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June 14, 2022

Residential Consumer Intervener Association
c/o Midgard Consulting Inc.
Suite 828 – 1130 W Pender Street
Vancouver, B.C.
V6E 4A4

Attention: Mr. Peter Helland, Director

Dear Mr. Helland:

Re: British Columbia Utilities Commission (BCUC) – 2022 Generic Cost of Capital Proceeding – Project No. 1599176

FortisBC Energy Inc. and FortisBC Inc. (collectively FortisBC) Response to the Residential Consumer Intervener Association (RCIA) Information Request (IR) No. 2 on FortisBC Evidence

On January 18, 2021, BCUC initiated the proceeding referenced above. In accordance with the regulatory timetable established in BCUC Order G-106-22 for the review of FortisBC's Evidence, FortisBC respectfully submits the attached response to RCIA IR No. 2.

For convenience and efficiency, FortisBC has occasionally provided an internet address for referenced reports instead of attaching lengthy documents to its IR responses. FortisBC intends for the referenced documents to form part of its IR responses and the evidentiary record in this proceeding.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of FORTISBC

Original signed:

Diane Roy

Attachments

cc (email only): Commission Secretary
Registered Parties

33.0 Reference Exhibit B-1-13, RCIA IR 1.3, PDF Page 2-3 of 69

RCIA IR 1.3:

Does Fortis believe that interest rates are being driven primarily by actions of central banks? Please specify which interest rates (e.g., 30 year rate) in your response.

FortisBC Response:

Concentric provides the following response:

Mr. Coyne has stated in his report that he believes bond yields are being primarily driven by the actions of central banks not investors in bond markets. This unusual circumstance has prevailed during the pandemic. This applies both to 10 and 30 year government bonds, as well as mortgage backed securities and corporate bonds that are priced based on a spread against Treasuries.

RCIA IR 1.3.1:

If yes, has this always been the case? Please elaborate.

FortisBC Response:

Concentric provides the following response:

"No, it has not always been the case that bond yields were driven primarily by the actions of central banks. Two prominent examples have occurred over the past decade. The U.S. Federal Reserve implemented the "Operation Twist" program in late 2011 and 2012 to help stimulate the economy. The operation involved the Fed buying longer-term Treasuries and simultaneously selling shorter dated issues to ease the economy by bringing down long-term interest rates. In December 2012, the Fed stated that it would end the program and replace it with a policy of "quantitative easing" designed to lower long-term rates by making open-market purchases of longer-dated U.S. Treasuries and mortgage-backed securities. As detailed in Mr. Coyne's report (pp. 18-23) the Fed acted with even stronger measures in response to the pandemic in 2020 and 2021. The Bank of Canada did not engage in Quantitative Easing in 2011-2012, but did during the COVID pandemic of 2020-2022."

33.1. Please clarify if FortisBC and its expert believe that the falling interest rates in Canada of the past decade are primarily driven by actions of the Bank of Canada or if this is the case only in the last two years (e.g., since the pandemic)?

Response:

Concentric provides the following response:

Lower interest rates in Canada were more likely driven by lower levels of inflation (and inflation expectations) over the past decade except for the 2008/2009 and 2020/2021 periods when central bank policies played a more central role. The Bank of Canada ("BOC") reduced the overnight rate to very low levels during the financial crisis and great recession of 2008/2009 in an effort to stimulate economic growth and promote full employment. The BOC held short-term rates at these levels for many years following the financial crisis. This extended period of accommodative monetary policy was possible because inflation rates and expectations were below the BOC's target in Canada. This contributed to the gradual decline in government and corporate bond yields in Canada over the past decade. In the spring of 2020, the BOC engaged in Quantitative Easing for the first time ever in response to the COVID-19 pandemic, further reducing short-term interest rates and also purchasing government bonds to drive down longer-term borrowing costs. However, that trend has now reversed, with the BOC raising the overnight rate by 25 basis points in March 2022, 50 basis points in April 2022 and another 50 basis points in June 2022 to combat the highest inflation rates in Canada since 1991.

33.2. How can one differentiate between the influence that investors have on interest rates versus the influence of central banks on the same interest rates?

Response:

Concentric provides the following response:

Central banks typically set short-term policy rates at a level that seeks to balance the dual mandates of low unemployment and price stability. However, central banks in both Canada and the U.S. have pursued an accommodative monetary policy for the past decade. Absent this central bank policy, interest rates on government and corporate bonds would arguably have been much higher. This has been an unusual time in history, and the policy responses from central banks and governments have been unprecedented.

While it is difficult to parse the exact degree to which bond yields are influenced by central banks as opposed to investors, there is no question that investors have been influenced by the accommodative monetary policy of central banks since the financial crisis, and as a result interest rates on government and corporate bonds gradually declined because inflation was low and was expected to remain low. Without that extraordinary policy accommodation, long-term rates would arguably have been much higher. However, the scale reached a tipping point when sharp increases in the money supply caused inflation to become a primary concern in both Canada and the U.S. Central banks were forced to withdraw this policy accommodation and start raising short-term borrowing rates to fight inflation rates that are well above the long-term target of 2.0%. The bond market is now adjusting to the normalization of short-term rates in response to higher than target inflation in both Canada and the U.S. The adjustment in financial markets has been dramatic for bond holders in 2022, as bond prices have declined sharply and interest rates on government, corporate and mortgage bonds have increased substantially.

33.3. Are forecasters able to know with certainty the cause and effect of investor behaviours and actions on interest rate levels? Please explain.

Response:

Concentric provides the following response:

No. Forecasters clearly consider the actions of central banks in forming their views because bank actions are both transparent and influential, but the actions of investors are more difficult to predict. While there is no certainty in interest rate forecasts, those forecasts represent the consensus opinion of leading economists, academics and analysts at the time the forecasts are published and are available to investors. Investors rely on those interest rate forecasts even though the forecast may ultimately prove to not be accurate. For the purpose of estimating the cost of capital, it is investor expectations that determine the required return.

33.4. Will lower interest rates impact investor return expectations differently if the perceived cause of low bond yields are being primarily driven by the actions of central banks not investors in bond markets? Please explain.

Response:

Concentric provides the following response:

Yes, the effect on investor return expectations may be different when bond yields are being primarily driven by actions of central banks and not investors in the bond markets. For example, central banks may pursue an accommodative monetary policy when inflationary pressure is low and there is a need to stimulate economic growth and full employment. However, the central bank can always decide to change that policy abruptly in response to new information, such as much higher than expected inflation. When that policy change occurs, the market reaction can be sudden and dramatic as we have seen thus far in 2022.

34.0 Reference Exhibit B-1-13, RCIA IR 11.1, PDF Page 30 of 69

RCIA IR 11.1

Do prospective investors in Canadian gas utilities enjoy the same range of potential alternative investment targets as do prospective investors in US Gas utilities? For example, to what extent did the availability of alternative investments (e.g., in Nasdaq or tech companies) influence the return expectations for US Gas utility investors, where the same pressures would not be present for Canadian gas utilities?

FortisBC Response:

Concentric provides the following response:

There are fewer publicly-traded utility companies in Canada than in the U.S. As such, the pool of potential alternative investments is smaller for Canadian investors assuming they are seeking companies with a similar business and financial risk profile as FEI and FBC. This is one reason that Canadian utility regulators have also accepted U.S. proxy groups, due to the limited number of regulated utilities in Canada that are publicly traded. While U.S. investors may have more alternative investments in technology companies or other NASDAQ listed companies than does a Canadian investor, those companies do not have the same risk profile and would not be considered viable alternatives to a utility investor. Investors in both Canada and the U.S. also have the ability to invest in stocks and mutual funds that own companies located in other countries.

34.1. To what extent are Canadian Institutional investors or funds that are dedicated to investing in Canadian securities restricted from investing in non- Canadian securities? In other words, to what extent do Fortis and other investor-owned Canadian utilities have a captive market? Please elaborate.

<u>Response:</u>

FortisBC is not aware of Canadian Institutional investors or funds being restricted from investing in non-Canadian securities. Canadian Institutional Investors such as pension funds may dedicate a percentage of their portfolio to the Canadian equity market and retain investment managers that are specialized in Canadian equity to manage that portfolio for them. However, there is no requirement for these investment managers to invest in particular companies or sectors and as such the investor-owned Canadian utilities do not have a “captive market”.

Concentric also adds the following response:

Concentric routinely works with Canadian institutional investment funds seeking to invest in U.S. utilities. These funds include, for example: British Columbia Investment Management Corporation (BCI); Brookfield Asset Management; Caisse de dépôt et placement du Québec; and the Ontario Teachers Pension Fund (OTPP).

This is aligned with the Government of Canada's policy to enhance Canada's investment opportunities abroad[1]:

> Enhancing Canada's investment opportunities abroad is essential to Canada's ongoing international competitiveness. Foreign investment links Canadian companies, consumers and workers to the new knowledge based global economy. It enhances Canada's competitiveness by revitalizing domestic industry and increasing the flow of goods and services between Canada and its trading partners. Foreign investment not only produces jobs, but introduces new technology, new management techniques and new market access. Canada has a clear interest in providing for stability, transparency, predictability, non-discrimination and protection for Canadian companies and individuals that invest abroad, as well as for foreign investors wishing to invest in Canada. Good investment rules make for a positive economic climate, which favours growth and jobs. Canada has, therefore, consistently supported a strong, rules-based system, multilaterally, regionally and bilaterally.

[1] https://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/invest/index.aspx?lang=eng

35.0 Reference Exhibit B-1-13, RCIA IR 32.2, PDF Page 64 of 69

RCIA IR 32.2:

Fortis Inc. shows Long-Term Issuer Rating as improving from 2018 to 2021, including an upgrade to A from BBB (high) – please reconcile this result with the arrival of the new business risks highlighted by FEI and FBC in this filing.

FortisBC Response:

Fortis Inc. is rated by three credit rating agencies: Moody's, S&P and DBRS. While S&P and Moody's have maintained their credit ratings of A-/BBB+ and Baa3, respectively, DBRS upgraded Fortis Inc.'s credit rating from BBB (high) to A (low) in May 2021.

As noted in DBRS' credit rating report for Fortis Inc. dated May 20, 2021, the primary reason for improved credit rating was a significant reduction in non-consolidated debt and an improvement in liquidity as a result of the sale of a 51 percent interest in Waneta Hydroelectric Expansion for $1 billion and a $1.2 billion common equity issuance in December 2019.

Therefore, Fortis Inc.'s improved credit rating by DBRS in May 2021 is not a good proxy for FEI and FBC performance and is unrelated to the arrival of the new business risks highlighted by FortisBC.

35.1. Please confirm that FortisBC's response to RCIA 32.2 indicates that actions taken by Fortis Inc. to improve its corporate balance sheet were the catalyst for the DBRS upgrade.

35.1.1. If not confirmed, please elaborate.

Response:

Confirmed. The sale of a 51 percent interest in Waneta Hydroelectric Expansion that generated $1 billion and a $1.2 billion common equity issuance in December 2019 allowed Fortis Inc. to repay a significant amount of debt on its balance sheet which was the catalyst for the DBRS upgrade.

35.2. What does Fortis Inc.'s improved credit rating indicate about the credit rating agency's views of the underlying regulated Fortis businesses, such as FEI and FBC?

Response:

The primary reason for the DBRS upgrade was a significant reduction in Fortis Inc.'s non-consolidated debt. The corporate debt decreased to approximately $3.6 billion at the end of 2020 from $5.4 billion in 2018. While Fortis Inc.'s credit metrics are based on consolidated results that include underlying regulated Fortis businesses such as FEI and FBC, the May 2021 credit rating upgrade by DBRS was due to a significant decrease in leverage and not to the agency's views on the underlying regulated Fortis businesses. Please refer to the Fortis Inc. DBRS Report dated May 20, 2021 for more information related to the upgrade (included in Appendix D).

35.3. Confirm that it is easier for FEI and FBC to raise capital when Fortis Inc. has a higher (versus lower) credit rating.

35.3.1. If not confirmed, please explain.

Response:

Fortis Inc.'s credit rating does not have a material effect on FEI's and FBC's ability to raise debt, unless investors had doubts about Fortis Inc.'s ability to provide required equity funding, which would only occur if Fortis Inc. were experiencing significant financial challenges. FEI and FBC have their own external credit ratings provided by Moody's and DBRS which investors use to decide whether the FortisBC utilities should be invested in. In addition, other factors such as an investor's portfolio, timing of the debt issuance, proposed yield, bond tenor and sizing and whether an investor has a specific ESG mandate play a role when raising debt.