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Active Support Against Poverty
BC Coalition of People with Disabilities
Counsel of Senior Citizens' Organizations of BC
And
Tenant Resource & Advisory Centre Society
Collectively referred to as "BCPSO et al."

FINAL SUBMISSION

BRITISH COLUMBIA UTILITIES COMMISSION
GENERIC COST OF CAPITAL PROCEEDING

Project No. 3698660

February 15, 2013

Part 1: Introduction

On November 28, 2011, the Commission issued a Preliminary Notification of the Initiation of a Generic Cost of Capital (“GCOC”) Proceeding. This was followed by G-20-12 in February of 2012 initiating this GCOC process to review: “(a) the setting of the appropriate cost of capital for a benchmark low-risk utility; (b) the possible return of an 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.”

Any process to set the ROE and Capital Structure for FEI as a benchmark utility is important not only to that one utility’s ratepayers, but to all ratepayers of utilities whose ROE’s are benchmark linked. As in the Terasen Gas Inc. (TGI), Terasen Gas (Vancouver Island) Inc. (TGVI) and Terasen Gas (Whistler) Inc. (TGW) (collectively, Terasen Utilities) Return on Equity (ROE) and Capital Structure process (“the 2009 Process”), the outcome of this GCOC hearing is of great importance to our clients and indeed all customer groups because both FEI’s equity thickness and ROE have significant cost implications. This common concern is evidenced by our decision to repeat the 2009 co-sponsorship of the evidence of Dr. Lawrence Booth with the Association of Major Power Customers of British Columbia (“AMPC”), known in that process as JIESC, and the Commercial Energy Consumers Association of British Columbia (“CEC”).¹

Because AMPC took the lead in presenting Dr. Booth’s evidence they are in a better position to file a submission that addresses all the technical matters at issue. In advance of its filing, we reviewed their submission on this matter and we both endorse and adopt it as our own while adding our own less technical, more common sense perspective and analysis where appropriate. As in the past, silence on any issue should not be construed as agreement with FBCU’s position.

Part 2: The Fair Return Standard

BCPSO agrees with much of FBCU’s characterization of the fair return standard, but disagrees with FBCU’s submission regarding its consequences.

As stated in the FBCU Final Submission, the conceptual framework underlying proceedings such as this is that a utility’s cost of capital is one component of its cost of service that is recoverable in rates². The impact on customers is irrelevant to determining the cost of capital in the sense that the utility’s cost of capital does not

¹ Exhibit C-16, AMPC Evidence on Behalf of Utility Customers.

² FBCU Final Argument, para. 18.

change simply because allowing it to be recovered would cause an increase in rates³. Conceptually, this is no different than saying that the cost of a length of pipe does not change simply because allowing its cost to be recovered would cause an increase in rates. BCPSO agrees utilities are entitled to a competitive return -- defined as a return that meets the comparable investment, financial integrity and capital attraction requirements⁴ -- regardless of the rate impact.

However, having adopted a cost of service model, the BCUC must be satisfied that each of the components making up the cost of service has been accurately and prudently stated. This duty is a necessary component of the duty to ensure rates are just and reasonable for both the utility and its users⁵. To say that rate impacts are irrelevant to the determination of a competitive return is not to say that customer interests carry no weight in setting an appropriate deemed cost of capital. As noted by the Federal Court of Appeal in the *TransCanada Pipelines* decision, utility customers have an interest in ensuring that the utility's cost of capital is not overstated⁶.

FBCU argues that the overall rate of return allowed for FEI must be based on the utility's 'true' cost of capital, as though adding the adjective confers objectivity and narrows the range of reasonable outcomes. But there is no 'true' cost of capital any more than there is a 'true' cost of pipeline maintenance or a 'true' cost of commodity. This is a forward looking exercise, undertaken in a continually changing world where investment decisions are made based on limited information. We have no choice but to rely on statistics and averages and indices and formulas, but we do ourselves a disservice in believing these tools can do more than help us identify a range of reasonable outcomes.

Consequently, BCPSO submits that FBCU is wrong to dismiss the evidence of Drs. Safir and Booth as misapplying the fair return standard by considering customer interests. On the contrary, BCPSO submits that Dr. Safir is correct in saying that "where a range of competitive returns is available for evaluation, the outcome of a 'fair return' should always favour the lower range presented"⁷. Dr. Safir's statement explicitly assumes the 'fair return' is being chosen from among a range of 'competitive returns'. In the immediately preceding paragraph, Dr. Safir identifies a 'competitive return' as one that meets the three part test described by FBCU as the 'fair return standard'. Dr. Safir says:

³ *TransCanada Pipelines Ltd. v. Canada (National Energy Board)*, 2004 FCA 149 at paras. 35-36.

⁴ FBCU Final Argument, para. 12.

⁵ *TransCanada, supra*, at paras. 33-34.

⁶ *TransCanada, supra*, at para.34.

⁷ Exhibit C4-9, ICG Evidence, Safir Evidence, p.7, ll.16-18 and FBCU Final Argument, para. 21.

Typically, as stated by utilities, this principal involves ensuring a regulated utility the opportunity to (a) attract capital on reasonable terms; (b) earn a return on investment commensurate with that of enterprises of comparable risk; and, (c) maintain its financial integrity. It is sometimes shortened to “an opportunity to earn competitive returns of and on capital,” and is often referred to by utilities as “the regulatory compact.”⁸

Starting from the premise that a utility is entitled to receive a competitive return, the Commission is obligated to choose a ‘competitive return’ that is also a ‘fair return’, and a ‘fair return’ is one that takes into account the right of utility customers to pay no more than a ‘fair and reasonable’ charge for the service provided. To use an analogy, the utility is entitled to receive a competitive return the same way it is entitled to include the cost of a length of pipe in rate base. But, just as the utility is not entitled to recover in rates any amount that it may choose to pay for a length of pipe, however exorbitant, in the same way the utility is not entitled to receive any competitive return it may seek, however exorbitant. The utility is only entitled to receive in rates the lowest reasonable competitive return. This is essentially what Dr. Safir said when he said:

Consequently, where a range of competitive returns is available for evaluation, the outcome of a “fair return” should always favor the lower range presented.”

This interpretation accords with the dual findings of the Federal Court of Appeal in *TransCanada Pipelines, supra*, that:

The cost of equity capital does not change because allowing the [utility] to recover it would cause an increase in tolls [at para. 36], and

Tolls which reflect a fair return on capital will be just and reasonable to both the [utility] and its users [at para.33].... customers and consumers have an interest in ensuring that the [utility’s] cost of equity is not overstated [at para.34].

In response to FBCU Final Argument paragraph 20, BCPSO submits that based on the foregoing, the evidence comparing the rate impact of a 5% change in the equity ratio to a 50 and 100 basis point change in ROE is admissible⁹. If the utility can be provided a competitive return with less rate impact, that option should be chosen.

⁸ Exhibit C4-9, ICG Evidence, Safir Evidence, p.7, ll. 3-8.

⁹ Exhibit B1-42, FBCU Undertaking No.7; Tr 2, p.277, l.20 to p.284, l.25 and Tr 3, p.302, l.14 to p.303, l.24

Part 3: Capital Market Conditions

Appropriate Comparators

It is inappropriate for FBCU to suggest that the appropriate dates for the comparison of capital market conditions are the date of decision in the 2009 proceeding (December 16, 2009) and the date of evidence in the 2012 proceeding (August and December 2012). To the extent a comparison of economic data is made, the comparator dates must be consistent across the two proceedings.

The BCUC's 2009 Terasen Utilities ROE & Capital Structure decision does not reference specific dates or capital market index levels, nor does it contain a detailed discussion of the overall condition of the capital market at the relevant time. The limited discussion of capital markets that is undertaken in the 2009 Decision is contained entirely in the section dealing with the automatic adjustment mechanism. All of the relevant references in that section are to the written evidence of Terasen's experts, Mr. Carmichael and Dr. Vander Weide. This evidence was submitted to the BCUC by letter dated May 15, 2009. Mr. Carmichael's written evidence on capital market conditions focuses on the financial crisis that unfolded in late 2008/early 2009, and its impact on the broader economy. Dr. Vander Weide's evidence focuses on the inability of the then existing AAM to make up the gap between the cost of equity and the yield on long-Canada bonds. It appears from this that the evidence relating to capital market conditions relied on by the BCUC in reaching the 2009 Decision, pre-dated the filing of evidence in May 2009. If this is correct, the appropriate comparator is the capital market conditions pre-dating the filing of evidence in this proceeding in August 2012.

It does not seem reasonable to assume, as FBCU appears to do¹⁰, that the relevant point of comparison is the date the 2009 Decision was issued, nearly 3 months after the close of evidence in that proceeding. The FBCU assumption appears to be based on a line in Recital D of Order G-20-12 initiating the proceeding:

Since the issuance of the 2009 ROE Decision, changes have occurred in the financial markets.

However, there is no indication the BCUC sought out or considered evidence relating to capital market conditions in December 2009. Alternatively, if the date of decision is the appropriate comparator, it behooves the BCUC to seek out and consider evidence relating to capital market conditions at the time it makes its decision in or about April 2013.

¹⁰ FBCU Final Argument, para.30

Purpose of Capital Market Conditions Evidence

This proceeding is forward-looking from the date of the hearing. That is, the hearing concluded on December 21, 2012, and the cost of capital and capital structure determined in this proceeding will be effective January 1, 2013¹¹ until it is adjusted either automatically or in a new proceeding. Accordingly, backward-looking or snapshot-style evidence of past capital market conditions is of limited value. The economic tests (equity risk premium, comparable earnings and discounted cash flow) provide a better basis for assessing the cost of capital because are more precise, forward-looking, and can be made industry or company specific. It seems, then, that evidence relating to general capital market conditions is of value in a proceeding like this primarily for the trends it displays. In particular, the question is: How difficult will it be for FBCU to attract capital in 2013-2015?

It is normal for capital markets to experience some volatility, and the equity markets continue to do so despite having substantially recovered from the 2008/2009 financial crisis. Based on the various charts and graphs presented in evidence by Mr. Engen, however, it does not appear that the volatility experienced in the market since late 2009 has been significantly greater than that experienced prior to the fall of 2008. That is, the graphs presented by Mr. Engen consistently show a precipitous drop/spike pattern occurring in 2008/2009 with conditions normalizing significantly thereafter. Although evidence was heard in 2009 near the top of the spike, the pattern of the immediately preceding time period was decidedly abnormal.

The rising prices and relative stability seen in equity markets during 2010-2012 suggests a return to normal in the equity arena, and the suppression of government bond yields has artificially lower rated in the debt arena. No evidence was submitted in this proceeding suggesting that the enthusiastic support of financial markets by the global policy maker is coming to an end. There is also little danger posed to capital markets by foreseeable future events, such as the (former) European sovereign debt crisis or the (formerly approaching) “fiscal cliff”. These events have already been priced into the market. By contrast, the extreme volatility, uncertainty and large-scale flight to quality seen in 2008/2009 are “foreseeable” only with the benefit of hindsight.

Price to Earnings Ratios

In his written evidence, Mr. Engen testified that “The falling trend in the S&P/TSX’s P/E ratio over the past two years taken together with growth in corporate earnings during the same period as demonstrated in Figure 9, is compelling evidence that the cost of equity in Canada has been rising.” However, in response to FBCU-BCUC IR 1.19.1, FBCU

¹¹ Order G-47-12, Appendix B

indicated that the P/E ratio for the utilities sector has been increasing since 2009¹², suggesting that there is a declining cost of equity for this sector. In its Final Argument¹³, FBCU suggests this result for the utilities sector is due to unique circumstances with respect to Enbridge and does not suggest a lower cost of utility equity generally. However, when asked about the current P/E ratio excluding Enbridge, Mr. Engen indicated that the value was higher than the ten-year average¹⁴. A general improving trend in the P/E ratio since 2009 for all six utilities can be seen from a visual inspection of the response to FBCU-BCUC IR 1.19.2. Overall, this would suggest that there has been no increase in the cost of utility equity since the 2009 proceeding and, indeed the cost of utility equity has declined.

If we narrow the focus even more, from the utility sector to FEI, we see that FEI's credit spreads are roughly the same as they were at the conclusion of the 2009 proceeding and lower than they had been earlier in 2009¹⁵.

Part 4: The Short-Term Business Risk

Short term risk is defined as the Company's risk of not earning its allowed ROE on a year to year basis¹⁶. FBCU's position is that FEI's short term risk is essentially the same as in 2009¹⁷ and they focus on the Company's demonstrated ability to earn its allowed ROE and the role of deferral accounts in mitigating risk.¹⁸

In its 2009 Decision the BCUC noted that TGI had earned more than its allowed ROE in 13 of the 15 years since 1994.¹⁹ Information filed in this proceeding²⁰ indicates that in the three additional years for which there is now information FEI over earned in two of the years and fell just short of meeting its approved ROE (a variance of -0.08%) in the third. This record of results is consistent with that considered by the BCUC in 2009 and supports the view that its short-term business risk is unchanged.

There is agreement between FBCU and Dr. Booth that the definition of risk is the possibility of suffering harm, or losing money in the present context.²¹ FBCU earned a record amount in 2011, with \$139.1 million in regulated earnings, and they expect those

¹² Exhibit B1-20, FBCU-BCUC IR 1.19.1

¹³ FBCU Final Argument, page 25

¹⁴ T6, p. 936

¹⁵ T3, p.325

¹⁶ FBCU Final Submission, page 38

¹⁷ FBCU Final Submission, page 45

¹⁸ Final Submission, pp. 37-38

¹⁹ 2009 Decision, pp. 26-27

²⁰ Exhibit B1-11, FBCU – BC Utility Customers IR 1.2.1

²¹ T2, page 123, ll 17-23; Exhibit B1-15, IR 4.1, page 10; Exhibit C6-12, Booth Report page 26

earnings to increase year over year.²² In BCPSO's submission this suggests a very low risk of losing money and therefore low short term risk.

Impact of deferral accounts

In its 2009 Decision the BCUC recognized the role of deferral accounts in reducing short-term business risk.²³ FBCU notes in its Rebuttal Evidence²⁴ that, relative to 2009, there are two new deferral accounts: one to address the unique circumstances related to the implementation of the Customer Care system and another relating to depreciation. In its Final Submission, the Company also notes that the depreciation-related account was not requested by FEI and that the longevity of both accounts is uncertain.

While the deferral account coverage of the revenue requirement has not changed materially, these two new deferral accounts demonstrate the continued willingness of the BCUC to use deferral accounts to address short-term challenges faced by the Company. It should be noted that the deferral account discussions in the Rebuttal Evidence and Final Submission both neglect to mention the Compliance to Emissions Regulation account sought by FEU in its 2012/13 Rate Application²⁵ which is a further example of the BCUC's willingness to mitigate the impact of short-term uncertainties. As such, the introduction and approval of new accounts such as these indicates that the short-term business risk should be viewed as no greater, and likely less than it was in 2009.

In 2009 BCOAPO (as BCPSO was then known) stated that "Terasen's [now FBCU] largest risk remains weather forecast variances which are mitigated by RSAM; a risk that has not changed since 2005." BCPSO further submits that this risk has not changed since 2009. In sum, BCPSO submits that FBCU's short-term business risk is lower than it was in 2009.

Part 5: The Long-Term Business Risk

BCPSO's views on long term risk are straightforward: commodity prices have dropped significantly, resulting in a greater cost advantage relative to BC Hydro rates that is likely to continue in the coming years. The trends of lower use per customer, capture rates and market share are not new and FBCUs customer count continues to grow.

²² T2, page 231, ll 6-22

²³ 2009 Decision, page 19

²⁴ Exhibit B1-32, page 5

²⁵ Exhibit B1-9-6, Appendix H, page 54, Footnote 40

Importantly, the trend of decreasing throughput bottomed out in 2009 and has increased in each year since.

Framework for assessing risk

BCPSO adopts and echoes AMPC's submissions on the FBCU's asserted framework and ranking of business risk. While assessing risk is inevitably a subjective exercise that requires a number of judgment calls, BCPSO submits that speculating on regulatory risk and political risk and then asserting that these are higher than energy price and energy supply respectively, is not helpful in assessing overall risk, as it may distort the impact of what clearly and measurably affects FBCU's risk. To that end, BCPSO re-iterates that energy price and energy supply are two factors that are inextricably linked with the FBCU's business and business risk.

BCPSO further submits that two axes upon which to assess relative risk are useful in assessing the various factors set out by FBCU: the level of risk relative to past decisions; and the level of risk now and in the future relative to the comparators and competitors. These axes are applied within the context of the relevant factors below.

Competitive Position of Natural Gas Relative to Electricity

MS. DES BRISAY: A: Yes, Mr. Wallace, I think that the company agrees that the outlook for natural gas prices is certainly lower than it was in 2009.²⁶

It is not in dispute that natural gas commodity prices have fallen since the 2009 proceeding.²⁷ However, FBCU submits that "competitive factors other than commodity price are still at work, such that lower commodity prices have not translated into materially lower long-term risk for FEI since the close of the 2009 proceeding."²⁸ These other competitive factors include: i) the higher capital costs associated with natural gas used versus electricity, ii) the volatility of natural gas prices, iii) the rising delivery cost for natural gas and iv) the projected future increases in natural gas prices.

Higher capital cost was also cited by TGI in the 2009 proceeding as a factor that weakened the competitive position of natural gas as compared to electricity:

²⁶ T2, page 128, ll 24-26

²⁷ FBCU Final Submission, page 58

²⁸ FBCU Final Submission, page 64

Residential and commercial space and water heating are the primary markets for the Terasen Utilities. Capital costs, including installation, are greater for natural gas than electricity for these applications. Figure 3.4 at page 31 of Tab 1 of the Application sets out a payback calculation showing that due to higher capital costs natural gas needs an operating cost advantage of \$10.31 per gigajoule (GJ) over 18 years, when comparing natural gas heating in a home to heating by electricity in the home²⁹.

While this factor continues to exist today, there is no evidence that its effect has increased such that it will offset any of the competitive gain made through lower commodity prices. Indeed, FBCU rates the risk associated with higher capital costs as being the same as in 2009³⁰

Natural Gas Price Volatility

Similarly, natural gas price volatility was also cited by TGI in its final submissions³¹ for the 2009 proceeding as being a factor that weakened the competitive position of natural gas relative to electricity:

Natural gas commodity prices became more volatile, as can be seen in the graph on page 8 of the BC Hydro Service Plan, August 2009 Update, Exhibit B-16 (re-produced below). Higher and more volatile natural gas commodity costs have two effects: decreased usage of natural gas, and increased public awareness of volatile market based pricing of natural gas and other fossil fuel energy sources.³²

FBCU's Final Submission attempts to support its argument regarding commodity price volatility by showing the range of forecast prices associated with the AECO Forward Curve based on a 95% confidence interval³³. However, this graph tells the Commission nothing about the change in the volatility of natural gas prices since 2009. Indeed, it only tells the obvious which is that the further out one goes in the future the greater the uncertainty about prices.

²⁹ TGI 2009 Process Final Submission, page 7

³⁰ Exhibit B1-9-6, Appendix H, page 5

³¹ 2009 Process TGI Final Submission, pp. 7-9

³² 2009 Process TGI Final Submission, pp. 8-9

³³ FBCU Final Submission, page 63

What the evidence in this proceeding does show is that the volatility of natural gas at the end of 2012 was actually less than for the same month at the end of 2009³⁴. As a result, there is no evidence to suggest that natural gas price volatility will increase over what was seen in 2009 and therefore serve to offset any of natural gas' competitive edge gained through lower commodity prices.

Rising Delivery Costs/Projected Future Natural Gas Prices

FBCU notes that, since 2009, delivery cost have increased such that there is effectively no reduction in the bill seen by customers.³⁵ FBCU also claims that the remaining gap is likely to disappear as commodity prices continue to rise³⁶.

What is more important from a "competitive perspective" is how the all in price for natural gas compares with that for electricity. The total customer cost for natural gas has *decreased* between 2009 and 2012³⁷ while the customer cost of electricity has continued to increase. The result is that the total bill advantage of natural gas over electricity has increased.³⁸ For a lower mainland Residential space heating customer the advantage has increased from 28% in 2009 to 45% in 2012, even after allowing for the impact of the carbon tax. For a similar customer, the water heating total bill advantage has increased from 5% to 16%.

FBCU's claim that natural gas commodity prices will rise in the future is not new. As Exhibit B1-37 (Undertaking #2) indicates, natural gas commodity price forecasts prepared in 2009 (and subsequently) all called for higher future gas prices. What has changed since 2009 is that these future increases are now leveraged off of a much lower base commodity rate, such that the forecast price for 2020 is now \$6 as opposed to \$9.³⁹ As Ms. DesBrisay stated:

Where we think prices will be in 2020 today is lower, and significantly lower, where we thought prices in 2020 would have been when we were looking out in 2009.⁴⁰

The overall result is that the total customer bill for natural gas is *lower* in 2012 than in 2009; will most likely also be lower in 2020 than was expected at the time of the 2009

³⁴ Exhibit B1-37 – Undertaking #2

³⁵ T3, page 344 and FBCU Final Submission, page 57

³⁶ FBCU Final Submission, page 65

³⁷ Exhibit B1-37 (Undertaking #2)

³⁸ Exhibit B1-11, FBCU – BC Utility Customers 1.4.2

³⁹ T2, page 146

⁴⁰ T2, page 148

proceeding. Thus, it is clear that the competitive advantage of natural gas over electricity (based on total bill) has improved since 2009.

Trends in Natural Gas Use and Demand

FBCU points to a number of trends in natural gas use such as declining use per customer (UPC) and lower capture rates for new housing⁴¹ as sources of business risk. However, these risks are not new. The same risks were raised by TGI in its Final Submissions for the 2009 proceeding:

The use of gas per account of TGI continues to decline. This was a risk factor identified in the 2005 Application, and has continued to occur. As an example, the TGI normalized annual usage rate for Rate Schedule 1 customers (residential customers) has declined from 103.1 GJs in 2003 to 92.5 GJs in 2008; with the projected annual use rate for Rate Schedule 1 for 2010 being 89.7 GJs. This decline in use rate can be attributed to factors such as the price of natural gas compared to other energy prices, improved efficiency of natural gas appliances and changes in housing mix within the residential sector. It is expected that these factors will continue into the future.⁴²

[...]

In addition to declining use per customer, TGI is also affected by reduced customer additions. This is discussed at pages 32 to 34 of Tab 1 of the Application⁴³

[...]

TGI has been faced with declining use per account for a number of years, which is forecast to continue. Declining use per account increases the per unit delivery rate. TGI has been affected by a shift in the new construction market, with a greater proportion of multi-family dwellings being constructed. TGI's capture rate in multi-family dwellings is low compared to single family dwellings. TGI has been adding customers, but at a lower rate than in the past. The delivered price of natural gas to consumers has increased more than have BC Hydro's electricity rates. All of these

⁴¹ FBCU Final Submission, pp 50-52

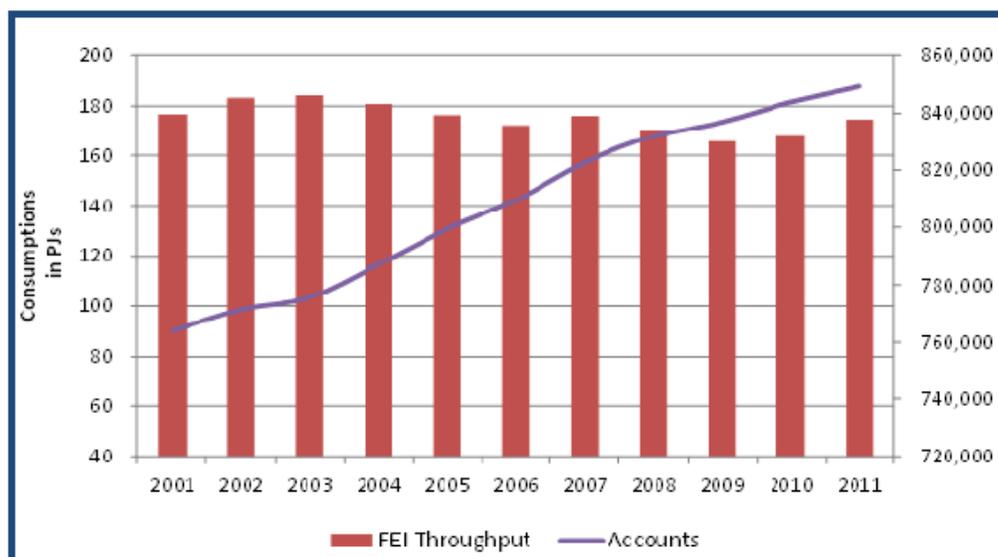
⁴² *Ibid* at pp. 9-10

⁴³ *Ibid* at p.11

factors contribute to an increase in the long-term business risks of TGI⁴⁴. (pages 13-14)

The BCUC acknowledged these risks in its 2009 Decision.⁴⁵ As a result, they are not new.

Figure 4. FEI's Total Throughput (Normalized Demand vs. Customer Accounts)



Note: This graph includes Lower Mainland, Inland, Columbia and Revelstoke service areas. Industrial demand includes both sales and transportation volumes.

B-1 Appendix H, p. 9

Indeed, circumstances are nowhere near the “death spiral” that TGI painted⁴⁶ for the Commission in its 2009 Submissions: Unit use is only declining slowly (15% over 10 years)⁴⁷ and appear to have leveled off somewhat since 2008⁴⁸; and FBCU continues to have positive customer additions.⁴⁹ What is new since the 2009 hearing is that the trend of declining throughput reversed starting in 2009 and has increased in each year since.⁵⁰

⁴⁴ *Ibid* at pp. 13-14

⁴⁵ 2009 Decision, page 20

⁴⁶ 2009 Decision, page 22

⁴⁷ T2, page 199

⁴⁸ Exhibit B1-9-6, Appendix H, page 32, Figure 21

⁴⁹ Exhibit B1-11 FBCU – BC Utility Customers 1.4.4

⁵⁰ Exhibit B1-9-6, Appendix H, page 9, Figure 4

Regulatory Risk

The “death spiral” scenario, faced more plausibly by PNG in the recent past only confirms the BCUC’s willingness to go to “significant lengths”⁵¹ to ensure the viability of BC utilities. This regulatory support is acknowledged and appreciated by PNG in their final argument.⁵²

FBCU characterizes “regulatory risk” as its number one risk.⁵³ The reason for this appears to be the fact that⁵⁴:

Regulatory framework does place fundamental business decisions in the hands of the regulator that would otherwise be in the hands of the company itself, and that does entail regulatory risk.

The other reason appears to be the fact that “administrative penalties” have recently been introduced as applicable to FEI⁵⁵.

Decisions by the BCUC can and should have a material impact on the FBCU. However, risk is based on not only possible impact but also the probability of the outcome in question occurring. In the case of the BCUC, FBCU has acknowledged that cost of service regulation is nothing new and that “the regulatory constructs that govern how FEI forecasts essentially the same constructs that have been in place for many years.”⁵⁶ Furthermore, FBCU has confirmed that it does not believe that the BCUC will do anything that is unreasonable.⁵⁷

With regard to administrative penalties, FBCU has confirmed⁵⁸ that they only apply if “you do something you shouldn’t” and the penalty imposed would be proportionate to the misconduct.⁵⁹

Overall, FBCU’s witnesses have confirmed⁶⁰ that the regulatory environment is “pretty predictable and stable” and regulatory risk should not be viewed as FBCU’s number one risk factor.

⁵¹ Exhibit C6-12, AMPC Evidence, Dr. Booth testimony, p. 1630

⁵² PNG final argument at p.6

⁵³ Exhibit B1-9-6, Appendix H, page 5 (Table 2)

⁵⁴ T2, page 92

⁵⁵ T2, page 209

⁵⁶ T2, page 92

⁵⁷ T2, pp. 208-9

⁵⁸ T2, page 209

⁵⁹ T2, page 210

Relative to the supply and price of energy, over which the FBCU have no control, regulatory risk is much more predictable and within the control of the utilities, in terms of what and when they file for approval within a predictable, stable environment in which the utilities have always operated.

Provincial Energy Policies

BCPSO submits that the political risks faced by the FBCU today are significantly lower than the picture they painted in 2009, as discussed in the 2009 decision:

Terasen states that the BC Carbon Tax, implemented effective July 1, 2008, to help the Province reach its GHG reduction targets, reduces the competitiveness of natural gas relative to alternative energy sources that are not subject to the carbon tax, and provides a direct pricing signal to customers in relation to GHG emissions. The tax started at \$10/tonne of GHG and will increase by \$5/tonne each year to \$30/tonne by 2012. Terasen cites the BC Climate Action Team's recommendation that: "After 2012, if required to achieve the emissions targets, increase the British Columbia carbon tax in a manner that aligns with the policies of other jurisdictions and key economic facts." (Exhibit B-1, Tab 1, pp. 10-11).

A Terasen witness testified that "and there are calls...from certain academics and others that say in order for the government to get the consumption of GHGs down, it's going to have to move to \$300. So, that's \$15 a GJ [gigajoule], not \$1.50, on top of the commodity and the delivery rates" (T2:155). \$300 per tonne is also the carbon tax assumed by 2026 in the Nyboer Report discussed later in this Section (Exhibit B-11, Panel 1.1).⁶¹

In contrast, in the current proceeding it was acknowledged that there are no plans to move the carbon tax beyond the current \$1.50 / GJ level⁶². Furthermore, earlier plans regarding emissions trading and the Western Climate Initiative are no longer being

⁶⁰ T2, pp. 229-230

⁶¹ 2009 Decision, Page 21-22.

⁶² T2, pp. 224 and 244

actively considered.⁶³ Indeed, to date, implementation of the Government's climate change and energy policies has proven to be less onerous for FEI than the picture set out by the Company in 2009.

Furthermore, the recently released BC Natural Gas Strategy⁶⁴ calls for the adoption of natural gas as a transportation fuel, and can be viewed as nothing but favourable for the FBCU. The same goes for the recent changes to the demand-side regulation⁶⁵ and the *Greenhouse Gas Reduction Regulation*, both of which were the result, in part of FBCU's efforts to lobby the Provincial government. With the *GGRR*, in particular, FBCU 'took the lead' in conversations with the Provincial Government, and promotes the use of Natural Gas in transportation through a \$62M incentive courtesy of FBCU's ratepayers.

Aboriginal Rights

FBCU claims that it faces a similar level of risk with respect to aboriginal claims as it did in the 2009 proceeding⁶⁶. At the time of the 2009 proceeding, Terasen submitted that there was a lack certainty as to the nature and extent of aboriginal rights and title in BC which, combined with the lack of treaties create operational and regulatory complexity and a risk of litigation.⁶⁷ The Commission concluded that it did not "cast doubt over TGI's ability to earn a return on or of its capital."⁶⁸

Since then, FBCU has gained experience with First Nations' consultations through its CPCN Applications⁶⁹. This experience should have increased FBCU's understanding of aboriginal rights and title claims as well as the operational and regulatory complexities of dealing with them. Overall, this should have reduced FBCU's level of risk relative to that faced at the time of the 2009 proceeding.

There is no doubt that FBCU's risk relative to BC Hydro on this issue is lower: BC Hydro is a Crown Corporation who has a Constitutional duty to consult and uphold the honour of the Crown. That cannot be said to be the case for FBCU.

⁶³ T2, page 224

⁶⁴ Exhibit C6-17

⁶⁵ T2, pp. 239-240

⁶⁶ Exhibit B1-9-6, Appendix H, page 51

⁶⁷ 2009 BCUC Decision, page 25

⁶⁸ 2009 Decision, page 42

⁶⁹ For example – 2010 Kootnay River Crossing Upgrade CPCN

Conclusion on Business Risk

In BCPSO's submission, FBCU's business risk as compared to 2009 must be considered lower. Short term risk is similar to that in 2009 (already very low), with record earnings and a continued use of deferral accounts. The lower commodity price has resulted in a lower total cost to natural gas customers compared to 2009 and those prices are predicted to be even lower moving forward than was anticipated in 2009. The trend of declining throughput has reversed since 2009, while trends in use per customer, capture rates and market share are the same. Political risk has improved since 2009, while regulatory and indigenous rights risks remain the same. Overall, FBCU's business risk is lower than in 2009.

Part 6: FEI's Capital Structure

BCPSO recognizes the importance of an appropriate capital structure because it is supposed to accurately reflect the relative riskiness of the utility and both signal and ensure its financial stability. If a utility's capital structure is skewed too far towards debt, the utility is subject to greater business risk. It becomes a comparatively unattractive venture for equity investors and ratepayers suffer because the utility is unable to secure reasonably low cost terms for capital. If the utility's structure is skewed too far towards equity, an unfair and unreasonable burden is placed on its ratepayers who bear the increased costs associated with that unnecessarily greater equity thickness. The introduction to section 5 of AMPC's submission provides a summary of Dr. Booth's evidence demonstrating the significant spread between costs borne by ratepayers for debt versus equity. This summary highlights the importance of ensuring, to the degree possible, that FEI's capital structure is calibrated properly to reflect the true risks the utility and its shareholders face.

Comparators

Much has been made of comparators in this process. Comparators for business risk, for ROE, for capital structure and so on. This is again a subject matter that is part art posing as a pure science requiring, in the end, the exercise of our regulator's logical and common sense judgment. Canadian regulated utilities such as those examined by Dr. Booth provide a reasonable and logical range of appropriate equity ratios unadjusted to account for FEI's specific business risk: 36% to 38.5%. The utilities Dr. Booth used to develop this range – ATCO Gas, Gaz Métro, Union Gas and Enbridge Gas Distribution Inc. – have much in common with FEI. They too are large, well-established and dominant gas distribution utilities. Dr. Booth's one other comparator, Nova Scotia Power Inc. (NSPI), is not a gas distribution utility but rather a monopolistic province-

wide integrated electricity utility.⁷⁰ Aside from the one obvious difference, we submit that NSPI has much in common with FEI and is therefore a reasonable addition to the comparator group.

Because the equity ratio range generated by this comparator group is unadjusted to account for FEI's specific (and lesser) business risks, it is not what BCPSO, AMPC, and CEC ask the Commission to consider as the utility's final equity thickness. It does, however, still form a strong basis upon which to proceed to determine what that final equity ratio should be.

Business Risk

Business risk is an umbrella term that covers a number of kinds of risk: regulatory risk, supply risk, operating risk, political risk, market shift, and commodity pricing. BCPSO accepts that an assessment of business risk, like many other aspects of this process, requires the exercise of no small amount of judgment. This is not a situation where the utility, interveners, or the Commission can apply a certain set of rigid values to FEI's circumstances to determine risk in absolute terms but logic and common sense must be exercised. As evidenced by Parts 4 and 5 of this submission as well as our adoption of AMPC's argument, BCPSO does not accept FBCU's representations regarding FEI's current business risks or its illogical and opportunistic ranking of those risks and we urge the Commission to exercise its own judgment rather than accepting FBCU's submissions on risk.

In 2009, the Commission accepted FBCU's corporate predecessor's risk assessment comparators and agreed that Terasen Inc.'s equity ratio would be 40% rather than the 35% to 38% range considered appropriate before business risk was considered.⁷¹ We, like AMPC and CEC, submit that it is clear on the evidence that FEI's business risk has decreased since the 2009 Process, negating the need to maintain its current 40% common equity thickness. Our clients ask this Commission Panel to reduce FEI's equity ratio to reflect its true business risk, thereby reestablishing that delicate balance between ratepayer interests in just and reasonable rates and the utility's operational requirements.

Part 7: The Appropriate ROE for FEI

As stated before, we are content to rely upon AMPC's submission in its entirety. Due to the highly technical nature of the subject matter dealt with in this section, BCPSO will offer no further comment.

⁷⁰ Exhibit C-12, AMPC Evidence on Behalf of Utility Customers, pp. 2 and 43.

⁷¹ TGU ROE and Capital Structure, Commission December 16, 2009 Decision, pp. 36-7.

Part 8: Automatic Adjustment Mechanisms

The Automatic Adjustment Mechanism or “AAM” was a formula developed by this Utilities Commission in 1994 to set on a yearly basis the Rate of Return on Equity (“ROE”) for Terasen Gas Inc. as the low-risk benchmark utility. This formula created fair returns and significant regulatory efficiency by tying the utility’s ROE to the forecast yield on long term Canada bonds for the coming year and it was subsequently adopted by many Regulators across the country. In the 2009 Terasen Gas Utilities ROE and Capital Structure process, the Applicant’s corporate predecessor relied upon the evidence of its three expert witnesses to argue for the elimination of the AAM. Because the formula failed to yield an ROE figure equivalent to the one the Commission Panel determined was appropriate for 2010, the AAM was eliminated.⁷²

In this process, the Commission asked whether a return to the AAM is warranted. Not surprisingly, given its corporate predecessor’s position in the 2009 hearing, FBCU rejects this possibility and asserts again that the allowed ROE for the benchmarked utility should only be set at periodic proceedings. BCPSO, like AMPC and CEC, disagrees and submits that this is indeed the time to reinstitute an AAM.

On behalf of the BC Utility Customers, Dr. Booth presented evidence of an enhanced ROE adjustment formula that ties the adjustments of the benchmark utility’s ROE to the Long Term Canada Bond but also includes an a credit market adjustment to prevent the result from being skewed too low should the LTCB rate remain low while the cost of debt continues to rise.⁷³ Dr. Booth’s formula was presented as follows:

$$\text{ROE} = 7.50 + 0.50 * (\text{Spread} - 1.80\%) + 0.75 * (\max(\text{Forecast LTC Yield}, 3.80\%) - 3.80\%).^{74}$$

However, because this formula is not tied to his recommended ROE of 7.5%, it could be presented in the following manner to avoid any perception that Dr. Booth’s ROE recommendation in this process is a requirement for the formula to work:

$$\text{ROE} = \text{Commission Approved ROE} + 0.50 * (\text{Spread} - 1.80\%) + 0.75 * (\max(\text{Forecast LTC Yield}, 3.80\%) - 3.80\%).$$

In Part Eight of its Submission, FBCU asserted that the implementation of an AAM would result in no regulatory efficiencies because both they and other parties to the process are contemplating periodic ROE reviews.⁷⁵ This is not true. Dr. Booth

⁷² TGU ROE and Capital Structure, Commission December 16, 2009 Decision, page 73.

⁷³ Exhibit C-16, AMPC Evidence on Behalf of Utility Customers, page 97.

⁷⁴ *Ibid*, page 99. (Note: this was updated to reflect the change in the spread from 1.86% to 1.80% between when Dr. Booth’s evidence was prepared and when he gave testimony in December of 2012)

⁷⁵ FBCU Final Argument, pp. 153-5.

observed that the benchmark utility has enjoyed a 9.5% ROE since the 2009 hearing despite market developments in the interim that would have “undoubtedly dropped” the ROE if an AAM had been in use.⁷⁶ It is perhaps cynical, but our clients are unsurprised that this disparity was not flagged by the benchmark utility and a process to adjust the ROE downwards convened. What would surprise our clients would be if the utility noticed an adverse trend that negatively affected its ability to realize what had been deemed a fair return but they failed to seek relief whether it was time for one of the “periodic reviews” or not. In other words, the regulatory efficiency is best evident when market conditions change.

In addition, an AAM is beneficial because it ensures FEI would not be able to operate for more than a brief time with an ROE that is higher than required. Like other intervenors, BCPSO is forced to rely on experts like Dr. Booth to perform the necessary analysis to determine whether FEI’s ROE is just and reasonable. Without that retainer, it is impossible for us as counsel or for BCPSO as British Columbia’s low and fixed income residential ratepayers to determine whether a downward ROE adjustment is required. Given our limited financial resources, that ongoing retainer is simply not practicable. An AAM would ensure there is no situation where the benchmark utility earns a greater than fair ROE or is forced to apply for relief when adverse market conditions are such that they could earn a greater one.

Part 9: Conclusion

Section 2.1 of AMPC’s submission correctly asserts that ratepayers are relevant. BCPSO wishes to add that the ratepayer groups in this process are all sophisticated players. We all recognize the necessary cost and intrinsic value of maintaining FEI as a strong and vital natural gas distribution utility able to secure debt on reasonable terms and to attract equity when needed particularly because it is a monopoly within its service area. Dr. Booth has presented evidence that we submit properly balances these considerations with the utility’s needs. It uses valuations that realistically reflect the changes in the market and FEI’s situation since 2009 and logical judgment to arrive at the just and reasonable recommendation that this Commission reduce the benchmark utility’s equity ratio to 35% with an ROE of 7.5%.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,

Original on File Signed by:

Leigha Worth, Tannis Braithwaite and Eugene Kung

⁷⁶ Exhibit C-16, AMPC Evidence on Behalf of Utility Customers, page 102.