



SIXTH FLOOR, 900 HOWE STREET, BOX 250  
VANCOUVER, B.C. V6Z 2N3  
CANADA

BRITISH COLUMBIA  
UTILITIES COMMISSION

ORDER  
NUMBER G-66-94

TELEPHONE: (604) 660-4700  
BC TOLL FREE: 1-800-663-1385  
FACSIMILE: (604) 660-1102

AN ORDER IN THE MATTER OF the Utilities Commission  
Act, S.B.C, 1980, c 60, as amended

and

Applications by Pacific Northern Gas Ltd. to  
Reconsider and Vary Order No. G-35-94 and Decision dated June 10, 1994

**BEFORE:** M.K. Jaccard, Chairperson, )  
K.L. Hall, Commissioner; and ) September 6, 1994  
P.G. Bradley, Commissioner )

**WHEREAS:**


- A. On April 5, 1994, a public hearing commenced at Vancouver, B.C. into the appropriate rate of return on common equity and capital structure for BC Gas Utility Ltd. ("BC Gas"), Pacific Northern Gas Ltd. ("PNG") and West Kootenay Power Ltd. ("WKP") ("the ROE hearing"); and
- B. On June 10, 1994, the Commission issued Order No. G-35-94 concurrent with Reasons for Decision; and
- C. On July 4, 1994, PNG requested that the Commission, pursuant to Section 114 of the Utilities Commission Act, reconsider and vary Order No. G-35-94; and
- D. On July 19, 1994, the Commission invited interested parties to provide written views on the Application for Reconsideration; and
- E. Such submissions were made to the Commission; and
- F. The Commission did review and discuss those submissions.

**NOW THEREFORE** the Commission orders as follows:

PNG's request for Reconsideration and Variance of Order No. G-35-94 is denied. The Commission issues its Reasons for Decision, attached as Appendix A.

Dated at the City of Vancouver, in the Province of British Columbia this 13<sup>th</sup> day of September, 1994.

BY ORDER

  
Dr. Mark K. Jaccard  
Chairperson

Attachment

**Pacific Northern Gas Ltd.  
Application for Reconsideration of Order No. G-35-94  
Reasons for Decision**

---

## **Background**

On July 4, 1994, Pacific Northern Gas Ltd. ("PNG") wrote to the Commission to request that the Commission reconsider and vary Order No. G-35-94 and the corresponding Decision which had set the rate of return on common equity for PNG at 11.5 percent. In support of its Application for Reconsideration, PNG wrote that the rate of return was set assuming that the yield on long-term Government of Canada bonds ("long-term Canada bonds") would average 7.75 percent in 1994. Subsequent to the Decision, the yield on long-term Canada bonds continued to rise and, at time of the Application for Reconsideration, was in the range of 9.5 percent. As a result, PNG suggested that "there may be a significant difference between the forecast long-term Canada bond rate of 7.75 percent utilized in the Decision and the actual average yield on long-term Canada bonds in 1994."

To remedy this concern, PNG requested that the Commission establish a rate of return deferral account which would operate such that if the actual 1994 average long-term Canada bond yield is less than 7.5 percent or greater than 8.0 percent, the difference between (i) PNG's revenue requirement based on the 11.5 percent rate of return approved in the Decision, and (ii) what PNG's revenue requirement would have been had its rate of return on common equity been established based on the actual 1994 average yield be established as a deferral balance in January 1995 and amortized in the 1995 rates.

By letter dated August 15, 1994, PNG revised its Application to suggest that for the purposes of determining the deferral account balance the actual 1994 average long-term Canada bond yield be reduced by 25 basis points to be consistent with the amount that the actual average long-term Canada bond yield would be reasonably expected to deviate above or below the forecast relied on by the Commission. Further, they suggested that the 1995 rate of return on common equity be determined as outlined in Chapter 4 of the Decision with the exception that i) the actual 1994 average long-term Canada bond yield not be reduced by the 25 basis point adjustment for the purposes of the setting the 1995 return; and ii) the determination of the appropriate 1995 rate of return on common equity be delayed to January 1995 so that full interest rate information will be available.

The Commission responded to the PNG Reconsideration Application on July 19, 1994, indicating that it was prepared to consider submissions on the single issue of whether the yields on long-term Canada bonds had deviated so significantly from the forecasts given in evidence at the hearing that an amendment to the earlier Decision should be made. The Commission invited PNG and all participants to the Joint ROE Hearing to provide written views on the following issues:

- i) Did the deviation of the yield on long Canada bonds, subsequent to the Decision, warrant some form of special remedy by the Commission?
- ii) Would such a hindsight adjustment of a forecasted factor impact the risk profile of the utilities such that a specific change to the risk premium should be considered?

Parties were requested to make their submissions no later than August 15, 1994.

### **Position of Pacific Northern Gas Ltd.**

By letter dated August 15, 1994, PNG argued that the changes in financial market conditions which have taken place since the evidentiary phase of the hearing warrant some form of remedy in as much as "there is a high degree of probability that the 1994 interest rate forecast used by the Commission will not be achieved". PNG noted that three of the expert witnesses which gave testimony at the Joint Hearing are presently forecasting an average long-term Canada bond yield of 8.5 percent for 1994.

Although PNG accepted that utilities appropriately bear some degree of risk that the actual average yield on long-term Canada bonds will differ from the forecast used in the determination of the rate of return on equity, PNG maintained that under ordinary financial conditions, the expected deviation from forecast long term Canada yields is in the order of plus or minus 25 basis points. PNG stated that in this particular case the margin by which the Commission's forecast may be exceeded is greater than that which is reasonable.

PNG stated that a variation in the Decision would not impact PNG's risk profile since there is virtually no possibility of the actual average yield on long-term Canada bonds being less than the forecast used by the Commission. As a result, PNG stated that the risk which it assumed as a result of this Decision was greater than normal.

### **Position of BC Gas Utility Ltd. ("BC Gas")**

BC Gas supported a reconsideration of the Commission finding that the yield on long-term Canada bonds would average 7.75 percent in 1994. In particular, BC Gas argued that the Commission erred in using the 7.75 percent forecast, since it was evident, by the date of the Decision, that the yield on long-term Canada's would be at a higher level. BC Gas stated that the Commission is required to evaluate the economic and financial information that becomes available to it after the close of evidence, and has done so in past decisions. Based on the history of long-term Canada yields over the period January 1, to June 10, 1994, BC Gas maintained that a reasonable expectation of long-term Canada yields for the year as a whole was 8.25 to 8.5 percent. BC Gas submitted that the Commission had erred in not considering the information which it had available to it at the date of the Decision and should vary its finding on the appropriate long-term Canada bond yield for 1994 to 8.5 percent and approve an adjustment to its authorized rate of return on common equity to 11.5 percent.

BC Gas maintained that the remedy being sought does not constitute a hindsight adjustment and therefore no change to the risk premium, based on this factor, was appropriate.

### **Position of West Kootenay Power Ltd. ("WKP")**

WKP stated that regulatory fairness requires that, in probabilistic terms, the risk of actual outcomes being either less than or greater than the forecast should be approximately equal. Further, WKP argued that the Commission is entitled to consider bond yields up to the time of the Decision's issuance and that such bond yields strongly supported the conclusion that actual average long-term bond yields for 1994 would be greater than the forecast of 7.75 percent. Therefore, WKP stated that an adjustment is required to provide a fair return to the Applicants; however, WKP did not suggest what that adjustment should be.

WKP agreed with BC Gas that hindsight regulation should be avoided. WKP argued that hindsight regulation would erode the financial integrity of the utility, provide for disallowance of costs that have already been incurred, and lessen incentives for the utility to implement enduring cost savings. However, WKP argued that as long as the Commission restricted itself to the evidence available up to the time the Decision was issued, the issue of hindsight regulation was avoided.

### **Position of Wholesale Customers**

By letter dated August 16, 1994, Counsel for the Wholesale Customers stated that the questions put forward in the Commission's letter of July 19, 1994 were of sufficiently technical nature that he had requested Dr. William Waters' input with respect to each of them. Dr. Waters gave evidence on the appropriate rate of return on common equity during the hearing. Attached to Counsel's letter was a report from Dr. Waters, dated August 16, 1994.

Dr. Waters stated that he had examined the month-end values for yields on long-term Canada bonds for the period January 1974 to July 1994 and concluded that the 1994 increase was sharp but not unprecedented. Although long-term bonds rose 2.64 percent over the six month period ending July 1994, he noted that this value had been exceeded by increases in five other periods. Those increases ranged from 2.76 percent to 4.18 percent. Further, Dr. Waters noted that the history of yield changes calculated over three month periods showed that changes are basically symmetrical, i.e. there are an equal number of changes above and below zero for each range of yield changes. (See attached figure.)

In response to these submissions, PNG stated that the five periods to which Dr. Waters referred had all occurred during the 1980 and 1981 period and that the increase in spot rates which occurred during the nine month period ended July 1994 had not been exceeded during the past 20 years except for that period. Further, although they agreed with Dr. Waters observation that interest rate changes are basically symmetrical, they stated that at the date of the Decision it was virtually impossible for the rate for the remainder of 1994 to fall to a point where the Commission's forecast could be achieved.

With respect to the second issue raised by the Commission, i.e. whether an adjustment to the forecast of the yield on long-term Canada bonds would affect the risk profile of the utility, Dr. Waters did not comment on whether this constituted hindsight regulation, but noted that his return recommendation had included a 25 to 50 basis point cushion to allow for the risk that interest rates might be greater than was anticipated at the time of the hearing. If PNG's deferral account request were granted, Dr. Waters stated that the cushion would be unnecessary.

Subsequent to his review of the submissions from the utilities, Counsel for the Wholesale Customers stated that he was opposed to the suggestion that the finding on the long term Canada bond yield be changed as a result of increased yields which occurred after the hearing record closed but prior to the issuance of the Decision. He stated that in order to meet the minimum requirements for fairness and to ensure that information was not taken out of context, it was essential that the Commission's Decision be based on the evidence before it.

## Commission Decision

The Commission agrees with the statements made by the utilities that it may consider significant, unforeseen changes to economic and financial conditions which occur after the close of the evidentiary portion of the hearing but prior to the release of the Decision. The Commission Panel did do so, as is clear from the statement made on Page 5 of the Decision where the Commission Panel explicitly recognized that the then current yields were in excess of 8.7 percent. The average of the weekly yields on long-term Canada bonds from January until the end of May, 1994 was approximately 7.95 percent.

In addition, the Commission Panel had a duty to exercise its judgment as to the most likely course of long-term bond yields over the remainder of the year. Bond yields are affected by many factors, such as economic activity, public sector borrowing needs, expectation of inflation, etc. some of which can act to influence yields in opposite directions. In these particular circumstances, the Commission Panel's judgment was that "these relatively high rates will not be maintained over the year." As a result, the Commission Panel accepted the recommendation of all the expert witnesses that the average yield on long-term Canada bonds would be 7.75 percent in 1994. Therefore, the Commission finds that it did consider all relevant evidence in making its forecast of the average yield on long-term Canada bonds as at the time of the Decision.

With respect to the question as to whether the current yield on long-term Canada bonds has deviated sufficiently from the forecast level as to warrant some form of special remedy, the Commission does not accept the premise put forward by PNG and supported by WKP, that under ordinary financial market conditions the actual average long-term Canada bond yield would not be expected to deviate by more than approximately plus or minus 25 basis points from the forecast relied upon by the Commission. Indeed the evidence prepared by Dr. Waters in support of the position of the Wholesale Customers indicates that substantial fluctuations in interest rates are not uncommon.

With respect to the bond yield changes which have occurred since the hearing, Dr. Waters analysis indicated that similar changes have occurred in the past. His submission also shows a symmetry in the fluctuations of yields such that a bias in actual versus forecast results is unlikely to be preferential towards either the utility shareholders or customer interests. As a result, the Commission finds that special circumstances do not exist and the risk that interest rates may change by an amount similar to that which occurred in this case is a normal business risk for which the utilities are already compensated in the rate of return on common equity. The Application for Reconsideration is denied.