

Robert Hobbs
Email: rhobbs@shaw.ca
Phone: (604) 742-1990

March 21, 2012

Via Email

Ms. Alanna Gillis
Acting Commission Secretary
BC Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, BC V6Z 2N3

Dear Ms. Gillis:

Re: Generic Cost of Capital Proceeding Order No. G-20-12 (Project No. 3698660)

The Industrial Customers Group (ICG) provides the following submissions regarding the Preliminary Scoping Document attached as Appendix B to the above noted order that establishes the Generic Cost of Capital (GCOC) proceeding.

The genesis of the GCOC proceeding is a Decision dated December 16, 2009 on the Return on Equity and Capital Structure Application (2009 ROE Decision), which eliminated the Return on Equity Automatic Adjustment Mechanism (ROE AAM) in place since 1995. The ROE AAM approach relied on the derivation and application of an “equity risk premium” to a “risk free” debt rate to determine a “benchmark low-risk utility” rate with a “utility specific premium” for other utilities, and then adjustment of the resulting ROE from year to year in accord with changes to the underlying “risk free” debt rate.

Together with elimination of the ROE AAM, the Commission determined that Terasen Gas Inc. could continue to be the “benchmark low-risk utility” for FortisBC Inc.. However, the Commission did not conclude that the ROE approved for FortisBC Inc. would continue to produce fair and reasonable rates beyond the period contemplated in the 2009 ROE Decision. The effective date of the returns on equity approved in the 2009 ROE Decision was July 1, 2009. (ROE Decision, p. 67)

The ROE AAM had been applied to determine rates on the basis of an explicit or implicit determination that the results it produces were reasonable. In the 2009 ROE Decision, in the circumstances of the financial markets in 2008 and 2009 the Commission concluded that the ROE AAM did not meet the fair return standard. Specifically, the concern was that the cost of capital resulting from the ROE AAM no longer met the fair return standard. (ROE Decision, p. 72) The objective market evidence is that the market crisis

of 2008 and 2009 has now abated. It is now necessary for the Commission to vary in a timely manner the cost of capital approved in the 2009 ROE Decision.

The cost of capital is a significant component of a regulated utility's revenue requirement and there should be no doubt that the cost of capital requires periodic adjustment so as to produce fair and reasonable rates. Given that the ROE AAM adjusted the cost of capital annually, the ICG submits that in the absence of the ROE AAM it is reasonable to conclude that the Commission Panel that issued the ROE Decision anticipated that the cost of capital would continue to be adjusted annually.

In June 2011, FortisBC Inc. filed the 2012-2013 Revenue Requirements Application and 2012 Integrated System Plan (2012-2013 RRA and 2012 ISP) for approval of rates for a two year test period, 2012 and 2013 (Test Period). During the procedural conference held on November 22, 2011 for the 2012 -2013 RRA and 2012 ISP, the ICG submitted that the Commission has never accepted any evidence other than expert evidence regarding cost of capital. The ICG further submitted that in the absence of expert evidence regarding cost of capital for the Test Period the application was deficient, and the Commission should not approve the rates being applied for.

On November 28, 2011, the Commission issued a Preliminary Notification of Initiation of the GCOC proceeding. On November 30, 2011, the Commission established the process for the proceeding and stated the following in the reasons attached to Order G-199-11, at p. 3 of 6:

Accordingly, the Commission Panel has determined that there is no need to expand this hearing to include a comprehensive review of FortisBC's capital structure and ROE. Therefore, the Commission Panel has determined that given the Commission announcement regarding a generic hearing process, it would be appropriate to maintain the current ROE and capital structure pending determinations made in the Generic Cost of Capital Hearing.

The principle submission of the ICG regarding the Preliminary Scoping Document is that it should be revised so that the GCOC proceeding will establish the cost of capital for FortisBC Inc. effective January 1, 2012. There are two aspects to this principle submission: 1) the effective date of the generic methodology that may be the outcome of the GCOC proceeding needs to be January 1, 2012, and 2) the effective date of the determination of the equity ratio and the utility specific risk premium of FortisBC Inc. needs to be January 1, 2012.

The record of the 2012/2013 RRA and 2012 ISP proceeding falls well short of the evidentiary record required to determine the cost of capital that will produce just and reasonable rates for FortisBC Inc. effective January 1, 2012. Nevertheless, unless all the elements necessary to determine the cost of capital for FortisBC Inc. are determined in the GCOC proceeding with an effective date of January 1, 2012, it will be necessary for the Commission Panel hearing the 2012-2013 RRA and 2012 ISP to either explicitly or

implicitly determine the cost of capital that will produce fair and reasonable rates for the first year of the Test Period, 2012, and perhaps the second year of the Test Period, 2013.

The Preliminary Scoping Document contemplates that the outcome of the GCOC proceeding will be a generic methodology. As stated in the Preliminary Scoping Document, p. 2 of 2, the cost of capital necessary to determine just and reasonable rates for a utility will not be addressed in the GCOC proceeding, but will be determined in a “separate future proceeding”. This “separate future proceeding” cannot reasonably be anticipated until early 2013, with a decision as late as mid 2013.

FortisBC Inc. should not receive returns that do not meet the fair return standard merely because of the timing of regulatory processes. Rates need to be set effective January 1, 2012 for FortisBC Inc., long before a decision in this separate future proceeding can reasonably be anticipated. Therefore, the ICG submits that the Preliminary Scoping Document should be revised so that utility specific capital structure and risk premiums are considered to be within the scope of the GCOC proceeding.

As noted in the Preliminary Notification of Initiation of Generic Cost of Capital Proceeding and recital D of Order G-20-12 changes have occurred in the financial markets since the issuance of the 2009 ROE Decision. The ICG submits that the Commission Panel hearing the 2012-2013 RRA and 2012 ISP cannot now determine that the cost of capital as determined by the 2009 ROE Decision with no adjustment to return on equity will produce fair and reasonable rates for the Test Period. In order to conclude that there should be no change in the cost of capital of FortisBC Inc. since July 1, 2009, it will be necessary for the Commission to conclude that there has been no change in the financial markets since 2009.

It is noteworthy that both the Ontario Energy Board and the Alberta Utilities Commission have periodically reduced the cost of capital for regulated entities since 2009.

Ontario Energy Board		Alberta Utilities Commission	
Effective Date	Return on Equity	Effective Date	Return on Equity
May 1, 2010	9.85	Jan. 1, 2009	9
Jan. 1, 2011	9.66	Jan. 1, 2011	8.75
Jan. 1, 2012	9.42	Jan. 1, 2012	8.75
May 1, 2012	9.12		

Sources: AUC 2009-16; AUC 2011-474; OEB Letters February 24, 2010, November 15, 2010, November 10, 2011, March 2, 2012

The effect of the elimination of the ROE AAM cannot be, as would result from Order G-199-11 and the Preliminary Scoping Document with an effective date of January 1, 2013, that rates for the first year of the Test Period would be approved by the Commission for FortisBC Inc. without the Commission first ensuring that the fair return standard was met. Prior to the elimination of the ROE AAM, Commission Panels hearing rate applications could rely on it to ensure that the fair return standard was met. Therefore, the Commission did not need to apply the fair return standard each time it approved rates.

However, with the elimination of the ROE AAM, the ICG respectfully submits that it is necessary for the Commission to apply the fair return standard each time it approves rates.

To be specific, for the period between the elimination of the ROE AAM and the outcome of the GCOC proceeding, the Commission must apply the fair return standard to determine fair and reasonable rates by a means other than by the application of an automatic adjustment mechanism. For the period between the 2009 ROE Decision and the Test Period, the Commission relied on negotiated settlements to ensure that the fair return standard was met. However, unless all elements of the cost of capital of FortisBC Inc. are within the scope of the GCOC proceeding with an effective date of January 1, 2012, the Commission Panel hearing the 2012-2013 RRA and 2012 ISP will need to apply the fair return standard by a means other than an automatic adjustment mechanism before it can determine fair and reasonable rates.

As noted in the Preliminary Scoping Document, the cost of capital includes capital structure, return on common equity, and interest on debt. In a rates proceeding, the onus is on the utility to justify all elements of the revenue requirements before setting rates. There is no onus on ratepayers to seek a change to elements, including the cost of capital, of the revenue requirements. Further, the Utilities Commission Act (Section 58(1)) requires a hearing before rates are set.

Considerations of fairness require that no decision having an effect on rates be made without there being an opportunity for parties opposite in interest to challenge, in a hearing, assertions of fact and opinion that are in dispute. There has been no adjudicative process to determine the cost of capital for FortisBC Inc. for the Test Period. The Commission Panel hearing the 2012-2013 RRA and 2012 ISP cannot now approve rates for the Test Period, unless there is an adjudicative process to determine the cost of capital for the Test Period. The ICG respectfully submits that the adjudicative process should be the GCOC proceeding, and the effective date should be revised from January 1, 2013 to January 1, 2012.

The ICG appreciates the opportunity to provide submissions on these important issues.

Yours truly,

(Original Signed)

Robert Hobbs