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October 20, 2022

British Columbia Public Interest Advocacy Centre
Suite 803 470 Granville Street
Vancouver, B.C.
V6C 1V5

Attention: Ms. Leigha Worth, Executive Director

Dear Ms. Worth:

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 British Columbia Public Interest Advocacy Centre representing the British Columbia Old Age Pensioners' Organization, Active Support Against Poverty, Disability Alliance BC, Council of Senior Citizens' Organizations of BC, Together Against Poverty Society, and the Tenant Resource and Advisory Centre *et al.* (BCOAPO) Information Request (IR) No. 1 on FortisBC Rebuttal Evidence

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On January 18, 2021, BCUC initiated the proceeding referenced above. In accordance with the regulatory timetable established in British Columbia Utilities Commission Order G-217-22A for the review of FortisBC's Evidence, FortisBC respectfully submits the attached response to BCOAPO Rebuttal IR No. 1.

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

86.0 Reference: Exhibit B1-21, Part 1, page 5

Exhibit B1-8, page 31, Table 6-1

Preamble: The Reply Evidence states:

"FortisBC notes that there have been certain instances for both FEI and FBC where the debt issuance timing has shifted because of volatile and unpredictable market conditions, most recently during the COVID-19 pandemic."

86.1 Is FortisBC Utilities aware of any companies with an "investment grade rating" (per Table 6-1) that found it necessary to shift the timing of their debt issuances during the COVID-19 pandemic?

<u>Response:</u>

FortisBC does not possess this information as it is confidential in nature and not typically shared with external parties. However, in response to BCOAPO IR2 81.1 Concentric discussed research that was compiled by Florida Power & Light Company (FPL) bankers and provided to FPL's regulator in its 2021 rate case that included a list of investment grade companies that either were not able to issue debt during the COVID-19 Pandemic or had to issue debt at very expensive terms to attract investor interest due to significant market volatility during COVID-19 Pandemic.

86.2 Is Concentric aware of any companies with an "investment grade rating" (per Table 6-1) that found it necessary to shift the timing of their debt issuances during the COVID-19 pandemic?

<u>Response:</u>

Concentric provides the following response:

Yes, Concentric is aware of companies with an investment grade credit rating that had to postpone planned debt offerings during the COVID-19 pandemic. For example, Entergy Corp. and Appalachian Power both had to cancel debt offerings in March 2020. In addition, other investment grade companies were able to issue debt, but at much higher than normal spreads over Treasury bonds. For example, Dominion Energy and Union Electric were able to raise capital in March 2020, but the spread over treasuries was much higher than usual – 200 basis points for Union Electric's secured debt and 265/275 bps for Dominion Energy's unsecured debt. Moreover, utilities that usually issue 30 year bonds were using much shorter terms, such as 5-10 years, in order to access the credit market during this period.

87.0 Reference: Exhibit B-21, Part 1, pages 6-7 (Table 1)

Exhibit B1-8, page 31, Table 6-1

Preamble: The Reply Evidence states:

> "As shown, the two metrics highlighted in Dr. Lesser's response as important credit metrics (capitalization ratio and interest coverage ratio) are each given 7.5% weighting in Moody's rating grid while other credit metrics, namely CFO Pre-WC/Debt and CFO Pre-WC – Dividends/Debt are given 15 percent and 10 percent weighting respectively indicating their higher level of importance".

87.1 It is noted that the total weighting applied by Moody's to the two sub-factors under "ability to recover costs and earn return" also totals 25%. Is FortisBC Utilities or Concentric aware of the measures used by Moody's to assess i) Timeliness of Recovery of Operating Costs and ii) Sufficiency of Rates and Returns?

87.1.1 If yes, what are they and what "values" are required to receive an investment grade rating (per Table 6-1)?

87.1.2 If yes, please provide the values for each of the two measures for FortisBC Energy Inc. and FortisBC Inc. for the years 2018-2021.

<u>Response:</u>

The following excerpts are from Moody's rating methodology:

- **How We Assess Timeliness of Recovery of Operating and Capital Costs for the Scorecard** - the criteria we consider include provisions and cost recovery mechanisms for operating costs, mechanisms that allow actual operating and/or capital expenditures to be trued-up periodically into rates without having to file a rate case (this may include formula rates, rider and trackers, or the ability to periodically adjust rates for construction work in progress) as well as the process and timeframe of general tariff/base rate cases – those that are fully reviewed by the regulator, generally in a public format that includes testimony of the utility and other stakeholders and interest groups. We also look at the track record of the utility and regulator for timeliness. For instance, having a formula rate plan is positive, but if the actual process has included reviews that are delayed for long periods, it may dampen the benefit to the utility. In addition, we seek to estimate the lag between the time that a utility incurs a major construction expenditures and the time that the utility will start to recover and/or earn a return on that expenditure.

- **How We Assess Sufficiency of Rates and Returns for the Scorecard** - the criteria we consider include statutory protections that assure full cost recovery and a reasonable return for the utility on its investments, the regulatory mechanisms used to determine what a reasonable return should be, and the track record of the utility in actually recovering costs and earning returns. We examine outcomes of rate cases/tariff reviews and compare them to the request submitted by the utility, to prior rate cases/tariff reviews for the same utility and to recent rate/tariff decisions for a peer group of comparable utilities. In this context, comparable utilities are typically utilities in the same or similar jurisdiction. In cases where the utility is unique or nearly unique in its jurisdiction, comparison will be made to other peers with an adjustment for local differences, including prevailing rates of interest and returns on capital, as well as the timeliness of rate-setting. We look at regulatory disallowances of costs or investments, with a focus on their financial severity and also on the reasons given by the regulator, in order to assess the likelihood that such disallowances will be repeated in the future.

Per Moody's rating methodology, the following is required for these two factors for investment level ratings:

Factor 2a: Timeliness of Recovery of Operating and Capital Costs (12.5%)

Aaa	Aa	A	Baa
Tariff formulas and automatic cost recovery mechanisms provide full and highly timely recovery of all operating costs and essentially contemporaneous return on all incremental capital investments, with statutory provisions in place to preclude the possibility of challenges to rate increases or cost recovery mechanisms. By statute and by practice, general rate cases are efficient, focused on an impartial review, quick, and permit inclusion of fully forward-looking costs.	Tariff formulas and automatic cost recovery mechanisms provide full and highly timely recovery of all operating costs and essentially contemporaneous or near-contemporaneous return on most incremental capital investments, with minimal challenges by regulators to companies' cost assumptions. By statute and by practice, general rate cases are efficient, focused on an impartial review, of a very reasonable duration before non-appealable interim rates can be collected, and primarily permit inclusion of forward-looking costs.	Automatic cost recovery mechanisms provide full and reasonably timely recovery of fuel, purchased power and all other highly variable operating expenses. Material capital investments may be made under tariff formulas or other rate-making permitting reasonably contemporaneous returns, or may be submitted under other types of filings that provide recovery of cost of capital with minimal delays. Instances of regulatory challenges that delay rate increases or cost recovery are generally related to large, unexpected increases in sizeable construction projects. By statute or by practice, general rate cases are reasonably efficient, primarily focused on an impartial review, of a reasonable duration before rates (either permanent or non-refundable interim rates) can be collected, and permit inclusion of important forward-looking costs.	Fuel, purchased power and all other highly variable expenses are generally recovered through mechanisms incorporating delays of less than one year, although some rapid increases in costs may be delayed longer where such deferrals do not place financial stress on the utility. Incremental capital investments may be recovered primarily through general rate cases with moderate lag, with some through tariff formulas. Alternately, there may be formula rates that are untested or unclear. Potentially greater tendency for delays due to regulatory intervention, although this will generally be limited to rates related to large capital projects or rapid increases in operating costs.

Factor 2b: Sufficiency of Rates and Returns (12.5%)

Aaa	Aa	A	Baa
Sufficiency of rates to cover costs and attract capital is (and will continue to be) unquestioned.	Rates are (and we expect will continue to be) set at a level that permits full cost recovery and a fair return on all investments, with minimal challenges by regulators to companies' cost assumptions. This will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are strong relative to global peers.	Rates are (and we expect will continue to be) set at a level that generally provides full cost recovery and a fair return on investments, with limited instances of regulatory challenges and disallowances. In general, this will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are generally above average relative to global peers, but may at times be average.	Rates are (and we expect will continue to be) set at a level that generally provides full operating cost recovery and a mostly fair return on investments, but there may be somewhat more instances of regulatory challenges and disallowances, although ultimate rate outcomes are sufficient to attract capital without difficulty. In general, this will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are average relative to global peers, but may at times be somewhat below average.

Both FEI and FBC were rated "Aa" for timeliness of recovery of operating and capital costs and "Baa" for sufficiency of rates and returns from 2018 to 2021.

88.0 Reference: Exhibit B-21. Part 1, page 7

Exhibit B1-8, page 33 (Table 6-4) and page 39 (Table 6-7)

Preamble: The Reply Evidence states:

> "In its primary evidence, FBC discussed that its CFO pre-W/C to debt metric for the two years ending 2020 and 2019 were 8.6 and 8.8 percent, respectively, which means that this financial metric is critically close to a rating downgrade threshold of 8 percent. To put this in perspective, 2019 was the first time in the last 10 years that this metric has been below 9 percent".

88.1 Please update Tables 6-4 and 6-7 to include the most recent values available.

<u>Response:</u>

Financial metrics for LTM Sept 2021 included in Tables 6-4 and 6-7 are the most recent values available from Moody's. Moody's has not completed its assessment of 2021 financial metrics as the annual review for FEI and FBC typically occurs in Q3 to Q4 of the year and the latest rating reports available are from November 25, 2021.

89.0 Reference: Exhibit B1-21, Part 2, pages 6-7

Exhibit B1-8-1, Appendix C, pages 160-161

(Figures 66, 67 and 68)

89.1 Did Concentric's calculations (per Figures 66, 67 and 68) of the results based on Dr. Lesser's methodologies include using Dr. Lesser's preferred proxy groups?

89.1.1 If not, please provide revised versions of the Figures based on Dr. Lesser's proxy groups

89.1.2 If not, please provide revised versions of the Figures based on Dr. Lesser's proxy groups – excluding those companies engaged in M&A activity (per page 6).

89.1.3 If yes, please provide revised versions of the Figures based on Dr. Lesser's proxy groups – excluding those companies engaged in M&A activity (per page 6).

<u>Response:</u>

Concentric provides the following response:

When Figures 66, 67 and 68 were developed, Concentric did not have Dr. Lesser's preferred proxy groups.

Please refer to the responses to BCUC Rebuttal IR1 2.1 and 2.2 for revised figures based on Dr. Lesser's proxy groups.

90.0 Reference: Exhibit B1-21, Part 2, page 11

Exhibit B1-8-1, Appendix C, pages 160-163

(Figures 66, 67, 68, 69 and 70)

90.1 Did Concentric's calculations (per Figures 66, 67 and 68) of the results based on Dr. Lesser's methodologies include using Dr. Lesser's preferred source for EPS growth rates?

90.1.1 If not, please provide revised versions of the Figures 66, 67 and 68 based on Dr. Lesser's preferred source for EPS growth rates.

90.1.2 If not, please provide revised versions of the Figures 66, 67 and 68 based on Dr. Lesser's preferred source for EPS growth rates – excluding those companies engaged in M&A activity (per page 6).

90.1.3 If yes, please provide revised versions of the Figures 66, 67 and 68 based on Dr. Lesser's preferred source for EPS growth rates – excluding those companies engaged in M&A activity (per page 6).

<u>Response:</u>

Concentric provides the following response:

Yes, Concentric used Dr. Lesser's preferred source for EPS growth rates (i.e., Yahoo Finance) in the Multi-Stage DCF results shown in Figures 66, 67, and 68.

Revised versions of Figures 66, 67 and 68 are provided below using Dr. Lesser's preferred source for EPS growth rates (i.e., Yahoo Finance) and excluding those companies engaged in M&A activity. Please refer to Attachment 90.1.3a for the underlying analysis for FEI (revised figure 66), Attachment 90.1.3b for FBC (revised figure 67), and Attachment 90.1.3c for FBC including the Hamada adjustment (revised figure 68).

Revised Figure 66: Summary of Gas Results – Lesser inputs [1]

	Canadian Regulated Utilities	US Gas Utilities	North American Gas Utilities
CAPM	10.7%	10.6%	10.9%
Multi-Stage DCF	10.5%	9.3%	9.9%
Avg.	10.6%	9.9%	10.4%

[1] Results include adjustment of 50 bps for flotation costs and financial flexibility.

Revised Figure 67: Summary of Electric Results – Lesser inputs[2]

	Canadian Regulated Utilities	US Electric Utilities	North American Electric Utilities
CAPM	10.7%	11.1%	10.8%
Multi-Stage DCF	10.5%	8.8%	9.1%
Avg.	10.6%	10.0%	9.9%

Revised Figure 68: Summary of Gas Results – Lesser inputs[3]

	Canadian Regulated Utilities	US Gas Utilities	North American Gas Utilities
CAPM	12.1%	11.6%	11.8%
Multi-Stage DCF	10.5%	9.3%	9.9%
Avg.	11.3%	10.4%	10.9%

90.2 Should the BCUC determine that a single source should be used for EPS growth rates, what source would Concentric recommend?

Response:

Concentric provides the following response:

As discussed in Mr. Coyne's rebuttal testimony, only Yahoo Finance and SNL Financial provide EPS growth rates for most companies in both Canada and the U.S. Zacks and Value Line do not provide EPS growth rates for many of the Canadian companies. For this reason, Concentric believes it is reasonable to consider growth rate forecasts from multiple sources because that is what an investor would do.

2 Ibid.
3 Ibid.

90.2.1 Please provide revised versions of Figures 69 and 70 using just this source for EPS growth rates using Dr. Lesser's methodologies.

Response:

Concentric provides the following response:

Please refer to the response to BCUC Rebuttal IR1 3.1.1 for the results of Mr. Coyne's DCF analysis if he had relied solely on EPS growth rates from Yahoo Finance.

91.0 Reference: Exhibit B1-21, Part 2, pages 12-13

Exhibit B1-8-1, Appendix C, pages 162-163 (Figures 69 and 70)

Preamble: The Rebuttal Evidence states:

> "Finally, my recommendations are based on the average results of my CAPM and Multi- Stage DCF models, obviating concerns with the constant growth DCF model." (emphasis added)

91.1 Was the MRP that was used for Concentric's CAPM Model results based on the Constant Growth DCF Model or the Multi-Stage DCF Model?

91.1.1 If based on the Constant Growth DCF Model, is the statement referenced in the Preamble still correct?

91.1.2 If based on the Constant Growth DCF, please provide revised versions of Figures 69 and 70 where the MRP for the CAPM results is based on the Multi-Stage DCF Model.

Response:

Concentric provides the following response:

Concentric's CAPM results are based on the average of the historical and forward-looking MRP in Canada and the U.S. For the forward-looking MRP, the calculation is based on the Constant Growth DCF model, as discussed on pages 59-60 of Concentric's January 2022 report.

Yes, the statement referenced in the preamble is still correct. Addressing the issue of the constant growth DCF estimation procedure for the MRP, Mr. Coyne has mitigated concern for use of the constant growth version by averaging the resulting MRP with the historical MRP, producing a result well below the constant growth DCF version (see Coyne Direct, p. 4, footnote 1). Mr. Coyne's approach is consistent with the FERC, which uses an average of the Two-Stage DCF model and the forward-looking CAPM to establish the authorized ROE for electric transmission companies. Even though FERC uses an average of the Two-Stage DCF model and the CAPM to establish the authorized return, FERC uses the Constant Growth DCF model, not the Multi-Stage DCF model, to compute the total return for the broad market, as explained on pages 16-17 of Mr. Coyne's rebuttal testimony and on page 61 of Concentric's January 2022 report.

Please refer to the response to BCUC Rebuttal IR1 5.2 for the requested information.

92.0 Reference: Exhibit B1-8-1, Appendix C, page 60

Exhibit B1-21, page 14

Preamble: The Initial Concentric Evidence states:

"The forward-looking MRP is calculated by subtracting the risk-free rate for each country from the estimated total return for the overall market, as calculated using the DCF methodology for the S&P/TSX Composite Index in Canada and the S&P 500 Index in the U.S."

The Rebuttal Evidence states:

"Under current market circumstances, when interest rates are changing rapidly as central banks in both Canada and the U.S. normalize monetary policy in response to higher than expected inflation after a period of extraordinary policy accommodation, the use of a current average risk-free rate tends to understate the level of interest rates during the period for which the cost of equity is being set. Interest rates on government bonds in June 2022 are much closer to the levels in the Consensus Economics' forecast from October 2021 than to the historical average level as of December 2021."

92.1 Please confirm that the market data (e.g., stock prices, dividend yields, EPS growth rates, etc.) used in Concentric's determination of the MRP for its CAPM Models were based on values for December 2021.

92.1.1 If not confirmed what was the basis for the values used?

<u>Response:</u>

Concentric provides the following response:

Confirmed. Concentric's ROE analysis was based on market data as of December 31, 2021.

92.2 What would be the results of Concentric's CAPM Models (gas and electric) if based on market data from June 2022?

<u>Response:</u>

Concentric provides the following response:

Mr. Coyne did not perform this analysis. As indicated in his rebuttal testimony, Mr. Coyne offered to update his ROE analysis before the hearing in November. The BCUC determined that an update based on end of September 2022 market data was appropriate, and Mr. Coyne has provided such an update along with the responses to these information requests.

93.0 Reference: Exhibit B-1-21, Part 2, page 17

Preamble: The Rebuttal Evidence quotes a FERC Opinion as follows:

> "the S&P 500 is regularly updated to include only companies with high market capitalization"

93.1 Is the S&P/TSX Composite Index in Canada also regularly updated to include only companies with high market capitalization?

Response:

Concentric provides the following response:

Yes. The TSX Composite Index is a benchmark index of approximately 250 companies that represents around 70 percent of the total market capitalization of the Toronto Stock Exchange. Companies must maintain strict liquidity and capitalization requirements in order to remain part of the TSX Index.

93.2 Does regular updating of these indices for only companies with high market capitalization bias their use as a measure for overall market returns?

93.2.1 If not, why not?

Response:

Concentric provides the following response:

No, regular updating of the TSX and S&P 500 indices does not bias their use as a measure of overall market returns. This is the return data that is used by sources such as Duff and Phelp's (now Kroll) to compute the historical average return data for both the U.S. and Canada. Further, in the U.S., S&P also maintains indices of midcap (400 companies) and small cap (600 companies) firms, which have higher average historical returns than large cap companies in the S&P 500. If those companies were included, the overall return would be somewhat higher than that of the S&P 500. In addition, focusing on the total returns for the benchmark indices is an appropriate way to measure the overall market return because there are mutual funds and exchange traded funds that track each market index, and those funds adjust their holdings as the composition of the underlying index changes. This is important because it shows that investors have the ability to earn the market return by purchasing an index fund that tracks the overall market. Theoretically, one could construct a market index composed of stocks, bonds, real estate and other investments, but as a practical matter, the broad-based stock market index is commonly used for these purposes.

94.0 Reference: Exhibit B1-21, Part 2, pages 12-13 and 17

Preamble: The Rebuttal Evidence states (page 12):

> "In my Report, I conducted an analysis showing that actual EPS and DPS growth rates exceeded GDP growth for the proxy group companies from 2005-2019. The results of that analysis are shown in Figure 23 on page 52 of my Report."

94.1 Has Concentric done any analysis as to whether the overall EPS and DPS growth rates for the S&P 500 Index companies in the US or the S&P/TSX Composite Index companies in Canada have historically exceeded the respective GDP growth rates in each country?

94.1.1 If yes, what were the results?

Response:

Concentric provides the following response:

As indicated in Figure 23, the actual EPS and DPS growth rates for the proxy group companies have exceeded GDP growth from 2005-2019, thereby demonstrating that the use of EPS growth rates in the Constant Growth DCF model is a reasonable measure of long-term growth. On the broader market, Mr. Coyne has identified the following based on available long-term data on the S&P 500 Earnings Growth and Nominal GDP growth:

S&P 500 EPS (Average Annual Growth) 1930 – 2021	9.82%[4]
Nominal GDP Growth (Average Annual Growth) 1930-1921	6.28%[5]

Taking the same data for the most recent three decades, 1990-2021, S&P Earnings growth outpaces GDP growth by an even greater degree:

S&P 500 EPS (Average Annual Growth) 1990 – 2021	15.89%
Nominal GDP (Average Annual Growth) 1990-1921	4.56%

All of these historic indicators demonstrate that the broader market and utilities have grown earnings at a faster rate than GDP growth.

4 https://www.in2013dollars.com/us-economy/s-p-500-earnings.
5 https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=2&isuri=1&1921=survey.

95.0 Reference: Exhibit B1-21, Part 2, pages 17-18

Preamble: The Rebuttal Evidence states:

> "Q. Are there any other differences in the MRP in your CAPM analysis and the approach preferred by Dr. Lesser?
>
> A. Yes. I have used an average of the historical MRP and the forward-looking MRP in my CAPM analysis, which is more conservative than relying solely on the forward- looking MRP. By contrast, both Dr. Lesser and FERC rely solely on a forward-looking MRP in the CAPM. If I were to use only the forward-looking MRP, my CAPM results would have been 180-190 basis points higher."

95.1 Was the forward-looking MRP used by Concentric for purposes of determining the "Dr. Lesser" results in the above comparison based on the Constant Growth DCF Model or the Multi-Stage DCF Modell?

95.1.1 If the Constant Growth DCF Model was used please revise the comparison based on using the Multi-Stage DCF Model to determine the forward-looking MRP for the "Dr. Lesser" results.

Response:

Concentric provides the following response:

The forward-looking MRP was based on the Constant Growth DCF model, as described in the response to BCOAPO Rebuttal IR1 91.1.

Please refer to the response to BCUC Rebuttal IR1 5.1 (which refers back to the response to BCUC IR2 84.1.1) for the requested information.

Attachment 90.1.3a

REFER TO LIVE SPREADSHEET MODEL

Provided in electronic format only

(accessible by opening the Attachments Tab in Adobe)

Attachment 90.1.3b

REFER TO LIVE SPREADSHEET MODEL

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(accessible by opening the Attachments Tab in Adobe)

Attachment 90.1.3c

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