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September 24, 2012

Industrial Customers Group
c/o Robert Hobbs
301-2298 McBain Avenue
Vancouver, BC V6L 3B1

Attention: Mr. Robert Hobbs

Dear Mr. Hobbs:

Re: Generic Cost of Capital Proceeding

FortisBC Utilities (the "FBCU")[1]

Response to Industrial Customers Group ("ICG") Information Request ("IR") No. 1 on the Evidence of Dr. James H. Vander Weide, PhD

On August 3, 2012, the FortisBC Utilities 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 ICG IR No. 1 on the Evidence of Dr. James H. Vander Weide, PhD.

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. **Reference:** **Evidence of Dr. James H. Vander Weide, PhD, p. 14, Q/A 37**

   Rationale: **Dr. Vander Weide says that comparable companies must be publicly traded due to information availability. But most Canadian utilities are not publicly traded.**

   Request:

   Is Dr. Vander Weide aware of any studies that show publicly traded companies are comparable to companies without publicly-traded stock? Are there any key differences between publicly traded and not publicly traded companies that he is aware of? If so, how does he correct for such differences in his analyses?

Response:

The major difference between publicly-traded and non-publicly-traded companies is that equity investments in publicly-traded companies are more liquid than equity investments in non-publicly-traded companies. (Note: the term "liquidity" refers to the ability to exchange an asset for cash at little or no cost.) Academic studies of the required returns on publicly-traded stocks with different degrees of liquidity indicate that there is an inverse relationship between the required return and the degree of liquidity; that is, investors require a higher return on stocks with less liquidity than on those with more liquidity. The evidence from these studies suggests that the required return on an equity investment in non-publicly-traded companies is very likely higher than the required return on publicly-traded companies with the similar business risk. Dr. Vander Weide has not adjusted the cost of equity model results for his publicly-traded proxy utilities to account for the lower liquidity of an equity investment in non-publicly-traded Canadian utilities such as FEI.

2. **Reference:** **Evidence of Dr. James H. Vander Weide, PhD, p. 15, Q/A 39**

   "I include both natural gas and electric utilities in my comparable risk groups to ensure that there is a sufficiently large group of companies to reliably estimate the cost of equity."

Rationale: **Dr. Vander Weide notes that "regulated natural gas and electric utilities generally face similar risks."**

Request:

Are there any notable differences between natural gas utilities and electric utilities in terms of the levels of debt or equity? If so, how does Dr. Vander Weide account for such differences? If not, please explain why the two types of utilities are similar.

Response:

No. As shown in Vander Weide Exhibit 18 and Exhibit 19, both natural gas and electric utilities have average allowed equity ratios in the range 49 percent to 50 percent. Dr. Vander Weide believes the two types of utilities are similar because they have similar business and financial risks.

3. Reference: **Evidence of Dr. James H. Vander Weide, PhD, p. 19, Q/A 51**

In regard to the companies in the S&P/TSX utilities index, Dr. Vander Weide states, "The primary disadvantage is that six of the ten companies in this group do not have a significant percentage of assets devoted to regulated utility service, and the financial statements of two of the companies with a significant percentage of regulated assets reflect essentially the same information"

Rationale: **Such a disadvantage may affect the comparability of the companies in the group.**

Request:

Given the disadvantage referenced above, please explain how the companies in the S&P/TSX are still comparable to a Canadian regulated natural gas utility

Response:

If there were a large sample of publicly-traded Canadian natural gas utilities, one could estimate FEI's cost of equity by applying cost of equity methods to the large sample of publicly-traded Canadian natural gas utilities. However, there are no Canadian natural gas utilities with publicly-traded stock; and there are only several Canadian utilities with a significant percentage of regulated utility operations in North America. Given the lack of direct market evidence on the market cost of equity for publicly-traded Canadian natural gas utilities, Dr. Vander Weide recommends that the Commission determine FEI's cost of equity by examining cost of equity evidence for two groups of Canadian utilities and two groups of U.S. utilities. The primary advantages of the S&P/TSX Utilities Index are that: (1) the companies are Canadian companies that are broadly associated with the Canadian utilities industry; (2) there are more companies in the index than in the BMO CM basket of utility stocks; and (3) return data for the S&P/TSX Index is available for a longer period of time than for the BMO CM companies.

4. Reference: Evidence of Dr. James H. Vander Weide, PhD, p. 21, Q/A 59

"Canadian utilities generally have greater financial risk than U.S. utilities because...they rely more heavily on debt financing than U.S. utilities"

Rationale: This may affect the comparability U.S. utilities to Canadian utilities.

Request:

How does Dr. Vander Weide account for the difference in financial risk and in the amount of debt to equity between Canadian and U.S. utilities when using U.S. utilities in his group of comparable companies?

<u>Response:</u>

To be conservative, Dr. Vander Weide does not make any adjustment for the higher financial risk of Canadian utilities compared to U.S. utilities.

5. Reference: Evidence of Dr. James H. Vander Weide, PhD, p. 22, Q/A 64

"...I find no significant difference in allowed ROEs for utilities in different bond rating categories."

Rationale: **Dr. Vander Weide finds no significant difference in allowed ROEs for utilities in different bond rating categories, yet uses bond rating categories as a criterion in his selection of comparable companies.**

Request:

If a utility's allowed ROE does not significantly vary with its bond rating category, then why does Dr. Vander Weide restrict the comparables group to only companies at or above a particular bond rating? Did Dr. Vander Weide perform any statistical significance tests to determine that there was "no significant difference in allowed ROEs?" If yes, please provide the results of any significance tests performed. If no, please explain that basis for Dr. Vander Weide concluding that there is no significant difference.

Response:

(a) Dr. Vander Weide restricts his comparable group only to companies at or above a particular bond rating to allay any possible concern that including companies with lower bond ratings might bias cost of equity model results upward.

(b) Dr. Vander Weide presents the evidence in Table 1 in response to the question: "Do you have evidence that bond ratings are a poor indicator of the risk of investing in a company's equity?" In Dr. Vander Weide's opinion, the evidence in Table 1 supports the conclusion that bond ratings are a poor indicator of equity risk because, if bond ratings were a good indicator of equity risk, the allowed ROEs would be higher the lower the bond rating. Instead, the evidence in Table 1 demonstrates that allowed ROEs are lower, the lower the bond rating, particularly at the BBB- and below investment grade levels.

6. Reference: **Evidence of Dr. James H. Vander Weide, PhD, p. 24, A 67**

Dr. Vander Weide cites the Board in stating they find that U.S. utilities can be comparable to Canadian utilities for estimating the cost of capital "...and that only an analytical framework in which to apply judgment and a system of weighting are needed...."

Rationale: **The cite mentions that a "system of weighting" is needed.**

Request:

Does Dr. Vander Weide use a system of weighting in his estimations of the cost of capital where he uses U.S. utilities as proxies for Canadian utilities? If so, please describe his weighting system and/or provide the weights used in an electronic format.

Response:

The quotation refers to both "an analytical framework in which to apply judgment" and "a system of weighting". Dr. Vander Weide provides an analytical framework in which to apply judgment when he compares the relative risks of Canadian and U.S. utilities in Section IV of his written evidence. With regard to a "system of weighting," as shown in Table 3 of his written evidence, Dr. Vander Weide gave equal weight to the results of all his recommended cost of equity models, which include both Canadian and U.S. comparable utility groups.

7. Reference: **Evidence of Dr. James H. Vander Weide, PhD, Exhibit 6, Summary of Discounted Cash Flow Analysis for Comprehensive Group of U.S. Utilities**

Rationale: **ICG would like to examine Dr. Vander Weide's calculations and underlying data.**

Request:

Please provide an electronic copy of Exhibit 6 and of the data used to perform the analysis. Please provide an electronic copy of the spreadsheet, or program code, used to conduct the analysis summarized in Exhibit 6.

Response:

The requested data are provided in Attachment 7.

8. Reference: **Evidence of Dr. James H. Vander Weide, PhD, Exhibit 7, Summary of Discounted Cash Flow Analysis for Smaller Group of U.S. Utilities**

with Mostly Regulated Assets and S&P Bond Rating Equal to or Greater Than BBB

Rationale: **ICG would like to examine Dr. Vander Weide's calculations and underlying data.**

Request:

Please provide an electronic copy of Exhibit 7 and of the data used to perform the analysis. Please provide an electronic copy of the spreadsheet, or program code, used to conduct the analysis summarized in Exhibit 7.

Response:

The requested data are provided in Attachment 8.

9. Reference: **Evidence of Dr. James H. Vander Weide, PhD, Exhibit 8, Experienced Risk Premiums on S&P/TSX Canadian Utilities Stock Index 1956-2011.**

Rationale: **ICG would like an electronic copy of the data.**

Request:

Please provide an electronic copy of Exhibit 8.

Response:

The requested data are provided in Attachment 9.

10. Reference: **Evidence of Dr. James H. Vander Weide, PhD, Exhibit 9, Experienced Risk Premiums on BMO Capital Markets Utilities Stock Data Set 1983-2011.**

Rationale: **ICG would like an electronic copy of the data.**

Request:

Please provide an electronic copy of Exhibit 9.

Response:

The requested data are provided in Attachment 10.

11. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 10, Comparison of DCF Expected Return on an Investment in Electric Utilities to the Interest Rate on Long-Term Government Bonds.

Rationale: ICG would like to examine Dr. Vander Weide's calculations and underlying data.

Request:

Please provide an electronic copy of Exhibit 10 and of the data shown and the data used to estimate DCF. Please provide an electronic copy of the spreadsheet, or program code, used to conduct the estimation of quarterly DCF.

Response:

The requested data are provided in Attachment 11.

12. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 11, Comparison of DCF Expected Return on an Investment in Natural Gas Utilities to the Interest Rate on Long-Term Government Bonds.

Rationale: ICG would like to examine Dr. Vander Weide's calculations and underlying data.

Request:

Please provide an electronic copy of Exhibit 11 and of the data shown and the data used to estimate DCF. Please provide an electronic copy of the spreadsheet, or program code, used to conduct the estimation of quarterly DCF.

Response:

The requested data are provided in Attachment 12.

13. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 12, Calculation of Capital Asset Pricing Model Cost of Equity Using SBBI 6.6 Percent Risk Premium and Value Line Betas for Proxy Utilities.

Rationale: ICG would like to examine the data used.

Request:

Please provide electronic copies of the tables in Exhibit 12.

Response:

The requested data are provided in Attachment 13.

14. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 14, Comparison of Risk Premia on S&P500 and S&P Utilities 1937-2012

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 14.

Response:

The requested data are provided in Attachment 14.

15. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 15, Comparison of Risk Premia on S&P TSX Composite, S&P TSX Utilities, and BMO Capital Markets Utility Group

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 15.

Response:

The requested data are provided in Attachment 15.

16. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 16, Allowed Returns on Equity, U.S. Electric Utilities 2010 - June 2012.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 16.

Response:

The requested data are provided in Attachment 16.

17. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 17, Allowed Returns on Equity, U.S. Natural Gas Utilities 2010 - June 2011.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 17.

Response:

The requested data are provided in Attachment 17. In addition, please note that there is a typographical error in the title of the exhibit: “June 2011” should read “June 2012”.

18. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 18, Allowed Equity Ratios, U.S. Electric Utilities 2009 - 2011.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 18.

Response:

The requested data are provided in Attachment 18. In addition, please note that there is a typographical error in the title of the exhibit: “2009 - 2011” should read “2010 – June 2012”, and the data in the exhibit were obtained from SNL Financial on July 5, 2012.

19. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 19, Allowed Equity Ratios, U.S. Natural Gas Utilities 2009 - 2011.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 19.

Response:

The requested data are provided in Attachment 19. In addition, please note that there is a typographical error in the title of the exhibit: “2009 - 2011” should read “2010 – June 2012”, and the data in the exhibit were obtained from SNL Financial on July 5, 2012.

20. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 20, Market Value Equity Ratios for Comprehensive Group of U.S. Utilities at May 2012.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 20.

Response:

The requested data are provided in Attachment 20.

21. Reference: Evidence of Dr. James H. Vander Weide, PhD, Exhibit 21, Market Value Equity Ratios for Smaller Group of U.S. Utilities with Mostly Regulated Assets and S&P Bond Rating Equal To or Greater Than BBB.

Rationale: ICG would like to examine the data used.

Request:

Please provide an electronic copy of the table in Exhibit 21.

Response:

The requested data are provided in Attachment 21.

Attachment 7

REFER TO LIVE SPREADSHEET

Provided in electronic format only

(accessible by opening the Attachments Tab in Adobe)

Attachment 8

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Attachment 9

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Attachment 14

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Attachment 15

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