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September 24, 2012

British Columbia Public Interest Advocacy Centre
Suite 209 – 1090 West Pender Street
Vancouver, BC
V6E 2N7

Attention: Ms. Leigha Worth, Executive Director

Dear Ms. Worth:

Re: Generic Cost of Capital Proceeding

FortisBC Utilities[1] ("FBCU")

Response to the British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Pensioners' and Seniors' Organization *et al* ("BCPSO") Information Request ("IR") No. 1

On August 3, 2012, the FBCU filed its Written Evidence in the Generic Cost of Capital proceeding as referenced above. In accordance with the British Columbia Utilities Commission Order No. G-84-12 setting out the Amended Preliminary Regulatory Timetable, the FBCU respectfully submit the attached response to BCPSO IR No. 1.

If there are any questions regarding the attached, please contact the undersigned.

Yours very truly,

on behalf of the FORTISBC UTILITIES

Original signed:

Diane Roy

Attachment

cc (e-mail only): Commission Secretary
Registered Parties

[1] comprised of FortisBC Inc., FortisBC Energy Inc., FortisBC Energy (Vancouver Island) Inc., and FortisBC Energy (Whistler) Inc.

1.0 Reference: Exhibit B1-9, FBCU Evidence, pages 3 and 7-8

Preamble: The Evidence states that one of the elements of FEI's business risk is the competitiveness of natural gas to alternative energy sources such as electricity.

1.1 Is it FBCU's view that, relative to the situation that existed in 2009, the competitive position of natural gas versus electricity has improved, or has it deteriorated?

Response:

Please refer to the response to BCUC IR 1.97.1.

2.0 Reference: Exhibit B1-9, FBCU Evidence, page 6

2.1 Was the outcome of the Commission's Decision regarding allowed ROE less than what had been identified by all of the experts who participated in the BCUC proceeding regarding the 2009 Application?

Response:

No. The 2009 ROE and Capital Structure Decision (Order No. G-158-09) determined an allowed ROE for FEI (benchmark utility) to be 9.5 percent effective July 1, 2009. This is lower than the 11 percent ROE requested by the FEU, which was identified by all the experts of the Company to be fair and reasonable. Dr. Booth recommended a 7.75 percent ROE, which was less than what was ultimately allowed.

3.0 Reference: Exhibit B1-9, FBCU Evidence, page 10

Exhibit B1-9, FBCU Evidence, Appendix G, page 6, lines 7-8

Exhibit B1-9, FBCU Evidence, Appendix F, page 1, line 18

3.1 Was the evidence provided by Ms. McShane and Dr. Vander Weide developed on a totally independent basis? More specifically, did the experts consult with each other and/or have available to them drafts of the other expert's evidence prior completing and finalizing their own evidence?

Response:

Ms. McShane and Dr. Vander Weide worked on their drafts independently and employed different methodologies to estimate FEI's cost of capital. Ms. McShane reviewed a draft of Dr. Vander Weide's report, but only after she had reached her own opinion based on her own analysis and had prepared her own draft. Ms. McShane informed Dr. Vander Weide of her opinion on FEI's cost of capital at approximately the same time, but Dr. Vander Weide did not review Ms. McShane's report in draft. Ms. McShane believes that she sought clarification from Dr. Vander Weide on a few discrete points in his report. Neither Ms. McShane, nor Dr. Vander Weide, altered his or her opinion as to FEI's cost of capital based on input from the other. In summary, each of the experts was aware of the importance of arriving at their own opinions via their own analysis and did so.

4.0 Reference: Exhibit B1-9, FBCU Evidence, pages 11-12 and page 29

4.1 What is FBCU's view regarding the need for a deemed interest rate in circumstances (such as PNG – see Exhibit B3-7) where the deemed debt level exceeds the actual debt level and, if required, how should the rate be established?

Response:

In FBCU's view, there is no need for a deemed interest rate. In the example of PNG, where the actual debt level is marginally different then the deemed debt level, the deemed debt level would attract interest at PNG's embedded rate on actual debt.

5.0 Reference: Exhibit B1-9, FBCU Evidence, pages 18-19

5.1 Even in circumstances where an actual utility is used as the "benchmark", will it not be necessary for there to be common agreement (or determination by the BCUC) regarding the characteristics of the utility – particularly for those characteristics, such as business risk and competitive position, where opinions may differ?

Response:

In principle, yes, there should be agreement or Commission determinations, or at a minimum a body of evidence, regarding the characteristics of the benchmark so as to provide an objective basis against which to assess the relative risk of individual BC utilities.

6.0 Reference: Exhibit B1-9, FBCU Evidence, pages 22-23

6.1 For each of the four trends noted on pages 22-23 that are viewed as increasing the business risk for FEI (as a distributor of natural gas), please comment on whether the same "trends" can be viewed as decreasing the business risk for electricity distributors and/or vertically integrated electric utilities.

Response:

For each of the four trends. the FEU responds as follows:

- Although climate change and energy policies in BC tend to favor electricity consumption over natural gas consumption, they do not necessarily decrease the business risk for individual electricity distributers and/or vertically integrated electrical utilities.

- Although appliance capital cost, perception of clean electricity and high density gas capture rates may cause a migration from gas to electricity, the general efficiency improvements of electrical appliances have essentially offset any potential increase in electrical load. Electrical use per customer has not and is not forecast to increase as a result of this migration. Therefore, this trend has not, as of this time, decreased or increased risk to electricity distributors and/or vertically integrated utilities.

- Alternative energy sources could also increase risk to traditional electric heating loads through reduced usage.

FBC will address its business risk in greater detail in the context of determining its appropriate return relative to the benchmark, however, please refer to the response to BCPSO IR 1.9.1.

7.0 Reference: Exhibit B1-9, FBCU Evidence, page 26

7.1 Please discuss FEI’s borrowing activities since 2008. For each debt issue please indicate whether or not FEI was able to borrow at the rate one would expect available for a minimum A rated company.

Response:

FEI has issued three Medium Term Note debentures since 2008 as follows:

	Amount ($000's)	Issue Date	Maturity Date	Term Years	Coupon %
Series 23	250,000	13-May-08	13-May-38	30	5.80
Series 24	100,000	24-Feb-09	24-Feb-39	30	6.55
Series 25	100,000	9-Dec-11	9-Dec-41	30	4.25

FEI was able to borrow at the market rate expected for an A rated company at the time of issuance.

8.0 Reference: Exhibit B1-9, FBCU Evidence, page 31

8.1 Based on the most recent actual financial results, what portion of FEI’s overall capital structure is associated with (i) its average working capital requirements and (ii) the development of assets?

Response:

Based on the 2011 annual report, the following is the percentage of capital structure associated with:

1. FEI’s average working capital requirements: 4.5%
2. FEI’s development of assets: 3.26%

9.0 Reference: Exhibit B1-9, Appendix F (McShane Evidence), pages 45-48 and 51

9.1 The discussion on pages 45-48 suggests that the business risk associated with vertically integrated electric utilities is higher than that of natural gas distribution utilities. However, the text on page 51 specifically notes the competitive advantage available to electric utilities with low embedded costs of heritage hydroelectric generation. Please comment on the relative ranking of vertically integrated electric utilities (with relatively low cost sources of generation such as hydro-electric) versus natural gas distributors, particularly in the context of BC.

Response:

In the BC context, the low embedded cost of heritage electricity is one element of business risk that is of particular importance to natural gas utilities like FEI. Although FBC has access to heritage generation, FBC is still exposed to greater risk than FEI due to factors such as its smaller size and its ownership of electric generation assets. It should also be noted that fuel switching to electricity can also create challenges. Over time, construction of new base load generation to meet the capacity requirements will be much more costly, reaching or exceeding the available low embedded cost heritage generation, which will increase the risk to the electric utility.

10.0 Reference: Exhibit B1-9, Appendix F (McShane Evidence), pages 92-93

10.1 The equations set out in both Table 17 and Table 18 have relatively low R2 values. At what level of R2 value would the results of the equation be viewed as insufficiently robust to be used in determining a reasonable utility relative risk adjustment?

Response:

There is no "bright line" cut-off point for the R^2 which indicates that the regression results are not sufficiently robust to be used. The results of the referenced equations are, as indicated by the summary Table 21, one of a number of indicators used to estimate the relative risk adjustment to the market equity risk premium.

11.0 Reference: Exhibit B1-9, Appendix F (McShane Evidence), page 121

11.1 What assurance is there that non-arm's length issues between a utility and an affiliated company have "cost rates that are based on market conditions"?

Response:

All debt that is issued by a utility in BC that is payable one year or more from its date must be first approved by the Commission under Section 50(2). This would include non-arm's length transactions.

12.0 Reference: Exhibit B1-9, Appendix F (McShane Evidence), page 135-136

12.1 The text on these pages concludes that "size matters" in evaluating ROE. Please explain how the relative size of FEI was taken into account in the determination of the return on equity values set out in Table 31.

Response:

Size was not taken into account for FEI in deriving the values in Table 31, as FEI is a relatively large company, with a rate base that is close to $3 billion, and which, if it were a publicly traded stock, would most likely be in the top two deciles of the S&P/TSX Index in terms of market capitalization. The reasons underlying FEI's selection as the benchmark utility are outlined at page 16, lines 414 to 434. As the benchmark utility, the benchmark ROE as set forth in Table 31 is applicable to FEI.

13.0 Reference: Exhibit B1-9, Appendix G (Vander Weide Evidence), page 14

Preamble: Other evidence filed in this proceeding has suggested that size is a factor consider in the determination of return on equity.

13.1 Does Mr. Vander Weide agree?

Response:

Dr. Vander Weide agrees that size may be a factor in determining a company's cost of equity if: (1) one or more of the proxy companies has small market capitalization; or (2) the market capitalizations of the proxy companies are significantly different from the market capitalization of the regulated company. In this regard, Dr. Vander Weide notes that the average market capitalization of the electric utilities is larger than the average market capitalization of the natural gas utilities in his proxy groups. He also notes that FEI does not have a market capitalization because it is not publicly traded.

13.2 Was size taken into account in the selection of utilities as set out on page 14?

Response:

As set out on page 14 of his written evidence, Dr. Vander Weide does not use size to select proxy companies.