Q. Have other Canadian utilities changed capital structures since 1996? Please explain any changes that have occurred.

A. **1. Introduction**

Newfoundland Power's 2016/2017 General Rate Application will be the 6th time since 1996 that the Board will consider the Company's cost of capital, including its capital structure.

Regulated investor-owned Canadian utilities' capital structures have been fairly stable since 1996. While there have been changes to certain Canadian utilities' capital structures over the past 20 years, where changes have occurred, they have tended to result in a stronger utility capital structure in 2015 than in 1996. These broad observations are true for both electric utilities and gas distribution utilities.

The basic information concerning Canadian utilities' capital structures has been before the Board on a regular basis over the period 1996 through 2015. It has been filed in each and every Newfoundland Power general rate application over this period.

This basic information, which has already been filed with the Board, has formed part of a continuing record relating to Canadian utilities' capital structures. For this reason, Newfoundland Power believes it appropriate to use this record to evaluate trends in capital structures in this response.[1]

2. Changes in Investor-owned Canadian Utility Capital Structures

Electric Utilities

Table 1 summarizes the evidence before the Board relating to the capital structures used for ratemaking purposes for Nova Scotia Power, FortisAlberta, ATCO Electric (Distribution), FortisBC and Newfoundland Power. The summary commences with the Board's 1998 investigation into Newfoundland Power's cost of capital (the "1998 investigation") and continues through the Company's 5 subsequent general rate applications.[2]

[1] The regulated investor-owned Canadian utilities selected for this evaluation were consistently referred to in evidence before the Board from the 1998 investigation into Newfoundland Power's cost of capital through *Newfoundland Power's 2013/2014 General Rate Application*.

[2] Some of the information before the Board at its 1998 investigation into Newfoundland Power's cost of capital reflected 1996 regulatory decisions. This response refers to *evidence* before the Board concerning capital structure in various proceedings. There will be timing differences associated with regulatory decisions in other jurisdictions. See, for example, footnote 14 *infra*.

Table 1
Summary of Evidence
Capital Structures: Canadian Electric Utilities
Common Equity Ratios (%)
1996-2015

PUB Proceeding	**1998**[3]	**2002**[4]	**2007**[5]	**2009**[6]	**2013**[7]	**2015**[8]
Nova Scotia Power	33/34	33/35	37.5	37.5	37.5	37.5
FortisAlberta[9]	40	54.5[10]	37	37	41	40
ATCO Electric (Distribution)[11]	35.7	35.7	37	37	39	38
FortisBC[12]	40	40	40	40	40	40
Newfoundland Power	45	45	45	45	45	45

At the 1998 investigation, the evidence before the Board indicated that the common equity ratios in the capital structures of these electric utilities ranged from a low of 33-34% for Nova Scotia Power to a high of 45% for Newfoundland Power.

By 2015, the evidence indicates that the range of common equity ratios has narrowed to a low of 37.5% for Nova Scotia Power to a high of 45% for Newfoundland Power. In 2015, the evidence indicates that none of the 5 utilities has a weaker capital structure than the evidence showed in 1998.

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[3] From Phase 1 Preliminary Written Evidence, March 31, 1998, Table 5 of William R. Waters and Ralph A. Winter filed on behalf of the Board in *The Matter of a Public Hearing called by the Board on its Own Motion to Consider the Appropriate Capital Structure and Rate of Return on Equity, etc. for Newfoundland Power*. This hearing resulted in Order No. P.U. 16 (1998).

[4] From Prepared Testimony of Kathleen C. McShane, Foster Associates, Inc., October 2002, Schedule 3, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2003/2004 General Rate Application*.

[5] From Direct Testimony of Kathleen C. McShane, Foster Associates, Inc., March 2007, Schedule 5, page 1 of 4 filed on behalf of Newfoundland Power in *Newfoundland Power's 2008 General Rate Application*.

[6] From Opinion on Capital Structure and Fair Return on Equity of Kathleen C. McShane, Foster Associates, Inc., May 2009, Schedule 23, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2010 General Rate Application*.

[7] From Opinion on Capital Structure and Return on Equity of Kathleen C. McShane, Foster Associates, Inc., September 2012, Schedule 3, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2013/2014 General Rate Application*.

[8] From Report: Cost of Capital of James Coyne, Concentric Energy Advisors, Inc., October 16, 2015, Exhibit JMC-1 filed on behalf of Newfoundland Power in *Newfoundland Power's 2016/2017 General Rate Application*.

[9] FortisAlberta was formerly Aquila Networks (Alberta) (2002), and prior to this, part of TransAlta Utilities (1998).

[10] The 54.5% common equity in the capital structure is anomalous and reflects the transitional effects of the restructuring of the Alberta electricity market.

[11] ATCO Electric was formerly Alberta Power (1998), capital structure shown is for regulated distribution operations.

[12] FortisBC was formerly Aquila Networks (BC) (2002), and prior to this West Kootenay Power.

Nova Scotia Power was a provincially owned crown corporation prior to its privatization in 1992. In 2005, the Nova Scotia Utility and Review Board ("UARB") increased Nova Scotia Power's ratemaking equity ratio to 37.5%. In doing so, the UARB simply observed that *"The Board is satisfied the strengthening of the balance sheet in this way is desirable in the current economic climate."*[13]

The common equity ratios of FortisAlberta and ATCO Electric (Distribution) have both changed since the financial crisis which commenced in 2008. In late 2009, the Alberta Utilities Commission ("AUC") increased the equity ratio of FortisAlberta from 37% to 41% and increased the equity ratio of ATCO Electric (Distribution) from 37% to 39%. In making this decision, the AUC observed that *"The credit crisis warrants an increase in the equity ratios for all utilities to reflect increased risk and the re-pricing of risk."*[14]

Subsequently, the AUC considered utility cost of capital in 2011 for the years 2011 and 2012 and reaffirmed the equity ratios for FortisAlberta and ATCO Electric (Distribution) approved in 2009.[15]

In 2015, the AUC determined that the capital structures of FortisAlberta and ATCO Electric (Distribution) should be decreased by 1% to 40% and 38%, respectively.[16] In making this decision, the AUC reiterated its approach to assessing common equity ratios as follows:

> *"420. The Commission's approach, consistent with past decisions, is to award common equity ratios that are intended to allow the affected utilities, on a stand-alone basis, to target credit ratings in the A-range."*[17]

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[13] See 2005 NSUARB 27 CanLII, page 83.
[14] See AUC Decision 2009-216 *2009 Generic Cost of Capital*, November 12, 2009, page 106-107. This decision was issued by the AUC after the evidence was completed in *Newfoundland Power's 2010 General Rate Application* and so wasn't included in the evidence before the Board at the fall 2009 hearing into the *2010 General Rate Application*.
[15] See AUC Decision 2011-474 *2011 Generic Cost of Capital*, December 8, 2011, pages 51-53.
[16] See AUC Decision 2191-D01-2015 *2013 Generic Cost of Capital*, March 23, 2015, page 100.
[17] See AUC Decision 2191-D01-2015 *2013 Generic Cost of Capital*, March 23, 2015, page 85.

Gas Distribution Utilities

Table 2 summarizes the evidence before the Board relating to the capital structures used for ratemaking purposes for FortisBC Energy, Union Gas, Enbridge Gas Distribution and Gaz Metropolitan. The summary commences with evidence before the Board in its 1998 investigation and continues through the Company's 5 subsequent general rate applications.

Table 2
Summary of Evidence
Capital Structures: Canadian Gas Distribution Utilities
Common Equity Ratios (%)
1996-2015

PUB Proceeding	**1998**[18]	**2002**[19]	**2007**[20]	**2009**[21]	**2013**[22]	**2015**[23]
FortisBC Energy[24]	33	33	35	35	40	38.5
Union Gas	34	35	36	36	36	36
Enbridge Gas Distribution[25]	35	35	35	36	36	36
Gaz Metropolitan	38.5	38.5	38.5	38.5	38.5	38.5

[18] From Phase 1 Preliminary Written Evidence, March 31, 1998, Table 5 of William R. Waters and Ralph A. Winter filed on behalf of the Board in *The Matter of a Public Hearing called by the Board on its Own Motion to Consider the Appropriate Capital Structure and Rate of Return on Equity, etc. for Newfoundland Power*. This hearing resulted in Order No. P.U. 16 (1998).

[19] From Prepared Testimony of Kathleen C. McShane, Foster Associates, Inc., October 2002, Schedule 3, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2003/2004 General Rate Application*.

[20] From Direct Testimony of Kathleen C. McShane, Foster Associates, Inc., March 2007, Schedule 5, page 1 of 4 filed on behalf of Newfoundland Power in *Newfoundland Power's 2008 General Rate Application*.

[21] From Opinion on Capital Structure and Fair Return on Equity of Kathleen C. McShane, Foster Associates, Inc., May 2009, Schedule 23, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2010 General Rate Application*.

[22] From Opinion on Capital Structure and Return on Equity of Kathleen C. McShane, Foster Associates, Inc., September 2012, Schedule 3, page 1 of 2 filed on behalf of Newfoundland Power in *Newfoundland Power's 2013/2014 General Rate Application*.

[23] 2015 common equity ratios for FortisBC Energy and Gaz Metropolitan from Report: Cost of Capital of James Coyne, Concentric Energy Advisors, Inc., October 16, 2015, Exhibit JMC-1 filed on behalf of Newfoundland Power in *Newfoundland Power's 2016/2017 General Rate Application*. The 2015 common equity ratios of Union Gas and Enbridge Gas Distribution were provided by Mr. Coyne for the purposes of assisting the Company in preparing this response.

[24] FortisBC Energy was formerly Terasen Gas (2007), and prior to this, BC Gas Utility (1998 & 2002).

[25] Enbridge Gas Distribution was formerly Consumers Gas Company Ltd. (1998).

At the 1998 investigation, the evidence before the Board indicated that the common equity ratios in the capital structures of these gas distribution utilities ranged from a low of 33% for FortisBC Energy to a high of 38.5% for Gaz Metropolitan.

By 2015, the evidence indicates that the range of common equity ratios has narrowed to a low of 36% for the Ontario gas distribution companies, Union Gas and Enbridge Gas Distribution, to a high of 38.5% for FortisBC Energy and Gaz Metropolitan. In 2015, the evidence indicates that none of the 4 utilities has a weaker capital structure than the evidence showed in 1998.

In 2015, the equity ratios of 3 of the 4 gas distribution utilities was greater than was indicated in 1998. For Union Gas and Enbridge Gas Distribution, the increased equity ratio of 2% and 1%, respectively, is small relative to the time period.

For FortisBC Energy, the largest change occurred following the financial crisis which commenced in 2008. In its decision on a return on equity and capital structure for Terasen Gas Inc. (now FortisBC Energy) and its affiliates, the British Columbia Utilities Commission ("BCUC") observed that Terasen Gas' business risk had increased and the additional risk suggested an increase in equity ratio from 35% to 40%.[26] In 2013, the BCUC again considered cost of capital and determined that a common equity ratio of 38.5% was appropriate for FortisBC Energy.[27]

3. Conclusion

The equity ratios in capital structures of regulated investor-owned Canadian utilities have been quite stable since 1996. Where changes have occurred, they have tended to have the result that the 2015 equity ratio was higher than the equity ratio in 1996.

[26] See Order G-158-09 and Decision, Terasen Gas Inc. et al., *Return on Equity and Capital Structure*, December 16, 2009, page 37.

[27] See Order G-75-13 and Decision, *Generic Cost of Capital Proceeding (Stage 1)*, May 10, 2013, pages 53-54.

A stable capital structure helps permit the overall sound financial management which is consistent with least cost reliable service delivery to customers. It is also consistent with the observation of the Newfoundland Court of Appeal found at page 4-21 of the Company Evidence:

> *"[134].....the level of overall capitalization and the composition of the capital structure of a utility are both matters of regulatory concern, at least insofar as they affect the utility's rate of return on rate base and hence the cost to consumers of the delivery of reliable service…*
>
> *[135] In approaching these questions, it has to be remembered that there is no such thing as one ideal capital structure. It is a function of economic conditions, business risks and 'largely a matter of business judgement'. Furthermore, a given capital structure cannot be changed easily or quickly. As well, the long-term effects of changes on capital structure on the enterprise and on the future cost of capital may not be easily predictable."*[28]

[28] *The Stated Case*, June 15, 1998, Newfoundland and Labrador Court of Appeal, paragraphs 134-135.