$\frac{1}{2}$	Q.	Evidence of Ms. McShane Page 60		
2 3 4 5 6		(a)	With reference to experienced returns on utilities, please indicate whether or not these returns would be higher or lower if allowed ROEs were systematically set too high and too low?	
7 8 9		(b)	Please estimate these experienced returns for the two sub periods 1956 (1947)-1981 and 1982-2008 and whether in her judgement the "risk premium" are the same in both periods.	
10 11 12 13		(c)	Please discuss any differences and why such estimates are not circular in reflecting previous regulatory decisions.	
14 15 16		(d)	Please indicate any Canadian regulator which has explicitly placed any reliance on such experienced returns.	
17 18 19 20 21	A.	(a)	Either is a theoretical possibility. If either were true, the implication would be that regulators in both Canada and the U.S. have consistently over-estimated or under-estimated a fair and reasonable return on average over the entire period for which the returns were estimated (1947/1956-2008).	
22 23 24		(b)	The experienced returns are provided in Attachment A. The achieved risk premiums are not the same in the two sub-periods.	
25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40		(c)	The most significant differences between the two periods are: (1) the differences in bond total returns and (2) the levels of equity returns achieved by the U.S. electric utility sector. All of the market-based tests as applied to utilities entail some circularity because the inputs (e.g., prices and changes in prices, growth expectations, actual returns) reflect some reaction on the part of investors to what returns regulators have set or what returns they expect regulators to set. The advantage of this test is that it provides a direct estimate of the utility expected return. Achieved market returns generally may differ from what investors had expected. More stable sectors of the market are more likely to have actual returns that are closer to what investors had expected. As utilities are relatively low risk equity investments, the expected and actual returns are more likely to converge over the long-run than those of more volatile sectors, and thus provide a better estimate of the expected utility risk premium than a CAPM or CAPM-like risk premium test, which requires that utility specific expected returns be inferred from those of the overall market.	
41 42 43		(d)	The BCUC gave weight to this test as applied to Canadian utilities in its March 2006 cost of capital decision for Terasen Gas and Terasen Gas (Vancouver Island).	

Historic Utility Equity Risk Premiums

Canada (1956-1981)						
Utilities Index Return	Bond Total Return	Risk Premium				
11.5	3.1	8.4				
Utilities Index Return	Bond Income Return	Risk Premium				
11.5	7.4	4.1				
	United States (1947-1981)					
S&P/Moody's						
Electric Index Return	Bond Total Return	Risk Premium				
8.8	2.3	6.5				
S&P/Moody's						
Electric Index Return	Bond Income Return	Risk Premium				
8.8 S&P / Moody's Gas	5.0	3.8				
Distribution Index Return	Bond Total Return	Risk Premium				
11.5	2.3	9.2				
S&P / Moody's Gas						
Distribution Index Return	Bond Income Return	Risk Premium				
11.5	5.0	6.5				

HISTORIC UTILITY EQUITY RISK PREMIUMS

.

Notes:

The Canadian Utilities Index is based on the Gas/Electric Index of the TSE 300 (from 1956 to 1987) and on the S&P/TSX Utilities Index from 1988-2008.

The S&P/Moody's Electric Index reflects S&P's Electric Index from 1947 to 1998 and Moody's Electric Index from 1999 to 2001. The 2002 to 2008 data were estimated using simple average of the prices and dividends for the utilities included in Moody's Electric Index as of the end of 2001. These utilities include American Electric Power, Centerpoint Energy, CH Energy, Cinergy, Consolidated Edison, Constellation, Dominion Resources, DPL, DTE Energy, Duke Energy, Energy East, Exelon, FirstEnergy, IDACORP, Nisource, OGE Energy, Pepco Holdings, PPL, Progress Energy, Public Service Enterprise Grp., Southern Co., Teco and Xcel Energy.

The S&P/Moody's Gas Distribution Index reflects S&P's Natural Gas Distributors Index from 1947 to 1984, when S&P eliminated its gas distribution index. The 1985-2001 data are for Moody's Gas index. The index was terminated in July 2002. The 2002-2008 returns were estimated using simple averages of the prices and dividends for the utilities that were included in Moody's Gas Index as of the end of 2001. These LDCs include AGL Resources, Keyspan Corp., Laclede Group, Northwest Natural, Peoples Energy and WGL Holdings.

Source: Ibbotson Associates, Stocks, Bonds, Bills and Inflation: 2009 Yearbook ;

Ibbotson Associates, *Canadian Risk Premia Over Time Report 2008*; Canadian Institute of Actuaries *Report on Canadian Economic Statistics 1924-2006*; www.standardandpoors.com, *TSX Review* Mergent Corporate News Reports, www.federal reserve.com

Canada (1982-2008)						
Utilities Index Return	Bond Total Return	Risk Premium				
12.4	12.4	0.0				
Utilities Index Return	Bond Income Return	Risk Premium				
12.4	8.2	4.2				
	United States (1982-2008)					
S&P/Moody's						
Electric Index Return	Bond Total Return	Risk Premium				
13.4	12.2	1.2				
S&P/Moody's						
Electric Index Return	Bond Income Return	<u>Risk Premium</u>				
13.4 S&R / Meedyle Cap	7.3	6.1				
Distribution Index Return	Bond Total Return	Risk Premium				
12.8	12.2	0.6				
S&P / Moody's Gas						
Distribution Index Return	Bond Income Return	Risk Premium				
12.8	7.3	5.5				

HISTORIC UTILITY EQUITY RISK PREMIUMS

.

Notes:

The Canadian Utilities Index is based on the Gas/Electric Index of the TSE 300 (from 1956 to 1987) and on the S&P/TSX Utilities Index from 1988-2008.

The S&P/Moody's Electric Index reflects S&P's Electric Index from 1947 to 1998 and Moody's Electric Index from 1999 to 2001. The 2002 to 2008 data were estimated using simple average of the prices and dividends for the utilities included in Moody's Electric Index as of the end of 2001. These utilities include American Electric Power, Centerpoint Energy, CH Energy, Cinergy, Consolidated Edison, Constellation, Dominion Resources, DPL, DTE Energy, Duke Energy, Energy East, Exelon, FirstEnergy, IDACORP, Nisource, OGE Energy, Pepco Holdings, PPL, Progress Energy, Public Service Enterprise Grp., Southern Co., Teco and Xcel Energy.

The S&P/Moody's Gas Distribution Index reflects S&P's Natural Gas Distributors Index from 1947 to 1984, when S&P eliminated its gas distribution index. The 1985-2001 data are for Moody's Gas index. The index was terminated in July 2002. The 2002-2008 returns were estimated using simple averages of the prices and dividends for the utilities that were included in Moody's Gas Index as of the end of 2001. These LDCs include AGL Resources, Keyspan Corp., Laclede Group, Northwest Natural, Peoples Energy and WGL Holdings.

Source: Ibbotson Associates, Stocks, Bonds, Bills and Inflation: 2009 Yearbook : Ibbotson Associates, Canadian Risk Premia Over Time Report 2008 ; Canadian Institute of Actuaries Report on Canadian Economic Statistics 1924-2006 ; www.standardandpoors.com, TSX Review Mergent Corporate News Reports, www.federal reserve.com