



Gordon Doyle
Vice President, Regulatory Affairs, Legal & Gas Supply

Pacific Northern Gas Ltd.
750 – 888 Dunsmuir Street
Vancouver, BC V6C 3K4
Tel: (604) 691-5684
Fax: (604) 697-6210
Email: gdoyle@png.ca

Via E-File

July 21, 2021

British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

File No.: 4.2(2021)

Attention: Patrick Wruck
Commission Secretary

Dear Mr. Wruck:

**Re: British Columbia Utilities Commission – Generic Cost of Capital Proceeding
Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd.
Comments Regarding the Use of a Benchmark Utility – Submission of Brattle Group
Report**

On June 11, 2021, the British Columbia Utilities Commission (BCUC) issued Order G-183-21 establishing further process in the Generic Cost of Capital (GCOC) proceeding along with a regulatory timetable and a request seeking submissions from utilities and interveners on whether a Benchmark Utility is appropriate to determine the cost of capital for public utilities in British Columbia is warranted.

Order G-66-21 dated March 8, 2021 included a list of utilities wherein Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (collectively, PNG) were established to be Affected Utilities with the expectation that they would participate as applicants in the proceeding. To supplement PNG's own views, PNG has engaged the services of the Brattle Group Inc. (Brattle) to provide expert advice to PNG in this cost of capital proceeding.

Independent of PNG, another affected utility, Corix Multi-Utility Services Inc. (Corix) has also engaged the services of Brattle to provide expert support in the GCOC proceeding.

In order to fully address the request in Order G-183-21, and to ensure that cost efficiencies for customers are recognized on generic items that impact both utilities, PNG and Corix have jointly requested Brattle to prepare expert testimony on the use of a Benchmark Utility

(Brattle Report). The Brattle Report is appended and is being submitted as an additional response to Order G-183-21 on behalf of both utilities.

In addition to the Brattle Report, PNG and Corix will each make separate submissions on the matter of the use of a Benchmark Utility.

Lastly, while PNG and Corix have both engaged Brattle as an expert witness, PNG and Corix do not share similar risk characteristics and should be considered independently and separately in the GCOC Proceeding.

If you require further information or have any questions regarding this submission, please contact the undersigned.

Sincerely,

Original on file signed by:

G. Doyle

Brattle Report

USE OF THE BENCHMARK UTILITY APPROACH IN THE BCUC'S GENERIC COST OF CAPITAL PROCEEDING

PREPARED BY

Michael R. Tolleth

PREPARED FOR

Pacific Northern Gas Ltd.
Corix Multi-Utility Services Inc.

JULY 21, 2021



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I. Introduction

1. This report has been prepared by The Brattle Group (“Brattle”) at the request of Pacific Northern Gas Ltd. (“PNG”) and Corix Multi-Utility Services Inc. (“Corix”).¹ Its purpose is to respond to certain questions posed by the British Columbia Utilities Commission (“BCUC” or “the Commission”) in Appendix A to Order G-183-21, issued June 11, 2021, which sought submissions regarding the use of a Benchmark Utility. Specifically, this report addresses the following questions, as designated on Page 2 of that Order G-183-21, Appendix A.
 - “What are the relevant factors, considerations, or set of criteria for the BCUC to determine whether a Benchmark Utility should be established to determine the cost of capital for the utilities in BC?”
 - “What are the pros and cons of using a Benchmark Utility in the determination of the cost of capital for utilities in BC?”
2. In relation to these questions, this report also responds to certain aspects of the BCUC Staff Consultant Report of Dr. Lesser of Continental Economics Inc. that was submitted on June 18, 2021 (“Continental Report”),² including components of the “limited jurisdictional scan of practices used outside of BC” contained therein.³
3. The remainder of this report is organized as follows. Section II addresses key considerations and criteria for evaluating a particular regulatory approach to setting the cost of capital. Section III then applies these criteria to assess the pros and cons the BCUC’s Benchmark Utility approach, while Section IV provides context for other jurisdictional practices in consideration of the same criteria. Section V provides a conclusion.

II. Considerations for Evaluating a Regulatory Approach to Setting the Cost of Capital

II.A. Determining Fair Returns Commensurate with Risk

4. The fundamental goal of a cost of capital proceeding is to establish allowed return and regulatory capital structure parameters for regulated utilities that are consistent with the Fair

¹ This report was prepared for PNG and Corix in accordance with The Brattle Group’s engagement terms, and reflects the analyses and opinions of its author, Mr. Michael R. Tolleth, Senior Associate of the Brattle Group. It does not necessarily reflect the views of the Brattle Group’s other consultants or other (non-sponsor) clients.

² DOC_63158_A2-2-Consultant-Report.

³ DOC_63082_A-5-G-183-21, Order G-183-21, Appendix A, page 2.

Return Standard. The BCUC has interpreted the Fair Return Standard as requiring “that a fair or reasonable overall return on capital should:

- Be comparable to the return available from the application of the invested capital to other enterprises of like risk (comparable investment requirement);
- Enable the financial integrity of the regulated enterprise to be maintained (financial integrity requirement); and
- Permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (capital attraction requirement).”⁴

5. The comparability, financial integrity, and capital attraction components of the fair return standard are commonly recognized in Canadian regulatory jurisdictions as arising from the Supreme Court of Canada’s *Northwest Utilities* decision,⁵ which stated:

By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company’s enterprise.⁶

6. The components of the Fair Return Standard also have direct analogs in the United States, where the U.S. Supreme Court *Hope* and *Bluefield* decisions established that a just and reasonable return on rate-regulated utility investments should be commensurate with returns on investments in other enterprises having corresponding risks,⁷ and that such a return should be adequate to ensure the financial soundness of the utility and enable it to raise the money necessary to fulfill its public service obligations.⁸

⁴ BCUC GCOC – Stage 1 Decision, page 7 (2013), citing National Energy Board (“NEB”) Reasons for Decision in RH-1-2008, pages 6-7 (2009).

⁵ See, e.g., NEB Reasons for Decision in RH-2-2004 Phase II, page 17 (2005); Ontario Energy Board (“OEB”) EB-2009-0084 Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, pages 15-18 (2009); Alberta Utilities Commission (“AUC”) Decision 22570-D01-2018 (2018 Generic Cost of Capital), para. 38 (2018), referencing AUC Decision 2009-216, Section 2 (2009).

⁶ *Northwestern Utilities Limited v. City of Edmonton*, (1929) S.C.R. 186 at 192-193 (*Northwestern*).

⁷ *Federal Power Com’n v. Hope Natural Gas Co.*, 320 U.S. 591 at 603 (1944) (“*Hope*”).

⁸ *Bluefield Water Works & Improvement Co. v. Public Service Com’n of West Virginia*, 262 U.S. 679 at 680 (1923) (“*Bluefield*”).

7. The Fair Return Standard—and particularly its “comparable investment” and “capital attraction components”—is directly aligned with the financial concept of the opportunity cost of capital,⁹ which is defined as the rate of return investors can expect to earn in capital markets on alternative investments of equivalent risk.¹⁰
8. By investing in a regulated utility’s asset, investors are tying up capital in that investment, thereby foregoing alternative investment opportunities. In economic terms, the investors are incurring an “opportunity cost” equal to the returns available on those alternative investments. If the allowed return on the utility investment is not at least as high as the expected return offered by alternative investments of equivalent risk, investors will choose these alternatives instead, and the utility’s ability to attract capital on reasonable terms to adequately fund its operations will be adversely impacted or even prevented.
9. Consequently, any regulatory cost of capital proceeding that seeks to establish financial parameters for utility rates that are consistent with the Fair Return Standard is fundamentally engaged in a benchmarking exercise: the fair return allowed for a particular regulated utility is necessarily determined relative to the returns available in capital markets for *alternative* investments. Furthermore, because investors are risk-averse and require higher expected returns to entice them to make riskier investments, it is essential that the regulator consider any particular regulated utility’s risks in relation to the available benchmark returns.

II.B. Criteria for Evaluating an Approach to Setting Fair Returns

10. The returns available for investing in relevant financial securities (*e.g.*, stocks and bonds) are ultimately determined by the transactions of such securities in financial markets. While the expected returns on debt securities are often directly implied by their market prices, the expected return on equities is not directly observable and must be estimated using the tools of modern finance. Financial models such as the capital asset pricing model (CAPM) and discounted cash flow (DCF) models, which have been employed by the BCUC to inform its

⁹ A formal link between the opportunity cost of capital as defined by financial economics and the proper expected rate of return for utilities is set forth by Stewart C. Myers, “Application of Finance Theory to Public Utility Rate Cases,” *Bell Journal of Economics & Management Science* 3:58-97 (1972).

¹⁰ The opportunity cost of capital is also referred to as simply the “cost of capital,” and can be equivalently described in terms of the “required return” needed to attract investment in a particular security or other asset (*i.e.*, the level of expected return at which investors will find that asset at least as attractive as an alternative investment).

determination of the cost of equity for the Benchmark Utility,¹¹ rely on market prices (and other market data) for equity securities that are publicly traded on stock exchanges.¹²

11. Therefore, the primary “benchmark” in regulatory cost of capital proceedings typically consists of a proxy group of publicly listed companies that are as comparable as possible to the utility whose fair return is being set. However, the fact that proxy group constituents must have exchange-traded stock complicates the task of selecting alternative investments that are truly of equivalent risk to a given specific regulated utility. In response to this constraint, utility regulators typically take a pragmatic approach featuring the following components.

- The market cost of equity is estimated for a proxy group of exchange-traded companies that are selected to be as closely comparable as possible to the regulated utility.
- Analysis and judgement inform a determination of how the regulated utility compares to the proxy group in terms of business and financial risk.
- Considering the market evidence and relative risk assessment, the regulator sets a risk-adjusted comparable rate of return and capital structure to meet the Fair Return Standard.

12. These elements are common to the fundamental benchmarking exercise underlying the determination of utility allowed returns and capital structures conforming to the Fair Return Standard. When it comes to evaluating what particular approach the BCUC should implement to set cost of capital parameters for the utilities it regulates, the most important criteria relate to the task of “bridging” the market cost of capital estimates with the particular risk characteristics of the utilities it regulates. In general, a regulator deciding on a particular procedural approach to cost of capital determinations should consider,

1. The tractability and reliability of analysis for assessing business and financial risk characteristics relative to publicly traded proxy companies;¹³
2. Jurisdictional context, including the number, sizes, and types of utilities for which a fair return must be established; and
3. Practicability and efficiency of the regulatory process, considering the time and expertise required – and the cost incurred – to develop and present the necessary evidence.

¹¹ BCUC GCOC – Stage 1 Decision, Executive Summary, page (iii) and Section 5.1, pages 55-56 (2013).

¹² *Id.*, page 62 (regarding the need for comparable firms with traded equity to estimate CAPM betas) and 67 (explaining the need for comparable firms with traded equity and a source for estimated expected dividends).

¹³ Data availability is one factor that influences the relative comparison of business and financial risk characteristics. For example, regulated utility companies that raise debt capital in public bond markets may have credit ratings from major rating agencies and be the subject of reports by ratings analysts that include comparative assessments of business and financial risk.

III. Pros and Cons of Benchmark Utility Approach

13. In assessing the pros and cons of the Benchmark Utility approach traditionally employed by the Commission, it is important consider the context of the Commission’s regulation of energy utilities in British Columbia. To provide perspective on the relative sizes of utilities under BCUC jurisdiction, Figure 1 below summarizes customer and sales revenue statistics for the three major categories of utilities regulated by the Commission for the year 2019, as reported in the BCUC’s 2019/20 Annual Report.¹⁴

FIGURE 1: BCUC REGULATED UTILITIES

Customers and Revenue by Service Type

		# Customers [1]	Revenue (\$ 000s) [2]	Revenue (% of Svc Type) [3]
Regulated Electricity				
BC Hydro	[A]	2,075,537	\$4,996,649	93.81%
FortisBC Inc.	[B]	141,021	\$318,688	5.98%
Corix Multi-Utility Services	[C]	1,433	\$2,093	0.04%
All Other	[D]	4,969	\$8,655	0.16%
Total Regulated Electricity	[E]	2,222,960	\$5,326,085	100.00%
Regulated Gas Utilities				
FEI	[F]	1,040,721	\$1,299,637	94.59%
PNG	[G]	42,077	\$69,245	5.04%
Corix Multi-Utility Services	[H]	1,376	\$1,278	0.09%
All Other	[I]	2,031	\$3,878	0.28%
Total Regulated Gas	[J]	1,086,205	\$1,374,039	100.00%
Regulated Thermal Energy Sales				
FortisBC AES	[K]		\$9,674	34.15%
Corix Multi-Utility Services	[L]		\$3,361	11.87%
All Other	[M]		\$15,290	53.98%
Total Regulated Thermal	[N]		\$28,325	100.00%

Sources and Notes:

[1]-[2]: BCUC 2019/20 Annual Report, Pages 66-69, "Regulated Electricity, Thermal Energy and Gas Sales"

[3]: Calculated by Brattle - revenue as a proportion of total for that service type

[C]: Sun Rivers and Sonoma Pines

[F]: Includes Mainland, Vancouver Island, Whistler, Revelstoke, and Fort Nelson Division

[G]: Includes Pacific Northern Gas (N.E.) Ltd. and Pacific Northern Gas Ltd.

[H]: Sun Rivers, Sonoma Pines, and Panorama

[K]: 28 individual thermal utilities as listed in BCUC Annual Report

[L]: 5 individual thermal utilities as listed in BCUC Annual Report

¹⁴ <https://www.bcuc.com/Documents/AnnualReports/2021/BCUC%E2%80%93Annual-Report%E2%80%932020-2021-11-11-WEB.pdf>, accessed July 20, 2021.

14. Of note, the Crown-owned BC Hydro & Power Authority (“BC Hydro”) served nearly 94% of the province’s electricity demand in 2019, while FortisBC Inc. is the only sizable investor-owned electric utility in BC. Similarly, regulated gas distribution in BC is dominated by FortisBC Energy Inc. (“FEI”), which accounted for 95% of total 2019 regulated gas sales revenue in the province.
15. As shown in Figure 2, considering only investor-owned utilities (*i.e.*, excluding BC Hydro), FEI’s \$1.3 billion of annual revenue made up over 75% of total regulated energy sales in 2019. Including FortisBC Inc.’s approximately \$320 million of annual revenue, these two largest investor-owned BC utilities (both owned by Fortis, Inc.) combined to account for 94% of total share of 2019 investor-owned utility sales revenue in BC. The many other electric, gas, and thermal utilities regulated by the Commission are small (or very small) by comparison, and collectively make up only 6% of regulated energy utility revenue in the province.

FIGURE 2: BCUC REGULATED INVESTOR OWNED UTILITIES

Utility Companies by Share of Total Investor-Owned Utility Revenue

Utility Company or Group (Svc Type)		Revenue (\$ 000s) [1]	Revenue (% of Total) [2]
FEI (Gas)	[A]	\$1,299,637	75.4%
Fortis BC Inc. (Electric)	[B]	\$318,688	18.5%
PNG (Gas)	[C]	\$69,245	4.0%
Fortis BC AES (Thermal)	[D]	\$9,674	0.6%
Corix Multi-Utility Services	[E]	\$6,732	0.4%
All Other	[F]	\$20,275	1.2%
Total Investor-Owned Utility Revenue	[G]	\$1,724,251	100.0%

Sources and Notes:

[1]: BCUC 2019/20 Annual Report, Pages 66-69, "Regulated Electricity, Thermal Energy and Gas Sales"

[2]: Calculated by Brattle - proportion of total investor-owned utility revenue (row [G])

[A]: Includes Mainland, Vancouver Island, Whistler, Revelstoke, and Fort Nelson Division

[C]: Includes Pacific Northern Gas (N.E.) Ltd. and Pacific Northern Gas Ltd.

[D]: 28 individual thermal utilities as listed in BCUC Annual Report

[E]: Includes Sun Rivers, Sonoma Pines, and Panorama, as well as 5 individual thermal utilities as listed in BCUC Annual Report

16. In addition to being much smaller than FEI, the many small or very small investor-owned utilities regulated by the BCUC are quite diverse in their operating characteristics and financial circumstances. They span electric, thermal, and gas as energy sources, and have differing types of service territories (some geographically dispersed, others locally concentrated), which differences may influence their risk profiles and affect the cost of capital.

17. The various small BC utilities also have diverse ownership structures (with most being stand-alone private companies or subsidiaries of privately held corporations) and sources of financing. Although the cost of capital depends on its use rather than its source, differences in corporate structure among small utilities may lead to differences in the availability of information for comparative risk analysis.
18. In this context, the primary “pro” of the using the Benchmark Utility approach is to promote regulatory efficiency through the GCOC process. As Dr. Lesser correctly noted,¹⁵ under the Benchmark Utility approach, there is no need for each small utility to make individual evidentiary submissions regarding the market cost of capital and financing parameters indicated in financial markets for a proxy group of publicly-traded utilities. This is efficient because the cost of making such submissions represent a significantly larger proportion of the total revenue requirements of such small utilities compared to the BCUC’s traditional Benchmark Utility, FEI.
19. Under the Benchmark Utility approach, the consideration and adjudication of evidence concerning the market cost of capital—and how it should be applied to the regulated energy utility sector in BC—is done only once, in the context of setting parameters for the Benchmark Utility. Other individual utilities (or relevant groups thereof) are then permitted to focus their more limited submissions on the unique characteristics that influence their business and financial risk (and other important financing considerations) relative to the Benchmark Utility. When it comes to characteristics that the Commission may find probative or relevant to assessing the relative business risk of specific utilities (*e.g.*, supply circumstances, size and geographic dispersion, competition, commodity demand), evidence on these factors is most efficiently provided by the utilities themselves, which are most familiar with their own circumstances.¹⁶
20. It is important to recognize that the Benchmark Utility parameters must themselves reflect the Commission’s judgement about how the Benchmark Utility’s operating and financial circumstances—coupled with factors related to the Commission’s regulation—affect the setting of allowed return and deemed equity thickness relative to the cost of capital estimates derived from capital market measurements for a relevant proxy group of publicly traded companies.

¹⁵ Continental Report, page 6.

¹⁶ Note that in the last BCUC GCOC proceeding, the Commission sought information on the scope of risks faced by particular utilities through the use of a risk matrix listing 19 specific (but potentially overlapping) risk factors. See BCUC GCOC – Stage 1 Decision, Appendix E (2013) and BCUC GCOC – Stage 2 Decision, Section 2.7, pages 38-41 (2014).

Put simply, (consistent with the discussion in Section II above) even setting the cost of capital for the Benchmark Utility is an exercise in benchmarking.

21. However, the BCUC's Benchmark Utility, FEI, is a relatively large and financially sophisticated corporate entity that raises funds directly in public capital markets and competes for equity capital as a subsidiary of a publicly-traded corporation—Fortis, Inc. Consequently, the task of comparing the Benchmark Utility's business and financial risk characteristics to those of the publicly traded proxy companies is more tractable than performing such comparisons for the many much smaller utilities that fall under the BCUC's jurisdiction. Further, it is clearly more efficient—in terms of cost, time, and pages of evidence—to marshal the expertise and information necessary for this “stage 1” analysis once for the Benchmark Utility, compared to imposing the same process on individual companies (or groups thereof) among the many much smaller BC utilities that are affected by this proceeding.
22. As Dr. Lesser identifies, it is the second stage of the Benchmark Utility approach where challenges arise with respect to the methodology employed to implement utility-specific adjustments to allowed returns and capital structures in consideration of their differential business and financial risk characteristics.
23. Dr. Lesser expresses concern that such methodologies may be subjective or performed on an *ad hoc* basis, and that “benchmarking across industries [may be] especially problematic.”¹⁷ He also warns of the possibility that the Benchmark Utility's return “may not meet the fair return standard,” such that other returns set relative to the benchmark would “meet the fair return standard only by chance” and opines that other utilities would be unlikely to “present evidence arguing for allowed returns below that of the benchmark utility.”¹⁸
24. However, Dr. Lesser does not explain how any of these purported “cons” to the Benchmark Utility approach would be ameliorated by abandoning that approach. He asserts that “[i]n fact, deriving just and reasonable empirical models to estimate risk adjustments is likely to be more difficult than[sic] simply using established methodologies to estimate allowed rates of return for those other utilities,”¹⁹ but provides no support or rationale for that conclusion.
25. It is true, as the BCUC has recognized, that “the determination of appropriate capital structures and ROEs requires a high degree of judgement by the Commission, since there is no consensus

¹⁷ Continental Report, page 8.

¹⁸ *Id.*

¹⁹ Continental Report, page 9. Emphasis original.

on” empirical approaches to such determinations.²⁰ However, this would be no less true if such determinations were made separately for each individual regulated utility than it is in context of the Benchmark Utility approach.

26. In its last GCOC proceeding, the Commission made the pragmatic decision to consider evidence from quantitative methods while emphasizing relative business risk evaluation to inform its judgement as to the fair return and capital structure for each utility.²¹ Ultimately, the necessity of such a pragmatic approach is inextricably linked to the fundamental objective of determining a fair return in consideration of each utility’s risk characteristics. Consequently, abandoning the Benchmark Utility approach in favor of some other regulatory process for the current GCOC would not remove the challenge of that task, nor the need for the regulator to exercise informed judgement in meeting that challenge.

IV. Comments on Regulatory Practice Outside British Columbia

27. When looking to regulatory practices in other jurisdictions, it is essential to consider the context in which they are applied. Dr. Lesser characterizes the BCUC’s Benchmark Utility approach as “unique,”²² but does not consider whether that approach may also be uniquely appropriate in consideration of the particular (and perhaps also unique) context of the BCUC’s regulation of a single large investor-owned utility alongside a large group of other utilities that are small in size and diverse in structure and purpose.
28. The remainder of this section addresses select examples of cost of capital practices in utility regulatory jurisdictions surveyed by Dr. Lesser, and places those practices in context of the regulatory circumstances in those jurisdictions.

IV.A. U.S. Practice

29. Dr. Lesser makes a simple conclusory statement that to his knowledge, neither the U.S. Federal Energy Regulatory Commission nor any U.S. state utility regulator apply the Benchmark Utility approach used by the BCUC.²³ However, the Continental Report does not attempt to place the cost of capital practices of these regulators in context of their jurisdictional circumstances.

²⁰ BCUC GCOC – Stage 2 Decision, page 15 (2014).

²¹ *Id.*, page 20.

²² Continental Report, page 1.

²³ *Id.*

30. Many U.S. state utility commissions regulate only a few major investor-owned utilities that have relatively large operations and service territories. In many instances, these state-regulated utilities issue debt in public markets and are subsidiaries of one of the many utility holding companies that have shares traded on U.S. stock exchanges. (In BC, by contrast, only FEI and FortisBC Inc. fit that description, but the BCUC must also establish fair returns for the many smaller utilities it regulates.) In those instances, it is typical for regulators to adjudicate ROE and capital structure within the context of each utility’s general rate case. As the cost of capital is one issue among many, it is often dealt with as part of a settlement among the utility, the regulator, and interveners that determines the revenue requirement—including allowed return on rate base—as part of a holistic package.
31. In some states, generic cost of capital proceedings are convened to set cost of capital parameters for groups of utilities that share general similarities in size and circumstance. For example, in California the four major energy utilities litigate their allowed returns and regulatory capital structures concurrently, with each utility receiving consideration of its individual business and financial risk characteristics as part of a single proceeding before the California Public Utilities Commission (CPUC).²⁴ All four parties to these generic proceedings issue their own debt on public markets and have credit ratings from major rating agencies.²⁵ They are subsidiaries of (or are themselves) publicly traded utility companies that provide electric and gas services over their respective large and populous franchise services areas within the state of California.²⁶
32. A similar process is used to set cost of capital parameters for the largest investor-owned water utilities in California.²⁷ Like the major California energy utilities, the four largest “Class A” water companies operate in large and populous service territories, raise their own debt in public capital markets, and are subsidiaries of publicly-traded corporations.²⁸ Notably, in the water utility context, the parameters determined in the generic proceeding for the largest California utilities have historically serve as a type of benchmark for the separate generic proceeding

²⁴ See, e.g., CPUC Decision 19-12-065, Decision on the Test Year 2020 Cost of Capital for the Major Energy Utilities, Application 19-04-015 (2019).

²⁵ *Id.*, pages 6-12.

²⁶ *Id.*, page 3.

²⁷ <https://www.cpuc.ca.gov/about-cpuc/divisions/water-division/decisions-and-resolutions-applied-to-all-investor-owned-water-utilities-section>, accessed July 20, 2021.

²⁸ The four large Class A California water utilities are California Water Service Company, a subsidiary of California Water Service Group (NYSE: CWT), San Jose Water Company, a subsidiary of SJW Group (NYSE: SJW), Golden State Water Company, a subsidiary of American States Water Co. (NYSE: AWR), and California-American Water, a subsidiary of American Water Works, Co. (NYSE: AWK).

applied to the *next* five largest “Class A” investor-owned water utilities. The five smaller utilities—which are privately held and generally do not issue their own debt—traditionally litigate their cost of capital in a proceeding one year following the large water utilities.²⁹ As such, the smaller companies can focus their submissions on updates over the course of that year and on relative risk and particular circumstances rather than a complete de novo analysis of capital market parameters.

IV.B. Ontario

33. As noted in the Continental Report, the Ontario Energy Board (“OEB”) employs a formulaic annual adjustment mechanism established in 2009 to determine a generic allowed ROE for all utilities in its jurisdiction.³⁰ However, contrary to Dr. Lesser’s claim,³¹ the OEB does not apply the same regulatory capital structure to all utilities. Rather, the OEB has stated a policy that 60% debt, 40% equity is appropriate for electricity distributors, but that the deemed capital structure for electricity transmitters, generators, and gas utilities should be determined on a case-by-case basis.³² Indeed, the OEB has established different regulatory capital structures for Ontario Power Generation and certain natural gas distribution utilities.³³
34. It is also worth noting that the OEB Staff’s cost of capital reviews have identified significant variability in the achieved rates of return on equity for the over 70 rate-regulated electricity distribution utilities in Ontario, with the greatest volatility observed for smaller distributors.³⁴

IV.C. Alberta

35. Energy utilities in Alberta are subject to economic regulation by the Alberta Utilities Commission (“AUC”), which has historically convened regular generic cost of capital proceedings to establish allowed returns for the Alberta utilities. The AUC’s process is in fact very similar to the BCUC’s. The AUC first evaluates capital market evidence and considers how business risk for Alberta utilities generically compares to the business risk for groups of publicly-traded comparable companies used to estimate the market cost of equity. Based on this

²⁹ <https://www.publicadvocates.cpuc.ca.gov/waterCOC.aspx>, accessed July 20, 2021.

³⁰ Continental Report, page 5, citing OEB 2021 Cost of Capital Parameters (November 9, 2020) and OEB Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, EB-2009-0084 (December 11, 2009).

³¹ Continental Report, page 5. (“The capital structure is set to 60% debt [...] and 40% equity for all utilities.”)

³² OEB Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, EB-2009-0084, pages 49-50 (December 11, 2009).

³³ OEB Staff Report, EB-2009-0084, page 3 (January 14, 2016).

³⁴ *Id.*, pages 13-15.

evaluation, the AUC selects a fair return on equity and “benchmark” deemed equity ratio. It then sets regulatory capital structures for each utility it regulates in consideration of its particular business and financial risk characteristics in comparison to the benchmark.³⁵

36. Compared to the BCUC’s process, the only significant difference is that the AUC employs a generic benchmark utility (which it has sometimes referred to as an “average risk” utility), rather than designating a specific utility as the benchmark.³⁶ This makes sense in Alberta because there are multiple sizable investor-owned utilities.³⁷ By contrast (as discussed in Section III above) the BCUC regulates only one large investor-owned gas utility (FEI) and one smaller but still sizable electric distribution utility (FortisBC Inc.), alongside many very small and diverse utilities. Given the differences in regulatory landscape between the AUC’s jurisdiction and the BCUC’s, this subtle difference between the two regulators’ approach to benchmarking is understandable.
37. It is true, as Dr. Lesser states, that the AUC does not adjust the allowed ROE for difference in risk among its regulated utilities.³⁸ However, as noted above, it does set different deemed equity ratios for different utilities, with the explicit purpose of adjusting for differences in business and financial risk. As Dr. Lesser acknowledges, the proportions of equity and debt financing in the regulatory capital structure influence financial risk for individual utilities.³⁹ Thus, the deemed equity ratio plays a role in determining a fair return, even if the same ROE is applied to all utilities.

V. Conclusion

38. As explained above the task of establishing cost of capital parameters that meet the Fair Return Standard for rate-regulated utilities is—fundamentally and unavoidably—an exercise in benchmarking. Considering the jurisdictional context of the BCUC’s regulation of a single large investor-owned utility (FEI) alongside many much smaller utilities, the two-stage Benchmark Utility approach that is currently in place for determination of utility cost of capital parameters

³⁵ AUC Decision 2191-D01-2015, Section 3, paras. 29-36 (2015); AUC Decision 20622-D01-2016, Section 3, paras. 26-27 and 32 (2016); AUC Decision 22570-D01-2018, Section 3, paras. 16-17 and 22 (2018).

³⁶ AUC Decision 2191-D01-2015, paras. 459-461 (2015); AUC Decision 20622-D01-2016, para 612 (2016).

³⁷ These include the ATCO distribution and transmission utilities owned by Canadian Utilities Ltd. (TSX: CU) and ATCO Ltd. (TSX: ACO), FortisAlberta Inc., an electric distribution utility and subsidiary of Fortis, Inc. (TSX: FTS), and electric transmission utility AltaLink, which is a subsidiary of Berkshire Hathaway (NYSE: BRK).

³⁸ Continental Report, page 2.

³⁹ Continental Report, page 8.

under the Commission's jurisdiction is a reasonable and pragmatic procedural framework that promotes regulatory efficiency.

39. Comparisons of practices in other sizable utility regulatory jurisdictions do not suggest that the BCUC's approach is unsuited to its jurisdictional circumstances. Nor is there any indication that abandoning the Benchmark Utility approach would ameliorate the inherent challenges that require the Commission to apply informed judgement in setting fair returns and capital structures for each of the utilities under its jurisdiction.