



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

March 29, 2021

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

Attention: Mr. Patrick Wruck, Commission Secretary

Dear Mr. Wruck:

Re: British Columbia Utilities Commission (BCUC) Generic Cost of Capital Proceeding
FortisBC (compromised of FortisBC Energy Inc. and FortisBC Inc.) Submission on the Preliminary Scoping Document

In Order No. G-66-21 (“the Order”), dated March 8, 2021, the BCUC established the Generic Cost of Capital (“GCOC”) proceeding under section 82 of the *Utilities Commission Act* (the “UCA” or “Act”). The BCUC identified a preliminary list of matters to be examined and determined in the GCOC proceeding (the “Preliminary Scoping Document”) and sought written submissions on the listed matters from all registered participants to establish the scope for this proceeding.

In accordance with the Order, FortisBC Inc., and FortisBC Energy Inc., (“FEI” and together with FortisBC Inc., “FortisBC”, the “Companies”, or “we” in this submission) submit the following comments on each subject matter identified in the Preliminary Scoping Document.

a. Whether the BCUC should establish the Cost of Capital effective January 1, 2022, including public utilities’ capital structure and return on common equity.

FortisBC agrees that the scope of this proceeding should include the review of the allowed return on common equity and capital structure.

Interest on the debt component of a utility’s capital structure should continue to be set in the

context of an individual utility's revenue requirements application. The actual cost of debt is observable based on the debt issued by the utility and therefore any issues with the cost of debt should be out of scope (except for the deemed debt issue that is discussed in section e below). Since the BCUC must approve debt issuances of a duration of one year or more under section 50 of the *Utilities Commission Act*, recovery of interest on those debt issuances is typically a straightforward matter that is efficiently addressed in the context of a revenue requirements application.

FortisBC believes that the issue of an appropriate effective date for the GCOC decision is dependent on the evidence filing deadline and the regulatory process in place. As such, FortisBC's submissions on this item first address the issue of the evidence filing deadline and then the issue of an appropriate effective date is discussed.

In terms of the evidence filing deadline, FortisBC believes there may be value in a later filing date, either late in 2021 or in the first part of 2022, for the following reasons:

- 1. There is currently elevated uncertainty in economic conditions and market data.**
The world is in the midst of a global pandemic that has brought economic uncertainty and capital market volatility. This situation may continue for some time.

An extension for filing of evidence to 2022 is consistent with recent determinations of the BCUC and the Alberta Utilities Commission (AUC). In March 2021, the AUC issued decision 26212-D01-2021 maintaining the current allowed ROE and capital structure for 2022 rates without any further process. In its decision, the AUC commented that "the economic and market data that would normally be used to inform its judgment regarding a fair return continue to remain in a state of flux" and agreed with the Alberta utilities that this would create a need for the evidence "to be updated (one or more times) during the course of a proceeding in response to changes in financial markets"¹. The AUC further stated that the passage of time, in itself, is not a sufficient reason for a GCOC review and that a GCOC proceeding in this environment is not aligned with the regulatory efficiency principle.

The BCUC has expressed similar views to the AUC on the current volatility and the relevance of the passage of time. In Order G-293-20, dated November 13, 2020, in respect of FBC's 2020-2021 Annual Review, the BCUC commented that the passage of time, alone, is not a sufficient reason to initiate a cost of capital proceeding and that the volatility in financial markets by itself does not imply that investor's opportunity costs or risk profiles have changed sufficiently to warrant a review. The BCUC panel further commented that it must take into account many factors to determine the appropriate time and process to undertake such a review. In its recent decision on BC Hydro's 2020-2021

¹ AUC Decision 26212-D01-2021, Page 4, Para 18

Revenue Requirement Application, the BCUC also noted that the impact of the pandemic on the economy is uncertain and that the uncertainty is expected to continue for a number of months².

The sharp and rapid movements in bond yields in recent weeks substantiate these statements³ and highlight the volatility of the financial markets during the pandemic.

- 2. The GCOC proceeding and the BCUC's ultimate decision can benefit from other upcoming regulatory applications.** A delay in the GCOC application filing date will also be efficient in the sense that some of the foundational evidence that is used in FortisBC's risk analysis is based on evidence to be filed in upcoming applications. These include both FEI's and FBC's Long-term Resource Plans as well as FEI's application for a comprehensive review and assessment of the RNG program, where the impact of government policy on demand and price competitiveness will be considered. To the extent that FEI remains the "Benchmark Utility", these matters ultimately affect all regulated utilities.

Despite these reasons why a later evidence filing deadline may have value, FortisBC is prepared to move forward with its evidence in the GCOC proceeding on whatever timeline the BCUC determines to be appropriate. However, with an earlier timeline, FortisBC and other applicants may request the right to update their evidence as time passes and new evidence develops.

Returning to the question of the effective date, FortisBC submits that the effective date of the GCOC decision should be considered as part of the scope of the GCOC proceeding, and that the effective date is connected with the regulatory process and regulatory timetable that is adopted for the proceeding. Generally speaking, although sometimes necessary, a prolonged period of interim rates is an undesirable outcome that causes regulatory and administrative inefficiencies due to adjustments to customers' bills which may become material as additional time passes. Further, avoiding an extended period of interim rates can mitigate some of the regulatory risk that investors face by virtue of not knowing the return on the invested capital until the decision is issued. Therefore FortisBC submits that, if the regulatory timetable set by the BCUC will result in a decision in the first quarter of 2022, then having an effective date of January 1, 2022 could be appropriate. If the regulatory timetable will result in a decision later than the first quarter of 2022 or into the first quarter of 2023, then an effective date of January 1, 2023 could be appropriate. This would avoid having interim

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

³ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-treasury-yields-surge-curve-steepens-as-bond-traders-look-past-pandemic-62875829> and <https://www.bloomberg.com/news/articles/2021-03-12/treasury-yields-surge-to-test-key-level-in-sudden-selling-bout>

rates in place for an extended period of time, improve administrative and regulatory efficiency, and may reduce customer bill impacts.

FortisBC submits these comments on the effective date with reference to the timing for stage one of the GCOC proceeding, if the BCUC determines that a two stage approach is appropriate. FortisBC recommends that the same principle regarding the effective date should apply to any subsequent stages, such that the Benchmark Utility may have an effective date earlier than the other utilities that are reviewed as part of stage two.

b. Should the BCUC continue to establish public utilities' Cost of Capital using a two-stage mechanism, where Stage 1 sets the Benchmark ROE based on a Benchmark Utility, and Stage 2 uses a generic methodology for each utility to determine its unique Cost of Capital in reference to the Benchmark Utility?

As indicated in the question, the established regulatory process for GCOC proceedings in BC has been comprised of two stages: Stage one GCOC where the Benchmark Utility's allowed ROE and capital structure⁴ are determined; and stage two GCOC where other utilities' risk profiles, on a standalone basis, are compared with that of the Benchmark Utility to determine whether a premium or discount to the Benchmark Utility's allowed ROE and equity thickness is warranted. FortisBC submits that the scoping of the GCOC proceeding should be based on a two-stage proceeding approach similar to the previous GCOC proceedings. It is important to have this determined up-front to promote an efficient process, and it should inform the filing date for evidence of various utilities.

This approach has a proven track record and is efficient. BCUC Order G-72-12 dated June 1, 2012 discussed the two-stage approach and commented that "the potential benefits stemming from this approach would be greater regulatory efficiency as well as improved timeliness and consistency due to the matter being dealt with by the same Commission panel in a contiguous manner⁵". The two-stage approach is particularly beneficial to the smaller utilities, as many of the smaller investor-owned utilities do not have the resources required to undertake the type of detailed studies needed to develop the evidence and arguments typically filed as part of these proceedings. Further, the small size of these utilities makes it difficult (if not impossible) to find comparable listed peer group companies that are used as proxies in financial models to compute separate return on common equity estimates for each utility.

In summary, the two-stage approach and the designation of one utility as the Benchmark Utility is efficient and fair. It avoids frequent reassessment of factors that are common to all

⁴ The question only refers to the Benchmark Utility ROE, but the Benchmark Utility's capital structure is also a part of Stage 1 reviews.

⁵ 2012 GCOC Proceeding, Order G-72-12, Appendix A, Page 7

utilities. In addition, it provides a means of ensuring that all the utilities subject to the jurisdiction of the BCUC are awarded overall returns that appropriately reflect their business risk relative to the Benchmark Utility, and relative to each other.

i. If so, should the Benchmark Utility continue to be FortisBC Energy Inc., a hypothetical utility, or some other entity? ii. Otherwise, should all utilities have an independent review process to establish the Cost of Capital? iii. Can certain public utilities be grouped together, where the BCUC establishes the Cost of Capital for the group? What are the characteristics for such grouping(s)?

FortisBC submits that it should be unnecessary to address this issue as part of the GCOC proceeding, and the BCUC should simply reaffirm at this time that FEI will continue to be used as the Benchmark Utility as it has been for the last 27 years. As discussed below, there were sound reasons for the BCUC's selection of FEI as the Benchmark Utility in the first place, sound reasons for reaffirming it on multiple occasions, and there is no compelling reason to change now. In the alternative, if the BCUC is not ready to confirm FEI's role as the Benchmark Utility without further process then it should determine the identity of the Benchmark Utility well before the evidence filing date as changing the Benchmark Utility after filings would cause significant procedural challenges and inefficiencies.

There are several compelling reasons for continuing the approach that has been used for the last 27 years:

1. **FEI serves the purpose of a Benchmark Utility well.** Designating a Benchmark Utility is simply a way to make determination of cost of capital for multiple utilities in the province more efficient – it avoids duplicating the same capital markets evidence in multiple proceedings for every utility in the province.

The BCUC has used FEI as the benchmark since 1994 and FEI continues to be the logical choice to serve as the benchmark BC utility. Unlike other investor-owned utilities in BC, there is a significant body of evidence that has been developed in recent proceedings that help to define FEI's financial and business risk profile. FEI is the largest investor-owned utility in British Columbia, is one of the largest gas distribution utilities in the country, and has a relatively diverse geographic, customer and asset base. These points, as well as the general agreement among all participants regarding the suitability of FEI as the Benchmark Utility, led to the BCUC confirming FEI as the appropriate Benchmark Utility in the 2012 GCOC proceeding.⁶

“The Commission Panel notes that there was general agreement among the parties with respect to FEI in 2012 being made the benchmark for the GCOC proceeding.

⁶ 2012 GCOC Proceeding, BCUC Order G-148-12, Appendix A, Page 4

FEI is well established, of sufficient size and has a diverse customer and asset base. In addition, FEI is well understood as a utility by all the participants as it has traditionally been used as the benchmark utility in British Columbia. This and the fact that there is a substantial body of FEI related evidence already on the record in this proceeding makes FEI a reasonable candidate for the benchmark utility. **Therefore, notwithstanding the various positions of the participants as to whether FEI can be described as a pure play gas distribution utility, the Commission Panel agrees with the participants and accepts FEI, in the present time frame, as the most appropriate choice for the benchmark utility.”**

Some of the political/policy risks associated with FEI are specific to natural gas utilities; however, the BCUC has never considered this to be problematic when making comparisons with other BC utilities for the purposes of assessing relative cost of capital. This same issue would exist no matter what utility is selected, as all utilities may have risks that are specific to their operations and service territory. Differences can be considered when determining the appropriate discount or premium for other utilities. Although FEI's equity is not publicly traded (nor is this the case for any other utility in BC), its debt is rated by two debt rating agencies, providing some independent capital market assessment of its overall business and financial risks, albeit from a bondholder's perspective. Further, its business risks and the trends in those risks have been extensively and comprehensively assessed by the BCUC in multiple proceedings.

2. **A hypothetical Benchmark utility is impractical and inefficient.** In the 2012 proceeding, the BCUC considered whether a hypothetical utility should be used as a benchmark. It rejected this idea, and rightly so. Further, all the participants in the 2012 GCOC proceeding agreed with FortisBC's position that "FEI rather than a hypothetical construct is the most appropriate benchmark"⁷. Designating a benchmark utility is supposed to make the process of determining cost of capital for BC utilities more efficient. Introducing another layer of complexity of having to "create" a utility and exhaustively define its characteristics before being able to perform comparisons would be less efficient. There is no data available for a hypothetical utility. It would create unnecessary debate when determining a specific utility's cost of capital about how the BCUC has defined the benchmark. Further, the concept of a hypothetical utility is too ambiguous to serve as a meaningful yardstick for the purpose of comparing business risks of utilities. Every utility has unique business risk characteristics that are a function of a variety of factors. While it might be possible to arrive at some general conclusions about the riskiness of a hypothetical utility, it is necessary to understand the particular circumstances affecting the benchmark utility in order to specify what the appropriate

⁷ 2012 GCOC Proceeding, BCUC Order G-148-12, Appendix A, Page 3

capital structure and ROE would be for that utility. FortisBC submits that the BCUC should continue to use its current approach.

3. Grouping of the public utilities for the cost of capital determinations is not needed.

Grouping of the public utilities into two or more groups is unnecessary and less efficient than using a single Benchmark Utility. Such an approach is more suitable for circumstances where there are many public utilities and the case by case comparison of each utility's risk relative to the Benchmark Utility is too cumbersome. The limited number of utilities in BC mitigates the need for such a grouping as it is always better to consider the particular circumstances of each utility on a case-by-case basis. Further, having two or more Benchmark Utilities is not needed nor is it practical as explained above. FEI has all the characteristics of an appropriate Benchmark utility while other investor-owned utilities in the province do not.

In summary, the approach of benchmarking BC utilities to FEI as it exists at the time of a cost of capital proceeding has worked for many years, despite changes in FEI's business during that time. There is every reason for the BCUC to continue using that approach, and no compelling reason to change. FortisBC submits that the scope of this proceeding should be based on the existing two-stage approach and with consideration of FEI as the only suitable investor-owned Benchmark Utility.

In the alternative, if the BCUC wishes to leave this issue in scope it is important for the BCUC to consider and determine this issue (along with the question of whether there is to be a two-stage process) before the utilities must file their evidence. It would be a threshold consideration that would impact the nature and presentation of the evidence significantly. Leaving it unresolved would inevitably create inefficiencies and unnecessary complexity.

c. What considerations should be made for the initial transition year January 1, 2022 to December 31, 2022 (e.g. setting rates for all utilities that may be affected by the GCOC proceeding's decision on an interim basis until a final decision is rendered)?

FortisBC interprets this to be asking about the propriety of making rates interim effective January 1, 2022 so that any implications of the decision are backdated to January 1, 2022. FortisBC has addressed this question in its response to issue "a" above.

d. Whether re-establishment of a formulaic ROE AAM is warranted. If a return to the use of a formulaic ROE AAM is accepted, what are the specifications of such a formula and should it be implemented starting on January 1, 2023 on an annual basis?

FortisBC considers that it is reasonable to include a review of the suitability and potential specifications of an ROE AAM approach, as well as a potential implementation date as part of the scope of the GCOC proceeding.

- e. In certain circumstances for those utilities that require a deemed interest rate, should a methodology be established or a determination be made on a deemed interest rate and should the deemed interest rate be subject to an AAM (Interest AAM)? If warranted, the Interest AAM would be implemented for January 1, 2023. If not warranted, setting a future regulatory process on how the deemed interest would be adjusted in future years beyond December 31, 2022.**

The circumstances described above do not directly apply to FEI or FBC given that both utilities frequently issue public third-party debt. However, for utilities required to estimate a deemed interest rate, the questions as to whether a methodology should be established and what constitutes an appropriate methodology could be considered as part of the scope for the stage two of this proceeding.⁸

As a final point, the BCUC staff filed an additional list of issues for consideration. FortisBC views most of those issues as encompassed within the scope of the BCUC Panel's issues addressed above. The only real addition seems to be the issue of how to determine when to hold a future cost of capital proceeding (after the conclusion of this proceeding). FortisBC considers that to be something that does not need to be addressed in this proceeding, as it will be subject to any number of considerations. However, FortisBC is prepared to address it if required.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of FORTISBC

Original signed:

Diane Roy

cc (email only): Registered Parties

⁸ Although FEI allocates a portion of its embedded cost of debt to the Fort Nelson service area, there is no deemed interest rate involved. Instead, the embedded cost of debt allocated to Fort Nelson instead reflects the incurrence of real debt service costs arising from FEI's issuance of debt securities to the public capital markets. No similar arrangements exist within FBC's business.