1   Q.   Reference: Cost of Capital: Evidence p. 26-27 and p. 42-43. Based on a
2   March 10, 2003 Consensus Forecast for the long-term government bond
3   yield of on average 5.45% (p. 26 line 30 to p. 27 line 1), a March 2003
4   spread between 10 and 30 year Canadas of 49 basis points (p. 27 lines 1-2),
5   a market risk premium of 6.0 – 6.5% (p. 43 lines 4-5) and electric betas of .60
6   - .65 (Table 8 p. 42), Ms. McShane estimates the equity risk premium for an
7   average Canadian utility at approximately 4.0%. Provide an estimate as of
8   today (July 2003) with all documents relied upon for the estimation, including
9   but not limited to the interest rate forecast relied upon, current beta
10   estimates, and the current spread between 10 and 30 year Canada long
11   bonds.
12
13
14   A.   Given the lower historic market risk premiums resulting from the addition of
15   2002 data, Ms. McShane's estimate of the required market risk premium
16   would be 6.0% (see attached). There would be no change to her 0.60-0.65
17   beta estimates. The indicated risk premium based solely on this form of the
18   equity risk premium test would be 3.75%. The most recent consensus
19   forecast (July 2003), reflecting the recently recognized softness in the
20   economy, anticipates 10-year Canadas at 4.6% in three-months and at 4.9%
21   in 12-months, for an average of 4.75%. The recent spread between 10- and
22   30-year Canadas (daily from June 24, 2003-July 23, 2003) was 62 basis
23   points. The indicated 30-year Canada yield is 5.4%.

**CANADIAN AND U.S. POST-WWII HISTORIC EQUITY
RISK PREMIUMS**

Canada
(1947-2002)

Average	Stock Return	Bond Return	Risk Premium
Arithmetic	11.8	6.8	5.0
Compound	10.6	6.4	4.2

United States
(1947-2002)

Average	Stock Return	Bond Return	Risk Premium
Arithmetic	13.0	6.3	6.7
Compound	11.7	5.8	5.9

Source: Canadian Institute of Actuaries, Report on Canadian Economic Statistics;
Ibbotson Associates, Stocks, Bonds, Bills and Inflation.