**BRITISH COLUMBIA UTILITIES COMMISSION**

**IN THE MATTER OF THE UTILITIES COMMISSION ACT (the "Act")**

**R.S.B.C. 1996, Chapter 473**

**and**

**British Columbia Utilities Commission**
**2012 Generic Cost of Capital Proceeding**

**Opening Remarks of Legal Counsel for**
**FortisBC Utilities ("FBCU")**

**December 12, 2012**

## INTRODUCTORY REMARKS OF COUNSEL FOR FBCU

The touchstone of this Generic Cost of Capital proceeding must be the Fair Return Standard. There is likely to be general agreement on this point among all parties, based on positions taken in past hearings. The key challenge for the Commission in this proceeding is giving real meaning to that legal standard as it applies to the benchmark FortisBC Energy Inc. ("FEI")

Fundamentally, the Fair Return Standard is about fairness to investors. Investors have committed, and will be asked to continue to commit, capital on a long-term basis to permit FEI to provide utility service. These investors are committing capital with the expectation that they will receive fair compensation for their investment, commensurate with the business and financial risks that the investment entails.

The Commission has recognized in past decisions that the Fair Return Standard is reduced to a hollow concept by simply targeting the minimum credit metrics necessary to avoid a credit downgrade. The FBCU's fundamental submission in this proceeding will be that the Commission should re-affirm its past approach of targeting a return that is reasonable and fair to investors. In the context of this hearing, targeting a reasonable and fair return means accepting the business risk evidence filed by the FBCU and giving weight to the expert evidence put forward by the FBCU.

### Requested Findings of Fact

The Commission last addressed the fair return for the benchmark FEI in late 2009. The Commission cited developments in the capital markets since its 2009 decision when it initiated this Generic Cost of Capital Proceeding. Comparing the state of the capital markets relative to late 2009 is the correct approach. The same is true for the assessment of FEI's overall business risk.

A comparison of the circumstances in late 2009 to those of today yields greater similarities than differences - not at all surprising given that only three years has elapsed. In that regard, the FBCU will be asking the Commission to make the following key findings:

- *First, FEI's business risk is similar – no lower, and perhaps somewhat higher – than in 2009.*

  FEI's business fundamentals and operating environment remain very similar to what they were three years ago. The Commission acknowledged in its 2009 decision a number of new, non-price considerations - e.g. government policy, housing trends, consumer preferences - which pose a long-term risk because they affect FEI's ability to retain and attract customers and maintain throughput levels. The lower natural gas commodity prices seen since 2009 have not reversed or even materially moderated the trends of declining use-per-customer, market share and total throughput. These trends continue due to the same non-price factors that were present in 2009.

- *Second, FEI's regulatory risk is similar to 2009.*

  Rate regulation, generally speaking, reduces investment risk compared to non-regulated businesses. But the regulatory framework places many fundamental business decisions in the hands of the regulator, and thus gives rise to regulatory risk. The regulatory constructs that govern how FEI forecasts costs and fixes rates, and thus earns a return on and of its capital, are essentially the same constructs that have been in place for many years. The risk that the utility faces in managing to the forecast is also more or less the same. It is a risk that can be mitigated, but never eliminated, by careful management.

- *Third, capital markets remain volatile and investors remain apprehensive and sensitive to world developments.*

  The Commission need only look to the objective market indicators identified in Mr. Engen's evidence to see that the capital markets do not look all that different from when the last benchmark cost of capital hearing took place in Fall 2009. The market tone is very sensitive. Canadian equity capital markets are challenging and volatile. Simply put, we are no longer facing the worst of the financial crisis, but we aren't out of the woods either.

The fair return for FEI in the circumstances, as determined by Ms. McShane and Dr. Vander Weide, is 10.5% Return on Equity ("ROE") on 40% common equity. This is 50 basis points lower than what these experts recommended in 2009, but is still above the present allowed ROE and capital structure. The point being - that if the Commission is going to initiate a change from the present benchmark ROE and capital structure, then FEI's ROE should go up, not down. FEI's capital structure should remain well-supported by common equity. It should not, as Dr. Booth suggests, be leveraged back up to pre-2005 levels. The pre-2005 capital structure reflected a time before natural gas utilities in BC faced new long-term challenges in the form of aggressive GHG policy, changing consumer attitudes towards fossil fuels and energy use, more efficient appliances, and smaller homes, to name a few.

**Witness Panels**

The Commission has the benefit of a very significant evidentiary record relating to the benchmark FEI. The FBCU have complied with the Minimum Filing Requirements, addressed a number of IRs, and have provided rebuttal evidence where appropriate. The witnesses that the Companies are putting forward can speak to the full breadth of the filed evidence.

The FBCU filed their witness list on November 30, 2012 as Exhibit B1-31. The Companies will be calling a total of eight witnesses, appearing as five panels.

- The Company panel consists of four members of FEI's executive, with responsibility for finance, regulatory, business development and gas supply. They will collectively address the materials relating to FEI's business risk.

- Kathleen McShane will sit as the second panel. Ms. McShane is an expert on cost of capital and the fair return for utilities. She has estimated FEI's fair return using

the same three methodologies that she employed in 2009: the Equity Risk Premium method; the Discounted Cash Flow (DCF) method; and, the Comparable Earnings test. In Ms. McShane's view, the Fair Return Standard is met for FEI by an ROE of 10.5% on 40% common equity.

- Jim Coyne, who is also a cost of capital expert, will sit as the third panel. In 2010, Mr. Coyne had authored a report on Automatic Adjustment Mechanisms ("AAM") that FEI had filed pursuant to a Commission directive. The scope of Mr. Coyne's retainer in this proceeding was limited to updating his 2010 report and commenting on the merits of reinstating an AAM at this time. Mr. Coyne demonstrates that the use of AAMs remains the exception, not the rule, in North America. He favours periodic reviews, identifying a number of challenges with AAMs.

- Aaron Engen will sit as the fourth panel. Mr. Engen is Managing Director of BMO Capital Markets, one of the country's largest investment banks. Mr. Engen has compared the current state of a variety of empirical indicators of market tone to where they stood in Fall 2009. The similarities in that data are striking. He concludes that overall Canadian equity capital markets are "challenging and volatile".

- Dr. Vander Weide, a cost of capital expert, will sit as the final panel. He estimates the fair return for FEI at 10.5% on 40% equity based on the same two models that he had employed in 2009: the risk premium approach and DCF approach.

**Conclusion**

At the conclusion of this proceeding, the FBCU will submit that the evidence put forward by the Companies, and the expert evidence tendered by the FBCU, should be accepted. The evidence, taken together, supports a benchmark return for 2013 of 10.5% ROE on 40% common equity.

*[Original Signed By:]*

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