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Maureen Howe is an associate of an insider  
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pipelines and utilities sector.

## Energy Infrastructure

### 2006 Allowed ROEs Still Expected to Negatively Impact EPS Estimates

#### Event

2006 allowed ROEs that will be set using bond yield forecasts from the November issue of *Consensus Forecasts* are expected to decline.

#### Investment Opinion

- **Formula-Based ROEs Set to Decline Significantly in 2006.** In our *ROE Outlook for 2006* report dated October 26, 2005, we calculated that 2006 allowed ROEs using the October issue of *Consensus Forecasts* would decline significantly. The November issue of *Consensus Forecasts* is the actual issue used to set the National Energy Board (NEB) Multi-Pipeline ROE, the British Columbia Utilities Commission (BCUC) Generic ROE and the Alberta Energy and Utilities Board (AEUB) Generic ROE. Based on the November data, we expect the allowed ROEs determined by the three formulas to decline by approximately 57 basis points to 76 basis points (depending on the formula), which is in line but slightly lower than our previous forecast.
- **Summary of Changes from 2005 to 2006.** Based on the November data, we expect the following changes for 2006 compared to 2005:
  - **NEB Multi-pipeline ROE.** Decline to 8.89% from 9.46% (↓57bp).
  - **BCUC Utility ROE.** Decline to 8.27% from 9.03% (↓76bp).
  - **AEUB Generic ROE.** Decline to 8.93% from 9.50% (↓57bp).
  - **Newfoundland Power ROE.** Decline to 8.77% from 9.24% (↓47bp).
- **EPS Estimates Already Anticipate Decline in 2006 ROEs.** In our *ROE Outlook for 2006* report, we reduced the earnings estimates for a number of companies in our coverage universe based on our calculations using October data. Given that the November data was not significantly different than the October data, the impact to our earnings forecasts is minimal. As such, we have left our EPS estimates unchanged. Exhibit 4 sets out the companies with major operations that are affected by the ROE formulas that are set using the November data in *Consensus Forecasts*, our estimates of the affected rate bases and our forecast EPS impact of the declines.
- **Alberta PPAs Determined at End of November.** The calculation of the allowed ROE for Alberta Power Purchase Arrangements (PPAs) is based on a calculation averaged over the months of September, October and November. As such, the data will not be available until the end of November.

## Details

In our *ROE Outlook for 2006* report dated October 26, 2005, we calculated that 2006 allowed ROEs using the October issue of *Consensus Forecasts* would decline significantly. The November issue of *Consensus Forecasts* is the actual issue used to set the National Energy Board (NEB) Multi-Pipeline ROE, the British Columbia Utilities Commission (BCUC) Generic ROE and the Alberta Energy and Utilities Board (AEUB) Generic ROE.

In Canada, most allowed ROEs are set by formulas based on either actual or forecast bond yields. Many regulators use forecast yields derived from *Consensus Forecasts*, published by London-based Consensus Economics Inc. When we published our *ROE Outlook for 2006*, the 10-year Government of Canada (GOC) bond yield forecast 3-months forward was 4.20% and the 10-year GOC forecast 12-months forward was 4.60%, for an average of 4.40%. In the November 2005 issue, the forecast 10-year GOC bond yield 3-months forward rose to 4.40% and the 10-year GOC forecast 12-months forward rose to 4.70%, for an average of 4.55%, which is an increase of 15 basis points from October 2005.

Exhibits 1, 2 and 3 summarize the formulas used to derive the allowed ROEs for 2006 for the NEB Multi-Pipeline ROE formula, BCUC Generic ROE formula and the AEUB Generic ROE formula.

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### Exhibit 1: Estimated 2006 NEB Multi-Pipeline ROE

#### NEB 2006E ROE Calculation

Consensus economic forecast 10-yr bond yield (3 Months Out)	4.40%
Consensus economic forecast 10-yr bond yield (12 Months Out)	4.70%
Average	4.55%
Add: average basis point spread between 10-year and 30-year GOC bond	0.24%
2006 Forecast of the 30-year Government of Canada bond yield	4.79%
2005 Forecast of the 30-year Government of Canada bond yield	5.55%
Difference between 2006 forecast and 2005 bond yield	-0.76%
Adjustment Factor	0.75
	-0.57%
2005 ROE	9.46%
<b>2006 Forecast ROE</b>	<b>8.89%</b>

Source: Consensus Economics Inc., Bloomberg, NEB, RBC Capital Markets estimates

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### Exhibit 2: Estimated 2006 BCUC Generic ROE

#### BCUC 2006E ROE Calculation

Consensus economic forecast 10-yr bond yield (3 Months Out)	4.40%
Consensus economic forecast 10-yr bond yield (12 Months Out)	4.70%
Average	4.55%
Add: average basis point spread between 10-year and 30-year GOC bond	0.22%
2006 Forecast of the 30-year Government of Canada bond yield	4.77%
Base 30-year Government of Canada bond yield	6.00%
Difference between 2006 and 6% base forecast	-1.23%
Adjustment Factor (100% when GOC 30-year yield estimate <= 6% and 80% when >6%)	1.00
	-1.23%
Base ROE	9.50%
<b>2006 Forecast ROE</b>	<b>8.27%</b>

Source: Consensus Economics Inc., Bloomberg, BCUC, RBC Capital Markets estimates

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**Exhibit 3: Estimated 2006 AEUB Multi-Pipeline ROE****AEUB 2006E ROE Calculation**

Consensus economic forecast 10-yr bond yield (3 Months Out)	4.40%
Consensus economic forecast 10-yr bond yield (12 Months Out)	4.70%
Average	4.55%
Add: average basis point spread between 10-year and 30-year GOC bond	0.24%
2006 Forecast of the 30-year Government of Canada bond yield	4.79%
2005 Forecast of the 30-year Government of Canada bond yield	5.55%
Difference between 2006 forecast and 2005 bond yield	-0.76%
Adjustment Factor	0.75
	-0.57%
2005 ROE	9.50%
2006 Forecast ROE	8.93%

Source: Consensus Economics Inc., Bloomberg, AEUB, RBC Capital Markets estimates

**NEWFOUNDLAND POWER**

The Board of Commissioners of Public Utilities in Newfoundland and Labrador (PUB) has adopted an ROE formula that is based on actual historical yields observed in the bond market for Newfoundland Power. An automatic adjustment formula is used to determine the annual permitted rate of return on rate base. In the absence of a rate decision by the PUB, Newfoundland Power's allowed ROE generally changes only if the return on rate base calculated by the automatic adjustment formula moves outside of the approved range. The automatic adjustment formula uses the observed yields for the three most recent series of long-term GOC bonds during the last five trading days of October and the first five trading days of November in each year of operation of the formula.

Based on this data, we calculate that the automatic adjustment formula results in an ROE of 8.77%, compared to our earlier estimate of 8.72%. As this is still below the current approximate allowed range of 8.95% to 9.75%, we expect Newfoundland Power's allowed ROE to decline from 9.24% for 2005 to 8.77% for 2006 with a new approximate allowed range of about 8.35% to 9.20%. We expect this allowed range to remain in place until actual long-term GOC bond yields increase above 4.85% or decrease below 3.80%.

**ESTIMATED EARNINGS IMPACT IN LINE WITH OUR FORECASTS**

In our *ROE Outlook for 2006* report, we calculated that 2006 allowed ROEs using the October issue of *Consensus Forecasts* would decline significantly. Based on these calculations, we reduced the earnings estimates for a number of companies in our coverage universe at that time. Given that the November data was not significantly different than the October data, the impact to our earnings forecasts is minimal – in each case, 1 cent per share or less. As such, we have left our EPS estimates unchanged. Exhibit 4 sets out the companies with major operations that are affected by the ROE formulas that are set using the November data in Consensus Forecasts, our estimates of the affected rate bases and our forecast EPS impact of the declines.

## Exhibit 4: Forecast EPS Sensitivity (In \$MM except per share figures)

Company	2005 ROE	Estimated 2006 ROE (if set today)	Chng. In ROE	Est. Ratebase Impacted by Change	Deemed Equity	Deemed Equity	Earnings Impact	EPS Impact	As a percentage
<b>Canadian Utilities</b>									
PPAs	9.49%	8.74%	-0.75%	\$1,036	45.00%	\$466	(\$3.5)	(\$0.028)	
ATCO Electric (Transmission)	9.50%	8.93%	-0.57%	824	33.00%	272	(1.6)	(0.012)	
ATCO Electric (Distribution)	9.50%	8.93%	-0.57%	621	37.00%	230	(1.3)	(0.010)	
ATCO Pipelines	9.60%	na	na	558	43.00%	240	na	na	
ATCO Gas	9.50%	8.93%	-0.57%	1,076	38.00%	409	(2.3)	(0.018)	
Total				\$4,116		\$1,617	(\$8.7)	(\$0.068)	-3.25%
<b>ATCO</b>									
ROE exposure through 51.8% interest in Canadian Utilities (see above)								(\$0.075)	-3.10%
<b>Enbridge</b>									
Line 9 and non-routine adjustments	9.46%	8.89%	-0.57%	\$242 <sup>1</sup>	41.00%	\$99	(\$0.6)	(\$0.002)	
Norman Wells	9.46%	8.89%	-0.57%	139	55.00%	76	(0.4)	(0.001)	
Enbridge Gas Distribution	9.57%	8.71%	-0.86%	3,562	35.00%	1,247	(10.7)	(0.032)	
Noverco preferred shares	9.59%	8.81%	-0.78%	182	na	182	(1.4)	(0.004)	
Total				\$3,942		\$1,422	(\$13.1)	(\$0.039)	-2.34%
<b>Fortis</b>									
Newfoundland Power	9.24%	8.77%	-0.47%	\$760	45.00%	\$342	(\$1.6)	(\$0.016)	
Maritime Electric	10.25%	Note (2)		222 <sup>2</sup>	40.00% <sup>2</sup>	89	na	na	
Fortis Alberta	9.50%	8.93%	-0.57%	704	37.00%	260	(1.5)	(0.014)	
Fortis B.C.	9.43%	8.67%	-0.76%	676	40.00%	271	(2.1)	(0.020)	
Total				\$2,363		\$962	(\$5.1)	(\$0.050)	-4.05%
<b>Pembina Pipeline Income Fund</b>									
Alberta Oil Sands Pipeline (AOSPL) <sup>3</sup>	9.46%	8.89%	-0.57%	\$289	38.00%	\$110	(\$0.6)	(\$0.006)	-0.51%
<b>Terasen</b>									
Terasen Gas	9.03%	Restricted			33.00%			Restricted	
Terasen Gas Vancouver Island (TGVI)	9.53%	Restricted			35.00%				
Total				\$0		\$0			
<b>TransCanada</b>									
Mainline	9.46%	8.89%	-0.57%	\$7,523	36.00%	\$2,708	(\$15.4)	(\$0.032)	
Alberta System	9.50%	8.93%	-0.57%	4,249	35.00%	1,487	(8.5)	(0.017)	
BC System	9.46%	8.89%	-0.57%	203	30.00%	61	(0.3)	(0.001)	
TQM	9.46%	8.89%	-0.57%	206	30.00%	62	(0.4)	(0.001)	
Foothills Alta	9.46%	8.89%	-0.57%	616	30.00%	185	(1.1)	(0.002)	
Total				\$12,797		\$4,503	(\$25.7)	(\$0.052)	-2.95%

## Notes:

(1) Includes rate base for Line 9 and non-routine adjustments (except SEP II).

(2) There is no formula ROE mechanism.

(3) Measured impact is Adjusted Cash Flow from Operations (ACFFO), not earnings.

Source: Bank of Canada; Consensus Economics; various regulatory decisions; company reports; RBC Capital Markets estimates

## Companies Mentioned

Canadian Utilities (TSX: CU.NV, \$ 45.00, Outperform, Average Risk)

ATCO Ltd. (TSX: ACO.NV.X, \$41.50, Sector Perform, Above Average Risk)

Enbridge Inc. (TSX: ENB, \$35.91, Outperform, Average Risk)

Fortis (TSX: FTS, \$25.25, Outperform, Average Risk)

Pembina Pipeline Income Fund (TSX: PIF.UN, \$13.89, Sector Perform, Average Risk)

Terasen - Restricted

TransCanada Corporation (TSX: TRP, \$35.63, Outperform, Average Risk)

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