the multi-year ratemaking plan (MRP), CPCNs for projects, power purchase agreements, and numerous others. Annual reviews are designed to be a relatively abbreviated and efficient process for setting rates within the context of FBC's approved MRP. It is neither efficient nor feasible to turn Annual Reviews into a forum in which the merits of every past order of the BCUC are subject to IRs and argument.

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[1] Ex. C4-3, ICG Letter, page 1.
[2] Ex. C4-3, ICG Letter, page 3.
[3] Ex. C4-3, ICG Letter, page 4.

ICG admits that the "record of this proceeding is going to fall far short of the evidentiary record required to determine the cost of capital".[4] FBC agrees that the evidentiary record in this proceeding will be insufficient, and submits that this illustrates why the cost of capital cannot be within the scope of this proceeding. Determining the cost of capital is a complex and important exercise that requires a separate proceeding specifically for that purpose. Cost of capital proceedings examine, among other things, the appropriate balance of risk and reward and financial market considerations. Further, the authorized ROE is ordinarily based on financial models such as the Capital Asset Pricing Model (CAPM) and/or Discounted Cash Flows (DCF), which are the subject of expert evidence. Determining the cost of capital cannot be accomplished as a side issue in what is designed to be an efficient annual review process. In short, it is not plausible that the record in this proceeding could or should be developed to the extent necessary for the BCUC to make a determination on FBC's cost of capital.

Cost of Capital Can Remain Appropriate Despite Changes in Financial Markets

ICG asserts that, in order to conclude that there should be no change to the cost of capital of FBC since Order G-129-16, it will be necessary for the BCUC to conclude that there has been no change in the financial markets since October 2015.[5] FBC submits that this is incorrect. FBC's and FEI's cost of capital have remained the same since 2013, although subject to review by the BCUC during that time, including Order G-129-16 which determined that FEI's ROE would remain at 8.75 percent. Clearly, a utility's cost of capital can remain the same despite changes in financial markets from time to time. This is because determining a utility's cost of capital is a complex exercise, and is driven by multiple factors. As stated by the BCUC on page 8 of its Decision approving FEI's cost of capital:[6]

> In this proceeding, similar to the approach set out in the 2013 GCOC Decision, the Panel has to assess a number of elements to determine if a change in FEI's ROE and common equity component is appropriate. This analysis includes weighing the impact of the changes in economic conditions and global market conditions since 2012 and the extent to which changes in these conditions imply changes in an investor's opportunity cost.

Thus, changes in market conditions may not necessarily mean a change in an investor's opportunity cost. For example, lower interest rates do not mean that cost of capital should be low as well, as the cost of capital may be driven higher due to the uncertainty and higher risk profile of the utility in the current environment that are reflected in other inputs such as wider credit spreads, higher equity risk premiums[7] and higher systematic risk (Beta coefficient). FBC raises this point merely to illustrate the complexity of a cost of capital determination. FBC submits that the BCUC need not engage in this exercise in this

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[4] Ex. C4-3, ICG Letter, page 1.
[5] Ex. C4-3, ICG Letter, page. 2.
[6] Decision and Order G-129-16, dated August 10, 2016, FortisBC Energy Inc. Application for its Common Equity Component and Return on Equity for 2016, page 8.
[7] There is an inverse correlation between risk-free rate and equity risk premiums.

proceeding. Rather, FBC submits that the BCUC can and should rely on its past decisions approving FBC's cost of capital.

Not a Good Time for a Cost of Capital Proceeding

Finally, this is not a good time to initiate a cost of capital proceeding considering that we are in the midst of a pandemic that has brought extraordinary turmoil and uncertainty to the capital markets and utilities' risk profiles. In March, the Alberta Utilities Commission suspended its generic cost of capital proceeding indefinitely, citing "the ongoing negative effect of the COVID-19 virus on the health and economic well-being of residents of Alberta (together with the rest of Canada and the world), as well as the pandemic's adverse effect on the state of financial markets, both nationally and globally".[8] In August, the AUC continued the suspension,[9] noting: "With the exception of the Consumers' Coalition of Alberta, all parties maintained that the ongoing COVID-19 pandemic and related economic and financial market uncertainty/volatility continued to preclude the immediate successful resumption of the proceeding." Further, in an August 2020 decision, the Regie de L'energie in Quebec stated that the "economic and financial adjustments resulting from the pandemic are still to come" and decided to maintain Gazifere's cost of capital for the 2021 Test year without any detailed review, suspend its automatic adjustment formula, and defer a detailed review to Test year 2022 or later.[10]

The volatile state of capital markets is expected to continue for some time, driven by the uncertainty associated with the potential for further waves of COVID-19 cases, and the impact on economic activities. In its recent Decision on BC Hydro's 2020-2021 Revenue Requirement Application, the BCUC noted that the impact of the pandemic on the economy is uncertain and that this uncertainty is likely to continue for a number of months.[11] In addition, the long-term impact of the pandemic on utilities' risk profiles is unknown. Government support for businesses and individuals and central banks' stimulus plans have helped to avoid a complete melt down of the economy in the short term, but they cannot continue over the long term as currently designed. As such, undertaking a cost of capital review in this environment would lead to evidence that is based on speculative and reactive data. Therefore, it is wise to keep monitoring the market environment and consider the timing of a potential cost of capital proceeding after the pandemic is over and its impacts are somewhat diminished.

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8 Exhibit Number 24110-X0445, letter dated March 19, 2020. Online: https://www2.auc.ab.ca/Proceeding24110/ProceedingDocuments/24110_X0445_2020-03-19AUCletter-RulingontheUCAmotion_000529.pdf.

9 Exhibit Number 24110-X0486,, letter dated August 7, 2020. Online: https://www2.auc.ab.ca/Proceeding24110/ProceedingDocuments/24110_X0486_2020-08-07%20AUC%20letter%20-%20Proceeding%20status_000577.pdf.

10 D-2020-104, R-4122-2020 Phase 1A, 2020 08 07, Page 23. Online: http://publicsde.regie-energie.qc.ca/projets/543/DocPrj/R-4122-2020-A-0013-Dec-Dec-2020_08_07.pdf.

11 BCUC Decision and Order G-246-20, dated October 2, 2020, BC Hydro 2020-2021 Revenue Requirement Application, page 181.

Conclusion

While FBC as a general policy seeks to provide comprehensive responses to all IRs, it is reasonable and appropriate for it to draw the line at some point to keep a proceeding within reasonable bounds. Otherwise, the evidentiary record is burdened with information irrelevant to the issues before the BCUC and the cost and time of the proceeding can be unnecessarily extended to the detriment of all parties. FBC submits that it has appropriately judged that ICG IR1 8 is outside of the scope of this proceeding. As such, FBC submits that ICG's request that FBC respond to ICG IR1 8 should be denied.

If further information is required, please contact the undersigned.

Sincerely,

FORTISBC INC.

Original signed:

Diane Roy

cc (email only): Registered Parties