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

July 21, 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. (FEI) and FortisBC Inc. (FBC)) Submission on the Use of a Benchmark Utility

---

In Order G-183-21 dated June 11, 2021, the BCUC noted that it had asked the expert it engaged for this proceeding, Dr. Lesser of Continental Economics, Inc., to provide an initial report (Initial Report) on the pros and cons of using a Benchmark Utility in the determination of cost of capital, alternatives to using a Benchmark Utility, a limited jurisdictional scan of practices used outside of BC, and the applicability of using the practices reviewed for utilities in BC. The BCUC sought written submissions from utilities and interveners on the Initial Report as well as submissions on the following:

1. What are the pros and cons of using a Benchmark Utility in the determination of the cost of capital for utilities in BC?
2. What are the relevant factors, considerations, or set of criteria for the BCUC to determine whether a Benchmark Utility should be established to determine the cost of capital for utilities in BC?
    a. If the Panel determines that the use of a benchmark is appropriate, should the benchmark continue to be FEI? In considering the choice of a Benchmark Utility, what criteria, such as stability of the utility or consideration of business risks, should be used to determine which utility should be the benchmark?
    b. If no Benchmark Utility will be used, what options should the Panel consider to determine public utilities' cost of capital? For example, would the BCUC initiate proceedings on an individual utility case-by-case basis or a generic proceeding for individual utilities or grouping of utilities?
3. Any other matters that would assist the Panel's determination on whether the use of a Benchmark Utility is appropriate.

FortisBC submits the BCUC should reaffirm the current approach to using a Benchmark Utility, and that FEI should continue to be used as the Benchmark Utility. Dr. Lesser's report establishes that the BCUC's approach is different from most other jurisdictions, but the composition of the regulated utilities in this province also differs; BC has more utilities than those jurisdictions identified by Dr. Lesser that determine cost of capital on a utility-by-utility basis, and fewer than those that adopt a uniform approach to setting cost of capital for multiple utilities. The BCUC's model of using a Benchmark Utility, and then determining the regulated return of other utilities in relation to it, has worked well for the last 27 years. There were also 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 sound reasons to maintain it now. Alternatively, the BCUC should limit a case-by-case review to larger utilities, while maintaining a generic approach for small utilities; FEI and FBC cannot be efficiently grouped with any other utility for cost of capital determination purposes without additional adjustments.

In this submission,

- FortisBC first discusses the cost of capital methodologies used in other jurisdictions, demonstrating how BC differs from the jurisdictions identified in Dr. Lesser's survey;
- In response to question 1, FortisBC addresses the pros and cons of the various methodologies, which demonstrates how the current approach is an efficient means of delivering fair results; and
- In response to question 2, FortisBC addresses why FortisBC remains appropriate as a Benchmark Utility. In the alternative, a case-by-case review is appropriate for larger utilities like FEI and FBC, while maintaining the generic approach for small utilities.

1. Jurisdictional Review Demonstrates that Jurisdictions Adopt Different Approaches Depending on their Circumstances

Dr. Lesser's survey shows that the regulatory process for determining cost of capital for public utilities in North America can generally be divided into two categories: (i) case-by-case review; and (ii) generic review. As discussed below, the approach that the BCUC has used for the past 27 years is best characterized as a type of generic review. All of the generic review approaches still recognize the need for relative risk adjustments among utilities. The distinct way in which the BCUC has gone about this analysis reflects an efficient means of making relative risk determinations given the number and nature of the regulated utilities in BC.

A case-by-case review process may be part of a general rate case where cost of capital is reviewed as part of the overall revenue requirement (as is the case in the majority of U.S. jurisdictions), or it may be subject to a separate regulatory process (as is sometimes the case in jurisdictions such as Quebec). Further, the case-by-case review of cost of capital may be subject to a negotiated settlement process where the cost of capital is set based on an overall stipulation of the utility's revenue requirement.

Generic cost of capital proceedings usually have one thing in common: they involve establishing a benchmark return on equity (ROE) and a process for utilities to file evidence for potential adjustments to account for their specific risk. There are, however, variations to

the benchmark approach used in generic reviews. In some jurisdictions, the same benchmark allowed ROE is applied to all utilities with individual utilities' business and financial risks taken into account through adjustments to the capital structure on a case-by-case basis. In these jurisdictions, the case-by-case review for risk adjustments may be made in the same proceeding in which the benchmark allowed ROE is determined (as is the case in Alberta) or in a separate proceeding (as is the case in Ontario for natural gas utilities).

As described in the Initial Report, BC's Benchmark Utility approach differs from other generic approaches identified by Dr. Lesser (note the Yukon Utilities Board (YUB) uses the same approach as the BCUC) in the sense that the generic cost of capital proceeding is comprised of two stages: a first stage in which a Benchmark Utility's allowed ROE and capital structure are determined, and a second stage in which the risk profiles of other utilities are compared on a standalone basis to that of the Benchmark Utility to determine whether a premium or discount to the Benchmark Utility's allowed ROE and equity thickness is warranted. Although the risk analysis for individual utilities in other "generic approach" jurisdictions does not involve a comparison with a Benchmark Utility, it still requires a risk analysis similar to the way FEI's business and financial risk has been compared with its peers in the first stage of the BCUC processes, or there is discussion of company specific risk and how the risks have changed since the previous cost of capital proceeding.

FortisBC submits that the choices made by various jurisdictions are driven by unique features of each jurisdiction, and properly so. Notably, as illustrated by the following table, the choice of approach in the various jurisdictions in Dr. Lesser's survey is closely related to the number of companies regulated in each jurisdiction.

Table 1: Jurisdictional Comparison - Regulatory Approaches to Determine Cost of Capital

Jurisdiction	Number of Utilities[1]	Description
Alberta	14[2]	The Alberta Utilities Commission (AUC) establishes a benchmark allowed ROE for all utilities. Specific risks of individual utilities may be taken into account through adjustments to the capital structure.
BC	20[3]	The BCUC establishes a Benchmark Utility and sets its allowed ROE and capital structure. In a second stage of proceedings, the allowed ROE and capital structure of other utilities are compared with that of the benchmark, and adjustments to both allowed ROE and capital structure are made (if required) to account for risk differentials and the specific circumstances of each utility.
Federal	N/A	For pipelines regulated by the Canada Energy Regulator (CER) (formerly the National Energy Board), the cost of capital is ordinarily determined on a case-by-case basis as part of negotiated settlement processes without further review or involvement by the CER.

1 This is the approximate number of natural gas and electric distribution and transmission utilities for whom the regulator determines cost of capital.
2 Based on the list of affected utilities provided in AUC Decision 22570-D01-2018.
3 Order G-66-21, Appendix C; Note: excluding Stargas.

Jurisdiction	Number of Utilities[1]	Description
Ontario	~ 60[4]	The Ontario Energy Board establishes a benchmark allowed ROE which is then used in a formula for setting allowed ROE in subsequent years with the appropriateness of the benchmark ROE being reviewed periodically. In the past, electric distribution utilities were divided into different cohorts based on the size of their rate base and each cohort was given a different equity thickness, but this practice was discontinued in 2006 to incent more consolidation. Currently all electric distribution utilities have the same 40 percent equity thickness irrespective of their size. However, for electric transmission, electric generation and natural gas utilities, the deemed capital structure is still decided on a case-by-case basis.
Quebec	5	The cost of capital is ordinarily reviewed on a case-by-case basis by the Régie de l'énergie. More recently, Quebec's natural gas utilities (Energir, Intagaz and Gazifere) filed a request for a joint cost of capital proceeding.
New Brunswick	2	As described in the Initial Report, the allowed ROE and capital structure in these three provinces are determined on a case-by-case basis.
Newfoundland and Labrador	2	
Nova Scotia	2	
United States	N/A	In majority of the cases, the cost of capital for U.S. distribution companies is determined on a case-by-case basis as part of their general rate case application. In many cases, these general rate cases are subject to negotiated settlement and therefore cost of capital is determined as part of the same negotiated settlement process without further process. At the federal level, the Federal Energy Regulatory Commission (FERC) uses a zone of reasonableness to determine the allowed ROE for individual utilities. Absent unusual circumstances showing that the utility faces anomalously high or low risks, the FERC sets the allowed ROE at the median of the zone of reasonableness.
Yukon	2	The YUB uses the BCUC determined benchmark ROE and capital structure as the foundation for determining utilities' authorized returns and applies a risk premium adder above the Benchmark Utility to account for a utility's specific risks and conditions.

The low number of utilities in Quebec, New Brunswick, Newfoundland and Labrador, and Nova Scotia obviates the need for a generic approach. Although, as in the Yukon and in Quebec for natural gas utilities, a benchmark approach or joint applications may still be used when a small number of utilities are involved to reduce costs and provide regulatory efficiency and consistency.

For a jurisdiction such as Ontario, with a large number of regulated utilities, a generic approach with automatic adjustments is important because a case-by-case approach, or even a case-by-case review of the individual capital structures, to adjust for risks would be

[4] Based on OEB's 2019 Year Book of Electricity Distributors.

cumbersome. The use of a generic formula approach in Ontario since 1997 is a direct result of the restructuring of Ontario's power industry in 1990s which created a significant number of small electric distribution utilities. Nevertheless, as can be seen from the case-by-case review of company specific risks that is undertaken for natural gas utilities and electric transmission companies, the OEB may still consider company specific risks when possible.

The number of regulated utilities in Alberta and BC is in the middle of the range. In these jurisdictions, the use of a benchmark can create regulatory efficiency for smaller utilities while meeting the Fair Return Standard (if the risk differentials are considered correctly).

The composition of the utilities in Alberta and BC does differ. There are a larger number of medium to large utilities in Alberta. While the BCUC sets returns for 20 utilities, most of these utilities are very small. The majority of BC residents are customers of one or two of these utilities (BC Hydro, FEI, FBC and Pacific Northern Gas). The limited number of large and medium-size utilities in BC accounts for the difference in how adjustments are made in BC and Alberta. The difference also opens up another possibility for BC, which is reflected in FortisBC's alternative position in the event that the BCUC determines to depart from long-standing practice: it is possible to perform a case-by-case review of cost of capital for the few utilities, while smaller utilities can be grouped together and undergo their own generic cost of capital proceeding (although as discussed below, doing so would not be without its own issues).

With this background, FortisBC's responses to the BCUC's questions are provided below. FortisBC's comments regarding certain sections of the Initial Report are also incorporated in the answers to these questions.

2. Pros and Cons of a Benchmark Utility Approach (BCUC Question 1)

In the following sections, FortisBC provides its summary of the benefits of using a Benchmark Utility followed by a summary of the drawbacks of using a Benchmark Utility. Included in the discussion of the drawbacks of a Benchmark Utility are FortisBC's comments on the drawbacks that were identified in the Initial Report.

FortisBC submits that the BCUC's long-standing model has worked well, and the advantages of maintaining it – particularly for small utilities - outweigh any cons. In summary, the main benefits of the generic benchmark approach relate to regulatory and administrative efficiencies reflected in cost savings, increased regulatory consistency and improved regulatory pragmatism. As the Benchmark Utility, the generic approach is less critical for FEI since the Benchmark Utility for most part files the same evidence that would have been filed in a case-by-case review process. However, for other smaller utilities in BC, the benefits of the benchmark approach compared to the alternatives are tangible and potentially significant.

2.1. Benefits of Using a Benchmark Utility

As described in more detail below, the major benefits of the benchmark approach that has been used in BC are regulatory efficiency, consistency, and a reduced burden on smaller utilities (and, ultimately, their customers). The generic benchmark approach has material

benefits for smaller utilities. However, for larger utilities like FEI and FBC, the generic approach is of lesser importance.

2.1.1. Regulatory Efficiency

FortisBC agrees with Dr. Lesser that a key benefit of the benchmark approach is the gain in regulatory efficiency.

BCUC Order G-72-12 dated June 1, 2012 in the 2012/2013 Generic Cost of Capital proceeding discussed the two-stage benchmark approach and commented that:[5]

> …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 manner.

The Yukon Energy Board has also held that the benchmark approach used by BCUC is the most efficient approach for the utilities in that jurisdiction[6]:

> The Board continues to be of the view that relying on a generic ROE from a different jurisdiction is the most efficient means of addressing an inherently complex and costly matter. The Board strongly believes that such an approach is the most efficient manner for a jurisdiction such as Yukon. The Board considers that the BCUC approach has been successfully applied to both utilities under this Board's jurisdiction and has resulted in fair returns to both utilities.

The current generic approach to cost of capital determination generates significant cost savings for the utilities other than the Benchmark Utility as it avoids additional, unnecessary duplication of effort and avoids frequent reassessment of factors that are common to all utilities. Indeed, the efficiency of the current approach can be demonstrated based on past experience in BC. The table below provides a breakdown of regulatory costs for three proceedings: 2012 GCOC Stage 1 total costs, FBC's estimated costs for the 2013 GCOC Stage 2 proceedings as well as FEI's costs for the 2016 cost of capital proceeding. The relative cost difference for FEI (the Benchmark Utility) and FBC is significant.

[5] 2012 GCOC Proceeding, Order G-72-12, Appendix A, Page 7
[6] Yukon Utility Board Order 2009-08, paragraphs 280-282.

Table 2: Cost Breakdown for Previous Cost of Capital Proceeding

Application	FEI 2016 Cost of Capital	2012 GCOC Stage 1*		FBC - GCOC Stage 2	
Commission Costs	$ 144,829	$ 500,000	(1)	11,234	(2)
Intervener PACA	249,799	477,650		19,887	
Experts/Consultants **	833,755	1,095,879		80,895	
Legal Costs	456,008	528,314		56,184	
Other/Misc.	18,767	6,953		-	
Total:	**$1,703,158**	**$2,608,796**		**$168,201**	
Limited Oral Hearing Scope	Yes	No		No	
# Oral Hearing Days	3	7		-	
# IRs	561	956		292	
# Rounds of IRs	2	2		2	
# FEI Experts	1	4		1	

Note (1) BCUC's direct costs $500,000 through the levy

Note (2) FBC's estimated share of BCUC's direct costs collected through the levy

** total costs, not including allocations to other utilties*

***Reflects converson to $CAD where applicable. Average annual exchange rates were as follows:*

2016	*0.76512*
2014	*0.90226*
2012	*1.00170*

FEI's 2016 cost of capital proceeding is similar to a case-by-case review process as it was only focused on FEI's specific allowed ROE and capital structure. As such, FEI's costs in that proceeding can be used as a reasonable comparison with that of a generic approach. As shown, FEI's 2016 cost of capital proceeding consisted of three days of oral hearing and two rounds of information requests (IRs) with total external costs of $1.7 million. This is lower than FEI's total cost in the 2012 GCOC Stage 1 proceeding (even after adjusting for cost allocations to other utilities[7]) which consisted of seven days of oral hearing and two rounds of IRs[8]. In addition to the regulatory process, a myriad of factors including inflation, exchange rate and tax changes may impact the costs. As such, an apples to apples comparison of the costs between these proceeding is not easily possible. However, the above table provides a reasonable indication that, while the generic approach may not generate material cost savings for the Benchmark Utility (in this case FEI), the benefits to the customers of other utilities can be significant. In the case of FBC, its total regulatory costs in the 2013/2014 Stage 2 proceeding were about $ 168,000 which are significantly lower than the alternative case-by-case review process.

Based on FEI's previous experience in cost of capital proceedings, a thorough review of individual companies' cost of capital applications could cost between one to two million dollars for each company.[9] For a utility such as FBC, $1.5 million of additional regulatory

[7] Approximately $305,000 of expert/consultant costs were shared with other participants, as well as a certain percentage of the BCUC's costs collected through the levy.

[8] The number of experts retained in the 2012 GCOC Stage 1 and FEI's 2016 cost of capital were four and one expert respectively. FEI believes that, all else equal, with the same number of experts, similar exchange rate and similar evidence filed, the regulatory costs for FEI's 2016 cost of capital proceeding would have been similar to the GCOC Stage 1 proceeding.

[9] A streamlined process can potentially reduce the costs and narrow the range.

costs would increase rates by approximately 15 basis points.[10] The rate impact for smaller utilities would be considerably greater, as the cost is spread out over fewer customers.

It is important to note that the costs shown in the table above represent external costs only. Utilities also incur other internal expenses in the preparation and review of their applications and during the proceedings. Preparing the application, answering detailed IRs, preparing for and participating in oral hearings, responding to undertakings and other regulatory processes requires the dedication of thousands of hours of employee and management time.

In addition, FortisBC notes that the regulatory efficiency gained through this process is not limited to the utilities. The BCUC itself will also benefit from administrative and cost efficiencies by avoiding a case-by-case review for each utility.

Based on this, FortisBC submits that, as the Benchmark Utility, FEI may not achieve any significant cost savings from the generic process, however the regulatory efficiencies associated with the generic benchmark approach for other utilities, particularly small utilities like FortisBC Alternative Energy Services Inc. (FAES), are demonstrably real and potentially significant.

2.1.2. Regulatory Consistency

As confirmed by the BCUC,[11] the use of the same panel in a contiguous manner for both stages of the GCOC proceeding will improve regulatory consistency. A generic benchmark methodology like the long-standing BCUC approach involves a uniform review and analysis of economic outlook and capital market conditions for all utilities. Further, the expert evidence in this approach is gathered at a single point in time. This means that the inputs and assumptions used in the financial models are consistent for all utilities. An additional benefit of the approach used in the BC is that all utilities are compared with the same Benchmark Utility which improves the consistency for risk adjustments.

2.1.3. Practicality for Small Utilities

The generic benchmark approach currently used in BC has a proven track record and is efficient. However, the benefit of this approach goes beyond the cost and regulatory efficiencies. A case-by-case review of the cost of capital may simply not be practical for many of the small utilities. There are two aspects to this challenge.

First, small utilities may not have the resources required to undertake the type of detailed studies needed to develop the evidence and arguments typically filed as part of a cost of capital proceeding.

Second, there are data challenges. Many of the investor-owned utilities regulated by the BCUC (such as FAES) are very small and provide niche energy services. These characteristics make it difficult (if not impossible) to find comparable publicly listed peer group companies that are used as proxies in financial models to compute separate return on common equity estimates for each utility. This is important since, without a reliable and

[10] Three year levelized rate impact would be around 8 basis points.
[11] 2012 GCOC Proceeding, Order G-72-12, Appendix A, Page 7.

comparable group of listed companies, the returns estimated through these models would again need to be adjusted to account for the risk differentials. This is equivalent to the type of analysis that is undertaken in comparing to a Benchmark Utility. Investor-owned utilities in BC are very familiar with FEI's operations and risks, and comparing their risks with FEI will be simpler to undertake and more straightforward to evaluate than comparing their operations with a list of benchmark companies outside the province and Canada. As such, FortisBC submits that another benefit of this approach is its pragmatism and practicality, especially for smaller utilities.

2.2. Drawbacks of Using a Benchmark Utility

As described above, the main alternative to the generic benchmark approach is the case-by-case review process. All else equal, the main advantage of the case-by-case approach is that it can be customized to the specific circumstances and characteristics of each utility, and provide regulators with more timely and updated analysis. However, FortisBC submits that some of the potential drawbacks identified in the Initial Report are overstated.

The long delay in the regulatory process between the first and second stages of the generic proceedings is a drawback of the generic benchmark approach. As an example, the 2012 GCOC Stage 1 proceeding was initiated in February 2012, with FortisBC filing its application on August 3, 2012. The BCUC Decision in the Stage 1 proceeding was released on May 10, 2013. Consequently, the applications for the 2013 GCOC Stage 2 proceeding were filed in July 2013 and the BCUC decision in the Stage 2 proceeding was released on March 25, 2014. The new approved returns and capital structure were then applied to the 2013 rates, which had previously been set on an interim basis. The regulatory lag, therefore, is one drawback of the approach used in the previous GCOC proceeding.

2.2.1. The Need to Adjust for Risks Relative to the Benchmark

The Initial Report opines that a major potential drawback of the benchmarking approach is the need to determine just and reasonable risk adjustments for other utilities relative to the benchmark ROE. In Dr. Lesser's view, if the regulator establishes one or more evidentiary proceedings for other utilities to submit evidence regarding their risk adjustments, then the efficiency gains are unlikely to be realized.

As discussed earlier, FortisBC believes the efficiency gains from a generic benchmark approach for non-benchmark utilities are demonstrably real and potentially material. It is true that in the Stage 2 proceedings other utilities should file evidence to compare their risks with that of the Benchmark Utility and that this process involves some cost and effort. However, the review of the relative risk differentials between the benchmark and other utilities is a much less costly and burdensome process than a case-by-case review or the work needed to prepare the cost of capital evidence in the GCOC Stage 1 proceeding. As mentioned above, many smaller utilities have less experience and expertise in cost of capital proceedings and, if subject to the case-by-case review or even grouped together, they will need to rely on costly consultants for most of the process. However, the same utilities understand their own risks, are capable of explaining them and can relatively easily compare their risks with that of a well-known local benchmark like FEI. Further, it is challenging to find comparable risk listed companies for smaller utilities that provide niche energy services and

therefore the need to compare the risks with the proxy companies for these utilities will still exist.

2.2.2. The Domino Effect of the Benchmark's Allowed Return

The Initial Report comments that another potential drawback to the use of a Benchmark Utility is that, if the regulator sets the allowed return for the Benchmark Utility improperly, then the adjustments to that benchmark return will meet the Fair Return Standard only by chance.

FortisBC agrees that this risk may exist. However, this risk is present for all generic approaches and is not unique to the approach used in BC. For instance, in the case of Ontario, if the base ROE and/or the formula construct are not set properly, then the allowed return for all utilities using the formula would not meet the Fair Return Standard. Applying the same allowed ROE and capital structure for a large number of utilities, irrespective of their risk differentials, may also result in the allowed ROE meeting the Fair Return Standard only by chance. Similarly, if the AUC's benchmark ROE is set improperly, then the adjustments to the capital structure will meet the Fair Return Standard only by chance. Indeed, the chain reaction effect may even present itself in the case-by-case review process as regulators may consider the cost of capital decisions made by other panels in the same jurisdiction and may be hesitant to approve allowed returns that are materially different.

2.2.3. Subjectivity of the Adjustments and the Fair Return Standard

The Initial Report further comments that *ad hoc* subjective adjustments are unlikely to result in fair returns. It further states that if *ad hoc* risk adjustments are unacceptable, then risk adjustments must be determined using some type of empirical model that will be the subject of regulatory scrutiny to determine whether the proposed risk adjustments were reasonable and met the Fair Return Standard. FortisBC respectfully submits that there are shortcomings with this view.

First, it is difficult to square this argument with the fact that the current methodology has been in place for 27 years, presumably because the BCUC was satisfied it has produced fair returns.

Second, FortisBC submits that the term "*ad hoc*" adjustment is a misnomer because the BCUC's informed regulatory adjustments follow a clear decision making process and the type of evidence that other utilities are to file in the second stage of a generic proceeding is well-defined.

Third, while it is true that the risk adjustments are not fully quantifiable and would require regulatory judgment, this is true of any approach.

The issue of regulatory judgment and subjectivity and its impact on the Fair Return Standard has been extensively discussed in North American legal and regulatory literature. In Canada, various regulators have confirmed that the Fair Return Standard gives the regulator sufficient leeway to apply informed judgment. For instance, as provided below, referring to historical

court decisions, the AUC confirmed that there is a need to apply judgment in assessing cost of capital evidence:[12]

> As noted by Mr. Justice Rothstein in the TransCanada Pipelines decision cited above, the determination of the rate of return on equity for a regulated utility is difficult given that the correct answer is not readily apparent. This determination requires an expert tribunal to apply its judgment in assessing often conflicting evidence and to consider the differing interests and perspectives on risk of debt and equity investors. This exercise is even more complex in Canada, and in Alberta in particular, given the limited number of stand-alone utilities issuing debt and the lack of any utilities that issue equity directly to investors.

Similarly, the OEB has discussed this issue in its previous decisions as follows:[13]

> The Board affirms its view that the Fair Return Standard frames the discretion of a regulator, by setting out three requirements that must be satisfied by the cost of capital determinations of the tribunal. Meeting the standard is not optional; it is a legal requirement. Notwithstanding this obligation, the Board notes that the Fair Return Standard is sufficiently broad that the regulator that applies it must still use informed judgment and apply its discretion in the determination of a rate regulated entity's cost of capital.

Referring to some of the above mentioned decisions, the BCUC has also confirmed that the Fair Return Standard leaves room for regulatory discretion:[14]

> The Commission Panel observes that the application of the FRS leaves room for disagreement, judgment and discretion. The methods relied upon by various regulators and practitioners therefore differ substantially.

FortisBC generally agrees that cost of capital decisions are sometimes controversial and adversarial in nature as the opportunity cost is not readily observable and there are varying approaches to estimate investors' expected return that reflects individual companies' risk profile. However, past experience in BC provides some assurance that the BCUC is capable of assessing conflicting evidence and reaching its own decision, which, meets the Fair Return Standard.

2.2.4. Application of the Automatic Adjustment Mechanism and the Benchmark Approach

As the final potential concern, the Initial Report comments that if an Automatic Adjustment Mechanism (AAM) is used to adjust the allowed ROE for the Benchmark Utility, then the risk adjustments for other utilities may need to be adjusted as, similar to bond yields, risk factors impacting the adjustments can change too.

---

[12] AUC 2009 Generic Cost of Capital Decision, November 12, 2009, p. 28.
[13] OEB Decision EB-2009-0084,"Report of the Board on the cost of capital for Ontario's regulated utilities", page i.
[14] BCUC Order G-75-13, "GCOC Stage 1 Decision", Page 8.

FortisBC submits that the suitability of an AAM formula approach and potential inputs to the formula will be the subject of regulatory scrutiny in the first stage of this proceeding; therefore, it is too soon to comment on the application of an AAM to the benchmark approach as a drawback.

Regardless, experience in BC and in other jurisdictions indicates that an AAM formula and benchmark approach can coexist. Similar to the ROE and capital structures set in the case-by-case review, the premium/discount to the benchmark can be fixed for a certain duration and revisited every few years. The potential drawbacks and examples provided in the Initial Report can more accurately be described as the drawbacks to the formula approach in general since the individual utility's circumstances (such as change in size or business risk or potential rating downgrades) may not be reflected in the generic formula. Nevertheless, if the circumstances have changed to the extent that the Fair Return Standard is not met, parties have been able to file a request with the BCUC to update the adjustments.

3. Relevant Considerations in Designating a Benchmark Utility (BCUC Question 2)

The previous section has addressed why FortisBC considers it appropriate to maintain the long-standing approach, which involves using a Benchmark Utility. In this section, we address the relevant factors for designating a Benchmark Utility and why FEI is the logical choice. Further, FortisBC's comments on the grouping of utilities discussed in the Initial Report are provided.

3.1. Relevant Factors to Consider when Designating a Benchmark Utility

Relevant factors to consider in determining a Benchmark Utility are as follows:

1. **Availability of comparable proxy group**: The comparable investment principle is one of the three elements of the Fair Return Standard. Under this principle a fair and reasonable return should be comparable to the return available from the application of the invested capital to other enterprises of like risk. To achieve this legal requirement, cost of capital experts usually establish a proxy group of publicly traded comparable risk companies and use the proxy group's data as inputs in their financial models. Therefore, the availability of a listed comparable risk proxy group is a critical consideration for establishing the Benchmark Utility.
2. **Credit ratings**: The Benchmark Utility should preferably issue its own debt and have its debt rated by major credit rating agencies. This would provide the BCUC and other parties with an independent analysis of a utility's risk profile, albeit from the bondholder's perspective.
3. **Size of operation**: This factor is closely tied to the availability of a comparable proxy group discussed above. The majority of the publicly listed utilities are very large. It is therefore preferable that the Benchmark Utility shares characteristics with the proxy group and has a large operation. Further, a relatively large utility with diversity in customer base, asset composition and geographic scope is less likely to be susceptible to unique or specific risks that have a disproportionate impact on risk profile that may make comparisons more difficult.

4. **Stability of operation**: The Benchmark Utility needs to have stable operations and not be subject to takeovers or mergers that can drastically change its risk profile.
5. **Resources and expertise**: As explained above, preparation of cost of capital applications requires both specialized expertise, usually acquired through retaining external consultants, and significant internal resources. The capability of the Benchmark Utility to provide these resources without material rate impact to its ratepayers is another relevant consideration.
6. **Familiarity with and acceptance of the Benchmark Utility by other affected utilities**: Other affected utilities must be fairly familiar with the Benchmark Utility operation to be able to compare their risk with that of the benchmark. A general consensus among affected utilities around the appropriate Benchmark Utility will help to facilitate the process and increase the administrative efficiencies and avoid unnecessary controversies.
7. **Ownership**: The opportunity cost for a Crown corporation like BC Hydro is fundamentally different from that of investor-owned utilities. Considering that the majority of the utilities are investor-owned, the Benchmark Utility should be an investor-owned utility.

In the Initial Report, Dr. Lesser suggests that the BCUC may wish to identify the Benchmark Utility as having the lowest overall business and financial risk of all of the affected utilities and that it is doubtful that any utility would propose a discount to the Benchmark Utility.

FortisBC notes that this issue was already discussed in the 2013 GCOC Stage 1 proceeding. In its decision the BCUC panel agreed with FortisBC that FEI is not a low-risk utility. The panel further confirmed that the benchmark does not need to be a low-risk utility and other utilities may receive a discount or premium compared to the benchmark:

> …we are in agreement with describing FEI as the "benchmark utility" rather than a "low-risk benchmark utility… we are of the view that describing FEI as low-risk would not be appropriate. Accordingly, for the purposes of Stage 2 of the GCOC, FEI will be referred to as the benchmark utility.[15]
>
> The Commission Panel considers that it is feasible that a stand-alone public utility may face overall business risks that are either higher, lower or the same as the benchmark utility.[16]

Further, FortisBC notes that the BCUC is legally required to approve rates that meet the Fair Return Standard. However, the BCUC has no obligation to approve a premium on a benchmark if a premium is not warranted.

3.2. FEI Is Well Suited to Be the Benchmark Utility

Based on the relevant factors described above, FortisBC submits that FEI continues to be the logical choice for the Benchmark Utility in BC.

---

[15] BCUC Order G-75-13; 2013 GCOC Stage 1 Decision, Page 114.
[16] BCUC Order G-75-13; 2013 GCOC Stage 1 Decision, Page 115

FEI's equity is not publicly traded (nor is this the case for any other utility in BC or Canada), however, its debt is rated by two debt rating agencies, providing an independent capital market assessment of its overall business and financial risks, albeit from a bondholder's perspective. 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. Although most of the publicly listed utility companies are holding companies that may operate both regulated and non-regulated as well as natural gas and electric assets in various jurisdictions, cost of capital experts are still capable of developing a proxy group whose operations are reasonably comparable with that of FEI.

FEI's experience and history in serving as the benchmark is also important. BCUC Order G-156-21 notes that a long history of using a particular utility as the Benchmark Utility should not presume continued usage. FortisBC agrees that a long history of using FEI as the benchmark, on its own, is not a sufficient reason to presume continued usage. However, with experience comes expertise and knowledge. Unlike the case for other investor-owned utilities in BC, there is a significant body of evidence that has been developed in recent proceedings that helps to define FEI's financial and business risk profile. Further, FEI's long-history as the benchmark means that other affected utilities are fairly familiar with its risk profile and are capable of comparing their risk with that of FEI. 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:

> 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. 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.** [emphasis in original][17]

Some of the political/policy risks associated with FEI are specific to natural gas utilities; however, the BCUC has not 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. Further, FEI's business risks and the trends in those risks have been extensively and comprehensively assessed by the BCUC in multiple proceedings.

[17] 2012 GCOC Proceeding, BCUC Order G-148-12, Appendix A, Page 4.

3.3. Grouping Utilities

The Initial Report suggests that a "middle ground" between the current approach and a case-by-case review process is to group utilities based on their characteristics (e.g., size, types of customers served, type of service (gas, electric), investor-owned, privately held firms), to reduce the regulatory burden of estimating a risk adjustment for each individual utility. In this way, according to the Initial Report, a single risk adjustment could be applied to groups of utilities, reducing the regulatory burden.

As discussed in FortisBC's March 29, 2021 submission,[18] grouping 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 fairly limited number of utilities in BC mitigates the need for such a grouping as it is better to consider the particular circumstances of each utility on a case-by-case basis. Further, having two or more benchmark utilities is both unnecessary and impractical, as explained above. FEI best meets the characteristics of an appropriate Benchmark Utility, while other investor-owned utilities in the province are less-suited.

Further, as shown in the table below, with the exception of certain group of utilities such as thermal energy and district energy systems,[19] the composition of BC utility profiles and characteristics do not lend themselves to any efficient grouping for cost of capital determination purposes in a way that would avoid the need for risk adjustments within the group. For instance, as a medium-size investor-owned vertically-integrated electric utility, FBC cannot be grouped with any other BC utility of similar risk profile. FEI is also much larger than the other two natural gas utilities.

Table 3: Utility Type Matrix for BC Utilities

Utility Type	Small	Med-size	Large
Natural gas - Investor-owned/privately held	StarGas	PNG	FEI
Electric - Investor-owned/privately held	Kyuquot Power, Boralex Ocean Falls, CB Powerline, Hemlock Valley	FBC	
Electric - government owned	Nelson Hydro		BC Hydro
Thermal and District Energy Systems	FAES, Corix, Creative Energy, River District Energy, Dockside Green Energy, Shannon Estates		
Propane	Superior, Big White Gas, Resort Gas		

[18] 2021 GCOC Proceeding, Exhibit B1-2.
[19] In the 2014 GCOC Stage 2 Decision, Stream B utilities were already grouped together and are subject to the same minimum default capital structure and risk premium over the benchmark ROE although even in this group Dockside Green Energy received a higher premium.

Conclusion

In conclusion, FortisBC submits that the currently used generic benchmark approach is in public interest and continues to work for all affected utilities. Further, FEI remains the logical choice for the Benchmark Utility. However, if the BCUC decides to discontinue the current benchmark approach, FEI and FBC should be subject to a case-by-case review as they cannot be efficiently grouped with any other utility for cost of capital determination purposes without additional adjustments.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of FORTISBC

Original signed:

Diane Roy

cc (email only): Registered Parties