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**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER** G-88-04

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**IN THE MATTER OF  
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473**

and

A Submission by Terasen Gas Inc. dated July 22, 2004  
Requesting a General Review of the Return on Equity ("ROE") and Capital Structure

**BEFORE:** M.P. Birch, Panel Chair  
L.F. Kelsey, Commissioner  
P.E. Vivian, Commissioner  
September 20, 2004

**O R D E R**

**WHEREAS:**

- A. In its Decision dated June 10, 1994, the Commission established rates of return on common equity ("ROE") for BC Gas Utility Ltd. ("BC Gas"), Pacific Northern Gas Ltd., West Kootenay Power Ltd., and Centra Gas Fort St. John Inc.; and
- B. In the same Decision the Commission established a mechanism for varying the ROE on an annual basis; and
- C. The Commission, by Order No. G-49-97, amended the mechanism to correct for certain problems and to make it more consistent with the practices of other public utility tribunals; and
- D. Following a public hearing held in June 1999 the Commission issued a Decision dated August 26, 1999 and Order No. G-80-99 further amending the automatic adjustment formula for establishing the ROE for a low-risk benchmark utility; and
- E. On November 1, 2000, BC Gas applied to the Commission to adjust the application of the automatic adjustment formula to address the situation of yields on 10-year Government of Canada bonds exceeding the yields on 30-year Government of Canada bonds; and
- F. In November 2000 the Commission requested the comments of other parties on the BC Gas request; and
- G. On December 21, 2000, following a review of the submissions of interested parties, the Commission issued Letter No. L-61-00 declining to amend the ROE adjustment mechanism at that time and stating that it would conduct a review in 2001, prior to the calculation of the low-risk benchmark ROE for 2002, to consider possible amendments to the mechanism with respect to the yield spread between medium and long-term bonds, and the rounding the benchmark ROE; and

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- H. The Commission established a written public hearing to review these aspects of the automatic adjustment formula and, following a review of the submissions, in Order No. G-109-01 determined that the treatment of the bond yield spread did not require adjustment at this time and that the ROE for the low-risk benchmark utility, expressed as a percentage, should be rounded to two decimal points prior to adding the utility-specific risk premium; and
- I. On July 22, 2004, Terasen Gas Inc. (formerly BC Gas Utility Ltd.) wrote to the Commission requesting that the Commission convene a hearing to review Return on Equity and Capital Structure; and
- J. On August 3, 2004 the Commission, in its Letter No. L-41-04, requested comments from interested parties as to the timeliness and necessity of convening such a proceeding; and
- K. The Commission Panel has reviewed the request of Terasen Gas Inc. and the submissions of interested parties and finds that, while reviews of the automatic adjustment mechanism used to establish the ROE for regulated utilities or to address associated capitalization issues are required from time to time, it is not persuaded that sufficient reasons exist to convene a review at this time.

**NOW THEREFORE** the Commission Panel determines that it will not convene a hearing now to review the ROE automatic adjustment mechanism or related capitalization issues as requested by Terasen Gas Inc., but concludes that such a review could be appropriate in the Fall of 2005 in time for implementation January 1, 2006. Reasons for Decision are attached as Appendix A.

**DATED** at the City of Vancouver, in the Province of British Columbia, this 20<sup>th</sup> day of September 2004.

BY ORDER

*Original signed by:*

L.F. Kelsey  
Commissioner

Attachment

Terasen Gas Inc.  
Application for a General Review of the Return on Equity and Capital Structure  
Applicable to a Low-Risk Benchmark Utility

**REASONS FOR DECISION**

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**1.0 BACKGROUND**

By letter dated July 22, 2004 Terasen Gas Inc. (“Terasen Gas”) requested the British Columbia Utilities Commission (the “Commission”) hold a hearing to review the Return on Equity (“ROE”) and Capital Structure that ought to be applied to a low-risk benchmark utility within the jurisdiction of the Commission.

Terasen Gas delivers natural gas to homes and businesses throughout much of British Columbia. Together with Terasen Gas (Vancouver Island) Inc., Terasen Gas (Whistler) Inc., and Terasen Gas (Squamish) Inc. (all of which are wholly owned, directly or indirectly, by Terasen Inc.). Terasen Gas serves about 862,000 customers in 125 communities and is the largest natural gas distributor in the province. Terasen Gas was formerly known as BC Gas Utility Ltd. (“BC Gas”), being renamed on April 25, 2003.

**2.0 FACTORS PROMPTING THE APPLICATION**

In its application dated July 22, 2004, Terasen Gas noted that the last comprehensive review of the factors relating to ROE and Capital Structure took place in 1994. This review gave rise to Commission Order No. G-35-94. Subsequent to that comprehensive review, further proceedings were initiated in 1997 (Order No. G-49-97), there were annual reviews on a utility-specific basis for the years 1995-98, and in 1999 there was a proceeding to further review the ROE set for a low-risk benchmark utility and the associated automatic adjustment formula (see Orders No. G-26-99 and G-80-99).

Finally, on November 1, 2000 Terasen Gas (then BC Gas) applied to the Commission for an change to the automatic adjustment formula for ROE based on the inverted bond yields then being earned by 10-year and 30-year Government of Canada bonds (see Order No. G-109-01). The Commission decided that no change in the mechanism was necessary although minor changes in calculations were made.

In brief, Terasen Gas supported its request for a review upon the following bases:

- i) the passage of time since the last comprehensive review in 1994;
- ii) a recent decision of the Alberta Energy and Utilities Board (July 2, 2004) dealing generally with the Generic Cost of Capital;
- iii) financial market evolution; and
- iv) continuing high gas prices.

### **3.0 THE COMMISSION'S RESPONSE**

In its letter of August 3, 2004 (Letter No. L-41-04), the Commission sought comments from interested parties concerning the following matters:

- Should there be a review of the current mechanism for setting the ROE for a low-risk benchmark utility?
- Should there be a review of the size of the risk premium used to establish the ROE for specific utilities?
- Should there be a review of the capital structure appropriate for a low-risk benchmark utility?
- Should there be a review of the capital structure for utilities individually?
- Are there any other issues related to ROE and capital structure that should be reviewed at this time?
- If the Commission determines that a review should be conducted on one or more of the above issues, should the review take place in an oral public hearing or a written hearing?

Responses were received from twelve interested parties including the Ministry of Energy and Mines, Oil and Gas Policy Branch, plus a further letter from Terasen Gas in support of its application (August 24, 2004). In general the majority of interested parties were opposed to any review at this time. The Ministry of Energy favoured such a review and suggested additional issues that might be addressed.

### **4.0 THE PANEL'S DECISION**

The Panel rejects the Terasen Gas application for a review of the mechanism used to set the ROE for a low-risk benchmark utility and associated matters dealing with Capital Structure at this time. The Panel is of the view that Terasen Gas has not provided sufficient detail to define any deficiency in the existing mechanism or to draw any cause-and-effect relationship between the existing mechanism and any perceived or real harm to Terasen Gas.

While Terasen Gas's application is rejected at this time, it is always open to the company to re-submit an application to the Commission with full documentation as to the perceived deficiencies in the existing mechanism and the consequent harm to be suffered by the company. Alternatively, any Terasen Gas concerns could be raised in the context of a utility-specific revenue requirement proceeding.

The Panel does recognize, however, that there has not been a comprehensive review of the ROE automatic adjustment mechanism used by the Commission for some time. Although it is costly and complex to review a matter of such fundamental importance to the regulation of utilities, the Panel is of the view that such a review should take place from time-to-time. The Alberta Energy and Utilities Board in its decision of July 2, 2004 dealing with the Generic Cost of Capital decided that there ought to be a periodic review every five years. The Panel does not think this is an unreasonable timeframe for a review, given that financial market conditions will evolve. That being the case, the Panel has concluded that in any event there should be a comprehensive review of the ROE automatic adjustment mechanism. In its response to the Commission's letter of August 3, 2004, the Ministry of Energy and Mines, Oil and Gas Policy Branch suggested that the scope of any proceeding dealing with the ROE mechanism and capitalization, be extended to include an investigation of the appropriate capital structure that should be applied for utilities operating under an income trust capital structure. This Panel agrees that this would also be a worthwhile area of investigation. The review will take place in the Fall of 2005 in time for consideration in the 2006 budget cycles of the regulated utilities and for a target implementation date of January 1, 2006. Further details as to scope and timing will be announced by the Commission in the normal course of regulatory business.