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August 12, 2013

Via Email
Original via Mail

British Columbia Utilities Commission
Sixth Floor
900 Howe Street
Vancouver, B.C. V6Z 2N3

Attention: Ms. Erica M. Hamilton, Commission Secretary

Dear Ms. Hamilton:

**Re: British Columbia Utilities Commission Generic Cost of Capital Proceeding
Stage 1 Decision dated May 10, 2013 Request for Written Submissions on
Automatic Adjustment Mechanism
Reply Submissions of FortisBC Utilities (FBCU)**

The FBCU retained Concentric Energy Advisers to review and reply to the evidence of Dr. Booth filed on behalf of AMPC, BCPSO and CEC with respect of the AAM inputs. There is agreement as between Concentric and Dr. Booth on a number of points. Concentric's brief reply on two issues is enclosed.

If you have any questions, please direct them to Grant Hodgkins (604-443-6543).

Sincerely,

on behalf of the FORTISBC UTILITIES

Original signed by: Shawn Hill

For: Roger A. Dall'Antonia

Attachments

cc (e-mail only): Registered Parties



August 12, 2013

FortisBC
10th Floor, 1111 West Georgia Street
Vancouver, BC V6E 4M4
Canada

Attention: Mr. Roger Dall'Antonia
Vice President, Strategic Planning, Corporate Development and Regulatory Affairs

Dear Roger:

Re: British Columbia Utilities Commission
Generic Cost of Capital Proceeding
Stage 1 Decision dated May 10, 2013
Automatic Adjustment Mechanism
Requests for Written Submissions

This letter provides Concentric's response to the submission of Dr. Laurence Booth on behalf of the AMPC, BCPSO and CEC, dated July 26, 2013, in regards to the above referenced letter requesting written submissions, dated June 27, 2013. Concentric has limited its response to the areas of difference with Dr. Booth, and otherwise, generally concurs with Dr. Booth on remaining aspects of the submission.

BaseUtilBondSpread

The first area of difference between Concentric's submission and Dr. Booth's pertains to the base utility bond spread. Dr. Booth selects the month of October 2012 for his formulation and arrives at an average daily utility bond spread of 145 basis points. Dr. Booth indicates that he recommends the use of October 2012 data since it is consistent with the evidentiary basis for the past GCOC proceeding.

Concentric differs on the use of the October 2012 data for two primary reasons. First, the October 2012 data is outdated and bears little relevance to either the current capital market environment or to the capital market environment and the associated level of spreads that may occur once the formula is ultimately triggered at 3.8 percent. Secondly, the Commission has already established that the current level of interest rates is well below the level of interest rates that would be consistent with normal cyclical lows, and that 3.8 percent is the lowest rate that should be considered consistent with a normal cyclical low.¹ Because the base utility bond spread is a function of the long

¹ BCUC Order, G-20-12 (May 10, 2013) at 91.



term government bond yield (i.e. it is the difference between the utility bond yield and the government bond yield), it follows that when government bond yields are abnormally low that utility bond spreads may be, correspondingly, abnormally high. Establishing a base utility bond spread that is abnormally high, such as the 145 basis points that Dr. Booth has recommended, would be inconsistent with normalizing the starting point trigger.

The Commission aptly determined in its Decision that it may not be appropriate to set a base utility bond spread using data from a period of abnormal interest rates, acknowledging that the use of such data may result in downward bias if risk free yields were to rise with no corresponding increase in utility bond yields (causing utility bond spreads to contract).² The Commission further acknowledged that in order to mitigate downward bias in the formula, care must be used in setting appropriate base rates.³ In Concentric's view, it makes little sense to tie the base utility bond spread to a period (October 2012) that the Commission has already determined to be abnormal and allow the utility bond spread component to become disassociated from the prevailing bond yields before the formula becomes activated.

Concentric's analysis in its previous submission, dated July 26, 2013, demonstrated that the credit spread is negatively correlated to the level of long term GOC bond yields. Consequently, as long term GOC bond yields rise to 3.8 percent, utility bond spreads would be expected to contract. In our submission, we showed, based on ten years of daily data, that the historical relationship (as determined by linear regression) between GOC 30-year bonds and the utility bond spread, indicates a utility bond spread of 134 basis points for GOC 30-year bond yields averaging 3.8 percent.⁴ These results incorporate cyclical highs and lows over the past ten years (including the global economic crisis) and still may prove to be substantially above the spread that prevails when actual long term government bond yields meet or exceed 3.8 percent.

Concentric maintains the best way to reasonably ensure that the base utility bond spread does not inadvertently create bias in the formula at the outset is to set the base utility bond spread at a level consistent with the utility bond spread at the time when the formula is triggered, i.e. when the average of the daily 30-year GOC bond yield meets or exceeds 3.8 percent for the given month of October. In this way, potential bias is eliminated by tying the base utility bond spread directly to the associated GOC bond yields used to establish the trigger. However, if the Commission determines that it should set the base utility bond spread component now, the 134 basis points determined by Concentric's regression analysis would provide a better estimate of the base utility bond spread than Dr. Booth's recommended 145 basis points.

AAM Trigger

Concentric also differs with Dr. Booth on the determination of the AAM trigger. Dr. Booth indicates that he envisioned using a one year-ahead 30-year forecast bond, i.e. the LCBF; whereas, the Commission has indicated that the trigger should be based upon the actual GOC bond yield.⁵

² Ibid. [paraphrased].

³ Ibid. [paraphrased].

⁴ Concentric Submission dated July 26, 2013, at 5.

⁵ BCUC Order, G-20-12 (May 10, 2013) at 91.



Concentric has based its submission on the assumption that the trigger for the formula should be based on “actual,” and has recommended that it be based on an average of the same daily GOC bond yield data used for the input “30CB” in the AAM formula. This starting point trigger would also coincide with the determination of the utility bond spread, providing a consistent starting point for both inputs.

Except as specifically addressed above, Concentric generally concurs with Dr. Booth on remaining respects of his submission.

Yours very truly,

A handwritten signature in black ink, appearing to read "J. M. Coyne". The signature is fluid and cursive, with a long horizontal stroke extending to the right from the end of the name.

James M. Coyne, Senior Vice President
Concentric Energy Advisors, Inc.