Diane Roy
Director, Regulatory Affairs - Gas
FortisBC Energy Inc.

16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (604) 576-7349
Cell: (604) 908-2790
Fax: (604) 576-7074
Email: diane.roy@fortisbc.com
www.fortisbc.com

Regulatory Affairs Correspondence
Email: gas.regulatory.affairs@fortisbc.com

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 Mr. Aaron Engen

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 Mr. Aaron Engen.

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 Aaron Engen, pp. 8:20 – 9:4

"Although spreads have seen a strong recovery from their 2008-2009 financial crisis highs, they remain high relative to historic levels. Despite good current market conditions, the average Canadian utilities group[1] 30-year spreads are wider (177 bps) than they were at the time of the 2009 Proceedings (163 bps). Investor appetite for risk in the debt capital market has generally diminished leading to an overall upward re-pricing of risk. Benchmark Government of Canada bond rates are expected to rise over the coming years with little room for the increase to be offset by corporate spread tightening."

Rationale: Engen discusses the changes in the utilities spreads, but doesn't explain how this might relate to the current issue of cost of capital and future changes in such.

Request:

Can Mr. Engen please explain how the conditions in the market stated above contribute to his opinion that FEI's requested return on equity of 10.5% on a deemed equity component of 40% is fair and reasonable? Does Mr. Engen expect this to still be true in the future as the market changes? If so, why? If not, how does Mr. Engen propose responses to such changes be built into the ROE adjustment formula?

Response:

Current debt capital market conditions, including wider generic "A" and utility 30-year spreads, are indicative of lower investor appetite for risk which has led to an increase in compensation for risk (re-pricing of risk). In a more risk adverse market, one would expect the cost of capital to increase. Mr. Engen considers this evidence along with all other market evidence he discusses to reach his conclusions.

Mr. Engen cannot speculate as to whether FEI's requested ROE would be consistent with future market conditions. There is no current or proposed ROE adjustment formula and Mr. Engen has not considered how or if such market condition changes would be captured by a formula.

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[1] Comprised of FEI, Gaz Métro, TransCanada, Enbridge, Emera, and CU.

2. Reference: Evidence of Aaron Engen, p. 9:8-10

“Some of the factors pushing Government of Canada bond yields to currently very low levels are the very same factors which would tend to put upward pressure on the cost of equity."

Evidence of Aaron Engen, p. 26:10-12

“The falling trend in the S&P/TSX’s P/E ratio over the past two years taken together with growth in corporate earnings during the same period as demonstrated in Figure 9, is compelling evidence that the cost of equity in Canada has been rising.

Rationale: Mr. Engen suggests that cost of equity will change, but does not discuss how this might be addressed.

Request:

If the cost of equity increases as trends seem to suggest they will, would Mr. Engen still feel that FEI’s requested return on equity is fair and reasonable? How does Mr. Engen propose adjustments to the formula (or formulae) be made in the face of such changes, if at all?

Response:

Mr. Engen cannot speculate as to whether future cost of equity trends as illustrated by the various factors discussed in his evidence would support FEI’s requested ROE. There is no current or proposed ROE adjustment formula and Mr. Engen has not considered how or if such market condition changes would be captured by a formula.

3. Reference: Evidence of Aaron Engen, pp. 51:17-52:3

“When considering ROEs stemming from an acquisition of regulated assets buyers generally include some or all of the following strategic factors in supporting acquisition prices including: geographic diversification; establishing a strategic foothold in a new market; and protecting the buyer’s regulated asset franchise”

Evidence of Aaron Engen, pp. 52:29-53:13 – Mr. Engen discusses further buyer considerations.

Rationale: **Mr. Engen lists these considerations, but does not discuss how they might be addressed within the proposed cost of capital methodology.**

Request:

How does MR. Engen propose accounting for these factors in the ROE adjustment formulae?

Response:

In Mr. Engen's view, nothing can be learned about the appropriateness of allowed returns on equity from Canadian merger and acquisition activity involving regulated assets.

There is no current or proposed ROE adjustment formula and Mr. Engen has not considered how or if such market condition changes would be captured by a formula.

4. Reference: **Evidence of Aaron Engen, pp. 67:16-68:2**

"In light of Canadian current and prospective capital market conditions, market required returns on capital for energy infrastructure assets, and opportunities for investments of comparable risk at attractive rates of return in Canada, the U.S. and elsewhere, I believe FEI's requested return on equity of 10.5% on a deemed equity component of 40% is consistent with current capital market conditions, which would be viewed by the financial market as more representative of FEI's true cost capital, and would be fair and reasonable in the context of such conditions."

Rationale: **Mr. Engen described various market conditions, investment returns, etc., but has not discussed how any of this directly relates to FEI's requested ROE and deemed equity component.**

Request:

How do the capital market conditions, returns on capital, and opportunities for investment support FEI's requested ROE of 10.5%, in particular? Would a different ROE or equity component also be considered fair and reasonable given the conditions? If conditions in the market, returns on capital, opportunities for investment change as forecasted, would the ROE requested by FEI remain fair and reasonable? How would Mr. Engen propose to adjust the ROE should conditions change?

Response:

Overall, FEI current debt capital market conditions, including wider generic "A" and utility 30-year spreads, are indicative of lower investor appetite for risk which has led to an increase in compensation for risk (re-pricing of risk). In a more risk adverse market, one would expect the cost of capital to increase. Mr. Engen considers this evidence along with all other market evidence he discusses to reach his conclusions.

Mr. Engen did not propose a specific ROE and capital structure for FEI; the FBCU engaged Ms. McShane and Dr. Vander Weide to do so. Mr. Engen's view is based on his analysis and conclusion that the cost of capital for FEI is higher than the current allowed return based on his assessment of current market conditions.

There is no current or proposed ROE adjustment formula and Mr. Engen's evidence has not considered how or if such market condition changes would be captured by a formula.

5. Reference: Evidence of Aaron Engen,

p. 14, Figure 1, S&P/TSX Composite Index 10-Year Performance, January 1, 2002 to July 4, 2012

p. 17, Figure 2, Investor Confidence, January 2002 to June 2012.

p. 19, Figure 3, VIXC Index Performance, October 1, 2009 to July 4, 2012

p. 20, Figure 4, VIX Index Performance, January 1, 2002 to July 4, 2012

p. 21, Figure 5, S&P/TSX Volatility, January 1, 1977 to July 4, 2012

p. 23, Figure 6, Canadian Equity Market Trading Volumes, January 1, 2002 to July 4, 2012

p. 24, Figure 7, Quarterly Mutual Fund Flows, January 2007 to May 2012

p. 26, Figure 8, S&P/TSX Composite Index Historical P/E Ratio, January 2002 to April 2012

p. 27, Figure 9, Aggregate Cdn Quarterly Corporate B-Tax Earnings, January 2002 to March 2012

p. 28, Figure 10, Earnings Yield – Gov’t Canada Bond Yield Spread, 1960 to June 2012

p. 32, Figure 11, Canadian Generic ‘A’ Spreads, January 2, 2002 to July 6, 2012

p. 33, Figure 12, Cdn Utilities Group 30-Year Spreads, January 2, 2002 to July 6, 2012

p. 34, Figure 13, Average Cdn Utilities Group 30-Year Spreads, January 2, 2002 to July 6, 2012

p. 35, Figure 14, 10-Year Generic BBB Spreads Less A Spreads, January 4, 2002 to July 6, 2012

p. 36, Figure 15, Aggregate Cdn Corporate Bond Issuance, 2002 to 2011

p. 42, Figure 17, Gov’t Canada Bond Yields, January 1, 2002 to July 4, 2012

Rationale: **ICG would like to examine the data.**

Request:

Please provide in electronic format the data used to generate each of the above-listed figures. How do the data and trends reflected in each of these figures demonstrate, in Mr. Engen’s opinion, that FEI’s requested ROE is fair and reasonable?

Response:

The requested data is provided in Attachment 5.

The referenced materials, taken together, reflect current financial market conditions and, along with evidence of market required returns on capital for energy infrastructure assets, and opportunities for investments of comparable risk at attractive rates of return in Canada, the U.S. and elsewhere, form the basis for Mr. Engen’s conclusions. He does not rely on individual data and trends and, other than as discussed in his written evidence, cannot draw the requested direct links between such individual data and trends and the fairness of FEI”s requested ROE.

Attachment 5

REFER TO LIVE SPREADSHEET

Provided in electronic format only

(accessible by opening the Attachments Tab in Adobe)