OWEN·BIRD
LAW CORPORATION

PO Box 49130
Three Bentall Centre
2900-595 Burrard Street
Vancouver, BC
Canada V7X 1J5

Telephone 604 688-0401
Fax 604 688-2827
Website www.owenbird.com

Direct Line: 604 691-7557
Direct Fax: 604 632-4482
E-mail: cweafer@owenbird.com
Our File: 23841/0071

June 25, 2012

VIA ELECTRONIC MAIL

British Columbia Utilities Commission
Sixth Floor, 900 Howe Street
Vancouver, BC V6Z 2N3

Attention: Alanna Gillis, Acting Commission Secretary

Dear Sirs/Mesdames:

Re: British Columbia Utilities Commission Generic Cost of Capital Proceeding, Project No. 3698660

We are counsel for the Commercial Energy Consumers Association of British Columbia (CEC). Attached please find the CEC's first set of Information Requests pertaining to the Commission Consultant's Survey Report with regard to the above-noted matter.

We acknowledge that we are late in filing these Information Requests. The attached Information Requests were not completed in time to meet the Friday deadline. We apologize for any inconvenience caused by this delay.

A copy of this letter and attached Information Requests have also been forwarded to the registered interveners by e-mail.

If you have any questions regarding the foregoing, please do not hesitate to contact the undersigned.

Yours truly,

OWEN BIRD LAW CORPORATION

Christopher P. Weafer

CPW/jlb
cc: CEC
cc: Registered Interveners

COMMERCIAL ENERGY CONSUMERS ASSOCIATION OF BRITISH COLUMBIA (CEC)

Information Request #1 on
The Brattle Group Survey Report of Canadian Cost of Capital Practices

British Columbia Utilities Commission Generic
Cost of Capital Proceeding (GCOC)
Project No. 3698660

---

1. Reference: Models Relied Upon for Cost of Capital Estimation, Page 4

greater economic uncertainty. As such, the reliability of DCF methods can be questionable in times of economic turmoil or when an industry is in transition. These reliability concerns are further exacerbated by the extent of simplification underlying the constant growth version of the DCF model. For example, assuming that cash flows will grow at a constant rate into the infinite future is a gross simplification and makes the model highly sensitive to the growth rate assumption. If five-year growth rate forecasts are used as the constant growth rate, as is often the case, then the reliability of the model can be significantly reduced in periods of abnormally high or low growth. Moreover, the results of applying the methodology can be unstable over time, leading to rapid shifts from high cost of capital estimates to low ones. Some of this

1.1. Please define the term reliability as it is used here to assess the DCF method.
1.2. Please describe and reference any literature documenting this reliability criteria and its application in assessing Cost of Capital models.
1.3. Please define the term unstable used in assessing the DCF methods.
1.4. Please describe and reference any literature documenting this stability criteria and its application in assessing Cost of Capital models?
1.5. Are the comments in the paragraph assessing DCF the author's opinions of reliability and stability or are there objective measures for applying this assessment?
1.6. Why has this assessment been applied to the DCF model and not to the CAPM model in the discussion in this section?

2. Reference: Evaluation Criteria, Page 12

- Reasonable
  - Be consistent with the objective being pursued – namely to provide regulated utilities with a fair and reasonable return;
  - Be transparent by relying as much as possible on a formula/structured methodology and by minimizing the use of judgmental factors;
- Reliable
  - Be based upon auditable information;
  - Produce consistent results for like conditions;
  - Be robust, and reasonably sensitive, to a broad range of economic/financial conditions;
- Pragmatic
  - Be based upon readily available information or information that can be obtained with minimal costs; and
  - Be simple to implement for interested parties.

2.1. Are these criteria the author's views or is there a literature on evaluation and if so could this please be provided or referenced?

2.2. Is the first definition of the first criteria a logical tautology and can this really be evaluated in this form?

2.3. Why is it reasonable to minimize the use of judgment?

2.4. Does reliability being based on auditable information refer to public information which has been audited and reported to a defined standard or does it mean based on documented information which can be accessed to retrace the quantitative calculations and verify the quantitative determinations?

2.5. What is the definition of 'like conditions' within which reliability ought to produce consistent results?

2.6. If there are conditions not included in the definition of 'like conditions' which cause differences in results, why would this result in unreliability as opposed to understandable differences?

2.7. What does it mean to be sensitive to a broad range of economic and financial conditions?

2.8. How is sensitivity defined and tested?

2.9. What are the economic and financial conditions for which reliability is to be demonstrated?

2.10. In order to be pragmatic limitations are proposed related to readily available information and minimal costs for obtaining information, what is the cost limit proposed and does it result in relevant information not being obtained and or lower quality of Cost of Capital decisions?

3. Reference: Risk Free Rate, Page 14

The Risk-free rate

It is common among Canadian regulators to rely on a forecasted yield on long-term Canadian Government bonds. The federal National Energy Board (NEB) and the provincial regulators often rely on forecasts from *Consensus Forecasts*,[19] when determining the risk-free rate. Commonly, the forecasted yield on 10-year government bonds is used with an amount added for the maturity premium needed to get to a 30-year bond.[20]

3.1. Is there data to demonstrate that the consensus forecast is retrospectively accurate and if so could that information be provided or referenced?

4. Reference: Short Term versus Long Term CAPM, Page 17

Short-term rates are a tool of monetary policy and are much more affected by efforts of a country's central bank to alter economic activity than long-term rates. As a result, short-term rates are more volatile. Cost of equity estimates based on short-rates could therefore change rapidly over the course of a few months.

4.1. Given that central banks and particularly the US Fed has been manipulating long term rates with tools like Operation Twist, is this likely to be a complicating factor for this aspect of the CAPM approach?

5. Reference: Analyst Growth Forecasts, Page 28

earnings volatility…."[52] In another paper, Markov and Tamayo (2006) find that the autocorrelation in analysts' forecast errors for the utilities industry is close to zero and state that "[t]his is not surprising. The quarterly earnings process for a utility firm is more likely to be stationary and present better opportunities for learning than other firms."[53] Thus, analyst forecasts for utilities may have characteristics that differ from those of other industries.

5.1. Does this mean that utility firms are inherently less risky than firms in other industries because of the stable earnings characteristics?

6. Reference: Risk premium Model, Page 34

methodology is well-defined, it is transparent and relies on a structured formula. Among the weaknesses of the risk premium approach is that it may be influenced by monetary policy - especially if the implementation relies on government bond yields.

6.1. Please explain which models are not influenced by monetary policy and therefore do not have this weakness.

6.2. Please provide the references to any literature assessing the evaluation models on the basis of sensitivity to monetary policy and or government fiscal policy.

7. Reference: Comparable Earnings, Page 35

return is used to determine the allowed rate of return. However, the use of unregulated companies requires careful consideration of the risk characteristics of the companies and the comparability to those of the target utility.

7.1. Please provide the best practice standard for assessing risk characteristics of the comparable companies.

7.2. Please provide any relevant literature or references on the 'careful consideration of the risk characteristics'.