



2022 Generic Cost of Capital

March 4, 2021



Alberta Utilities Commission

Decision 26212-D01-2021
2022 Generic Cost of Capital
Proceeding 26212

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2022 Generic Cost of Capital

1 Decision summary

1. In this decision, the Alberta Utilities Commission sets out the return on equity (ROE) of 8.5 per cent and deemed equity ratio of 37 per cent (39 per cent for Apex Utilities Inc.) (collectively, the ROE and equity ratios, also referred to as “parameters”) for the year 2022 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 Corporation⁶
- EPCOR Distribution & Transmission Inc.⁷
- FortisAlberta Inc.⁸
- KainaiLink L.P.⁹
- City of Lethbridge¹⁰
- PiikaniLink L.P.¹¹
- The City of Red Deer¹²
- TransAlta Corporation¹³

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 utilities are

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 (formerly AltaGas Utilities Inc.).

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 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 to PiikaniLink L.P. in Decision 22612-D01-2018, referenced above.

¹² Electricity transmission.

¹³ Electricity transmission assets.

regulated pursuant to the *Electric Utilities Act* and the *Regulated Rate Option Regulation*, and the *Gas Utilities Act* and the *Default Gas Supply Regulation*, respectively.

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 proceedings, should issues respecting ROE and deemed equity ratios arise for these 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 for customers.¹⁴ The components of a fair return determined in a generic cost of capital (GCOC) proceeding are the ROE and deemed equity ratio. While each of the aforementioned statutes provides matters for the Commission to consider, there is no prescribed method for determining a fair return.¹⁵

5. Over the past 20 years, the Commission has used various methods to determine the ROE and deemed equity ratios for each utility it regulates. Historically, the Commission considered ROE and equity ratios for each utility on a case-by-case basis. For the 2004 test year, the Commission set a generic ROE for all utilities and adopted an adjustment mechanism formula to determine the ROE in subsequent years.¹⁶ The formula was used from 2005 to 2008, and then the global financial recession of 2007 to 2009 led the Commission to alter its approach.

6. Starting in 2009, the Commission began setting ROE based on economic and financial evidence and argument filed by parties in GCOC proceedings, rather than on the formula-based methodology it had previously employed. From 2009 to 2020, the Commission established the ROE and equity ratios for a two- to three-year test period at a time following an intensive regulatory process in a GCOC proceeding. 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;¹⁷ 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.

7. Parties filed evidence for the 2021 GCOC proceeding in January 2020. On March 19, 2020, the Commission suspended its established process in light of the uncertainty in financial markets resulting from the COVID-19 pandemic. To provide a measure of stability for utilities, as well as their customers and investors in the face of unsettled markets, the Commission utilized a menu-based approach, which allowed each utility to select its preferred option for setting its

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 has previously addressed the fair return standard in Decision 2009-216 with reference to the statutory framework and case law in Decision 2009-216: 2009 Generic Cost of Capital, Proceeding 85, Application 1578571-1, November 12, 2009, Section 2.

¹⁶ 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.

¹⁷ β , or beta, measures the sensitivity of a required return of an individual security to changes in the market return.

ROE and equity ratio based on its particular circumstances.¹⁸ Ultimately, this approach resulted in the Commission prospectively approving generic ROE and equity ratios for all utilities by extending the approved rate for 2020 to the end of 2021 on a final basis.¹⁹

8. On December 22, 2020, the Commission initiated the present 2022 GCOC proceeding and issued a letter²⁰ which sought parties' comments on specific proceeding-related matters that are further discussed below. These submissions were acknowledged by the Commission in a letter dated January 27, 2021.

9. 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.

3 2022 parameters and completion of current GCOC proceeding

10. Being mindful of a number of factors affecting the current 2022 GCOC proceeding, including the ongoing uncertainty arising from the COVID-19 pandemic, the Commission provided all interested parties the opportunity to file comments before establishing any process for this proceeding. In its letter dated December 22, 2020, the Commission canvassed all registered parties in this proceeding for comments on: (i) whether there were sufficient grounds to extend the currently approved ROE and equity ratios for a further period of time; (ii) the appropriate duration of the current GCOC test period; (iii) the feasibility of exploring a return to a formula-based approach to establishing ROE; (iv) how best to avoid duplicative GCOC evidence; and (v) the time required for parties to prepare their evidentiary submissions.

11. The first question sought comments on whether there were sufficient grounds to extend the currently approved parameters for a further period of time or whether it would be preferable to maintain them only until such time as a specified threshold is passed (e.g., a specific set of market conditions or capital market parameters, or such time as any registered party brings an application satisfying the Commission that changed circumstances now warrant a reconsideration of the currently approved parameters). The Commission carefully considered the parties' responses in arriving at its determinations herein, with the utilities predominantly requesting that the current parameters be extended for at least one year, thereby dispensing with the need for the 2022 GCOC proceeding, while the interveners generally opposed this view.

12. More specifically, the ATCO Utilities, Apex and Fortis highlighted persisting conditions such as continued market volatility, the relative lack of certainty and clarity characterizing data available today and in the foreseeable future, and the ongoing COVID-19 pandemic and potential impact of the virus' more infectious variants. It was further noted that while the extraordinary fiscal liquidity support measures undertaken by governments worldwide have stabilized their economies to a certain degree, these extraordinary support measures cannot continue over the long term and the timing and the effect of them being withdrawn or wound down cannot be

¹⁸ Proceeding 24110, Exhibit 24110-X0459.

¹⁹ Decision 24110-D01-2020: 2021 Generic Cost of Capital, Proceeding 24110, October 13, 2020.

²⁰ Exhibit 26212-X0018.

predicted with confidence. Given the unstable environment, these utilities stressed not only the very high likelihood that parties would be required to file multiple forecast updates throughout the proceeding but that, even with multiple updates, the evidence would remain subject to an unusual, if not unacceptable, degree of uncertainty.²¹ In support of their position, the ATCO Utilities, Apex and Fortis pointed to the Bank of Canada's own disclaimers concerning increased uncertainty in the Bank's own economic forecasts, which have replaced the usual forward scenarios it offered prior to the pandemic.²²

13. AltaLink and EPCOR similarly emphasized 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 impossible to forecast relevant economic conditions for 2022 with any reasonable degree of accuracy. As such, any initially filed evidence would likely not adequately reflect the economic conditions in 2022 and would be unhelpful in establishing a fair return. Both utilities submitted that such circumstances would render the fully litigated proceeding highly contentious, complex and inefficient, contrary to the Commission's recent efforts to reduce regulatory burden and cost.²³ AltaLink and EPCOR also drew attention to a number of particular market indicators, such as the depressed government of Canada bond yields, elevated utility betas, and highly variable VIX,²⁴ combined with aggressive and broad-based fiscal intervention by various levels of government throughout North America. They further stated that a number of relevant considerations in determining a fair return indicate that return requirements for investors have increased.²⁵

14. ENMAX observed that capital markets were still in a state of uncertainty, as economies continue to adjust to the impacts of multiple waves of COVID-19, as well as to such factors as the degree of support provided by government fiscal policy, the speed and effectiveness of vaccine rollout, and the impact of new virus strains. ENMAX recommended that any decision on whether to proceed with the 2022 GCOC proceeding be deferred until March 2021. ENMAX also submitted that if the level of uncertainty continues to persist, or increases, the Commission should be prepared to extend the current parameters through to the end of 2022.²⁶

15. The Office of the Utilities Consumer Advocate (UCA) submitted that there are insufficient grounds to extend the parameters for a further period of time, as the uncertainty surrounding the trajectory of the pandemic and its impact on the economy has lessened since the 2021 GCOC proceeding and parties are now in a better position to make informed forecasts of future economic conditions. In this regard, the UCA noted that the cost of capital parameters have not been subject to a full review and testing by the Commission since 2018.²⁷ The Industrial Power Consumers Association of Alberta endorsed the UCA's position.²⁸

16. The City of Calgary (Calgary) submitted that the timing of an economic recovery across all sectors is uncertain and, in any event, is not expected until the latter half of 2021 at the earliest in the United States and, likely not any earlier in Canada. At the time of its submission,

²¹ Exhibit 26212-X0025.

²² Exhibit 26212-X0025, PDF page 2.

²³ Exhibit 26212-X0024.

²⁴ 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.).

²⁵ Exhibit 26212-X0024, PDF page 3.

²⁶ Exhibit 26212-X0022.

²⁷ Exhibit 26212-X0020.

²⁸ Exhibit 26212-X0021.

Calgary recommended delaying the start of the 2022 GCOC proceeding for two to three months, when more information on the COVID-19 vaccine launch and the pandemic's progress is available. This reservation notwithstanding, Calgary considered that a review of the parameters should still take place for a test period beginning on January 1, 2022.²⁹

17. In the Consumers' Coalition of Alberta's (CCA) view, given the substantial changes in capital markets since 2018, there are insufficient grounds to extend the currently approved parameters for a further period of time. These changes include lower values for "i) risk free rate ii) growth and forward return expectations, iii) utility betas and iv) CPI [Consumer Price Index]." Overall, the CCA concluded that an updated GCOC decision is required based on current "inputs", taking into account the substantial changes that have taken place in general circumstances and economic drivers.³⁰

18. The Commission finds that the economic and market data that would normally be used to inform its judgment regarding a fair return continue to remain in a state of flux, nearly six months after the 2021 GCOC decision was released in October 2020. Accordingly, the Commission agrees with those parties that suggested evidence would almost certainly need to be updated (one or more times) during the course of a proceeding in response to changes in financial markets, and that the evidence would be clouded by an unusual degree of uncertainty. While AltaLink and EPCOR claimed that a number of relevant considerations in determining a fair return indicate that return requirements for investors have increased, the CCA pointed to lower values for several key variables suggesting the opposite conclusion, namely, that return requirements have decreased. Ultimately, the Commission concludes that there is an inadequate basis to depart from the currently approved ROE and equity thicknesses (either up or down).

19. The Commission rejects the suggestion made by certain interveners that the period of time that has passed since the Commission last conducted a full examination of capital parameters requires the continuation of a full-scale GCOC proceeding in the current circumstances. Access to stable and reliable, current and forward-looking economic and market data is more important than the mere passage of time as a determinant of whether the Commission should conduct a full GCOC proceeding, especially at a time of major uncertainty. 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 that is likely to be frustrated by the need for multiple, potentially significant updates throughout a proceeding. To impose the extensive regulatory process typically relied upon by the Commission in a full-review GCOC proceeding, during a time of significant market volatility and uncertainty, would not be consistent with, or promote, regulatory efficiency. Nor is it entirely clear to the Commission that, in the circumstances, such additional process would necessarily provide any greater assurance that the resulting rates would be just and reasonable.

20. On balance, the Commission considers that the above-mentioned uncertainties about economic and market fundamentals are likely to persist throughout 2021. Given the current unsettled nature of capital markets, and the need for certainty and stability for Alberta ratepayers, as well as utilities and their investors, the Commission finds that extending the currently approved ROE and deemed equity ratios for an additional year best meets the public interest

²⁹ Exhibit 26212-X0023.

³⁰ Exhibit 26212-X0019.

objective of ensuring just and reasonable rates without undertaking a further complex process, as well as the Commission's policy goal of greater regulatory efficiency. Therefore, the Commission approves the ROE of 8.5 per cent and deemed equity ratio of 37 per cent (39 per cent for Apex Utilities Inc.) for the year 2022 on a final basis.

21. In light of the foregoing, the Commission concludes the present proceeding and will commence a new GCOC proceeding in due course to address fair return for a future test period.

4 Costs award

22. 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 the date of this decision. In this regard, the Commission considers the date of this decision, March 4, 2021, to represent the close of record date for the purpose of filing costs claim applications.

5 Order

23. It is hereby ordered that:

- (1) The final approved generic return on equity for Apex Utilities Inc., AltaLink Management Ltd. and its partners PiikaniLink L.P. and 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 by extending the currently approved rate of 8.5 per cent for the duration of 2022.
- (2) The final approved deemed equity ratio for Apex Utilities Inc., AltaLink Management Ltd. and its partners PiikaniLink L.P. and 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 by extending the currently approved rate of 37 per cent (39 per cent for Apex Utilities Inc.) for the duration of 2022.

Dated on March 4, 2021.

Alberta Utilities Commission

(original signed by)

Carolyn Dahl Rees
Chair

(original signed by)

Bohdan (Don) Romaniuk
Acting Commission Member

Appendix 1 – Proceeding participants

Name of organization (abbreviation) Company name of counsel or representative
AltaLink Management Ltd. (AltaLink) Borden, Ladner Gervais LLP
Apex Utilities Inc. (Apex)
ATCO Electric Ltd.
ATCO Gas & Pipelines Ltd. Bennett Jones LLP
Canadian Association of Petroleum Producers
Consumers' Coalition of Alberta (CCA)
ENMAX Power Corporation
EPCOR Distribution & Transmission Inc. (Borden, Ladner Gervais LLP)
FortisAlberta Inc.
Industrial Power Consumers Association of Alberta
Office of the Utilities Consumer Advocate (UCA) (Reynolds, Mirth, Richards & Farer LLP)

<p>Alberta Utilities Commission</p> <p>Commission panel</p> <ul style="list-style-type: none"> C. Dahl Rees, Chair B. Romaniuk, Acting Commission Member <p>Commission staff</p> <ul style="list-style-type: none"> D. Reese (Commission counsel) A. Jukov D. Mitchell
