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VIA EMAIL

August 31, 2012

BRITISH COLUMBIA UTILITIES COMMISSION
GENERIC COST OF CAPITAL PROCEEDING EXHIBIT A2-11

To: All Registered Parties
(*BCUC-GCOC*)

Re: British Columbia Utilities Commission
Project No. 3698660/G-20-12
Generic Cost of Capital Proceeding

Commission staff submits the following document for the record in this proceeding:

Extracts from TGI-TGVI Return on Equity and Capital Structure Application
and
The Terasen Utilities 2009 ROE and Capital structure Application

Yours truly,

Erica Hamilton

/dg
Attachment

IGI - TGVI
Return on Equity and Capital Structure
Application (June 30, 2005)

The British Columbia "penalty" can perhaps best be illustrated by the following table. The table assumes the returns on equity of the utilities listed are set using a forecast long Canada bond yield of 5.25%. The first two columns show the disadvantage that TGI and TGVI suffer against comparable Canadian utilities in allowed equity thickness and in allowed returns on equity. The third column shows how these two disadvantages compound to create an approximate fifty basis point disadvantage for return on investment in TGI rate base and an approximate 150 basis point disadvantage for return on investment in TGVI rate base.

	Allowed Common Equity Ratio (1)	**Allowed Return at Forecast 5.25% Long Canada (2)**	**Weighted Equity Return Component (Col 1 x Col 2)**
Terasen Gas	**33.0%**	**8.75%**	**2.89%**
Comparables			
ATCO Gas	38.0%	9.28%	3.52%
Enbridge Gas	35.0%	9.15%	3.20%
Gaz Metro	38.5%	9.28%	3.57%
TransCanada Pipelines	36.0%	9.24%	3.33%
Union Gas	35.0%	9.30%	3.25%
AVERAGE	**36.5%**	**9.25%**	**3.38%**
TGVI	**35.0%**	**9.25%**	**3.24%**
Comparables			
AltaGas Utilities	41.0%	9.28%	3.80%
EGNB	50.0%	13.00%	6.50%
Gazifère	40.0%	9.68%	3.87%
Heritage	45.0%	13.00%	5.85%
Natural Resource Gas	40.0%	9.15%	3.66%
AVERAGE	**43.2%**	**10.82%**	**4.74%**

The Commission should further consider that a utility seeking to attract capital is in competition not just with utilities and other companies in Canada, but also with participants in capital markets beyond Canada. While TGI has the lowest allowed return on equity in Canada, average returns are lower in Canada than they are in the U.S. This is of significant concern as U.S. investments are being made more accessible to Canadian individuals and institutions as a result of changes in foreign content investment rules, and as utility investment analysts provide more coverage of U.S. utility investment opportunities. Circumstances have changed since the ROE automatic adjustment mechanism was first introduced, and since the Commission held its last hearing on ROE, and the changed circumstances require a different response if British Columbia wishes to be seen as an attractive place in which to invest capital.

1.3 Lack of Fair Return Hinders Competition for Capital in Canada

Such investment is increasingly unlikely to take place if the current allowed rates of return on equity are not changed. Under the Commission's current AAM, TGI has amongst the lowest allowed returns on equity of any regulated gas or electric utility in Canada at 8.47% (which was set based on a forecast long-term GCB yield of 4.35%) and the lowest effective total return on equity. At 35.01% TGI also has the lowest level of common equity in its capital structure of the major Canadian investor-owned gas and electric distribution utilities.

This higher leverage (more debt, less equity) makes TGI even less attractive to equity investors. Because higher leverage increases financial risk, it can impact the company's credit ratings, degrade financial ratios and debt covenant tests and impact its ability to attract capital on reasonable terms and in sufficient quantities under all market conditions.

Sub-standard utility investment returns do not create the investment climate the Provincial Government wants to foster given the infrastructure challenges we are facing in BC.

TGI's disadvantage can perhaps best be illustrated by the following table. The table reflects the effective returns on equity of the utilities listed for 2008/09. TGI's allowed return was set using a forecast long GCB yield of 4.35%. The first two columns show the disadvantage that TGI suffers against comparable Canadian utilities in allowed equity thickness and in allowed returns on equity. The third column shows how these two disadvantages compound to create an approximate fifty basis point disadvantage on average for return on investment in TGI rate base compared to other major gas and electric utilities in Canada.

	Current Allowed ROE	Equity Component	Effective Return	Advantage to Terasen (bps)	Year Set
Newfoundland Power	8.95%	44.55%	3.99%	102.2	2009
Maritime Electric	9.75%	40.00%	3.90%	93.5	2009
TGVI	9.17%	40.00%	3.67%	70.3	2009
FortisBC	8.87%	40.00%	3.55%	58.3	2009
Gaz Metro	8.94%	38.50%	3.44%	47.7	2009
TCPL	8.57%	40.00%	3.43%	46.3	2009
Atco Gas *	8.75%	38.00%	3.33%	36.0	2008*
FortisAlberta*	8.75%	37.00%	3.24%	27.2	2008*
Westcoast Energy Inc (Spectra)	8.57%	36.00%	3.09%	12.0	2009
Union Gas **	8.54%	36.00%	3.07%	10.9	2007
Enbridge Gas **	8.39%	36.00%	3.02%	5.5	2007
TGI	8.47%	35.01%	2.97%	N/A	2009

* The current ROE for the Alberta utilities is based on the 2008 formula setting pending a determination in the generic AUC cost of capital proceeding now underway.

** The Enbridge and Union rates are set for five years based on the formula reset for 2007

While TGI has the lowest effective return of all the major gas utilities, it must be noted that **all** of the major utilities, Gaz Metro, Atco Gas[4], Union Gas, Enbridge Gas, TCPL and Spectra (Westcoast Energy Inc.) have their allowed ROEs set by an automatic adjustment mechanism

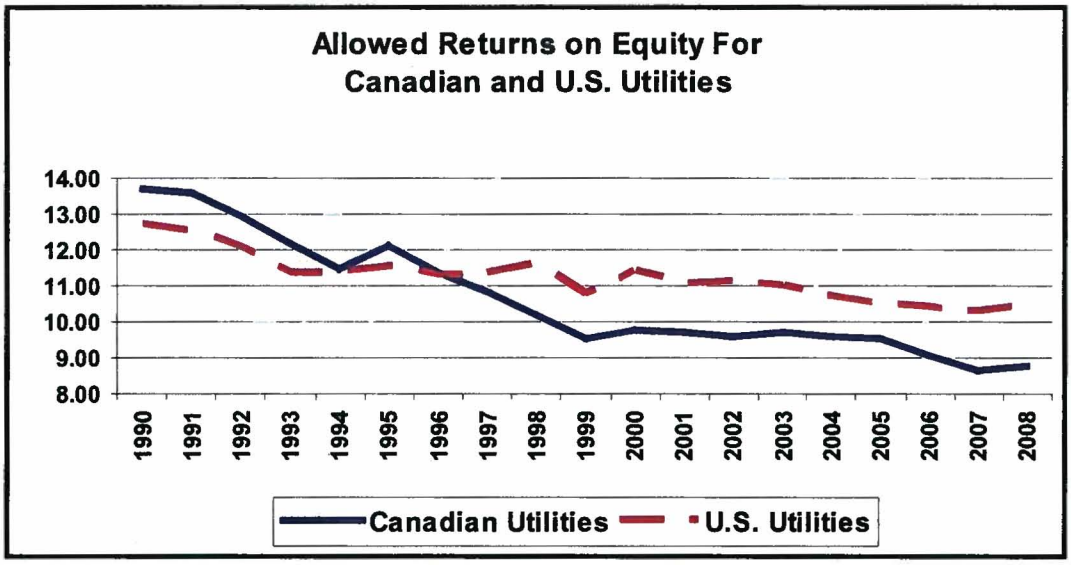
[4] Alberta utilities whose ROE and capital structure are set by the AUC pursuant to its generic formula are continuing to use the 2008 cost of capital on an interim basis while the AUC conducts its current review of the generic formula.

substantially similar to the BCUC formula. The Terasen Utilities understand that ***all of the gas distribution utilities are seeking to change the formula allowed returns in their respective jurisdictions to the extent permissible*** (Union and Enbridge are currently under PBR arrangements which may restrict them from pursuing changes to the formula but the OEB is currently considering whether its formula should be adjusted in light of current market conditions).

In addition, as discussed in the Background Section above, the AUC, the NEB and the OEB are all in the process of considering cost of capital issues.

1.4 Lack of Fair Return Hinders Competition for Capital Globally

The Commission should further consider that TGI competes for capital not just with utilities and other companies in Canada, but also with participants in capital markets outside of Canada. While TGI has the lowest effective return on equity in Canada, the returns on equity in Canada for the last 10 years have been substantially lower on average than they have been in the U.S (see figure below).



This is of significant concern as U.S. investments are more accessible to Canadian individuals and institutions as a result of changes in foreign content investment rules, and as utility investment analysts provide more coverage of U.S. utility investment opportunities. Circumstances have changed since the ROE automatic adjustment mechanism was first introduced, and since the Commission held its last hearing on cost of capital in 2005 the returns on equity produced by the AAM have tracked abnormally low GCB yields. The changed circumstances require a different response if British Columbia wishes to be seen as an attractive place in which to invest capital.

The NEB holds a view consistent with the position TGI is taking. At page 66 and 67 of the TQM Decision, the NEB found that: