

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

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Concentric Energy Advisors, Inc. (Concentric) is pleased to publish the second edition of this newsletter. It summarizes 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. Regulators, stakeholders, and analysts in Canada routinely consider allowed returns in other Canadian jurisdictions, and increasingly consider the comparability of Canadian 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.

Concentric observes that the gap between authorized ROEs for Canadian and U.S. gas distributors continues to narrow, from 100 basis points in 2000 to 77 basis points in 2013 and to 35 basis points through the first three months of 2014. In 2013, the median authorized ROE for Canadian gas distributors was 8.93 percent, while the median for U.S. gas distributors was 9.70 percent. The difference also narrowed for electric distributors, but not to the same extent, where a larger gap between Canadian and U.S. distributors remains, 125 basis points in 2013 and 111 basis points in 2014. Concentric notes that gas ROEs are higher than their electric counterparts in Canada, while the opposite is true in the U.S.

Concentric attributes the closure of the gap between Canadian and U.S. authorized ROEs to the resetting and replacement of automatic formulas widely used in Canada to re-based ROE's and revised formulas or periodically litigated ROEs.

While authorized ROEs have converged in the two countries, the authorized common equity ratios have not. In 2013, the median common equity ratio for Canadian gas distributors was 40.5 percent while the same figure in the U.S. was 50.4 percent, comparable to the difference for electric distributors.

In this update, Concentric has added the allowed returns and equity ratios for Canadian electric transmission companies. Median ROEs are identical to those allowed for Canadian electric distributors, but 111–125 basis points below U.S. electric distributors over the 2013–2014 period. Allowed equity ratios

for Canadian electric transmission companies are 3.0 percent lower than their electric distribution counterparts, and 13.0 percent below U.S. distributors.

Canadian utility regulators have issued several important ROE decisions since the first edition of this newsletter in October 2013. For example, in British Columbia, the BCUC set the allowed ROE and deemed equity ratio for the benchmark utility (FortisBC Energy Inc.) in May 2013 and for all other gas and electric utilities in the province in March 2014. The BCUC also decided to return to a formula (subject to government bond yields rising above a specified level). In Québec, the Régie revised the base allowed ROE for Hydro-Québec Distribution and Hydro-Québec TransÉnergie in March 2014 which had previously been set by a formula in place for more than a decade. The Régie further determined that an adjustment formula was not warranted at this time.

In Alberta, the AUC accepted evidence in a generic cost of capital proceeding in January 2014, with hearings scheduled for June and a decision is expected in the fourth quarter of 2014. The AUC will also rule on whether it is appropriate to return to an ROE formula, which was suspended in Alberta in 2009. In Ontario, the Ontario Energy Board's revised ROE formula established in December 1999 remains in effect, but will be subject to its first regular review in 2014. Union Gas recently settled its incentive rate plan, locking in the Board approved 2013 ROE of 8.93 percent for the five-year life of the plan.

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. have been increasing since July 2012. While government bond yields play an important role in determining the authorized ROE for 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 continue to exert upward pressure on the cost of capital for utilities over the next several years.

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

	Return on Common Equity (%)			Common Equity Ratio (%)		
	2012	2013	2014	2012	2013	2014
Canadian Gas Distributors ²						
AltaGas Utilities Inc. ³	8.75	8.75	8.75	43.00	43.00	43.00
ATCO Gas ³	8.75	8.75	8.75	39.00	39.00	39.00
Centra Gas Manitoba Inc.	N/A	N/A	N/A	30.00	30.00	30.00
Enbridge Gas Distribution Inc. ⁴	8.39	8.93	9.36	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.	9.50	8.75	8.75	40.00	38.50	38.50
FortisBC Energy (Vancouver Island) Inc.	10.00	9.25	9.25	40.00	41.50	41.50
FortisBC Energy (Whistler) Inc.	10.00	9.50	9.50	40.00	41.50	41.50
Gaz Métro Limited Partnership	8.90	8.90	8.90	38.50	38.50	38.50
Gazifère Inc.	8.29	7.82	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.	10.15	9.50	9.50	45.00	46.50	46.50
Pacific Northern Gas (N.E.) Ltd. (Fort St. John/Dawson Creek)	9.90	9.25	9.25	40.00	41.00	41.00
Pacific Northern Gas (N.E.) Ltd. (Tumbler Ridge)	10.15	9.50	9.50	40.00	46.50	46.50
SaskEnergy Inc.	8.75	8.75	8.75	37.00	37.00	37.00
Union Gas Limited ⁴	8.54	8.93	8.93	36.00	36.00	36.00
Average	9.46	9.23	9.37	39.66	40.31	40.31
Median	9.50	8.93	9.25	40.00	40.50	40.50

	Return on Common Equity (%)			Common Equity Ratio (%)		
	2012	2013	2014	2012	2013	2014
Canadian Electric Distributors ²						
ATCO Electric Ltd. ³	8.75	8.75	8.75	39.00	39.00	39.00
ENMAX Power Corporation ³	8.75	8.75	8.75	41.00	41.00	41.00
EPCOR Distribution Inc. ³	8.75	8.75	8.75	41.00	41.00	41.00
FortisAlberta Inc. ³	8.75	8.75	8.75	41.00	41.00	41.00
FortisBC Inc.	9.90	9.15	9.15	40.00	40.00	40.00
Hydro-Québec Distribution	6.37	6.19	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	41.70	43.50	43.10
Newfoundland and Labrador Hydro	4.47	4.47	Pending	20.00	20.00	Pending
Newfoundland Power Inc.	8.80	8.80	8.80	45.00	45.00	45.00
Nova Scotia Power Inc.	9.20	9.00	9.00	37.50	37.50	37.50
Ontario's Electric Distributors ⁴	9.12	8.98	9.36	40.00	40.00	40.00
Saskatchewan Power Corporation	7.40	8.50	8.50	40.00	40.00	40.00
Average	8.33	8.32	8.89	37.40	37.54	38.97
Median	8.75	8.75	8.75	40.00	40.00	40.00

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 opened a Generic Cost of Capital proceeding in 2013 to review the current allowed ROE for regulated gas and electric utilities in Alberta.

⁴ Rates effective May 1 under the Board's formula. The ROE proposed for 2014 by Enbridge in its five-year incentive rate filing, July 3, 2013, EB-2012-0459, is 9.27%. Union's 2014 ROE per settlement agreement in its five-year plan. Beginning in 2014, the Ontario Energy Board intends to update cost of capital parameters for setting rates in cost of service applications only once per year.

* N/A indicates the data is not available.

Return on Common Equity (%)			Common Equity Ratio (%)		
2012	2013	2014	2012	2013	2014

Canadian Electric Transmission Companies ¹						
	2012	2013	2014	2012	2013	2014
AltaLink Management Ltd.	8.75	8.75	8.75	37.00	37.00	37.00
ATCO Electric Ltd. ²	8.75	8.75	8.75	37.00	37.00	37.00
ENMAX Power Corporation ²	8.75	8.75	8.75	37.00	37.00	37.00
EPCOR Transmission Inc. ²	8.75	8.75	8.75	37.00	37.00	37.00
Hydro One Networks Inc.	9.42	8.93	9.36	40.00	40.00	40.00
Hydro-Québec TransÉnergie	6.39	6.41	8.20	30.00	30.00	30.00
Average	8.47	8.39	8.76	36.33	36.33	36.33
Median	8.75	8.75	8.75	37.00	37.00	37.00

Return on Common Equity (%)			Common Equity Ratio (%)		
2012	2013	2014	2012	2013	2014

U.S. Gas Distributors ³						
	2012	2013	2014	2012	2013	2014
Average of all Rate Cases Decided in the Year	9.94	9.68	9.54	51.13	50.60	51.14
Median of all Rate Cases Decided in the Year	10.00	9.70	9.60	51.47	50.38	52.30
U.S. Electric Distributors ³						
	2012	2013	2014	2012	2013	2014
Average of all Rate Cases Decided in the Year	10.17	10.02	10.23	50.59	49.25	51.08
Median of all Rate Cases Decided in the Year	10.08	9.90	9.86	51.72	50.84	50.00

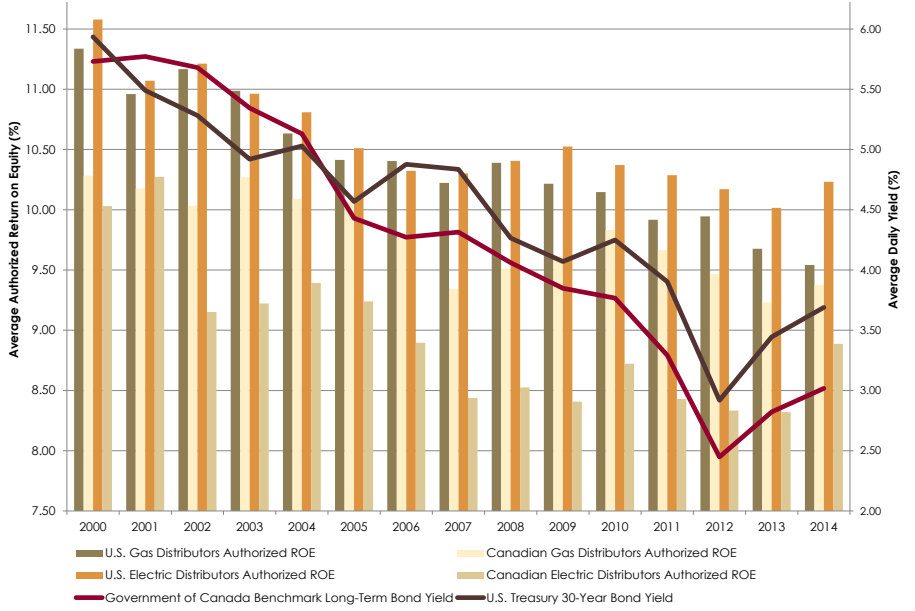
Economic Indicators (% Yields) ⁴			
	2012	2013	2014
Government of Canada Benchmark Long-Term Bond Yield	2.45	2.82	3.02
U.S. Treasury 30-Year Bond Yield	2.92	3.45	3.68
Bloomberg Fair Value Canada A-rated Utility Bond Yield	3.91	4.24	4.36
Moody's A-rated Utility Bond Index (U.S.)	4.13	4.48	4.56

Presented by Concentric Energy Advisors, Inc.
For more information regarding this data, please contact:

Jim Coyne
 Senior Vice President
 Concentric Energy Advisors, Inc.
 jcoyne@ceadvisors.com
 508.263.6255
 www.ceadvisors.com

John Trogonoski
 Senior Project Manager
 Concentric Energy Advisors, Inc.
 jtrogonoski@ceadvisors.com
 508.263.6258
 www.ceadvisors.com

Nathaniel Standish
 Project Manager
 Concentric Energy Advisors, Inc.
 nstandish@ceadvisors.com
 508.263.6259
 www.ceadvisors.com



¹ 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.
² The Alberta Utilities Commission opened a Generic Cost of Capital proceeding in 2013 to review the current allowed ROE for regulated gas and electric utilities in Alberta.
³ Source: SNL Financial LC's Regulatory Research Associates Division. Data for 2014 includes decisions through March 31, 2014.
⁴ Average daily yield. Source: Bloomberg Finance L.P. Data for 2014 through March 31, 2014.