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Sent via eFile

BCUC GENERIC COST OF CAPITAL EXHIBIT A-4

To: All Registered Parties

Re: British Columbia Utilities Commission – Generic Cost of Capital – Project No. 1599176 – Proceeding Scope and Further Regulatory Timetable

Further to the British Columbia Utilities Commission's (BCUC) Proceeding Notice issued January 18, 2021, by the attached Order G-156-21 with Reasons, the BCUC establishes the Generic Cost of Capital proceeding's scope and a further regulatory timetable.

Sincerely,

Original signed by Jessica O'Brien on behalf of:

Patrick Wruck
Commission Secretary

/jb
Enclosure



ORDER NUMBER
G-156-21

IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

British Columbia Utilities Commission
General Cost of Capital Proceeding

BEFORE:

D. M. Morton, Panel Chair
A. K. Fung, QC, Commissioner
K. A. Keilty, Commissioner
T. A. Loski, Commissioner

on May 21, 2021

ORDER

WHEREAS:

- A. By Order G-66-21 dated March 8, 2021, pursuant to section 82 of the *Utilities Commission Act*, the British Columbia Utilities Commission (BCUC) established a Generic Cost of Capital (GCOC) proceeding. Order G-66-21 included the following items:
- i. an initial Regulatory Timetable;
 - ii. a Preliminary Scoping Document containing a list of matters to be examined and determined for registered participants to provide their submissions on by March 31, 2021;
 - iii. a List of 21 Utilities regulated by the BCUC categorized as either Affected Utilities (5) or Other Utilities (16); and
 - iv. a Public Notice of the GCOC proceeding;
- B. By the March 22, 2021 registration date, a total of five Affected Utilities and five Other Utilities registered. Seven non-utility parties and two Other Utilities registered as Interveners;
- C. By March 31, 2021, submissions regarding the Preliminary Scoping Document were received from FortisBC Energy Inc. (FEI), FortisBC Inc. (FBC), Corix Multi-Utility Services Inc. (Corix), Pacific Northern Gas Ltd. (PNG) and Pacific Northern Gas (N.E.) Ltd. (PNGNE) (collectively PNG), FortisBC Alternative Energy Service Inc. (FAES), Nelson Hydro, Kyuquot Power Ltd. (KPL), Creative Energy Vancouver Platforms Inc. (Creative Energy), River District Energy (RDE), Residential Consumer Intervener Association (RCIA), Movement of United Professionals (MoveUP), Association of Major Power Customers of BC (AMPC), Industrial Customers Group (ICG), the Commercial Energy Consumers Association of British Columbia (CEC), British Columbia Old Age

Pensioners' Organization, Active Support Against Poverty, Disability Alliance BC, Council of Senior Citizens' Organizations of BC, Tenants Resource and Advisory Centre, and Together Against Poverty Society (BCOAPO), and BCUC Staff; and

- D. The Panel has reviewed the submissions received and determines that an order to establish the GCOC proceeding scope and to establish a further Regulatory Timetable is warranted.

NOW THEREFORE the BCUC orders as follows:

1. As set out in the Reasons for Decision attached as Appendix A to this Order, the scope for the GCOC proceeding is established as attached in Appendix B to this Order.
2. A further Regulatory Timetable is established as set out in Appendix C to this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 21st day of May 2021.

BY ORDER

Original signed by:

D. M. Morton
Commissioner

Attachments

British Columbia Utilities Commission
Generic Cost of Capital Proceeding

REASONS FOR DECISION

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1.0 Introduction

On January 18, 2021, the British Columbia Utilities Commission (BCUC) issued a notice to all regulated entities and interveners in past proceedings that the BCUC will initiate a Generic Cost of Capital (GCOC) proceeding. On March 8, 2021, the BCUC issued Order G-66-21 to establish the GCOC proceeding, and attached four items: an Initial Regulatory Timetable; a Preliminary Scoping Document; a List of Utilities regulated by the BCUC categorized as either Affected Utilities and Other Utilities; and a Public Notice.

In these Reasons for Decision, the Panel will review the submissions received by the registered participants and establish the scope for the GCOC proceeding.

1.1 Order G-66-21

In Appendix B of Order G-66-21, the BCUC identified five matters it intends to review as part of the GCOC proceeding and invited registered participants to provide submissions:

- a. Whether the BCUC should establish the Cost of Capital effective January 1, 2022, including public utilities' capital structure and return on common equity.
- b. Should the BCUC continue to establish public utilities' Cost of Capital using a two-stage mechanism, where Stage 1 sets the benchmark return on equity (ROE)(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?
 - 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)?
- 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)?
- d. Whether re-establishment of a formulaic ROE Automatic Adjustment Mechanism (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?
- 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.

1.2 Registered Utilities and Interveners

The List of Utilities included in Appendix C to Order G-66-21 categorizes utilities regulated by the BCUC as either Affected Utilities or Other Utilities. Affected Utilities are those in this GCOC proceeding that are expected to take a lead role in filing evidence for cost of capital matters that may impact them. All Affected Utilities identified in Appendix C to Order G-66-21 have registered for the GCOC proceeding.

The following Affected Utilities have registered:

- FortisBC Energy Inc. (FEI)
- FortisBC Inc. (FBC)
- Corix Multi-Utility Services Inc. (Corix)
- Pacific Northern Gas Ltd. (PNG) and Pacific Northern Gas (N.E.) Ltd. (PNGNE) (collectively PNG)

The following Other Utilities have registered:

- FortisBC Alternative Energy Service Inc. (FAES)
- Nelson Hydro
- Kyuquot Power Ltd. (KPL)
- Creative Energy Vancouver Platforms Inc. (Creative Energy)
- River District Energy (RDE)

The following parties have registered as Interveners:

- Residential Consumer Intervener Association (RCIA)
- Movement of United Professionals (MoveUP)
- Clean Energy Association of BC (CEABC)
- Association of Major Power Customers of BC (AMPC)
- Industrial Customers Group (ICG)
- Commercial Energy Consumers Association of British Columbia (CEC)
- British Columbia Old Age Pensioners' Organization, Active Support Against Poverty, Disability Alliance BC, Council of Senior Citizens' Organizations of BC, Tenants Resource and Advisory Centre, and Together Against Poverty Society (BCOAPO),
- British Columbia Hydro and Power Authority (BC Hydro)
- Boralex Ocean Falls Limited Partnership (Boralex)

1.3 Past Cost of Capital Orders

The current framework to review a public utility's cost of capital was generally established by the previous GCOC proceeding which was conducted in a two-stage process. By Order G-75-13, with accompanying decision dated May 10, 2013, the BCUC in its Stage 1 decision established that FEI would serve as the benchmark (Benchmark Utility) for any other utility in British Columbia (BC) that uses a Benchmark Utility to set rates. The Benchmark Utility's common equity component was set at 38.5 percent and the ROE was set at 8.75 percent, effective January 1, 2013.

In Stage 2, by Order G-47-14 with accompanying decision dated March 25, 2014, the BCUC reviewed and determined the cost of capital for all other utilities that use the Benchmark Utility to set its ROE.

In October 2015, FEI filed an application for its Common Equity Component and Return on Equity for 2016 pursuant to the BCUC's GCOC Stage 1 proceeding. By Order G-129-16 with accompanying decision dated August 10, 2016, the BCUC reaffirmed the Benchmark Utility's cost of capital and suspended use of an AAM as a mechanism to adjust FEI's return on equity on an annual basis.

In this GCOC proceeding, as established by Order G-66-21 dated March 8, 2021, the BCUC intends to establish a method to determine the appropriate Cost of Capital for regulated utilities in British Columbia. This GCOC proceeding will also review the appropriateness of continuing the use of a Benchmark Utility, and if so, how to determine the appropriate cost of capital for the Benchmark Utility.

2.0 Submissions Received

Utilities and interveners expressed general support for the GCOC Preliminary Scoping Document issued as part of Order G-66-21. Written submissions on the Preliminary Scoping Document were received by March 31, 2021 as outlined in the Regulatory Timetable.

Recurring themes of interest amongst participants include the timing of the GCOC proceeding, the continued use of FEI as the Benchmark Utility, the ability of small utilities to actively participate, and BC Hydro's involvement in this GCOC proceeding. The Panel also notes that most participants had no comments on the BCUC Staff submission on the Preliminary Scoping Document.

In the section below, the Panel reviews the submissions received and additional related matters, followed by the Panel's comments and determination. The section is organized as follows:

Submissions related to the GCOC Preliminary Scoping Document

- Timing of the GCOC proceeding
- Two-stage proceeding
- Re-establishment of ROE AAM
- Deemed Interest Rate
- Deferral account financing scope item

Submissions on additional matters were received from utilities, interveners and BCUC Staff and are organized as follows:

Participation and Process

- BC Hydro's participation
- Small utilities' participation
- Nelson Hydro's participation
- Trigger for future proceeding

Cost of Capital Determination

- Equity Risk Premium and Minimum Default Capital Structure
- Consideration for contextual issues and market trends

2.1 Submissions related to the GCOC Preliminary Scoping Document

2.1.1 Timing of the GCOC proceeding

The BCUC sought submissions on whether the GCOC proceeding should establish the Cost of Capital to be used in rates effective January 1, 2022, including public utilities' capital structure and return on common equity. Parties commented on the timing of the proceeding in light of several factors regarding the financial market and other regulatory filing timelines.

The BCUC also sought submissions on how the GCOC proceeding should consider the initial transition year from January 1, 2022 to December 31, 2022 such as setting interim rates for utilities affected by the GCOC proceeding until a final decision is rendered. Parties commented on this matter highlighting the need for regulatory efficiencies and minimizing the length of time that interim rates would have to remain in place.

Submissions by the Parties

FortisBC,¹ PNG, and Creative Energy submit that there may be value in postponing the GCOC proceeding until later in 2021 or early 2022 due to uncertainties in current economic conditions.² FortisBC cites that the Alberta Utilities Commission's (AUC) March 2021 decision³ noted that the data that would normally be used to determine a utility's fair return continue to remain in flux and utilities may need to update the evidence during the course of a proceeding. Further, FortisBC submits that the GCOC proceeding can benefit from upcoming regulatory applications, sharing in the efficiencies of foundational evidence used in risk analysis as well as consideration of government policy on demand and price competitiveness. Upcoming regulatory applications include FortisBC's upcoming Long-Term Resource Plans and comprehensive review and assessment of the Renewable Natural Gas (RNG) program. FortisBC also cites BCUC Order G-293-20 which noted that the passage of time, alone, is not a sufficient reason to initiate a cost of capital proceeding and that volatility in financial markets by itself does not imply that investors' opportunity costs or risk profiles have changed.⁴

However, ICG and RCIA object to FortisBC's request to delay the GCOC proceeding.⁵ MoveUP notes that FortisBC's submission to extend the proceeding by one year assumes that economic volatility will subside over the coming months, but this is difficult to assess.⁶

Regarding the January 1, 2022 rates effective date, several utilities submit, and MoveUP agrees, that a prolonged period of interim rates causes regulatory and administrative inefficiencies due to potentially large adjustments in customers' bills and uncertainties for investors to know their return on invested capital. It would be ideal to have rates set on a prospective basis to avoid interim rates and retroactive adjustments.⁷

¹ FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC), collectively, FortisBC.

² Exhibit B1-2, FortisBC, p. 2; Exhibit B9-2, PNG, p. 2; Exhibit B7-2, Creative Energy Vancouver Platforms Inc. (Creative Energy), p. 1.

³ AUC Decision 26212-D01-2021 retrieved from <https://efiling-webapi.auc.ab.ca/Document/Get/685809>; Exhibit B1-2, FortisBC, pp. 2–3.

⁴ BCUC Order [G-293-20](#); Exhibit B1-2, FortisBC, pp. 2–3.

⁵ Exhibit C1-2, Residential Consumer Intervenor Association (RCIA), p. 1; Exhibit C5-2, ICG, p. 2.

⁶ Exhibit C2-2, MoveUP, p. 1.

⁷ Exhibit B1-2, FortisBC, p. 3; Exhibit B8-2, River District Energy (RDE), p. 2; Exhibit B9-2, PNG, p. 2; Exhibit C2-2, MoveUP, p. 3.

Panel Determination

The Panel finds it appropriate to continue, without delay, with the hearing that has been established by Order G-66-21.

The Panel notes that while there are uncertainties in economic conditions, volatility in financial markets and changes in government policies are uncertainties that always exist. The Panel is not persuaded that market uncertainty warrants a delay of the GCOC proceeding. It is unclear to the Panel why some parties argue that a cost of capital review is only relevant under stable conditions. The determination of a fair return for regulated utilities at regular intervals is necessary given the BCUC's mandate under sections 59 and 60 of the *Utilities Commission Act* (UCA). Further, while the Panel acknowledges there are upcoming regulatory applications that could benefit from the decisions flowing out of this GCOC proceeding, as identified by FortisBC, the GCOC proceeding impacts all utilities regulated in British Columbia and not just those utilities with pending applications.

Regarding timing, the Panel finds that the effective date to implement a new cost of capital will depend on the timing and progress of this GCOC proceeding. Therefore, it would be premature at this time to decide on the cost of capital effective date and whether interim rates are necessary or not. The same would also apply to any other effective dates that were noted in the Preliminary Scoping Document such as for the ROE AAM and debt interest rate which are discussed further below. If a transition period is required, this will be determined at a later point in the GCOC proceeding. The Panel acknowledges the utilities' submissions on inefficiencies that can occur with a prolonged period of interim rates and encourages thoughtful and timely participation from all parties to ensure an efficient and effective GCOC proceeding.

2.1.2 Two-stage proceeding

The BCUC sought submissions on whether the GCOC proceeding should review the matter of continuing to establish public utilities' Cost of Capital using a two-stage mechanism. The two-stage mechanism comprises of Stage 1 where the Benchmark ROE is set based on a Benchmark Utility and Stage 2 where the BCUC determines each utility's Cost of Capital in reference to the Benchmark Utility. Further, the BCUC sought submissions on whether certain public utilities can be grouped together.

Submissions by the Parties

The parties commented with general support for the two-stage proceeding but offered differing views on an appropriate benchmark and grouping of utilities.

The majority of utilities and interveners support a two-stage proceeding with the use of a Benchmark Utility.⁸ For example, FortisBC submits that the GCOC proceeding should follow the two-stage approach of previous GCOC proceedings, and make this determination upfront to promote an efficient process.⁹ The CEC suggests a four-stage proceeding to include an initial GCOC decision based on FEI, followed by an application specific to Corix and FBC, then followed by an application specific to the grouping of Other Utilities, and lastly an application specific to BC Hydro.¹⁰

⁸ Exhibit B1-2, FortisBC, p. 4; Exhibit B7-2, Creative Energy, p. 2; Exhibit B8-2, RDE, p. 2; Exhibit B9-2, PNG, p. 2; Exhibit C2-2, MoveUP, p. 2; Exhibit C6-2, the CEC, p. 2.

⁹ Exhibit B1-2, FortisBC, p. 4.

¹⁰ Exhibit C6-2, the CEC, p. 2.

In regard to the appropriate Benchmark Utility, FortisBC submits that the BCUC should reaffirm at this time that FEI will continue to be used as the Benchmark Utility as it has been for the last 27 years.¹¹ In contrast, ICG submits FEI's business risks may have changed and therefore, FEI may no longer be an appropriate Benchmark Utility.¹²

Regarding the topic of whether certain public utilities can be grouped together to have an established Cost of Capital for the groups, the submissions vary. For example, FortisBC view the grouping of the public utilities into two or more groups is unnecessary and less efficient than using a single Benchmark Utility.¹³ Other utilities submit that certain public utilities may be grouped together given the evolution of utilities and sector over time. Corix and Creative Energy submit it would be beneficial for the BCUC to provide proceeding participants with a list of current / proposed members of each public utility group and that the characteristics of any such groupings might only be considered within a Stage 2 proceeding to follow the establishment of a capital structure and return on equity for a Benchmark Utility.¹⁴

Panel Determination

The Panel finds a two-stage proceeding to establish public utilities' Cost of Capital is appropriate. The scope attached as Appendix B to this Order reflects the two-stage process for this GCOC proceeding.

In Stage 1, the Panel will consider the need for a Benchmark Utility, and if applicable, which entity would be designated as the Benchmark Utility and the cost of capital for the Benchmark Utility. The Panel notes that a long history of using a particular utility as the Benchmark Utility should not presume continued usage. As part of this GCOC proceeding, registered participants will have the opportunity to submit evidence and examine whether the use of a Benchmark Utility is appropriate, and if so, the cost of capital for such Benchmark Utility.

If the Panel in Stage 1 determines that the use of a Benchmark Utility is not warranted, the Panel would then advance to Stage 2. In Stage 2, the Panel will consider a) the grouping of utilities, if warranted, and b) the cost of capital for each public utility, or groups of public utilities (with the exception for BC Hydro).

2.1.3 Re-establishment of ROE AAM

The BCUC sought submissions on whether the scope of the GCOC proceeding should review the re-establishment of a formulaic ROE AAM, and if so, the specifications of such a formula and whether the ROE AAM should be implemented starting on January 1, 2023 on an annual basis. Parties express general support for an ROE AAM with considerations of several factors that should be contemplated as part of the formula.

Submissions by the Parties

The majority of utilities and interveners support the inclusion of a review for the suitability and potential specifications of an ROE AAM approach.¹⁵ Further, the parties submit that the re-establishment of a formulaic ROE AAM should consider, among other items, utilities' rate levelization plans and revenue deficiency deferral accounts.¹⁶

¹¹ Exhibit B1-2, FortisBC, p. 5.

¹² Exhibit C5-2, ICG, p. 3.

¹³ Exhibit B1-2, FortisBC, p. 7.

¹⁴ Exhibit B6-2, Corix, pp. 2–3; Exhibit B7-2, Creative Energy, p. 2.

¹⁵ Exhibit B1-2, FortisBC, p. 8; Exhibit B6-2, Corix, p. 3; Exhibit C1-2, RCIA, p. 1.

¹⁶ Exhibit B8-2, River District Energy (RDE), p. 3; Exhibit B6-2, Corix, p. 3.

Panel Determination

The Panel finds it appropriate to include the consideration of the re-establishment of a formulaic ROE AAM and the specifications of such a formula in the scope for Stage 1 of the GCOC proceeding.

The Panel notes that a formulaic ROE AAM can be an effective tool for regulatory efficiency. Parties are encouraged to submit evidence regarding the required specifications of such a formula, if an ROE AAM is desirable, and its applicability to a Benchmark Utility (if determined) in Stage 1. Conversely, parties are also encouraged to submit evidence as to why an ROE AAM should not be re-established at this time.

2.1.4 Deemed Interest Rate

The BCUC sought submissions on whether the GCOC proceeding scope should review the circumstances that would require a deemed interest rate and how the deemed interest rate should be established. Further, the BCUC sought submissions regarding considerations of an AAM for a deemed interest rate, implementation for January 1, 2023 and setting a future regulatory process to adjust the rate in future years beyond December 31, 2022. Parties provide general support for the inclusion of a deemed interest rate in the GCOC proceeding.

Submissions by the Parties

The majority of utilities and interveners support the inclusion of deemed interest rate considerations in the scope of the GCOC proceeding even if they are not directly affected by a deemed interest rate.¹⁷ Further, RDE submits that the existing practice for establishing a deemed interest rate should continue, where comparison can reliably be made to prevailing bank interest rates to establish a deemed interest rate within a narrow band.¹⁸

Panel Determination

The Panel finds it appropriate to include the matter of deemed interest rate for utilities, including establishment of the methodology or determination and consideration of an interest rate AAM, in the scope for Stage 2 of the GCOC proceeding.

In Stage 1, the Panel's primary focus is on the merits of using a Benchmark Utility and if applicable, the determination of the Benchmark Utility's cost of capital. The determination of a deemed interest rate is typically a separate review and depends on a utility's circumstances. Therefore, Stage 2 of the GCOC proceeding will consider the deemed interest rate including determination of the circumstances that a deemed interest rate will apply, and the methodology to determine the level of deemed interest rate. Stage 2 of the GCOC proceeding will also include a review of each utility, or a utility group's, circumstances and determine if and how the interest rate will be applied to the respective utility, or utility group.

¹⁷ Exhibit B1-2, FortisBC, p. 8; Exhibit B9-2, PNG, p. 3; Exhibit C7-2, BCOAPO, p. 2.

¹⁸ Exhibit B8-2, RDE, p. 3.

2.1.5 Deferral account financing scope item in GCOC proceeding

Submissions by the Parties

ICG suggests that the Panel consider the appropriate deferral account financing costs in this GCOC proceeding for all utilities in BC because ICG views that deferral account financing is a significant cost to ratepayers.¹⁹ ICG suggests applicable scope related to deferral account financing costs should include the following:

- whether deferral accounts be financed at the utilities return on common equity, long-term debt rate, short-term debt rate, weighted average cost of debt, or weighted average cost of capital; and
- the principles that should guide the BCUC when determining the financing costs for various deferral accounts.

Panel Determination

The Panel makes no determination on this scope item at this time and seeks further submissions from registered participants on whether deferral account financing should be addressed as a scope item in the GCOC proceeding. Participants are requested to provide their submissions by Friday, June 4, 2021.

The Panel notes that other participants have not had the opportunity to make submissions on ICG's proposal on including deferral account financing costs as part of the scope in the GCOC proceeding. Specifically, the Panel invites submissions from participants on the following:

1. Whether deferral account financing costs should form as part of the scope of the GCOC proceeding.
 - a. If so, should the Panel review this matter in Stage 1, Stage 2, or initiate a Stage 3 process?
 - b. If not, why not?

2.2 Submissions regarding other matters

The Panel notes that several matters were proposed as topics to be added to the scope of this GCOC proceeding from utilities, interveners and BCUC Staff.

In this section, the Panel reviews the additional scope items received in the written submissions regarding participation, cost of capital determination and proceeding process followed by the Panel's comments and determinations.

2.2.1 BC Hydro's participation in GCOC proceeding

Submissions by the Parties

Some interveners made submissions on the extent to which BC Hydro should participate in this GCOC proceeding.²⁰ The CEC recommends that BC Hydro should be a participating utility instead of an intervener to bring expert evidence for the BCUC's consideration, as BC Hydro will have to do so in the future anyways.²¹

¹⁹ Exhibit C5-2, ICG, pp. 1–2.

²⁰ Exhibit C2-2, MoveUP, p. 1; Exhibit C6-2, the CEC, pp. 1–2.

²¹ Exhibit C6-2, the CEC, pp. 1–2.

In contrast, AMPC requests that the BCUC rule now that BC Hydro falls outside the scope of this proceeding for the purposes of efficiency given Direction No. 8 of Order in Council (OIC) 172/2021 (OIC 172/21) in which BC Hydro's cost of capital will not be set by the BCUC for F2022 and F2023.²²

Panel Determination

As per Exhibit C8-1 of the GCOC proceeding, BC Hydro has registered as an intervener. While the Panel acknowledges that BC Hydro's cost of capital will be reviewed in a separate proceeding, the evidence and matters to be explored in this GCOC proceeding may be relevant or have implications for BC Hydro. Therefore, the Panel is not persuaded that any ruling regarding BC Hydro's participation in this GCOC proceeding is necessary at this time. BC Hydro may participate in this GCOC proceeding as they choose.

2.2.2 Small utilities' participation in the GCOC proceeding

Submissions by the Parties

Some utilities note that their participation in the GCOC proceeding will be limited because they do not have the resources to provide expert evidence.²³ There is concern that the ability to actively participate is at risk of being impeded due to the cost and resources required. Corix proposes that the BCUC use an independent expert to provide information pertaining to small utility cost of capital.²⁴

Panel Determination

The cost of capital of each public utility, or group of utilities, will be addressed in Stage 2 of the GCOC proceeding.

As noted above, the Panel considers that Stage 2 should explore the possibility of grouping utilities. Such grouping may be determined by size or other metrics. Corix and other utilities that consider themselves small utilities are encouraged to participate actively in the GCOC proceeding to ensure they are represented by any potential utility grouping. Corix and all participants are encouraged to submit evidence in Stage 2 of the GCOC proceeding when the cost of capital for each utility, or groups of utilities, is considered.

With respect to the use of an independent expert, the BCUC has engaged Continental Economics, Inc. to provide an independent expert report in the GCOC proceeding. More information regarding the report scope is available in the Terms of Reference attached to this Order as Appendix D.

2.2.3 Nelson Hydro's participation in the GCOC proceeding

Submissions by the Parties

Nelson Hydro submits that the scope should consider how any established Benchmark Utility should apply to municipally-owned utilities, in that these utilities have limited borrowing abilities and do not pay income taxes.²⁵

²² Exhibit C4-2, AMPC, p. 1.

²³ Exhibit B5-2, Kyuquot Power Ltd. (KPL), p. 1; Exhibit B8-2, RDE, pp. 2, 4; Exhibit C3-1, Boralex, p. 1.

²⁴ Exhibit B6-2, Corix, p. 5.

²⁵ Exhibit B4-2, Nelson Hydro, p. 1.

Panel Determination

The Panel will review the cost of capital of Nelson Hydro, as it pertains to Nelson Hydro's regulated business serving non-municipal ratepayers, in Stage 2 of the GCOC proceeding when the cost of capital for each utility, or groups of utilities, is considered.

The Panel notes that of all the municipally-owned utilities in the province, Nelson Hydro is unique and is currently the only entity to require some form of regulation under the UCA. Nelson Hydro is in part excluded from regulation under the UCA as it is owned and operated by the City of Nelson and therefore any services provided within the City's municipal boundaries do not fall within the UCA's definition of a public utility.²⁶ Accordingly, the GCOC proceeding pertains solely to Nelson Hydro's operations serving non-municipal ratepayers in accordance with the UCA.

The Panel further notes that Nelson Hydro's cost of capital is concurrently being reviewed in the Nelson Hydro Cost of Service Analysis and Rate Design proceeding.²⁷ Accordingly, the Panel encourages Nelson Hydro to ensure its active participation in this GCOC proceeding as the outcome of this proceeding may have future implications for the utility.

2.2.4 Trigger for future proceeding

Submissions by the Parties

BCUC Staff submit the applicable criteria or triggers to warrant another proceeding to review the cost of capital should be considered as part of the GCOC proceeding scope.

FortisBC submits that the issue of how to determine when to hold a future cost of capital proceeding (after the conclusion of this GCOC proceeding) does not need to be addressed in this proceeding, as it will be subject to any number of considerations. However, FortisBC states that it is prepared to address this issue if required.²⁸

Panel Determination

The Panel finds the consideration of applicable criteria, off-ramp or other triggers for another cost of capital proceeding is an appropriate scope item in Stage 1 of the GCOC proceeding.

In particular, in the absence of an AAM, it is relevant for all parties including the BCUC, utilities and interveners to know when a future hearing would occur. Determining the appropriate criteria, off ramp, or other triggers to warrant another cost of capital proceeding can act as safeguard mechanisms to protect the utility and ratepayers against the potential unintended consequences of using a cost of capital that may no longer be representative of a fair return. To be efficient, the Panel views that the topic of when to hold a future cost of capital proceeding is relevant in this GCOC proceeding especially given the concurrent participation of all utilities and interveners in one proceeding.

²⁶ BCUC Order G-274-19, November 7, 2019, Appendix A, Reasons for Decision, p. 3, available at https://www.bcuc.com/Documents/Proceedings/2019/DOC_56196_G-274-19-NelsonHydro2019RuralRate-Final-Order-Reasons.pdf

²⁷ See Nelson Hydro Cost of Service Analysis and Rate Design Application, available at <https://www.bcuc.com/ApplicationView.aspx?ApplicationId=839>

²⁸ Exhibit B1-2, FortisBC, p. 8.

2.3 Cost of Capital determination

2.3.1 Consideration for contextual issues and market trends

Submissions by the Parties

BCUC Staff submit that the GCOC proceeding should consider contextual issues and market trends in determining the cost of capital and its components, including but not limited to a regulated utility's operational environment, reference to the cost of capital methodology applied in other comparable jurisdictions, a regulated utility's risk exposure, regulatory and public policy context, green bonds and environmental, social, and governance investing, and impact due to the COVID-19 pandemic.

MoveUP submits that "the process should be structured to take fuller and more explicit account of the diverging impact of climate policy and climate-driven market dynamics, as between gas and electric utilities" which is raised in BCUC Staff submission in the consideration of contextual issues and market trends in determining the Cost of Capital and its components.²⁹

Panel Determination

The Panel finds that consideration of contextual issues and market trends, including risks related to the impact of climate policy, is important and should be included in the scope of the GCOC proceeding particularly as these issues relate to risks impacting the cost of capital. However, the Panel finds that contextual issues and market trends in themselves are not separate scope items as they would be incorporated as supporting evidence for cost of capital determinations.

The Panel acknowledges the growing importance of climate policy and climate-driven market dynamics but does not view the topic of climate policy and change as a separate scope item because these could be specific risk factors among many others to consider a utility's fair return. The Panel encourages participants to discuss all contextual matters and include their evidence in this GCOC proceeding in the consideration for the risks impacting the cost of capital.

2.3.2 Equity Risk Premium and Minimum Default Capital Structure

Submissions by the Parties

Corix submits the scope items should include whether an equity risk premium should be implemented to account for varying utility risks within a utility group relative to the Benchmark Utility and if so, the methodology that should be used, factors that should be considered and the ranges for minimum, median and maximum. Further, Corix submits that the scope items should include consideration as to which group(s) of utilities the equity risk premium ranges should apply to and how the premiums should be updated if there is a change in risk for that utility sub-sector relative to the Benchmark Utility.³⁰

FAES submits that the proceeding should include consideration of whether to continue using a minimum default capital structure, established in the 2014 GCOC Decision for TES "Stream B" utilities, as part of the scope of the proceeding.³¹

²⁹ Exhibit C2-2, MoveUP, p. 2.

³⁰ Exhibit B6-2, Corix, p. 4.

³¹ Exhibit B3-2, FAES, p. 2.

Panel Determination

The Panel finds it appropriate to include the consideration of equity risk premium and minimum default capital structures within the scope items in Stage 2 of the GCOC proceeding. As discussed above, the potential grouping of utilities will be considered in Stage 2 of the GCOC proceeding. The Panel in Stage 2 will determine the cost of capital for each public utility, or groups of public utilities. Participants may submit evidence regarding minimums, defaults, or ranges in the equity risk premium or the equity component in a deemed capital structure for the Panel's consideration in Stage 2 of the GCOC proceeding.

3.0 BCUC Independent Expert

The BCUC published a notice of intent to engage an independent expert to provide evidence in the GCOC proceeding on April 1, 2021.³² In particular, the BCUC stated that it intends to enter into an Agreement with Continental Economics, Inc. for cost of capital technical expert services.

Dr. Jonathan A. Lesser of Continental Economics, Inc. will provide an independent expert report in the GCOC proceeding. The report will include items such as the methods to determine a public utility's cost of capital, relevant market conditions to consider as part of the determination, and a survey of regulatory practices regarding cost of capital and other issues within the scope of this proceeding.

The BCUC provides the Terms of Reference for the Independent Expert Report in Appendix D to this order. The report release target timeline is Friday, August 6, 2021.

³² BCUC NOI - Cost of Capital Technical Expert Consulting Services Economic Analysis available at [Document Summary \(gov.bc.ca\)](https://www.gov.bc.ca)

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SCOPE

PROCEEDING SCOPE – Stage 1

1. Whether a Benchmark Utility is appropriate to determine the cost of capital of public utilities.
 - a) If the establishment of a Benchmark Utility is warranted, then:
 - i. Whether the Benchmark Utility should continue to be FortisBC Energy Inc. (FEI), some other utility, or a hypothetical utility.
 - ii. The determination of the allowed return on equity (ROE) and deemed capital structure of the Benchmark Utility.
 - iii. The effective date for which the Benchmark Utility's cost of capital will take effect.
 - b) If the establishment of a Benchmark Utility is not warranted, then determine the process for public utilities to establish their individual cost of capital.
2. Whether re-establishment of a formulaic ROE automatic adjustment mechanism (AAM) is warranted. If a return to the use of a formulaic ROE AAM is warranted, then:
 - a) The specifications of the ROE AAM formula.
 - b) The frequency that the ROE AAM will apply (i.e. annually or some other frequency) and to whom the ROE AAM will apply.
 - c) The date for which the ROE AAM will take effect.
3. The criteria, off-ramps, or other triggers to warrant a future cost of capital proceeding.
4. Any other items that may arise during the proceeding to be considered in Stage 1. The Panel will communicate any additional items to participants.

PROCEEDING SCOPE – Stage 2

1. The groupings of public utilities for cost of capital determinations.
2. The establishment of the cost of capital for public utilities, or groups of public utilities, except for BC Hydro.
3. Whether any range or default in the equity component and equity risk premium is warranted for public utilities, or groups of public utilities.
4. Whether the determination of a deemed interest rate is warranted. If warranted, then:
 - a) The circumstances where a deemed interest rate is required.
 - b) The determination of the deemed interest rate where required.
 - c) Whether an interest rate AAM is warranted.

- d) The effective date for which the deemed interest rate or interest rate AAM will take effect.
- 5. Any items that may be identified during the proceeding to be considered in Stage 2. The Panel will communicate any additional items to participants.

PENDING SCOPE – Submissions Requested from Participants

The Panel seeks submissions from registered participants on deferral account financing. Specifically, the Panel invites submissions from participants on the following:

- 1. Whether deferral account financing costs should form as part of the scope of the GCOC proceeding.
 - a. If so, should the Panel review this matter in Stage 1, Stage 2, or initiate a Stage 3 process?
 - b. If not, why not?

Participants are requested to provide their submissions by Friday, June 4, 2021.

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REGULATORY TIMETABLE

Action	Date (2021)
Written submissions from registered participants on deferral account scope item	Friday, June 4
Further process	To be determined

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TERMS OF REFERENCE – INDEPENDENT EXPERT REPORT

The British Columbia Utilities Commission (BCUC) has engaged Dr. Jonathan A. Lesser of Continental Economics, Inc. to provide an independent expert report in the Generic Cost of Capital (GCOC) proceeding. Dr. Lesser will be responsible for preparing a GCOC Report (Report), responding to information requests from participants in the GCOC proceeding, and may be required to provide oral or written testimony and undergo cross-examination as part of the GCOC proceeding. The Report will be fully referenced, consisting of two parts and include the following information:

Part I – Methodologies

Part I of the Report will discuss the major methodologies generally employed in cost of capital proceedings, including methodologies to establish the allowed return on equity (ROE) and deemed capital structure, for public utilities in Canada and in the United States. The discussion will assess the methodologies' strengths, weaknesses, and suitability for adoption in whole or in part for public utilities in British Columbia (BC). Furthermore, the Report will comment on the pros and cons of using a Benchmark Utility, the mechanisms to adjust cost of capital components applied to a Benchmark Utility, and alternatives to using a Benchmark Utility.

Methodologies, Inputs and Adjustments – Cost of Capital

1. The major methodologies and inputs used to consider the cost of capital for public utilities including but not limited to capital asset pricing model, discounted cashflow model, and comparable earnings.
2. Any significant changes in methodology used to determine the cost of capital since the 2008 financial crisis.
3. Variations or modifications to the methodologies that should be considered in light of market, company specific, or other factors. For information that arises from jurisdictions outside of BC, the applicability of that information to utilities in BC, and any adjustments required when applying that information to those utilities.
4. Consideration for contextual issues and market trends in determining the cost of capital, including but not limited to a utility's operating environment, risk exposure, regulatory and public policy context, green bonds and environmental, social, and governance investing, and impact due to the COVID-19 pandemic.
5. The pros and cons of using an automatic adjustment mechanism (AAM) to determine ROE; the conditions for which a ROE AAM will be suitable; whether the BCUC should re-instate a ROE AAM in the current market, and if so, why.
6. The merits and feasible use of a range or default of a market-based proxy, including but not limited to a risk-free rate or government bond yield, that could be implemented as a trigger for a future cost of capital proceeding. The objective is to develop a set of criteria or triggers to ensure that over time, the cost of capital established for utilities continues to provide a fair return for their invested capital that is commensurate with their level of risk.

7. The use of deferral accounts by regulated utilities and its relevance to cost of capital determinations in jurisdictions outside of BC; the applicability of using deferral accounts and impact on cost of capital determinations to utilities in BC and adjustments that would be required.

Benchmark Utility

8. The pros and cons of using a Benchmark Utility in the determination of cost of capital and alternatives to using a Benchmark Utility. A review of benchmarking practices in jurisdictions outside of BC; the applicability of using the practices reviewed for utilities in BC and any adjustments that would be required.

Part II – History and Jurisdictional Scan in Canada

Part II of the Report will summarize the cost of capital approaches taken in comparable and relevant Canadian provinces and territories, recent decisions made by the respective regulators, and any major changes since 2012.

9. A review of the cost of capital for major regulated companies operating in Canada which are comparable to those regulated under the BCUC jurisdiction. The review is to include whether cost of capital components were determined as a result of a hearing or a negotiated settlement agreement and whether regulators have instituted fundamental changes since 2012.
10. A history of the use of AAM to determine ROE including specifications of the ROE AAM formula, the frequency that the ROE AAM applies (i.e. annually or some other frequency), to which entities the ROE AAM applies and any material differences in the AAM formulas among the jurisdictions considered in the Report since 2012.
11. A review of utilities in jurisdictions outside of BC which use preferred shares in their capital structure and their relevance on cost of capital determinations; the applicability of how preferred shares are used in capital structure and impact on cost of capital determinations to utilities in BC and adjustments that would be required.
12. A review of utilities in jurisdictions outside of BC which require deemed interest rates including the circumstances for which a deemed interest rate is required for rate regulation and the methodologies to establish such a rate; the applicability of such circumstances and methodologies related to a deemed interest rate to utilities in BC and any adjustments that would be required.