

OPENING STATEMENT OF DR. ANDREW SAFIR

Thank you for allowing me to appear before you today. This is the first time that I have testified before the BCUC, although I have, from time to time, presented evidence bearing on capital cost issues before other Canadian regulatory bodies. As the “new kid” on the block here, however, I have the advantage of having very little past testimonial “baggage” to defend. As a result, let me present a few, perhaps heretical, propositions.

First, I don't believe you need to be a full professor of finance to attack or defend the appropriate return on equity of a benchmark utility. Although an understanding of the nuances of cutting edge finance theory is always to be hoped for in life, it is actually not necessary for setting a fair return for a regulated utility.

Second, the setting of a fair return on equity is not rocket science. Virtually every commission does it in essentially the same manner. They review the output from a capital asset pricing model, a discounted cash flow model, or a comparative earnings approach, mix and match the outcome of all three, or sometimes land squarely on the outcome of only one. In fact, the US Federal Energy Regulatory Commission has even streamlined this process. It has basically limited the ROE model for oil & gas pipelines to only the DCF approach.

Third, the real fight is not about economic theory. Rather, it is about exercising appropriate judgment and analysis in interpreting the data, and doing so in a manner that balances the interests of shareholders and customers alike. For example, which companies to use, how long a period to consider, and to what extent existing information can be used to determine future outcomes are all relevant concerns. This last point is particularly important. Absent being a psychic, there is really no way to predict the future without reliance on the past. At best, forecasts are inherently speculative. This implies that there is no one certain answer, and a fair return estimate need not be a precise point from some complex estimation

algorithm. Rather it can, and in my opinion should be, a common sense number based on direct, first order estimation techniques from readily available data.

Does this approach violate the fair return standard? Not at all. Selecting a result by triangulating from the output of several straightforward return on equity models should ensure a result which is not too far from some theoretically perfect ROE “point.” After all, these models have all been designed to calculate a market ROE. Even without theoretical tweaks and adjustments, their outputs should not fall far from that mark. In any case, utilities have almost always been able to over-earn their allowed ROEs, so a number that falls slightly below “normal” will probably still end up “acceptable” on the scale of fair return levels. Outcomes which end up above the “normal” range will not be questioned by the recipients.

My approach toward estimating a fair ROE for the benchmark utility follows the above approach. Where possible, I have used simple model specifications and data which were relatively easy to obtain. Where I have modified traditional approaches, as I have done in my analysis of comparable earnings, I have done so in order to emphasize my belief that historical data are the only real sources for forecast information. Because I am cognizant that regulators in Canada have not embraced the comparable earnings approach presented by any witnesses, I have attempted to recast the approach in such a manner that it may provide some guidance to the Commission.

When you don't get fancy – and avoid buzzer and whistle add ons – you don't get verbose. My written testimony runs only 50 pages. Other participants in the ROE estimation sweepstakes have filed tomes 3 times this length. In my view, this complexity is unnecessary. Moreover, this is British Columbia, and you do value the trees.