



**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-148-12**

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

and

Generic Cost of Capital Proceeding

BEFORE: D.A. Cote, Commissioner
M.R. Harle, Commissioner October 11, 2012
L.A. O'Hara, Commissioner
R. Giammarino, Commissioner

O R D E R

WHEREAS:

- A. By Order G-20-12 dated February 29, 2012, the British Columbia Utilities Commission (Commission) established a Generic Cost of Capital (GCOC) Proceeding to review: (a) the setting of the appropriate cost of capital for a benchmark low-risk utility; (b) the possible return to an Return on Equity Automatic Adjustment Mechanism (ROE AAM) for setting an ROE for the benchmark low-risk utility; and (c) the establishment of a deemed capital structure and deemed cost of capital methodology, particularly for those utilities without third-party debt;
- B. By Order G-72-12 dated June 1, 2012, the Commission established, among others, the Final Minimum Filing Requirements for Affected Utilities and the Preliminary Regulatory Timetable for the first stage of the GCOC proceeding;
- C. On June 5, 2012, FortisBC Utilities (FBCU) wrote to the Commission seeking to vary the Preliminary Regulatory Timetable set forth in Appendix C to Order G-72-12. On June 20, 2012, the Commission issued Order G-84-12 to amend the Preliminary Regulatory Timetable. The Amended Preliminary Timetable established, among other things, a Procedural Conference to be held on October 2, 2012 and the commencement date for an oral hearing, if required, on December 12, 2012;
- D. The Procedural Conference date was subsequently amended to October 4, 2012. By letter dated September 27, 2012, the Commission Panel requested participants to address a number of matters that would assist in the efficient review of the evidence. In particular, participants were asked to make submissions on four options for a benchmark utility: (i) FortisBC Energy Inc. (FEI) today as described in its company profile, (ii) FEI in 2009 frozen in time, (iii) FEI in 2012 but only as a 'pure play' gas distribution utility, and (iv) other hypothetical construct or other utility;

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- E. The Procedural Conference that was held on October 4, 2012 addressed the following items: (1) the appropriate benchmark utility for the determination of the generic cost of capital; (2) whether a Stage 2 to immediately follow Stage 1 is desirable; and (3) whether an oral phrase is required and the proposed timetable going forward. Parties who made submissions at the Procedural Conference were FortisBC Utilities, Corix Multi Utility Services Inc., the Industrial Customers Group, the British Columbia Pensioners' and Seniors' Organization, the Association of Major Power Customers of B.C., the Commercial Energy Consumers of British Columbia, and Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd.;
- F. The Commission Panel has made the determinations with respect to the issues of benchmark utility for the generic cost of capital, the phasing of Stage 2 after Stage 1, and the format of the hearing to review the GCOC proceeding.

NOW THEREFORE in Reasons for Decision attached as Appendix A to this Order, the Commission orders as follows:

1. FEI in 2012 in its present pre-amalgamation state will serve as the benchmark for the GCOC Proceeding. Whether FEI in 2012 is a pure play gas distribution utility will be determined after hearing further evidence regarding this matter.
2. A Stage 2 will be added to this GCOC proceeding with the schedule to be determined prior to the end of Stage 1.
3. The review of the GCOC proceeding will continue by way of an oral hearing commencing on December 12, 2012. Dates for the argument phase will be determined in the course of the oral phase of the proceeding.

DATED at the City of Vancouver, in the Province of British Columbia, this 11th day of October 2012.

BY ORDER

Original signed by:

D.A. Cote
Commissioner

Attachment

GENERIC COST OF CAPITAL PROCEEDING
PROCEDURAL CONFERENCE
OCTOBER 4, 2012

REASONS FOR DECISION

1.0 BACKGROUND

On February 28, 2012, the British Columbia Utilities Commission (Commission) issued Order G-20-12 and established the Generic Cost of Capital Proceeding (GCOC) pursuant to section 82 of the *Utilities Commission Act* (the Act) and provided an Initial Regulatory Timetable. This order also established that all participating public utilities regulated by the Commission were considered to be applicants in the GCOC unless, at the time of registration, they requested an alternate status and provided an explanation.

On April 18, 2012, the Commission issued Order G-47-12 which included a Final Scoping Document outlining the purpose and scope of the proceeding. On June 1, 2012, by Order G-72-12, the Commission issued the minimum filing requirements for affected utilities and a Preliminary Timetable for the first stage of this. The Preliminary Timetable was amended on June 20, 2012, by Order G-84-12 in response to a proposal by FortisBC Utilities (FBCU, Companies) to vary dates. The Amended Preliminary Timetable, in addition to other matters, included provision for a Procedural Conference to be held on October 2, 2012, a date which was subsequently amended to October 4, 2012.

By letter dated September 27, 2012 (Exhibit A-17), the Commission Panel requested participants to address the following matters at the Procedural Conference:

1. The appropriate benchmark utility for the determination of the generic cost of capital;
2. Whether a Stage 2 to immediately follow Stage 1, which involves applying the generic benchmark utility in the determination of an appropriate Return on Equity (ROE) and capital structure for each utility in the Affected Utilities' group, is desirable (Exhibit A-6, Appendix A to Order G-72-12, p. 11);
3. Whether an oral phase is required and the proposed timetable going forward; and
4. Other matters that will assist in the efficient review of the evidence.

With respect to the first matter concerning an appropriate utility to serve as a benchmark utility, the Panel requested participants to provide their views as to whether the benchmark should be FortisBC Energy Inc. (FEI) or a generic low risk utility. Participants were asked to make submissions on four options for a benchmark utility as follows:

- FEI today as described in its company profile;
- FEI in 2009 frozen in time;
- FEI in 2012 but only as a pure play gas distribution utility;
- Other hypothetical construct or other utility.

Participants were asked to describe the pros and cons of each option.

2.0 MATTERS ARISING AT THE PROCEDURAL CONFERENCE OF OCTOBER 4, 2012

2.1 Appropriate Benchmark Utility

The 2012 GCOC Proceeding differs from other cost of capital proceedings in that it has been initiated by the Commission rather than by application from a utility. Typically, a utility like FEI would make an application for review of the cost of capital. Since the 1994 Return on Capital Equity Decision, FEI or its predecessor has been designated the benchmark utility for the purposes of setting the return on equity and capital structure for other utilities in B.C. The setting of this benchmark has provided a reference point against which other utilities could be compared. However, in the case of the 2012 GCOC proceeding, there is no application and there is no common agreement as to an appropriate benchmark utility or even whether the benchmark is a utility or a hypothetical construct. This has resulted in a number of challenges with respect to determining an appropriate benchmark.

The Commission Panel has raised two concerns with regard to FEI as it exists today being an appropriate benchmark:

- whether the new business initiatives being undertaken by FEI have already been recognized by the financial markets; and
- whether amalgamation will impact its risk profile.

These factors bring into question whether FEI can be fairly described as a pure play gas distribution utility and serve the need for a stable point of reference against which other utilities can be measured. Additionally, there is a need for consistency among the participants as to a description of what the benchmark utility ought to be. Failing to address this need for continuity could potentially create difficulty in comparing the evidence presented by the parties within the proceeding. Because of this, the matter was raised by the Commission and participants were requested to make submissions on a number of potential options defining an appropriate benchmark utility.

The position taken by FBCU is that the option describing FEI as of today is most appropriate as a benchmark for the purposes of determining the allowed return for BC Utilities until the next Commission review. To support their position, the Companies have made the following assertions:

- The use of a real utility over that of a hypothetical construct will allow the characteristics of the benchmark to be better understood allowing for more efficient comparisons.
- FEI's diverse geographic, customer and asset base and other attributes make it more suitable as a benchmark than other BC utilities.
- The FEI described in the company profile is the same as the FEI in 2012 as a 'pure play' gas distribution utility.
- The use of FEI in 2009 frozen in time option offers no advantages and has some potential disadvantages.
- The expansion into Alternative Energy Services (AES) and the potential amalgamation of the Fortis Energy Utilities need not be a factor in determining the appropriate benchmark. FBCU pointed out among other things that the benchmark should be FEI as of today prior to amalgamation.
- If the Commission were to adopt a different benchmark than that proposed by the FBCU, it would

introduce fairness issues as well as procedural challenges and inefficiencies as FEI has presented its evidence based on the FEI as of today.

(Exhibit B1-22, pp. 1-2, T1: 9-10)

FBCU submit that even if the Commission were to take FEI of today and modify it to meet what it determines is a pure play utility, there would be an efficiency problem related to determining those characteristics which differentiate the two options. They state that this debate can take place in this and subsequent proceedings where individual utilities will seek to compare themselves to the benchmark.

With respect to AES, the FBCU submit that Thermal Energy Services (TES) are not being undertaken by FEI but through FortisBC Alternative Energy Inc. (FAEI) and therefore do not affect FEI's current cost of capital. Biomethane and natural gas for transportation initiatives, in the view of the Companies, are truly natural gas services in that they use the existing natural gas infrastructure. While having an effect on customer composition, the size of rate base and on the end use that is driving revenues, it doesn't change the fact that it is all system throughput. FBCU note that the size of the impact of the TES initiatives is small when put in the context of the overall utility and therefore submit that FEI remains a natural gas business or as reasonably close to what could be expected notwithstanding the new AES initiatives. (T1:12-16)

With respect to amalgamation, FBCU submit that the appropriate approach would be to take FEI as it exists today as the benchmark with no consideration of amalgamation. In the event that amalgamation is approved, the new amalgamated company can be compared to FEI as it exists today like other utilities in the province. (T1:18)

Among the other participants there was no disagreement that for the purposes of this proceeding FEI rather than a hypothetical construct is the most appropriate benchmark. Additionally, none of the participants disagreed with the notion that FEI in 2012 as a benchmark was most appropriate. However, there is less agreement among the participants with whether FEI was a 'pure play' gas distribution utility. Among the utilities, Corix Multi-Utility Services Inc. (Corix), while adopting most of the FBCU submissions, noted its agreement with the Commission's concerns with alternative energy solutions and their impact on the risk profile. (T1:31)

The Industrial Customers Group (ICG) agrees that the benchmark should as closely as possible represent a stable, mature pure play gas distribution utility in order for it to be an appropriate reference point for other utilities. ICG states that the evidence does not support that the FEI of today option supports this conclusion. ICG further note that it is early in the proceeding and discourages the Commission Panel from making a determination at this time as there will be further evidence from expert witnesses and a second round of information requests. (T1:34-36)

British Columbia Pensioners' and Seniors' Organization et al (BCPSO) agrees that a pure play utility reference point is a more conceptually efficient way to make comparisons and set rates of return for other utilities. However, it also raises concern as to whether the changes (presumably related to AES) at FEI are insignificant or minor. BCPSO submits that the Commission will have to take this factor into account in setting the benchmark. More specifically, BCPSO states that the changes related to CNG and LNG are significant and while they result in an increase in throughput, the activities are not pure play gas distribution. (T1:37-41)

The Association of Major Power Customers (AMPC) agree that FEI is the most appropriate utility to be used as a benchmark. AMPC also agree with ICG that it is premature to decide the pure play issue stating that the Commission should hear from the experts and company witnesses prior to making a determination. (T1:43-46)

Commission Determination

The Commission Panel notes that there was general agreement among the parties with respect to FEI in 2012 being made the benchmark for the GCOC proceeding. FEI is well established, of sufficient size and has a diverse customer and asset base. In addition, FEI is well understood as a utility by all the participants as it has traditionally been used as the benchmark utility in British Columbia. This and the fact that there is a substantial body of FEI related evidence already on the record in this proceeding makes FEI a reasonable candidate for the benchmark utility. **Therefore, notwithstanding the various positions of the participants as to whether FEI can be described as a pure play gas distribution utility, the Commission Panel agrees with the participants and accepts FEI, in the present time frame, as the most appropriate choice for the benchmark utility.**

FEI has submitted that its choice as a benchmark utility need not be affected by the FBCU Amalgamation Application currently before the Commission as the FEI can be considered in its present pre-amalgamation state for the purposes of benchmarking. **The Commission Panel accepts the FEI proposal and establishes FEI in 2012, pre-amalgamation, as the benchmark for the GCOC proceeding.**

As noted, there is considerable disagreement among the participants with regard to whether FEI can be accurately described as a pure play gas distribution utility. To assist in making a determination on this, the Commission Panel is of the view that the process will be best served by allowing the evidence to be presented in its entirety and arguments made prior to making a final determination. Accordingly, we make no determination on whether FEI is to be considered pure play gas distribution utility at this time and will address the matter in our Decision at the conclusion of this proceeding.

2.2 A Stage 2 to Immediately Follow Stage 1

There was no disagreement among any of the participants with respect to whether there should be a Stage 2 for the GCOC proceeding. However, a number of the participants made submissions as to the approach the Commission may consider in preparing the process for Stage 2. The FBCU submitted it would be most efficient to break the process down into three groups which would be handled separately; one for the FBCU, a second for PNG and a third for micro utilities which would include Corix and FAES. Additionally, FBCU noted that the participants would need time to prepare following the Commission's Decision on Stage 1 and the timetable which would follow would need to reflect constraints like the status of the FBCU amalgamation proceeding. FortisBC proposes there be a Procedural Conference a month following the Decision to deal with this matter. (Exhibit B1-22, pp. 10-11)

ICG underlined the importance of proceeding with Stage 2 as quickly as possible and submit that a Procedural Conference prior to starting is not a requirement. (T1:65-66) BCPSO submit that consistency in the panel members is important and shares similar view as ICG with respect to proceeding expeditiously. (T1: 69) AMPC notes that its interests lie with resolution of Stage 1 only but submits that the second stage could be part of revenue requirements hearings for other proceedings. (T1: 71)

Commission Panel Determination

The Commission Panel agrees with ICG with respect to the moving ahead as quickly as possible and has determined that adding a Stage 2 to the process is the most efficient way to achieve this. The Panel acknowledges the submissions of the parties with respect to process, consistency among the panel members and timing. The Commission will begin the process of planning for Stage 2 in the near future. This will potentially involve scheduling a procedural conference to address process and logistics prior to the end of Stage 1.

2.3 Oral Phase and Proposed Timetable

The most recent Amended Preliminary Timetable provided for an Oral Hearing, if required, to commence on December 12, 2012. The requirement for an oral phase of the proceeding was canvassed.

The FBCU submits that there is nothing inherently superior in having an oral process as opposed to a written one and the Commission should weigh the costs and benefits of each. They also submit that there will be sufficient written evidence on the record for the Commission to undertake a written process rather than an oral one. In support of this, the Companies note that in this proceeding there is a substantial body of evidence due to the minimum filing requirement which was not available in past proceedings. However, in the event the Commission determines there is a need for oral evidence, the FBCU submit that the oral phase should be restricted to expert testimony on the cost of capital of the benchmark. In their estimation this will create greater focus and reduce “the risk of diminishing returns.” (Exhibit B1-22, pp. 11-12, T1: 59-61)

Corix and PNG both state they are in agreement with the comments of FBCU. (T1:63-68)

ICG strongly disagree with the position of the utility participants. ICG asserts that proceedings such as these are challenging and the Commissions’ need to weigh the expert evidence will benefit from cross-examination. With respect to restricting the oral phase to expert testimony on the cost of capital, ICG cites the example of the automatic adjustment mechanism as an example of an important issue which would be excluded. (T1:67)

BCPSO agrees with the views ICG with respect to an oral phase and one that that is a full hearing. In support of its position BCPSO states that “we’re going to see competing evidence from experts on what the appropriate ROE should be, and those determinations are reliant on a number of judgement calls and those can only and best be tested by live cross-examination.” Additionally, BCPSO notes that the increased role of BCUC staff in an oral proceeding ameliorates to an extent the utilities resources versus those of the Interveners. (T1:70-71)

AMPC submits it supports having an unrestricted oral proceeding. AMPC notes that the Commission will be hearing conflicting opinion evidence from both experts and non-experts on difficult issues like ROE, capital structure, the automatic adjustment mechanism and business risk. AMPC asserts that while information requests are good for getting background facts, the Commission and the parties should have the opportunity to ask questions of others and bring out the strengths and weaknesses in a manner that does not happen in a written process. Moreover, in its view, argument is not an adequate substitution for cross-examination. (T1:72)

None of the participants made further submissions with respect to the Regulatory Timetable.

Commission Panel Determination

The Commission Panel has determined that adding an oral phase to the GCOC proceeding is appropriate.

While the Panel acknowledges the concerns raised by the Affected Utilities with the costs of an oral phase and the fact that there will be extensive written evidence, we are of the view that the benefits of affording all of the parties an opportunity for cross-examination is worth the additional time and costs. As a number of Interveners have submitted, cost of capital proceedings involve difficult issues upon which there are often opposing points of view. Both the Commission and the participants will benefit from having the opportunity to examine them in finer detail through cross-examination. The Panel also acknowledges the comments of BCPSO that the increased role of BCUC staff will offer benefits in the decision making process.

The Commission Panel also accepts the view of the Interveners with respect to the FBCU proposal to restrict the content of the oral phase. We are not persuaded there is a need to restrict cross-examination as it may only serve to frustrate the participants.

As noted, none of the participants made submissions with respect to the Regulatory Timetable. The oral phase of the GCOC proceeding will commence on December 12, 2012 as outlined in the Amended Preliminary Timetable. Given the time of year, the Commission Panel will not make a determination with respect to the timing of Final and Reply Submissions at this time. Participants will be canvassed on this matter during the oral phase of the proceeding.