Decision **27084-D01-2022**

EGI-38.1

Alberta Utilities Commission

2023 Generic Cost of Capital

March 31, 2022

Alberta Utilities Commission
Decision 27084-D01-2022
2023 Generic Cost of Capital
Proceeding 27084

March 31, 2022

Published by the:
Alberta Utilities Commission
Eau Claire Tower
1400, 600 Third Avenue S.W.
Calgary, Alberta T2P 0G5

Telephone: 310-4AUC (310-4282 in Alberta)
1-833-511-4AUC (1-833-511-4282 outside Alberta)
Email: info@auc.ab.ca
Website: www.auc.ab.ca

The Commission may, within 60 days of the date of this decision and without notice, correct typographical, spelling and calculation errors and other similar types of errors and post the corrected decision on its website.

Contents

Decision 27084-D01-2022
2023 Generic Cost of Capital **Proceeding 27084**

1 Decision summary

1. In this decision, the Alberta Utilities Commission approves the return on equity (ROE) of 8.5 per cent and deemed equity ratio of 37 per cent, except for an approved deemed equity ratio for Apex Utilities Inc. of 39 per cent (together, the ROE and deemed equity ratios are also referred to as "parameters") for 2023 on a final basis. The established parameters apply to the following utilities:

- AltaLink Management Ltd.[1]
- Apex Utilities Inc.[2]
- ATCO Electric Ltd.[3]
- ATCO Gas & Pipelines Ltd.[4] [5]
- ENMAX Power Corporation[6]
- EPCOR Distribution & Transmission Inc.[7]
- FortisAlberta Inc.[8]
- KainaiLink L.P.[9]
- City of Lethbridge[10]
- PiikaniLink L.P.[11]
- The City of Red Deer[12]
- TransAlta Corporation[13]

---

[1] Electricity transmission, including AltaLink Management Ltd. as general partner of AltaLink L.P., KainaiLink L.P. and PiikaniLink L.P.

[2] Natural gas distribution.

[3] Electricity transmission and distribution. Unless otherwise indicated, a reference to ATCO Electric includes both the transmission and distribution operations of this utility.

[4] ATCO Gas refers to the utility's natural gas distribution operations. ATCO Pipelines refers to the utility's natural gas transmission operations.

[5] Collectively, ATCO Electric, ATCO Gas and ATCO Pipelines are referred to as the ATCO Utilities.

[6] Electricity transmission and distribution. Unless otherwise indicated, a reference to ENMAX refers to both the transmission and distribution operations of this utility.

[7] Electricity transmission and distribution. Unless otherwise indicated, a reference to EPCOR refers to both the transmission and distribution operations of this utility.

[8] Electricity distribution.

[9] Electricity transmission. The Commission approved the transfer of specific transmission assets from AltaLink to KainaiLink L.P. in Decision 22612-D01-2018: AltaLink Management Ltd., AltaLink L.P. Transfer of Specific Transmission Assets to PiikaniLink L.P. and KainaiLink L.P. and the Associated 2017-2018 General Tariff Applications, Proceeding 22612, November 13, 2018.

[10] Electricity transmission.

[11] Electricity transmission. The Commission approved the transfer of specific transmission assets from AltaLink to PiikaniLink L.P. in Decision 22612-D01-2018.

[12] Electricity transmission.

[13] Electricity transmission.

2. The parameters set out in this decision do not apply to EPCOR Energy Alberta GP Inc., ENMAX Energy Corporation and Direct Energy Regulated Services because these entities are regulated rate providers pursuant to the *Electric Utilities Act* and the *Regulated Rate Option Regulation*. Similarly, the parameters in this decision do not apply to Direct Energy Regulated Services as a default supply provider under the *Gas Utilities Act* and the *Default Gas Supply Regulation*.

3. The parameters for the various investor-owned water utilities under the Commission's jurisdiction were not determined in this proceeding. However, the determinations in this proceeding may be considered in other Commission proceedings, should issues respecting ROE and deemed equity ratios arise in the regulation of investor-owned water utilities.

2 Background and procedural summary

4. In each of the *Public Utilities Act*, the *Gas Utilities Act* and the *Electric Utilities Act*, the Commission is required to set a fair return for utilities as a component of setting just and reasonable rates.[14] It has been the Commission's practice to consider the components of a fair return, namely the ROE and deemed equity ratio, for all utilities it regulates in a generic cost of capital (GCOC) proceeding.[15]

5. While each of the aforementioned statutes requires the Commission to determine a fair return, there is no prescribed method for doing so.[16] Rather, as recently confirmed by the Alberta Court of Appeal, the Commission has broad discretion in determining what factors are relevant in setting a fair return.[17] Determining just and reasonable rates requires the Commission to balance the interests of both the utility and its customers.[18] Rates must provide the utility a reasonable opportunity to earn a fair return on invested capital, while also ensuring that customers are not paying more than is required to maintain safe, reliable and economic service. In applying its judgment, the Commission often assesses conflicting evidence on risk, including the differing interests and perspectives of debt and equity investors.[19]

6. The Commission and its predecessors have accepted and considered the following three factors when setting a fair return: comparable investments, capital attraction, and financial integrity.[20] The Commission considers these factors to be well established and continues to be satisfied that the fair return standard is met when the return satisfies these three factors, while also understanding that a fair return is one component of the Commission's determination of just and reasonable rates. Another component of just and reasonable rates is a reasonable opportunity to recover costs and expenses including capital costs, operating costs, taxes and depreciation.

14 *Public Utilities Act*, Section 90(1); *Gas Utilities Act*, Section 37(1); *Electric Utilities Act*, sections 121(2)(a) and 122(1)(a)(iv).
15 The Commission addressed the fair return standard in Decision 2009-216: 2009 Generic Cost of Capital, Proceeding 85, Application 1578571-1, November 12, 2009.
16 See Decision 2009-216, paragraphs 89, 93 and 98.
17 *The Office of the Utilities Consumer Advocate v Alberta Utilities Commission*, 2021 ABCA 336, paragraph 16.
18 For example, see the seminal case of *Northwestern Utilities Ltd. v Edmonton (City)* [1929] SCR 186, pages 192-193.
19 Decision 2009-216, paragraph 110.
20 Decision 2009-216, paragraphs 92-98.

7. Over the past 20 years, the Commission has used various methods to determine the ROE and deemed equity ratios. Historically, the Commission's predecessors considered these parameters for each utility on a case-by-case basis. For the 2004 test year, the Commission set a generic (i.e., the same) ROE for all utilities and adopted an adjustment mechanism formula to determine the ROE in subsequent years.[21] The formula was used from 2005 to 2008, and then the global financial recession of 2007 to 2009 led the Commission to deviate from the formula-based approach.

8. Starting in 2009, the Commission set the ROE based on economic and financial evidence filed by parties in GCOC proceedings, rather than on the formula-based methodology. In these proceedings, parties submitted a broad range of economic and financial evidence, including trends in Canadian and global capital markets; interest rates; bond yields; utility betas;[22] market volatility measures; and monetary policy considerations, among other variables and indicators that were employed in various financial models, to arrive at expectations of reasonable return. From 2009 to 2020, the Commission established the ROE and deemed equity ratios for a series of two- to three-year test periods. The parameters were set following intensive regulatory processes in GCOC proceedings, including oral hearings.

9. For 2021 and 2022, the Commission maintained an ROE of 8.5 per cent and a deemed equity ratio of 37 per cent (39 per cent for Apex Utilities Inc.).[23] These decisions were premised on the Commission's finding that the economic and market data that would normally be used to inform its judgment regarding a fair return were in a state of significant flux, in light of the COVID-19 pandemic. The decisions also took into account that there was conflicting evidence (some of which supported the need for increased returns, some of which supported decreased returns), and that it was not clear that additional process, like that used by the Commission in the period between 2009 and 2020, would provide any greater assurance that the resulting rates would be just and reasonable. Ultimately, the Commission concluded that there was an inadequate basis for departing from the currently approved parameters.

10. On January 3, 2022, the Commission initiated the present 2023 GCOC proceeding and issued a letter[24] informing interested parties that it was bifurcating this proceeding, with the first stage establishing the parameters for 2023, and the second stage focusing on 2024 and future years. This decision relates to the first stage.

11. In reaching the determinations set out within this decision, the Commission has considered all relevant materials comprising the record of this proceeding. Accordingly, references in this decision to specific parts of the record are intended to assist the reader in understanding the Commission's reasoning relating to a particular matter and should not be taken as an indication that the Commission did not consider all relevant portions of the record with respect to a particular matter.

[21] Decision 2004-052: Generic Cost of Capital, AltaGas Utilities Inc., AltaLink Management Ltd., ATCO Electric Ltd. (Distribution), ATCO Electric Ltd. (Transmission), ATCO Gas, ATCO Pipelines, ENMAX Power Corporation (Distribution), EPCOR Distribution Inc., EPCOR Transmission Inc., FortisAlberta (formerly Aquila Networks), NOVA Gas Transmission Ltd., Proceeding 13130, Application 1271597-1, July 2, 2004.

[22] β, or beta, measures the sensitivity of a required return of an individual security to changes in the market return.

[23] Decision 24110-D01-2020: 2021 Generic Cost of Capital, Proceeding 24110, October 13, 2020; and Decision 26212-D01-2021: 2022 Generic Cost of Capital, Proceeding 26212, March 4, 2021.

[24] Exhibit 27084-X0004, AUC letter - Proceeding to determine fair return starting in 2023.

3 2023 parameters and completion of current GCOC proceeding

12. Recognizing the lingering uncertainty and continued volatility of financial markets due to the COVID-19 pandemic, the Commission indicated in correspondence dated January 3, 2022, its preparedness to extend for an additional year the cost-of-capital parameters previously approved for 2022. However, before making its decision, the Commission provided all interested parties in this proceeding an opportunity to comment on its proposal to maintain the status quo for another year, i.e., 2023.

13. In the sections that follow, the Commission discusses parties' responses and the reasons for the Commission's determination to maintain the ROE and deemed equity ratios for 2023 consistent with the approved parameters for 2022.

14. The Commission's reasons can be briefly summarized as follows:

(a) Although the utilities provided evidence to support higher cost-of-capital parameters for 2023, they were prepared to accept extending the 2022 parameters to the end of 2023. One customer group (The City of Calgary) was amenable to such an outcome as well.

(b) The evidence on some of the key economic indicators and market conditions shows upward pressure associated with inflation and interest rates. Other indicators such credit spreads and market equity risk premium (MERP) remain largely stable. Market volatility remains elevated, making it difficult to forecast relevant economic conditions for 2023. The evidence on business risk is mixed.

(c) Submissions from a customer group regarding the use of formulas led to proposed ROEs that were very close to 8.5 per cent, and recent decisions from other Canadian regulators provided additional validation that the current ROE is reasonable and represents a fair return.

(d) There are significant costs associated with a fully contested GCOC proceeding. The Commission considers that adding further process to the present proceeding would not permit prospective rates (which in turn can increase utilities' risk and future rates). In addition, the Commission is not persuaded that these additional costs, which are ultimately borne by customers, can be justified in this case.

15. The Commission's reasons are outlined in detail in the sections that follow.

3.1 Support from stakeholders

16. The utilities and one of the customer groups, Calgary, did not object to keeping the parameters for 2023 the same as the approved parameters for 2022. Each provided reasons to support the continuation of the approved parameters for 2023. While all of the utilities submitted that the ROE for 2023 should increase,[25] and ENMAX[26] and ATCO/Fortis/Apex[27] also argued that the deemed equity ratio should increase, each of the utilities was prepared to accept keeping

[25] Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 5. Exhibit 27084-X0028, ATCO/Apex/Fortis, PDF page 1. Exhibit 27084-X0025, ENMAX, PDF pages 1-2.

[26] Exhibit 27084-X0025, ENMAX, PDF page 2.

[27] Exhibit 27084-X0028, ATCO/Apex/Fortis, PDF page 2. Exhibit 27084-X0032, Fortis, PDF pages 1-3.

the ROE and deemed equity ratios for 2023 the same as the approved parameters for 2022, in light of other considerations.[28] Calgary identified certain economic factors and circumstances that favour keeping the parameters the same and, ultimately, did not object to such an outcome.[29] The Commission considers this unanimous support from the utilities, and partial support from the customer groups, weighs in favour of the Commission's proposal.

17. The Commission also took into consideration submissions of parties that opposed keeping the parameters for 2023 the same, namely views of the Office of the Utilities Consumer Advocate (UCA) and the Consumers' Coalition of Alberta (CCA). The Commission discusses pertinent parts of these parties' submissions below.

3.2 Key economic and market conditions

18. Generally, the Commission considers a number of key economic indicators and financial market conditions in determining a just and reasonable ROE and deemed equity ratios. These include the interest rate environment, credit spreads and market volatility, as well as some other indicators that serve as inputs to, and guide the outcome of, the capital asset pricing model (CAPM). While some of these conditions were relatively stable, others have shifted materially over the last two years with the most prominent being substantial changes in inflation. Market volatility, and inflationary pressures especially with respect to food and energy prices, have been amplified by the geopolitical risks, uncertainty, and global economic ramifications of the largest land war the world has witnessed in 75 years triggered by Russia's recent invasion of Ukraine.

19. The Commission finds that the evidence before it shows upward pressure associated with inflation and interest rates. Other indicators such as credit spreads and MERP remain largely stable. Market volatility remains elevated, making it difficult to forecast relevant economic conditions for 2023. The evidence on business risk is mixed. These observations are discussed below.

3.2.1 Inflation, interest rate increase and credit spreads

20. In their submissions,[30] utilities made reference to the Bank of Canada (BoC) increasing its policy interest rate, and potential rate increases from both the BoC and the United States Federal Reserve in the upcoming year. The utilities referred to the BoC's latest Monetary Policy Report[31] and viewed the BoC's projections and commentary as an indication of future interest rate increases. The utilities made note of the BoC's overview of the Canadian economy, which highlighted recent developments such as increased inflationary pressures and absorbed economic slack.[32] AltaLink/EPCOR provided data from Statistics Canada showing the year-over-year growth rate in the Canadian consumer price index peaking at 4.8 per cent in December 2021. This was higher than the maximum annual growth rates seen in 2018, 2019 or 2020, and showed no indication of subsiding. These parties stated that the duration and extent of inflationary

---

28 Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 5. Exhibit 27084-X0028, ATCO/Apex/Fortis, PDF page 2. Exhibit 27084-X0025, ENMAX, PDF pages 1-2.

29 Exhibit 27084-X0021, Calgary, paragraphs 17-18.

30 Exhibit 27084-X0023, AltaLink/EPCOR, paragraphs 11-16, and exhibits 27084-X0025, 27084-X0029 and 27084-X0030.

31 https://www.bankofcanada.ca, Bank of Canada, Monetary Policy Report, January 2022.

32 Exhibit 27084-X0030, Appendix B, R. Buttke evidence, PDF page 1. Exhibit 27084-X0023, AltaLink, paragraph 14. Exhibit 27084-X0025, ENMAX, PDF pages 9-10.

pressure cannot be reasonably forecast.[33] J. Coyne for ENMAX concluded that "getting inflation under control will take several years."[34]

21. The UCA also referred to comments from the BoC's January 2022 Monetary Policy Report,[35] indicating that uncertainty regarding its inflation outlook was high, but lower than that found in previous monetary policy reports.

22. Overall, the utilities submitted that they view inflation and interest rates as positively correlated with authorized ROEs and, with all else equal, the expected future path of the policy interest rate should place upward pressure on authorized ROEs and other rates of return in the capital markets. The Commission notes that the BoC increased its target monetary policy interest rate on March 2, 2022.[36]

23. The Commission observes that higher interest rates are likely to affect expected utility returns. While interest rates are expected to increase, the magnitude of BoC rate increases (timing and scale of monetary policy rate change) is unknown. This adds a layer of uncertainty in establishing equity risk premiums and expected return values, absent reliance on a formula-based methodology. Under the circumstances, the Commission finds: (i) the utilities' preparedness to accept the current ROE of 8.5 per cent, coupled with (ii) the ongoing and pervasive uncertainty regarding the timing and extent of future changes in inflation and interest rates, including the potentially significant impact on global food and energy prices occasioned by Russia's invasion of Ukraine at the end of February 2022, supports a continuation of the current GCOC parameters into 2023, while moving forward with consideration of a formula-based approach in 2024.

24. Interveners submitted that utility credit spreads[37] are within the same range as credit spreads for debt issued by utilities in 2020 and 2018. The CCA[38] noted that credit spreads for ATCO Electric Distribution and ATCO Pipelines, when they issued debt in September 2020, was less than the cost of ATCO Electric Transmission's debt in 2018, which was the year of the last fully litigated GCOC proceeding. The CCA also noted that AltaLink issued debt with a smaller credit spread than previous debt issues, and ENMAX Distribution issued 10-year debt in 2020 at roughly the same spread as in June 2018. The CCA also submitted U.S. data as of February 2022 for corporate A-rated debentures showing a cost of debt at 42 basis points below the 25-year average, and 14 basis points above the one-year trend.

25. The UCA[39] referenced the spread between 30-year Canadian A-rated utility bonds and the yield on 30-year Government of Canada bonds (A-rated utility credit spreads). The utility credit spread was at 1.39 per cent in January 2022, which is very close to the long-term average of 1.40 per cent. The same credit spread data in March 2018 was reported to be 1.30 per cent.

26. Consistent with past GCOC decisions, the Commission views credit spreads as a measure of utility bond investors' risk perceptions and return expectations of utility investors. The spread

33 Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 11.
34 Exhibit 27084-X0025, ENMAX, PDF page 13.
35 Exhibit 27084-X0031, UCA, paragraph 11.
36 https://www.bankofcanada.ca, Bank of Canada increases policy interest rate - Bank of Canada, March 2, 2022.
37 Credit spreads are the difference between the yield for a government bond (i.e., Bank of Canada or U.S. Treasury) and the debt securities of corporations (i.e., utilities). A higher credit spread indicates a higher level of risk.
38 Exhibit 27084-X0026, CCA, PDF pages 4-6.
39 Exhibit 27084-X0031, UCA, PDF page 7.

measured by the difference between 30-year Canadian A-rated utility bonds and 30-year Government of Canada bonds is similar to levels in March 2018, when the parameters were set in the 2018 GCOC decision. The Commission finds that the credit spread data submitted by the interveners indicates that this measure has not deviated significantly since 2018.

3.2.2 Market equity risk premium

27. In the 2018 GCOC proceeding, Dr. Villadsen, on behalf of Apex/ATCO Utilities,[40] provided the following description of the MERP:

> Like the cost of capital itself, the market equity risk premium is a forward-looking concept. It is by definition the premium above the risk-free interest rate that investors can expect to earn by investing in a value-weighted portfolio of all risky investments in the market. The premium is not directly observable, and must be inferred or forecasted based on known market information.[41]

28. Estimates of a forward-looking MERP are used as an input in the CAPM and the empirical capital asset pricing model (ECAPM). The greater is the estimate of the forward-looking MERP, the higher will be the ROE generated by the CAPM and the ECAPM, all else being equal. Different approaches can be used to estimate the forward-looking MERP.[42]

29. In the present proceeding, both the CCA and Dr. Villadsen presented Canadian MERP data; however, while the CCA relied on annual values, Dr. Villadsen focused on monthly data with special emphasis on January 2022. On this basis, she submitted that the forward-looking MERP has increased markedly since the 2018 GCOC decision was issued and since the submission of her evidence in the 2021 GCOC proceeding. She submitted that on average in January 2022, the Canadian forward-looking MERP was 11.07 per cent, which is nearly double the historical average of 5.68 per cent and well above the current U.S. forward-looking MERP of 8.12 per cent.[43] With reference to the annual MERP data, the CCA submitted that measures of the equity risk premium have remained largely stable. In support of this view, the CCA provided a table, based on publicly available sources of MERP, showing U.S. and Canadian premiums from 2011 to 2022.[44] The CCA submitted that the data and other factors support a downward adjustment to the Commission-approved MERP.[45]

30. Dr. Villadsen did not explain why the Canadian forward-looking MERP estimate in January 2022 was much higher than the historical average and much higher than the U.S. forward-looking MERP. Dr. Villadsen's monthly chart shows that MERP values demonstrated some marked "peaks and valleys" in 2020 and 2021; however, the annual average MERPs remained stable as the CCA's data shows. In the absence of any information and support from Dr. Villadsen on whether January 2022 is indicative of a long-term trend or whether it is a temporary change that is expected to reverse, the Commission places greater weight on the data presented by the CCA, which shows that the average annual MERP has remained largely stable

40 The ATCO utilities are ATCO Electric - Distribution; ATCO Gas; ATCO Electric - Transmission; and ATCO Pipelines.
41 Decision 22570-D01-2018: 2018 Generic Cost of Capital, Proceeding 22570, August 2, 2018, paragraph 300.
42 Dr. Villadsen's description of two approaches is quoted in paragraph 300 of Decision 22570-D01-2018.
43 Exhibit 27084-X0029, Appendix A - Dr. Villadsen evidence, PDF pages 4-5.
44 Exhibit 27084-X0026, CCA, PDF page 12, paragraph 39.
45 Exhibit 27084-X0026, CCA, PDF page 14, paragraph 41.

since 2018, and finds that the data supports a continuation of the current GCOC parameters into 2023.

3.2.3 Market volatility

31. The utilities highlighted persistent heightened market volatility, and the lack of certainty and clarity in available market data. AltaLink/EPCOR[46] referenced that market volatility reached an all-time high during 2020, and remains highly variable. Using the VIX[47] index as a short-term measure, AltaLink commented that the market was at least 30 per cent more volatile compared to historical norms. ENMAX[48] provided similar evidence of heightened market volatility: Canadian and U.S. volatility indexes were still relatively high compared to five-year averages.

32. J. Coyne for ENMAX submitted that investor perceptions of market volatility and expected return, as measured by utility betas, have changed. Data submitted indicated that proxy utility betas were 23 per cent to 38 per cent higher in January 2022 compared to January 2020.[49]

33. The CCA[50] submitted that it is not clear that the VIX has a substantial effect on the risk premium and expected return demanded by investors. The CCA noted that the correlation between the VIX index and equity risk premium has declined over the last decade.

34. The UCA[51] submitted that the VIX and credit spreads were both within the long-term average, and that there was no basis in maintaining the status quo for the GCOC parameters. The UCA noted the VIX was near its long-term average of 20 at the time of its submission in this proceeding.

35. Parties' submissions also diverged when it came to the timeframe over which a VIX index should be observed, with the UCA emphasizing "that volatility has decreased"[52] within the 2018-2022 range, while Robert Buttke, on behalf of ATCO Utilities/Apex/Fortis, stated that the "VIX index remains well above its twenty-year historical average."[53] R. Buttke further submitted that with the BoC and U.S. Federal Reserve on the cusp of instituting quantitative tightening, the balance of volatility risks remains solidly toward the upside.[54]

36. Consistent with its determinations in past GCOC decisions, the Commission considers market volatility to be relevant to determining the parameters.[55] In the Commission's view, the heightened volatility and the uncertain outlook remain present and are likely to affect economic and market fundamentals in 2023. The Commission acknowledged this environment in its last GCOC decision, where it referenced AltaLink/EPCOR emphasizing "the COVID-19 pandemic and other related global events that continue to elevate capital market volatility, as well as economic uncertainty, potentially extending through 2021 and beyond, therefore making it

46 Exhibit 27084-X0023, PDF pages 3 and 13.
47 Chicago Board Options Exchange Volatility Index (VIX), measures the 30-day implied volatility of the S&P (Standard and Poor's) 500 index (representing the stock market in the U.S.).
48 Exhibit 27084-X0025, ENMAX, PDF pages 17-18, Table 1.
49 Exhibit 27084-X0025, ENMAX, PDF page 18.
50 Exhibit 27084-X0026, CCA, PDF page 9.
51 Exhibit 27084-X0031, UCA, PDF page 5.
52 Exhibit 27084-X0031, UCA, paragraph 12.
53 Exhibit 27084-X0030, Appendix B - Mr. Buttke evidence, PDF page 4.
54 Exhibit 27084-X0030, Appendix B - Mr. Buttke evidence, PDF page 4.
55 Decision 26212-D01-2022, paragraph 19. Decision 20622-D01-2016: 2016 Generic Cost of Capital, Proceeding 20622, October 7, 2016, paragraphs 90-91.

impossible to forecast relevant economic conditions for 2022 with any reasonable degree of accuracy."[56] Overall, the Commission finds market volatility remains elevated, making it difficult to forecast relevant economic conditions for 2023. This lends further support to a rollover of GCOC parameters into 2023.

3.2.4 Business risk and earning above awarded ROE

37. Parties submitted conflicting assessments of changes to business risk since the 2018 GCOC decision. The ATCO Utilities/Apex/Fortis[57] submitted that there have been significant transformations occurring in the utility industry since 2018, including emphasis on decarbonization; a focus on environmental, social and governance standards; the need for grid modernization; and changes in the way in which customers are receiving utility service. These utilities stated that they are directly affected by these transformations, and these changes engender risk and uncertainty for utilities at a level seldom witnessed in the past.[58]

38. J. Coyne, on behalf of ENMAX, pointed to renewable energy investments and high capital expenditure plans in an increasing interest rate environment as contributors to the observed elevated utility risk.[59] Fortis engaged Dr. Toby Brown of the Brattle Group to assess the business risk of utilities in Alberta. Dr. Brown concluded that the business risk of the utilities in Alberta in 2023 remains elevated and may have increased since the 2021 GCOC proceeding.[60]

39. The UCA submitted that there has been no change in business risk since the 2018 GCOC decision was issued. It stated that the COVID-19 pandemic appeared to have little effect on the utilities' ability to provide safe and reliable service, and submitted that this confirms the utilities continue to have low business risk and operate within a supportive regulatory environment.[61] The CCA submitted that financial risk and regulatory risk are lower now than they were at the time of the 2018 GCOC proceeding. It noted the reduction in regulatory lag and stated that utility asset disposition risk has been largely eliminated.[62]

40. Some customer groups pointed to the utilities achieving actual ROEs in excess of the Commission-approved ROEs. For example, Calgary noted that ATCO Gas has been remarkably consistent in earning in excess of its approved ROE over the last four years, even when the economy at large has been decimated. It submitted that this indicates minimal business risk for ATCO Gas.[63] The Industrial Power Consumers Association of Alberta (IPCAA) submitted that over the last 10 years, most of the utilities in Alberta have been earning an ROE above the Commission-approved ROE.[64]

41. The Commission considers that historical earnings above or below the approved ROEs do not help it to determine what the ROE for a future test period should be. The Commission agrees with the following submissions made by AltaLink/EPCOR:

56 Decision 26212-D01-2021, paragraph 13.
57 The ATCO utilities, Apex and Fortis filed a joint submission on the record, which is in Exhibit 27084-X0028.
58 Exhibit 27084-X0028, ATCO/Apex/Fortis, page 2.
59 Exhibit 27084-X0025, ENMAX, PDF page 18.
60 Exhibit 27084-X0032, Fortis, PDF pages 6-7.
61 Exhibit 27084-X0031, UCA, paragraphs 33-36.
62 Exhibit 27084-X0026, CCA, paragraph 53.
63 Exhibit 27084-X0021, Calgary, paragraph 38.
64 Exhibit 27084-X0024, IPCAA, paragraphs 7-9.

> Invariably, whether or not a utility earns its approved ROE in a given year will depend on utility specific matters, such as the utility's O&M [operating and maintenance] and capital cost performance in that year. Although these matters may be relevant to the regulation of a utility's revenue requirement (whether under cost of service regulation or performance-based regulation), they are not relevant in the context of establishing fair return within a GCOC proceeding.[65]

42. The Commission notes the conflicting evidence and positions of parties with respect to indicators of business risk and whether business risk is increasing or decreasing. The Commission is not persuaded that there is a quantifiable shift in business risk that would require either an increase or decrease in the deemed equity ratios for 2023.[66]

3.3 Comparable returns on equity

43. Some interveners referenced approved ROEs and ongoing GCOC proceedings from other jurisdictions. Calgary, for example, highlighted[67] two recent determinations of the Newfoundland and Labrador Board of Commissioners of Public Utilities and the New Brunswick Energy and Utilities Board. Both cases resulted in an approved ROE of 8.5 per cent through either a negotiated settlement or an award by a board. In Calgary's view, this is another circumstance accentuating that "the roll-over of 2022 GCOC parameters into 2023 should assure Customers with the comfort that distribution rates will not rise once again due to any parameter adjustments in 2023."[68]

44. The UCA used the Ontario Energy Board's (OEB) formula and, using the Commission's last approved ROE of 8.5 per cent as the base, along with certain market data values as recent as of January 18, 2022, arrived at a calculated ROE of 8.37 per cent. Alternatively, it noted that using a formula proposed by Dr. S. Cleary in the 2021 GCOC proceeding, updated with more current data, would produce an ROE of 8.3 per cent.[69] In the UCA's view, if the Commission was to set the ROE on a final basis without conducting further process, at a minimum, the approved ROE should be 0.27 per cent below the currently approved ROE of 8.5 per cent (i.e., 8.23 per cent).[70] The UCA also pointed to the ongoing GCOC proceeding at the British Columbia Utilities Commission (BCUC) notwithstanding "uncertainties in economic conditions, volatility in financial markets and changes in government policies."[71]

45. While all utilities supported keeping the ROE at 8.5 per cent, some utilities submitted evidence that current economic indicators would actually lead to a higher ROE for 2023 (as well as higher deemed equity ratios), if the Commission was to carry out a full GCOC proceeding.

46. AltaLink and EPCOR identified a number of relevant data points indicating that investor return expectations for utilities have increased, for example: (i) high inflation puts an upward pressure on interest rates and, as a result, investor-required returns on utility investments;

---

65 Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 27.
66 Since the 2009 GCOC decision, it has been the Commission's practice to establish an ROE that uniformly applies to all of the affected utilities and account for particular business risks faced by the affected utilities by incorporating any required adjustments into their respective approved deemed equity ratios, either collectively or on an individual basis.
67 Exhibit 27084-X0022, Calgary, paragraph 31.
68 Exhibit 27084-X0022, Calgary, paragraph 46.
69 Exhibit 27084-X0031, UCA, paragraphs 28-31.
70 Exhibit 27084-X0031, UCA, paragraph 27.
71 Exhibit 27084-X0031, UCA, paragraph 6.

(ii) a higher level of required return for debt instruments, which would correspond to a greater cost of common equity; and (iii) the upward directional movement of beta coefficients indicating an elevated level of observed investor risk and requiring a higher level of return to compensate investors for the additional risk. Nevertheless, AltaLink and EPCOR submitted that when all factors relevant to the Commission's statutory mandate and approval process are considered, it is just and reasonable that the Commission extend the current parameters into 2023 on a final basis.[72]

47. The Commission notes that matching the ROE and deemed equity ratios awarded by other regulators, on its own, does not satisfy the fair return standard, nor does it establish just and reasonable rates. The objective of the GCOC is to consider the market expectation for the utilities raising capital necessary to provide safe and reliable utility service in Alberta. In setting the GCOC for the utilities in Alberta, other jurisdictions can be a useful indicator or benchmark for evaluating contemporaneous rates of return and whether return expectations are generally increasing or decreasing.

48. In this regard, the Commission observes that the ROEs from other jurisdictions noted by interveners or calculated using formulaic methodologies do not materially depart from the Commission's last approved 8.5 per cent figure and, hence, provide no justification for commencing a full-scale review process given the additional time and costs involved. The Commission also notes that the OEB's latest 2022 approved formulaic cost-of-capital parameters result in an ROE of 8.66 per cent, which is 0.16 per cent higher than the Commission's rate of 8.5 per cent (and represents an increase from the OEB's approved ROE in 2021).[73]

49. The Commission is also not persuaded by the UCA's argument that just because the BCUC is currently conducting a GCOC proceeding, the Commission should as well. Each regulator makes determinations based on its own circumstances and jurisdiction, using its discretion and the best information available to it. The Commission observes that the benchmark ROE of 8.75 per cent and the benchmark deemed equity ratio of 38.5 per cent last approved by the BCUC has been unchanged for nearly a decade, since January 1, 2013 (and reaffirmed part way in 2016)[74] and can be distinguished on that basis.

3.4 Prospectivity

50. Nearly all parties[75] highlighted the importance of ensuring prospectivity of the approved parameters and commended the Commission's significant efforts over the past several GCOC proceedings in this regard. This endeavour helps reduce regulatory lag related to the cost-of-capital element of rates. Parties also emphasized that there would be insufficient time to prepare, file and test relevant cost-of-capital material to permit new parameters to be in place before January 1, 2023. In this respect, the Commission notes that during one of the most recent GCOC proceedings,[76] parties requested between four weeks and six months of time to prepare their evidence.

72 Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 18.
73 https://www.oeb.ca/sites/default/files/OEB-Ltr-2022-Cost-of-Capital-Update-20211028.pdf
74 https://docs.bcuc.com/Documents/Proceedings/2021/DOC_60592_A-1-GCOC-Proceeding-Notice.pdf
75 Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 26; Exhibit 27084-X0028, ATCO/Apex/Fortis, PDF page 3; Exhibit 27084-X0021, Calgary, paragraph 8; Exhibit 27084-X0031, UCA, paragraph 57.
76 Proceeding 26212, 2022 GCOC.

51. The UCA submitted that "the Commission's objective of prospectivity, while commendable, can and should always be subordinate to the objective of establishing a fair return based on the best available information."[77] The Commission agrees with this statement but it is also aware that a failure to maintain prospectivity can be a factor that results in unfairness, greater risk and uncertainty, and can put upward pressure on rates.

52. Furthermore, given the bifurcated process established by the Commission, timely conclusion of this first stage of the proceeding provides parties with certainty and finality of 2023 rates while allowing parties and the Commission time to focus on a second stage, which addresses 2024 and future years. This approach is expected to maintain prospectivity, and mitigate risk and cost increases for utilities and their customers.

3.5 Cost of proceedings

53. Full GCOC proceedings are resource intensive and costly to conduct. For example, the most recent fully contested 2018 GCOC proceeding had costs awards that totalled $1,503,869.[78] The total costs, including the Commission's own costs and the costs incurred by parties over and above the Commission's scale of costs, were in excess of $4 million. While the amount of awarded costs is not the primary consideration, it is a relevant one for the Commission as these costs are ultimately paid by ratepayers. In the present circumstances, the Commission is not persuaded that incurring these additional costs is justified or would result in a better overall outcome. This view was echoed by AltaLink and EPCOR who stated that a detailed GCOC proceeding for 2023 would be costly and inefficient and, in the end, would be unlikely to provide any greater assurance of a just and reasonable result.[79]

54. For 2023, the Commission considers that its objective of ensuring that utilities earn a fair return and customers pay just and reasonable rates can be met without undertaking complex, lengthy and costly further process. A full process is likely to be frustrated by the need for multiple, potentially significant updates due to the current market volatility and uncertainty as noted by experts and the parties. Evidence, updates to evidence and further regulatory process could result in further delays.

4 Conclusion

55. Given the considerations outlined in this decision, the Commission concludes that there is an inadequate basis to depart from the currently approved ROE and the deemed equity ratios (either up or down). The Commission finds that maintaining the existing ROE of 8.5 per cent will, when combined with the existing deemed equity ratios, provide the utilities with a fair return for 2023. The Commission is satisfied that these parameters support an outcome that will ensure customers are not paying more than is required to maintain safe, reliable and economic service.

56. The Commission is not persuaded that there is a quantifiable shift in business risk that would require an increase or decrease in the deemed equity ratios for 2023. Therefore, the

[77] Exhibit 27084-X0031, UCA, paragraph 57.
[78] Decision 23628-D01-2018: 2018 Generic Cost of Capital Costs Award, Proceeding 23628, December 20, 2018.
[79] Exhibit 27084-X0023, AltaLink/EPCOR, paragraph 21.

Commission finds that the deemed equity ratios for 2023 should remain the same as those approved for 2022.

5 Costs award

57. The Commission will treat the date of this decision as the close of record date for the purpose of filing costs claim applications for the first stage of this proceeding. Accordingly, in accordance with the requirements of Rule 022: *Rules on Costs in Utility Rate Proceedings*, parties may submit their cost applications for the Commission's consideration within 30 days of March 31, 2022.

58. In light of the foregoing, the Commission concludes the first stage of this proceeding and will commence the second stage in due course to address its consideration of a formula-based approach to setting the parameters for 2024 and future years.

6 Order

59. It is hereby ordered that:

(1) The final approved generic return on equity for Apex Utilities Inc., AltaLink Management Ltd., PiikaniLink L.P., KainaiLink L.P., ATCO Electric Ltd., ATCO Gas, ATCO Pipelines, ENMAX Power Corporation, EPCOR Distribution & Transmission Inc., FortisAlberta Inc., the transmission operations of the City of Lethbridge, the transmission operations of The City of Red Deer, and certain electricity transmission assets of TransAlta Corporation, is set at 8.5 per cent for the entirety of 2023.

(2) The final approved deemed equity ratio for Apex Utilities Inc., AltaLink Management Ltd., PiikaniLink L.P., KainaiLink L.P., ATCO Electric Ltd., ATCO Gas, ATCO Pipelines, ENMAX Power Corporation, EPCOR Distribution & Transmission Inc., FortisAlberta Inc., the transmission operations of the City of Lethbridge, the transmission operations of The City of Red Deer, and certain electricity transmission assets of TransAlta Corporation, is set at 37 per cent (39 per cent for Apex Utilities Inc.) for the entirety of 2023.

Dated on March 31, 2022.

Alberta Utilities Commission

(original signed by)

Carolyn Dahl Rees
Chair

(original signed by)

Douglas A. Larder, QC
Vice-Chair

(original signed by)

Bohdan (Don) Romaniuk
Acting Commission Member

Appendix 1 – Proceeding participants

Name of organization (abbreviation) **Company name of counsel or representative**
Alberta Direct Connect Consumers Association (ADC)
AltaLink Management Ltd. (AltaLink)
Apex Utilities Inc. (Apex)
ATCO Electric Ltd. (ATCO Electric)
ATCO Gas Bennett Jones LLP
Capital Power Corporation (CPC) Dentons Canada LLP
Consumers' Coalition of Alberta (CCA)
ENMAX Power Corporation (ENMAX or EPC)
EPCOR Distribution & Transmission Inc. (EPCOR or EDTI)
FortisAlberta Inc. (Fortis or FAI)
Industrial Power Consumers Association of Alberta (IPCAA)
Office of the Utilities Consumer Advocate (UCA) Reynolds, Mirth, Richards & Farmer LLP
The City of Calgary (Calgary) McLennan Ross Barristers & Solicitors

Alberta Utilities Commission

Commission panel
C. Dahl Rees, Chair
D.A. Larder, QC, Vice-Chair
B. Romaniuk, Acting Commission Member

Commission staff
L.-M. Berg (Commission counsel)
A. Sabo (Commission counsel)
A. Jukov
D. Mitchell
L. Bondad