

Authorized Return on Equity for Canadian and U.S. Gas and Electric Utilities

Volume III, May 1, 2015

INTRODUCTION

Concentric Energy Advisors, Inc. (Concentric) is pleased to publish the third edition of this newsletter summarizing authorized returns on common equity (ROEs) and common equity ratios for Canadian gas and electric distributors, Canadian electric transmission companies, U.S. gas and electric distributors, and select bond yields. Many regulators, stakeholders and analysts in Canada consider allowed returns in other Canadian jurisdictions and U.S. utilities when assessing the cost of capital. This newsletter seeks to assist with these inter-jurisdictional comparisons.

This newsletter and supporting database contain the authorized ROEs and common equity ratios for over 40 Canadian electric and gas utilities. For comparison purposes, the newsletter also presents the average and median authorized ROEs and common equity ratios for U.S. gas and electric distributors, as reported by SNL Financial's Regulatory Research Associates.

ROE

Concentric observes that the differential between the median authorized ROEs for Canadian and U.S. gas distributors continues to narrow, from 100 basis points in 2000 to 53 basis points in 2014 and to only 18 basis points through the first three months of 2015. There is a larger gap between Canadian and U.S. electric distributors, at 125 basis points in 2014 and 122 basis points in 2015. Concentric notes that gas ROEs are higher than their electric counterparts in Canada, while the opposite is generally true in the U.S. Median ROEs for Canadian electric transmission companies are 20 basis points lower than those awarded to Canadian electric distributors, but 142–145 basis points below U.S. electric distributors over the 2014–2015 period.

Concentric attributes the closure of the gap between Canadian and U.S. authorized ROEs over the past decade to the resetting and replacement of automatic formulas widely used in Canada, which has generally increased allowed ROEs from previous formula levels. Simultaneously, U.S. ROEs have followed the decline in interest rates and earnings growth projections that drive ROE estimates.

EQUITY RATIOS

While authorized ROEs have converged between the two countries, the authorized common equity ratios have not. In 2014, the median common equity ratio for Canadian gas distributors was 39.3% while the U.S. median was 51.9%, comparable to the difference for electric

distributors which was 40.0% and 50.1%, respectively. Allowed equity ratios for Canadian electric transmission companies are 4.0% lower than their electric distribution counterparts, and 14.0% below U.S. electric distributors.

RECENT DECISIONS

Canadian utility regulators have issued several important cost of capital decisions since the second edition of this newsletter was published in May 2014. Notably, in Alberta, the Alberta Utilities Commission recently issued its decision in the 2013 Generic Cost of Capital proceeding for all gas and electric utilities in the Province. The allowed ROE for Alberta's gas and electric utilities was set at 8.3% for 2015. In addition, the AUC determined that the allowed ROE for 2013 and 2014 would be modified from the previous interim rate of 8.75% to 8.3%. The AUC also reduced the deemed common equity ratio by one percentage point for most Alberta regulated utilities and decided to forego returning to an automatic formula at this time. The Alberta utilities have filed applications to appeal this decision.

In Ontario, the Ontario Energy Board's revised ROE formula established in December 1999 remains in effect but is scheduled to be reviewed in 2015. In Québec, the Régie again decided to allow Gaz Métro to maintain its allowed ROE of 8.9% without a formal proceeding, and similarly for Hydro-Québec Distribution and TransÉnergie, maintaining 8.2% for both divisions.

BOND YIELDS

Government and corporate bond yields are often considered when setting authorized ROEs for utilities. As shown in the chart on page 3, after declining for many years, the long-term government bond yields (considered the risk-free rate of return) in both Canada and the U.S. increased from mid-2012 through mid-2013, but have since resumed their prolonged decline. While government bond yields play an important role in determining the authorized ROE for regulated utilities, changes in government bond yields do not imply a one-for-one change in the cost of equity for utilities. The relationship between government bond yields and the equity risk premium (the spread between government bond yields and the cost of equity) has historically exhibited an inverse relationship.

Going forward, Concentric anticipates that improving economic conditions and the withdrawal of accommodative monetary policy in both Canada and the U.S. will begin to exert upward pressure on the cost of capital for utilities over the next several years.

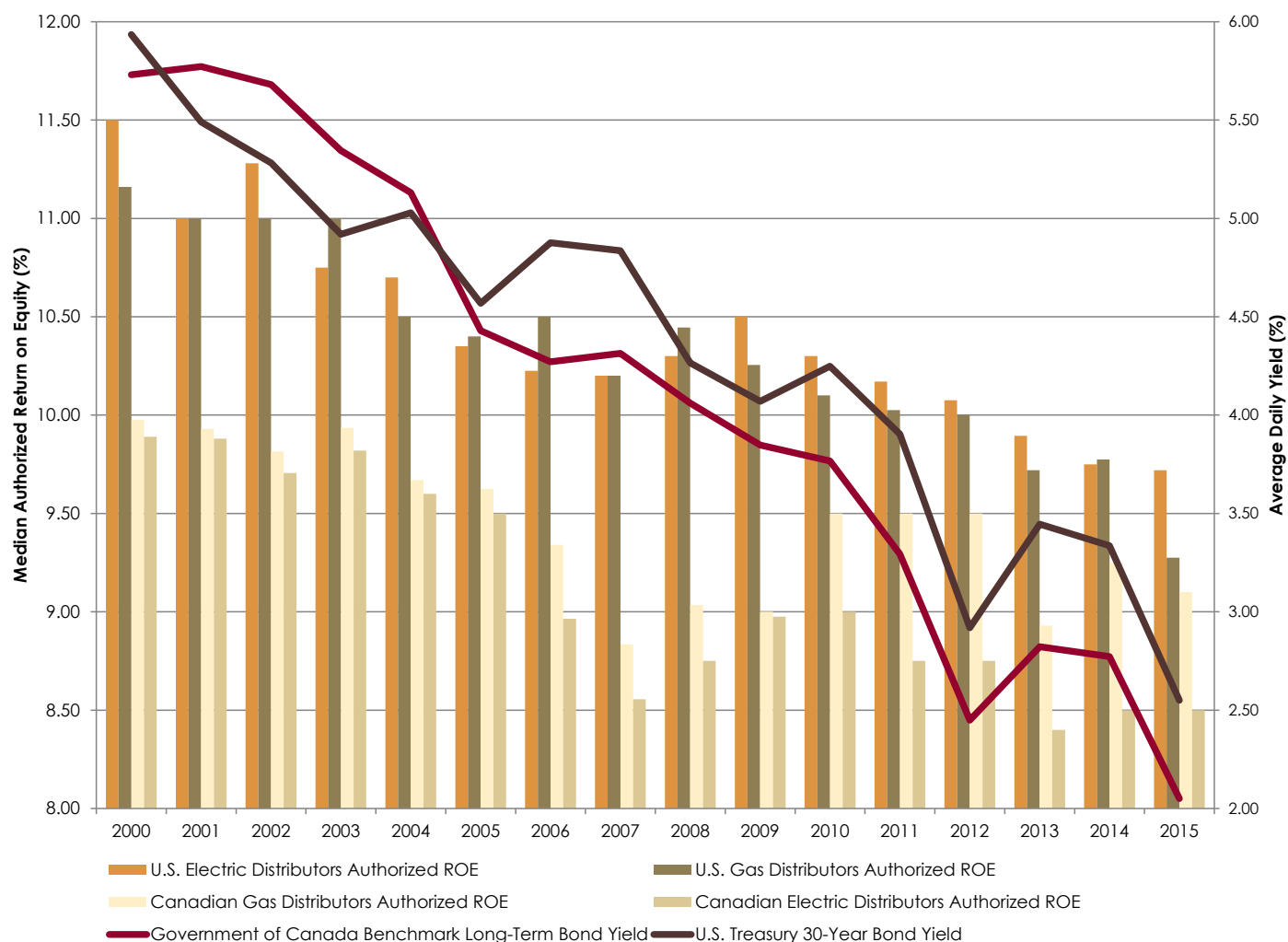
**Authorized Return on Equity
for Canadian and U.S. Gas and Electric Utilities ¹**

| | Return on Common Equity (%) | | | Common Equity Ratio (%) | | |
|---|-----------------------------|---------|---------|-------------------------|---------|---------|
| | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 |
| Canadian Gas Distributors ² | | | | | | |
| AltaGas Utilities Inc. ³ | 8.30 | 8.30 | 8.30 | 42.00 | 42.00 | 42.00 |
| ATCO Gas ³ | 8.30 | 8.30 | 8.30 | 38.00 | 38.00 | 38.00 |
| Centra Gas Manitoba Inc. | N/A | N/A | N/A | 30.00 | 30.00 | 30.00 |
| Enbridge Gas Distribution Inc. ⁴ | 8.93 | 9.36 | 9.30 | 36.00 | 36.00 | 36.00 |
| Enbridge Gas New Brunswick | 10.90 | 10.90 | 10.90 | 45.00 | 45.00 | 45.00 |
| FortisBC Energy Inc. | 8.75 | 8.75 | 8.75 | 38.50 | 38.50 | 38.50 |
| FortisBC Energy (Vancouver Island) Inc. ⁵ | 9.25 | 9.25 | — | 41.50 | 41.50 | — |
| FortisBC Energy (Whistler) Inc. ⁵ | 9.50 | 9.50 | — | 41.50 | 41.50 | — |
| Gaz Métro Limited Partnership | 8.90 | 8.90 | 8.90 | 38.50 | 38.50 | 38.50 |
| Gazifère Inc. | 7.82 | 9.10 | 9.10 | 40.00 | 40.00 | 40.00 |
| Heritage Gas Limited | 11.00 | 11.00 | 11.00 | 45.00 | 45.00 | 45.00 |
| Pacific Northern Gas Ltd. | 9.50 | 9.50 | 9.50 | 46.50 | 46.50 | 46.50 |
| Pacific Northern Gas (N.E.) Ltd. (Fort St. John/Dawson Creek) | 9.25 | 9.25 | 9.25 | 41.00 | 41.00 | 41.00 |
| Pacific Northern Gas (N.E.) Ltd. (Tumbler Ridge) | 9.50 | 9.50 | 9.50 | 46.50 | 46.50 | 46.50 |
| SaskEnergy Inc. | 8.75 | 8.75 | 7.74 | 37.00 | 37.00 | 37.00 |
| Union Gas Limited ⁶ | 8.93 | 8.93 | 8.93 | 36.00 | 36.00 | 36.00 |
| Average | 9.17 | 9.29 | 9.19 | 40.19 | 40.19 | 40.00 |
| Median | 8.93 | 9.25 | 9.10 | 40.50 | 40.50 | 39.25 |
| U.S. Gas Distributors ⁷ | | | | | | |
| Average of all Rate Cases Decided in the Year | 9.68 | 9.78 | 9.48 | 50.60 | 51.25 | 50.60 |
| Median of all Rate Cases Decided in the Year | 9.72 | 9.78 | 9.28 | 50.38 | 51.90 | 50.48 |
| Canadian Electric Distributors ² | | | | | | |
| ATCO Electric Ltd. ³ | 8.30 | 8.30 | 8.30 | 38.00 | 38.00 | 38.00 |
| ENMAX Power Corporation ³ | 8.30 | 8.30 | 8.30 | 40.00 | 40.00 | 40.00 |
| EPCOR Distribution Inc. ³ | 8.30 | 8.30 | 8.30 | 40.00 | 40.00 | 40.00 |
| FortisAlberta Inc. ³ | 8.30 | 8.30 | 8.30 | 40.00 | 40.00 | 40.00 |
| FortisBC Inc. | 9.15 | 9.15 | 9.15 | 40.00 | 40.00 | 40.00 |
| Hydro-Québec Distribution | 6.19 | 8.20 | 8.20 | 35.00 | 35.00 | 35.00 |
| Manitoba Hydro | * N/A | N/A | N/A | 25.00 | 25.00 | 25.00 |
| Maritime Electric Company Limited | 9.75 | 9.75 | 9.75 | 43.50 | 43.10 | 41.90 |
| Newfoundland and Labrador Hydro ⁸ | 4.47 | Pending | Pending | 20.00 | Pending | Pending |
| Newfoundland Power Inc. | 8.80 | 8.80 | 8.80 | 45.00 | 45.00 | 45.00 |
| Nova Scotia Power Inc. | 9.00 | 9.00 | 9.00 | 37.50 | 37.50 | 37.50 |
| Ontario's Electric Distributors ⁴ | 8.98 | 9.36 | 9.30 | 40.00 | 40.00 | 40.00 |
| Saskatchewan Power Corporation | 8.50 | 8.50 | 8.50 | 40.00 | 40.00 | 40.00 |
| Average | 8.17 | 8.72 | 8.72 | 37.23 | 38.63 | 38.53 |
| Median | 8.40 | 8.50 | 8.50 | 40.00 | 40.00 | 40.00 |
| U.S. Electric Distributors ⁷ | | | | | | |
| Average of all Rate Cases Decided in the Year | 10.02 | 9.75 | 9.66 | 49.25 | 50.57 | 51.81 |
| Median of all Rate Cases Decided in the Year | 9.90 | 9.75 | 9.72 | 50.84 | 50.14 | 51.43 |

**Authorized Return on Equity
for Canadian and U.S. Gas and Electric Utilities**

| | Return on Common Equity (%) | | | Common Equity Ratio (%) | | |
|--|-----------------------------|------|------|-------------------------|-------|-------|
| | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 |
| Canadian Electric Transmission Companies ² | | | | | | |
| AltaLink Management Ltd. ³ | 8.30 | 8.30 | 8.30 | 36.00 | 36.00 | 36.00 |
| ATCO Electric Ltd. ³ | 8.30 | 8.30 | 8.30 | 36.00 | 36.00 | 36.00 |
| ENMAX Power Corporation ³ | 8.30 | 8.30 | 8.30 | 36.00 | 36.00 | 36.00 |
| EPCOR Transmission Inc. ³ | 8.30 | 8.30 | 8.30 | 36.00 | 36.00 | 36.00 |
| Hydro One Networks Inc. | 8.93 | 9.36 | 9.30 | 40.00 | 40.00 | 40.00 |
| Hydro-Québec TransÉnergie | 6.41 | 8.20 | 8.20 | 30.00 | 30.00 | 30.00 |
| Average | 8.09 | 8.46 | 8.45 | 35.67 | 35.67 | 35.67 |
| Median | 8.30 | 8.30 | 8.30 | 36.00 | 36.00 | 36.00 |

| Economic Indicators (% Yields) ⁹ | 2013 | 2014 | 2015 |
|--|-------------|-------------|-------------|
| Government of Canada Benchmark Long-Term Bond Yield | 2.82 | 2.77 | 2.05 |
| U.S. Treasury 30-Year Bond Yield | 3.45 | 3.34 | 2.55 |
| Bloomberg Fair Value Canada A-rated Utility Bond Yield | 4.24 | 4.14 | 3.50 |
| Moody's A-rated Utility Bond Index (U.S.) | 4.48 | 4.27 | 3.67 |



NOTES

1. Data for an expanded group of Canadian gas transmission companies is contained in the Concentric Energy Advisors Return on Equity Database.
2. Allowed in rates for the corresponding year; where the year overlaps, the rate/ratio shown prevails for the majority of the year. Sources: Regulatory decisions and documents; annual information forms; annual reports.
3. The Alberta Utilities Commission's 2015 decision in the Generic Cost of Capital proceeding was retroactive. Returns on common equity and common equity ratios were adjusted for 2013–2015. This also affects the category averages for 2013–2015 as compared to those reported in previous years.
4. Beginning in 2014, the Ontario Energy Board updates cost of capital parameters for setting rates in cost of service applications only once per year.
5. FortisBC Energy (Vancouver Island) Inc. and FortisBC Energy (Whistler) Inc. were amalgamated with FortisBC Energy Inc. and are no longer separate entities in 2015.
6. Union's ROE per settlement agreement in its five-year incentive regulation plan for 2014–2018.
7. Source: SNL Financial LC's Regulatory Research Associates Division. Data for 2015 includes decisions through March 31, 2015.
8. Newfoundland and Labrador Hydro (NLH) filed a General Rate Application (GRA) on July 30, 2013. A decision has not yet been issued on that GRA. The Company subsequently filed a request for interim rates that was denied by the Board in Order No. P.U. 39 (2014), issued September 17, 2014. On November 10, 2014, NLH filed an amended 2013 GRA based on changes to the previous 2014 test year and a new forecasted 2015 test year. That amended GRA remains pending before the Board.
9. Average daily yield. Source: Bloomberg Finance L.P. Data for 2015 through March 31, 2015.

* N/A indicates the data are not available.

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