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BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-47-12

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

Generic Cost of Capital Proceeding

BEFORE: D.A. Cote, Panel Chair/Commissioner
M.R. Harle, Commissioner
L.A. O'Hara, Commissioner

April 18, 2012

O R D E R

WHEREAS:

A. On December 16, 2009, the British Columbia Utilities Commission (Commission) issued its Decision on the Return on Equity and Capital Structure Application (2009 ROE Decision) for Terasen Gas Inc. (TGI), Terasen Gas (Vancouver Island) Inc., and Terasen Gas (Whistler) Inc. (TGW), (collectively, the Terasen Utilities, now known as the FortisBC Energy Utilities);

B. By Order G-158-09 issued concurrently with the 2009 ROE Decision, the Commission ordered, among other things, that the Return on Equity Automatic Adjustment Mechanism (ROE AAM) in place since 1995 be eliminated; that the appropriate equity ratio for TGI would be 40 percent effective January 1, 2010; that the 9.5 percent ROE approved for TGI effective July 1, 2009 should continue to serve as the Benchmark ROE for FortisBC Inc. and any other utility in British Columbia that uses a Benchmark ROE to set rates; and that TGI was to complete its study of alternative formulas to an ROE AAM and report to the Commission by December 31, 2010;

C. On December 8, 2010, the Terasen Utilities filed their study on ROE alternative formulas with the Commission;

D. Since the issuance of the 2009 ROE Decision, changes have occurred in the financial markets. On November 28, 2011, the Commission issued to all regulated entities a Preliminary Notification of Initiation of Generic Cost of Capital (GCOC) Proceeding;

E. By Order G-20-12 dated February 28, 2012, the Commission established a Generic Cost of Capital (GCOC) Proceeding. Appended to Order G-20-12 were: (a) an Initial Regulatory Timetable, (b) a Preliminary Scoping Document containing a list of matters to be examined and determined; (c) a non-exhaustive List of Utilities regulated by the Commission characterized as either Affected Utilities or Other Utilities; and (d) a Public Notice

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of the GCOC Proceeding. Order G-20-12 also established that registered participants who wish to provide submissions on the Preliminary Scoping Document must file their submissions by March 21, 2012;

F. FortisBC Energy Inc., FortisBC Energy (Vancouver Island) Inc., FortisBC Energy (Whistler) Inc. and FortisBC Inc. (collectively, FBCU); Corix Multi-Utility Services Inc. (Corix); and Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (collectively, PNG) registered as Affected Utilities;

G. British Columbia Hydro and Power Authority (BC Hydro) and River District Energy Limited Partnership (RDE) registered as Other Utilities;

H. A total of seven parties, comprised mostly of ratepayer groups, registered as Interveners;

I. Submissions regarding the Preliminary Scoping Document were received from the FBCU, Corix, PNG, BC Hydro, Industrial Customers Group of FortisBC Inc. (ICG), the British Columbia Old Age Pensioners' Association *et al.* (BCOAPO), and the Commercial Energy Consumers Association of British Columbia (CEC);

J. The Commission Panel has reviewed the submissions by all parties and has determined that an Order to establish a Final Scoping Document is warranted.

NOW THEREFORE for the Reasons in the Decision attached as Appendix A to this Order, the Commission orders that the scope of the Generic Cost of Capital Proceeding is that set out in the Final Scoping Document attached as Appendix B to this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 18th day of April 2012.

BY ORDER

Original signed by:

D.A. Cote
Panel Chair/Commissioner

Attachments

GENERIC COST OF CAPITAL PROCEEDING
REASONS FOR DECISION

1.0 BACKGROUND

On December 16, 2009, the British Columbia Utilities Commission (Commission) issued its Decision on an application by Terasen Gas Inc. (TGI), Terasen Gas (Vancouver Island) Inc. (TGVI), and Terasen Gas (Whistler) Inc. (TGW) (collectively, the Terasen Utilities, now known as the FortisBC Energy Utilities)[1] regarding the companies' return on equity (ROE) and capital structure (2009 ROE Decision).

Order G-158-09 was issued concurrently with the 2009 ROE Decision. Among other things, it ordered the following:

- The ROE Automatic Adjustment Mechanism (AAM) in place since 1995 be eliminated;
- The appropriate equity ratio for TGI (now FEI) would be 40 percent effective January 1, 2010; and
- The 9.5 percent ROE approved for TGI effective July 1, 2009 should continue to serve as the Benchmark ROE for FortisBC Inc. and any other utility in British Columbia that uses a Benchmark ROE to set rates.

In addition, TGI was to complete its study of alternative formulas to an ROE AAM and report to the Commission by December 31, 2010.

Since the 2009 ROE Decision was issued, changes have occurred in the financial markets. On November 29, 2011, the Commission issued a Preliminary Notification of Initiation of Generic Cost of Capital (GCOC) Proceeding, and on February 28, 2012, the Commission issued Order G-20-12 to initiate the GCOC Proceeding. There are four Appendices attached to Order G-20-12: an Initial Regulatory Timetable; a Preliminary Scoping Document; a non-exhaustive List of Utilities regulated by the Commission characterized as either Affected Utilities and Other Utilities; and a Public Notice. The Public Notice was published by the Commission on March 5, 2012.

In the Preliminary Scoping Document the Commission identified six matters that it intended to review as part of the GCOC Proceeding and invited registered participants to provide submissions. The six matters are described below:

1. The appropriate cost of capital for a benchmark low-risk utility effective January 1, 2013. Cost of capital includes capital structure, return on common equity, and interest on debt.

2. Establishment of a Benchmark ROE based on a benchmark low-risk utility effective January 1, 2013 to December 31, 2013, for the initial transition year.

3. Whether re-establishment of an ROE AAM is warranted. If a return to the use of a formulaic ROE AAM is accepted as a result of this GCOC Proceeding, it would be implemented January 1, 2014. If not, a future regulatory process will be set to review the ROE for a benchmark low-risk utility beyond December 31, 2013.

[1] The FortisBC Energy Utilities are composed of FortisBC Energy Inc. (FEI), FortisBC Energy (Vancouver Island) Inc. (FEVI) and FortisBC Energy (Whistler) Inc. (FEW)

4. A generic methodology on how to establish each utility's cost of capital based on the cost of capital for a benchmark low-risk utility.

5. A methodology to establish a deemed capital structure and deemed cost of capital, particularly for those utilities without third-party debt. This would involve setting a methodology on how to calculate a deemed interest rate.

6. A methodology to establish a deemed interest rate automatic adjustment mechanism (Interest AAM). If warranted, the Interest AAM would be implemented for January 1, 2014. If not warranted, setting a future regulatory process on how the deemed interest for a benchmark low-risk utility would be adjusted in future years beyond December 31, 2013.

The Initial Regulatory Timetable provided for the filing of Written Submissions on the Preliminary Scoping Document by Affected Utilities, Other Utilities, and Interveners by March 21, 2012.

The List of Utilities appended to Order G-20-12 in Appendix C characterizes utilities regulated by the Commission as either Affected Utilities or Other Utilities. Affected Utilities are those who in this GCOC Proceeding are expected to take a lead role in filing evidence for cost of capital matters that may impact them. The FortisBC Utilities (FBCU),[2] Corix Multi-Utility Services Inc. (Corix), and Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. (collectively, PNG) have registered as Affected Utilities. British Columbia Hydro and Power Authority (BC Hydro) and River District Energy Limited Partnership (RDE) have registered as Other Utilities. Seven parties, made up mostly of ratepayer groups, have registered as Interveners by the first round registration deadline.

The FBCU, Corix, PNG, BC Hydro, Industrial Customers Group of FortisBC Inc. (ICG), the British Columbia Old Age Pensioners' Association *et al*. (BCOAPO), and the Commercial Energy Consumers Association of British Columbia (CEC) filed submissions on the Preliminary Scoping Document.

2.0 POSITIONS OF PARTIES

The FBCU provided detailed submissions on the six matters and as well as the appropriateness of using "low-risk utility" when referring to the benchmark utility. (Exhibit B1-2) PNG concurs with the comments made by the FBCU in respect to the six matters set out in the Preliminary Scoping Document. (Exhibit B3-2)

Corix submits that the 'Purpose of the Proceeding' as described in the Preliminary Scoping Document should be broadened to include those matters dealing with establishing methodologies for determining the cost of capital for smaller utilities, which it refers to as "utilities without third party debt." (Exhibit B2-2) BCOAPO suggests that the stated purpose of the GCOC Proceeding may be broadened to include a generic methodology on how to establish each utility's cost of capital based on the cost of capital for a benchmark low-risk utility. (Exhibit C5-2)

BC Hydro submits that the proposed scope for the GCOC Proceeding is appropriate and has no further submissions. (Exhibit B4-2)

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[2] FortisBC Utilities are composed of FEI, FEVI, FEW, and Fortis BC Inc. FortisBC Inc., the vertically integrated electric utility, was a Registered Intervener in the 2009 ROE proceeding but in the current GCOC Proceeding, it has registered jointly with FortisBC Energy Utilities to form FortisBC Utilities

2.1 **Matter #1**: The appropriate cost of capital for a benchmark low-risk utility effective January 1, 2013. Cost of capital Includes capital structure, return on common equity, and interest on debt.

The FBCU submit that the appropriate effective date should be January 1, 2013 or a later date. While the FBCU agree that the cost of capital comprises capital structure, return on common equity and interest on debt, they submit that the interest on debt should be set in the context of an individual utility's revenue requirements application. The FBCU point out that the GCOC Proceeding cannot remain 'generic' insofar as the Commission includes the issue of interest on debt, which is the embedded rate for recovery, and is unique to each utility. (Exhibit B1-2, pp. 2, 3)

Corix did not comment on the appropriate effective date and submits that it is important this generic process establish a clear framework to facilitate the Commission's review of future applications by smaller utilities (Exhibit B2-2)

BCOAPO requests further clarity on the difference between "as of January 1, 2013" in Matter #1 and "the overall period January 1, to December 31, 2013" in Matter #2.

ICG submits that the market crisis of 2008 and 2009 has now abated and that it is now necessary for the Commission to vary in a timely manner the cost of capital approved in the 2009 ROE Decision. ICG quoted the Reasons attached to Order G-199-11 in the FortisBC Inc. 2012-2013 Revenue Requirements Application and 2012 Integrated System Plan proceeding (in which it participated), where the Commission Panel in that proceeding stated that it would be "appropriate to maintain the current ROE and capital structure pending determinations made in the Generic Cost of Capital Hearing." (FortisBC Inc. 2012-13 RRA and 2012 ISP November 30, 2011 Reasons for Decision) On the basis of those Reasons, ICG submits that the effective date of the generic methodology needs to be January 1, 2012, and that the effective date of the determination of the equity ratio and the utility specific risk premium of FortisBC Inc. needs to be January 1, 2012. (Exhibit C4-2, pp. 1, 2)

2.2 **Matter #2**: Establishment of a Benchmark ROE based on a benchmark low-risk utility effective January 1, 2013 to December 31, 2013, for the initial transition year.

The FBCU note that they are content with the concept of a one year transition period. This is subject to comments made in their submission with respect to the benchmark utility being referred to as the "low-risk" utility. The FBCU submit that this is no longer the case, as is recognized in the 2009 ROE Decision and this updated language should be used the GCOC Proceeding. (Exhibit B1-2, pp. 2,3)

As mentioned above in section 2.1, BCOAPO submits that it is not clear what Matter #2 covers that is not already covered by Matter #1.

2.3 **Matter #3**: Whether re-establishment of an ROE AAM is warranted. If a return to the use of a formulaic ROE AAM is accepted as a result of this GCOC Proceeding, it would be implemented January 1, 2014. If not, a future regulatory process will be set to review the ROE for a benchmark low-risk utility beyond December 31, 2013.

The FBCU submit that the framework as outlined in the Preliminary Scoping Document is reasonable. (Exhibit B1-2, p. 4) No other parties made submissions related to Matter #3.

2.4 **Matter #4**: A generic methodology on how to establish each utility's cost of capital based on the cost of capital for a benchmark low-risk utility.

The FBCU submit that in addition to the components of cost of capital defined in the Preliminary Scoping Document, an additional component is the risk premium to be added to the ROE for individual utilities. The FBCU further submit that the most practical and efficient approach is for the Commission to determine in the GCOC Proceeding what the *process* would look like for each utility to determine its unique cost of capital in reference to the benchmark, with the determination of a utility's unique cost of capital being addressed in a subsequent utility-specific proceeding. [Emphasis in original]

The FBCU also submit that the individual utilities' equity ratios and risk premiums can best be set once the capital structure and the ROE parameters are set by the Commission for the benchmark utility. (Exhibit B1-2, p. 4)

PNG submits that it particularly supports the FBCU's submission on Matter #4. PNG's position is that its specific equity risk premium and capital structure should continue to be set under its revenue requirement application proceedings and not under a generic proceeding. (Exhibit B3-2)

BCOAPO submits that it is unclear what is to be accomplished under Matter #4. BCOAPO is of the view that Matter #4 should deal with the appropriate range for the risk premium, the factors that should be considered in determining the risk premium for each utility relative to the low-risk benchmark utility, and the relative importance of the various factors. (Exhibit C5-2)

ICG submits that the Preliminary Scoping Document should be revised so that utility specific capital structure and risk premiums are considered to be within the scope of the GCOC Proceeding. (Exhibit C4-2, p.3)

2.5 **Matter #5**: A methodology to establish a deemed capital structure and deemed cost of capital, particularly for those utilities without third-party debt. This would involve setting a methodology on how to calculate a deemed interest rate.

The FBCU believe that Matter #5 should be excluded from the GCOC Proceeding. In the view of the FBCU it would be almost impossible to come up with a single methodology that would be applicable across different utilities as they have different risks. In addition, it is their opinion that the existing approach of the Commission in determining the interest costs on a utility specific basis is the most efficient and appropriate and therefore, preferable to that of the Commission deeming an interest rate on debt for certain utilities. The FBCU submit that only where a utility does not have debt (affiliate or third-party) or has less debt than is appropriate to maintain its regulated capital structure, would a deemed interest rate be appropriate. (Exhibit B1-2, pp. 5-6)

Corix submits that the GCOC Proceeding should establish a framework for determining the appropriate cost of capital for other smaller utilities (referred to as "utilities without third-party debt") in the province. (Exhibit B2-2)

CEC submits that it is concerned with providing for a deemed cost of capital in the GCOC Proceeding as this would potentially allow for a cost of debt other than the actual cost of debt for the entity owning the utility, and could lead to unnecessary increased costs and rates for utility customers. (Exhibit C7-1)

BCOAPO submits that Matter #5 should also deal with the situation where there is third party debt but the debt holder is not "arms-length" from the utility. (Exhibit C5-2)

2.6 **Matter #6**: A methodology to establish a deemed interest rate automatic adjustment mechanism (Interest AAM). If warranted, the Interest AAM would be implemented for January 1, 2014. If not warranted, setting a future regulatory process on how the deemed interest for a benchmark low-risk utility would be adjusted in future years beyond December 31, 2013.

The FBCU take the position that the use of a benchmark interest rate or Interest AAM should be excluded from the scope of the GCOC Proceeding. The FBCU submit that the current methodology allows each utility to apply for the appropriate debt based on prevailing market conditions. The FBCU also submit that the introduction of an Interest AAM would result in greater administrative complexity, as not only would the difference between forecast and actual rates be tracked but, in addition, the difference to a deemed interest rate would have to be factored in and would create the need to develop individual utilities' credit risk premium. (Exhibit B1-2, p. 6)

No other party made comments on this matter except CEC, who commented on this matter in conjunction with Matter #5. CEC submits that in allowing for a cost of debt other than the actual cost of debt would lead to increased costs and rates. (Exhibit C7-1)

2.7 Other Matters

In addition to comments on the six matters, the FBCU also made submissions regarding: (1) a benchmark utility, (2) the scope of Commission Consultant Survey Report, (3) the future Regulatory Process and Timetable, and (4) the cost allocation of regulatory review costs arising from the GCOC Proceeding.

Corix submits that in addition to the matters in the Preliminary Scoping Document, an additional item should be added to the list to address the development of a framework for determining the capital structure and risk premiums associated with smaller utility operations. (Exhibit B2-2)

2.7.1 Benchmark Utility

The FBCU submit that in the GCOC Proceeding 'benchmark utility' should be used instead of 'benchmark low-risk utility'. The FBCU further submit that the initial part of the GCOC Proceeding should determine the characteristics of a benchmark utility and identify which utility, if any, is the most appropriate benchmark utility in BC for the future determination of allowed ROE and capital structure. (Exhibit B-2, p. 2)

No other party takes issue with the description of a 'benchmark low-risk utility'. BCOAPO requests clarification on the intention of the Commission as to whether FEI or a generic low-risk utility would be used as the benchmark and submits that using an actual utility would be an easier approach. CEC, in its submission, points out that the risks for the FortisBC entities' shareholders will change significantly on amalgamation. (Exhibit C5-2)

2.7.2 Scope of Commission Consultant Survey Report

The FBCU submit that the scope of the survey should be broadened to consider North American practices, including both U.S. and Canadian jurisdictions as this is consistent with the Commission's past recognition of the relevance of U.S. comparables. The FBCU submit that the Commission should avoid narrowing the scope of the evidence available for the Commission Panel at the early stages of the GCOC Proceeding. (Exhibit B1-2, pp. 7-8)

No other party made submissions on this topic.

2.7.3 Future Regulatory Process and Timetable

The FBCU request that the Commission, when setting the regulatory timetable for the GCOC Proceeding, consider the several regulatory proceedings that will require significant company resources for the FBCU. The FBCU also submit that it would be more effective to have the Commission Consultant Survey filed before the utilities' file their evidence. (Exhibit B1-2, p. 8)

CEC asks if the Commission would consider scheduling the GCOC Proceeding to follow the FortisBC Energy Utilities Amalgamation hearing and/or whether the order for the GCOC Proceeding could outline how these related decisions are to be integrated. (Exhibit C7-1)

2.7.4 Cost Allocation of Regulatory Review Costs

The FBCU submit that regulatory review costs should be shared among all participants pursuant to the utility cost sharing formula established in Order F-5-06 irrespective of whether they have been characterized as "Affected Utilities" or "Other Utilities" in the List of Utilities. The FBCU submit that this treatment is consistent with past proceedings.

PNG highlights its support of the FBCU proposal regarding allocation of the costs of the GCOC Proceeding.

3.0 COMMISSION DETERMINATIONS

3.1 Scoping Document

Benchmark Utility

In the 2009 ROE Decision, it was determined that TGI should continue to serve as the Benchmark ROE for FortisBC Inc. and any other utility in B.C. that uses the Benchmark ROE to set rates. In this respect, the Commission Panel agrees with the FBCU's submission that FEI, while used as the benchmark utility for other regulated utilities in BC, is no longer referred to as the "low-risk" utility. However, the Commission Panel believes that it is important to point out that the GCOC Proceeding is not the result of an application by FEI for a review of its ROE and capital structure. Although FEI, together with its affiliated companies, is among the Affected Utilities in the GCOC Proceeding, the purpose of this generic proceeding is to set the capital structure and ROE for a benchmark low-risk utility. This benchmark low-risk utility could be based on a "set of low risk, high grade benchmark utilities" as suggested in the Commission's June 10, 1994 ROE Decision on page 48. This low-risk, high-grade benchmark utility or utilities could be a hypothetical construct, or it could be a FEI-like utility with certain attributes that are to be defined in the GCOC Proceeding. There may be other options. Further, with respect to the existing benchmark utility, the Commission Panel believes it would be inefficient to go through a process of setting out the cost of capital for FEI at the same time as dealing with its long-term sustainability through the proposed amalgamation and postage stamp rates and the potential changes in its business.

The Commission Panel agrees, in part, with the FBCU's submission that part of the GCOC Proceeding should determine the characteristics of a benchmark low-risk utility and identify which utility, if any, is the most appropriate benchmark low-risk utility in BC for the future determination of allowed ROE and capital structure. However, absent any actual utility that fits a benchmark description, a hypothetical low-risk benchmark utility could be constructed as suggested in the 1994 ROE Decision.

Accordingly, the Commission Panel determines that one of the major matters for the GCOC Proceeding is the cost of capital for a benchmark "low-risk" utility.

Purpose of the GCOC Proceeding

The Commission Panel is of the view that within this Commission-initiated GCOC Proceeding, it is important to include input from smaller utility operators regulated by the Commission and to establish a methodology to set a deemed capital structure and deemed cost of capital, particularly for those utilities without third-party debt. Accordingly, the Commission Panel accepts Corix's proposed amendment to the "Purpose of the Proceeding" to include reference to smaller utilities in the province.

The Commission Panel also accepts BCOAPO's suggestion to broaden the "Purpose of the Proceeding" to reflect the intention of applying a generic methodology to estimate an individual utility's cost of capital based on the cost of capital for a benchmark low-risk utility.

Both proposed amendments have been incorporated into the "Purpose of the Proceeding" section in the Final Scoping Document.

Matter #1

None of the registered participants disagree with using January 1, 2013, as the effective date with the exception of ICG, who submits that the date in the Preliminary Scoping Document should be revised to January 1, 2012.

As this is a generic proceeding, the Commission Panel does not consider it appropriate to address a specific utility such as FortisBC Inc.'s ROE and equity ratio. The issue of the determination of FortisBC Inc.'s cost of capital is addressed under Matter #4. **After considering the submissions from all parties, the Commission Panel determines the effective date should be January 1, 2013 for establishing the benchmark low-risk utility cost of capital including setting the Benchmark ROE.**

The benchmark low-risk utility would take into consideration the optimal capital structure. The optimal capital structure is a function of the capital structure, required return on equity, and the short and long-term interest cost of debt. In turn the interest cost of debt would be influenced by the company's credit rating and the prevailing risk-free rate. The cost of debt becomes relevant when an unlevered firm takes on debt.

As stated previously, the Commission Panel wishes to be clear that the benchmark low-risk utility would not necessarily be based on any specific utility. Also, the Commission Panel is not proposing to utilize a generic deemed interest rate methodology in place of third party debt issued by a specific utility. We believe that the GCOC Proceeding can remain 'generic' by considering all the costs of capital in considering the appropriate benchmark low-risk utility.

Further, the Commission Panel is of the view that a thorough review of the cost of debt facing certain utilities, and in particular those that fall into the category of smaller utilities and/or utilities without third-party debt, will provide better insight and understanding of those utilities' cost of capital. The Commission Panel therefore considers that including the interest on debt in the GCOC Proceeding would benefit future reviews of certain utilities, in particular, smaller utilities.

Matter #2

The Commission Panel expects that the evidence in the GCOC Proceeding will examine the capital market's pricing for risk and the expected returns on investments for 2013. While it is possible for the Commission to propose a wider scope that would include a full review of the capital structure and ROE for two years: 2013 and 2014, the Preliminary Scoping Document stated 2013 because the Commission is cognizant that, should the GCOC Proceeding result in the determination that a return to an ROE AAM is warranted, an ROE AAM formula would then be implemented at the beginning of 2014. Matter #1 is distinct from Matter #2. Matter #1 contemplates January 1, 2013 as the effective start date for the cost of capital including Benchmark ROE, if revised, for the benchmark low-risk utility. Matter #2 contemplates a one year transition period for the Benchmark ROE where following the transition period an ROE AAM could be implemented on January 1, 2014. Also, Matter #2 allows for a transition period for a decision determination, if any, which changes the generic methodology that sets an individual utility's cost of capital.

The Commission Panel concludes that a one-year transition period would allow for an orderly implementation of a Benchmark ROE and any resulting generic methodology to set subsequent years' Benchmark ROE.

Matter #3

The Commission Panel notes that no party has registered any opposition to the proposed examination of whether an ROE AAM is warranted.

Matter #4

As submitted by the FBCU and supported by PNG, specific equity risk premiums and capital structures are unique to each individual utility. The Commission Panel notes that their submissions are aligned with the Preliminary Scoping Document which states that the GCOC Proceeding is not intended to set each utility's risk premium on the Benchmark ROE, and that any adjustment to an individual utility's premium that is effective after December 31, 2013 will be set in a separate future proceeding for that utility.

The Commission Panel agrees with BCOAPO that the GCOC Proceeding should consider the factors in the determination of the risk premium for each utility.

In its submission, ICG has quoted part of the Commission's determination at page 3 of 6 of the FortisBC Inc. 2012-13 RRA and 2012 ISP November 30, 2011 Reasons for Decision relating to the submissions ICG made on capital structure and return on equity. The entire determination of the Commission Panel in that proceeding on the issue of the capital structure and return on equity of FortisBC Inc. was as follows:

> On November 28, 2011, the Commission issued a letter expressing its intent to conduct a Generic Cost of Capital Hearing focused on capital structure and ROE which would have application for all utilities. Because of this, the Commission Panel is of the view there is little value or efficiency to be gained by considering this issue as part of this hearing. **Accordingly, the Commission Panel has determined that there is no need to expand this hearing to include a comprehensive review of FortisBC's capital structure and ROE. Therefore, the Commission Panel has determined that given the Commission announcement regarding a generic**

> **hearing process, it would be appropriate to maintain the current ROE and capital structure pending determinations made in the Generic Cost of Capital Hearing.**
> [Emphasis in original]

Consistent with that determination, the current capital structure and ROE of FortisBC Inc. will be maintained pending determinations made in the Generic Cost of Capital Proceeding. Specific determinations of FortisBC Inc.'s cost of capital will be determined in a separate future proceeding for that utility based on the determinations in the generic proceeding.

<u>Matter #5</u>

The Commission Panel notes the FBCU's objection to including a review of a framework for deemed capital structure and deemed cost of capital in the GCOC Proceeding. However, the Panel has also considered that the FBCU concede that a deemed interest rate can be appropriate under certain circumstances, for example, when a utility does not have debt or has less debt than is appropriate to maintain its regulated capital structure.

The Commission has recently undertaken a number of reviews of applications by smaller utilities that are without third-party debt. An example is the December 19, 2011 River District Energy Limited Partnership Decision (RDE Decision). On page 21 of the RDE Decision the Commission states: "The Commission will review the appropriateness of the 5.5 percent deemed rate annually considering any recommendations or tools that may result from the Generic Cost of Capital proceeding the Commission will initiate in early 2012."

The RDE Decision is an example of those circumstances where a generic review of the deemed capital structure and deemed cost of capital methodology is appropriate. An established methodology to address issues similar to RDE would allow for a more efficient and effective regulatory review process that would benefit f uture applicants and ultimately ratepayers.

The Commission Panel has considered BCOAPO's submission that Matter #5 should also deal with the situation where there is third-party debt but the debt holder is not "arms-length" from the utility. The Panel agrees with BCOAPO's submission and confirms that such a situation is included within the scope of Matter #5.

<u>Matter #6</u>

The Commission Panel has considered the FBCU's position regarding the exclusion of the Interest AAM from the scope of the GCOC Proceeding.

In our view the Interest AAM is intended for those utilities where a deemed interest rate is required. The deemed interest rate is not intended to replace the actual interest rates from third party debt under normal circumstances. The FBCU's concerns are not applicable. This is more clearly reflected in the final scope for Matter #6.

3.2 Scope of Commission Consultant Survey

The FBCU submits that the scope of the survey should be broadened to consider North American practices, including both U.S. and Canadian jurisdictions. In the view of the FBCU this is consistent with the Commission's past recognition of the relevance of U.S. comparable jurisdictions.

The Commission Panel does not believe that the scope of the Commission Consultant Survey will limit the comprehensiveness of the evidentiary record as the Commission Consultant Survey is intended to serve as initial evidence to assist all parties to become familiar with the common methodologies that are being used in Canada. The FBCU and any other registered participant are free to provide evidence on North American practices that would inform the Commission Panel on matters within scope of the GCOC Proceeding.

3.3 Future Regulatory Process and Timetable

With regard to the request made by CEC that the Commission consider scheduling the GCOC Proceeding to follow the FortisBC Energy Utilities Amalgamation hearing, the Commission Panel notes that the GCOC Proceeding is concerned with the cost of capital for a benchmark low-risk utility. While the hypothetical benchmark low-risk utility may resemble FEI's businesses and risks, this generic proceeding is not dealing with FEI alone.

The Commission Panel believes that the GCOC Proceeding should proceed to establish the cost of capital including ROE for a benchmark low-risk utility by the effective date of January 1, 2013. A revised Regulatory Timetable will be issued following the issuance of this Final Scoping Document.

3.4 Cost Allocation of Regulatory Review Costs

The FBCU submit that the cost-sharing formula set out in Commission Order F-5-06, where costs are to be shared among all participants, should be applied to the GCOC Proceeding. PNG supports the FBCU's submission.

Since this is a generic proceeding, the Commission Panel intends to allocate all the Commission-incurred costs in the GCOC Proceeding through the annual recovery of Commission costs. An example of this approach is found in Order G-80-11 which sets out the levies and cost recoveries for the 2011/2012 fiscal year. In terms of the costs arising from Participant Assistance/Cost Awards (PACA) the Commission intends to allocate these costs to those utilities that would be affected by the determinations from the GCOC Proceeding. The Commission Panel plans to further address the method of cost allocation for PACA after the issuance of the Final Scoping Document by seeking submissions from participants on this PACA matter.

GENERIC COST OF CAPITAL PROCEEDING
FINAL SCOPING DOCUMENT

The Generic Cost of Capital (GCOC) Proceeding is initiated by the British Columbia Utilities Commission pursuant to section 82 of the *Utilities Commission Act*.

PURPOSE OF THE PROCEEDING

The main purposes of the GCOC Proceeding are:

I. to establish a method to determine the appropriate cost of capital for a benchmark low-risk utility in British Columbia, commencing January 1, 2013, and to establish how the Benchmark return on equity (ROE) will be reviewed, and if required, adjusted on a regular basis;

II. to establish a generic methodology or process on how to establish each utility's cost of capital based on the cost of capital for a benchmark low-risk utility; and

III. to establish a framework for determining the appropriate cost of capital for other smaller utilities in the province.

SCOPE OF THE PROCEEDING

1. The appropriate cost of capital for a benchmark low-risk utility effective January 1, 2013. Cost of capital includes capital structure, return on common equity, and interest on debt.

2. Establishment of a Benchmark ROE based on a benchmark low-risk utility effective January 1, 2013 to December 31, 2013 for the initial transition year.

3. Whether re-establishment of an ROE automatic adjustment mechanism (AAM) is warranted. If a return to the use of a formulaic ROE AAM is accepted as a result of the GCOC Proceeding, it would be implemented January 1, 2014. If not, a future regulatory process will be set to review the ROE for a benchmark low-risk utility beyond December 31, 2013 on a regular basis.

4. A generic methodology or process for each utility to determine its unique cost of capital in reference to the benchmark low-risk utility.

5. In certain circumstances, a methodology to establish a deemed capital structure and deemed cost of capital, particularly for those utilities without third-party debt. This would involve setting a methodology on how to calculate a deemed interest rate.

6. In certain circumstances for those utilities that require a deemed interest rate, a methodology to establish a deemed interest rate automatic adjustment mechanism (Interest AAM). If warranted, the Interest AAM would be implemented for January 1, 2014. If not warranted, setting a future regulatory process on how the deemed interest for a benchmark low-risk utility would be adjusted in future years beyond December 31, 2013.