

1 **Q. Re: Modern portfolio theory and efficient markets page 7**

2
3 (a) **Please indicate in view of Mr. Cicchetti' s support of modern portfolio**
4 **theory, efficient markets and beta why he has not presented a cost of**
5 **equity estimate based on the CAPM or any of its variants?**

6
7 (b) **Mr. Cicchetti refers to betas many "documented drawbacks." Please**
8 **provide citations and references in the literature to these**
9 **"documented drawbacks" and why nothing specific is mentioned in**
10 **his testimony.**

11
12 (c) **Has Mr. Cicchetti reviewed the basis for allowing fair ROEs in**
13 **Canada, if so is he aware that in almost all cases they are based on**
14 **estimated fair rates of return from a CAPM or its variants?**

15
16 (d) **Is Mr. Cicchetti aware of RH-1-2008 the most recent decision of the**
17 **National Energy Board that based its recommended award exclusively**
18 **on the CAPM with estimates of approximately 7.4-9.0%.**

19
20 (e) **If Mr. Cicchetti has not reviewed Canadian board decisions in terms**
21 **of estimating the fair rate of return, please explain why the Board**
22 **should place any weight on his evidence.**

23
24
25 A. (a.) Mr. Cicchetti believes the concept of beta is sound in theory but
26 significantly lacking in practice.

27
28 (b.) A comprehensive list would be voluminous. A small listing includes:

29
30 Fama, Eugene and Kenneth French, 2004, "The Capital Asset Pricing
31 Model: Theory and Evidence." *Journal of Economic Perspective*, 18,
32 pp.25-46.

33
34 Levy, R.A., 1971, "On the Short-Term Stationarity of Beta Coefficients."
35 *Fiencial Analysts' Journal*, pp. 55-62.

36
37 Blume, M.E.,1975, "Betas and Their Regression Tendencies." *Journal of*
38 *Finance*, pp.785-796.

39
40 Kryzanowski, L and A. Jalilvand, 1983, "Statistical Tests of the Accuracy
41 of Alternative Forecasts: Some Results for U.S. Utility Betas." *The*
42 *Financial Review*, pp. 319-335.

43
44 Brigham, Eugene and Roy Crum, 1977, "On the Use of the CAPM in
45 Public Utility Rate Cases." *Financial Management*, pp. 7-15.

- 1 Carleton, Willard, 1978, "A Highly Personal Comment on the Use of the
2 CAPM in Public Utility Rate Cases." *Financial Management*, pp. 57-59.
3
4 Fama, Eugene and Kenneth French, 1992, "The Cross-Section of Expected
5 Stock Returns." *Journal of Finance*, pp.427-465.
6
7 Fama, Eugene and Kenneth French, 1993, "Common risk Factors in the
8 Returns on Stocks and Bonds." *Journal of Financial Economics*, 39: pp. 3-
9 56.
10
11 Fama, Eugene and Kenneth French, 1997, "Industry Costs of Equity."
12 *Journal of Financial Economics*, 43: pp.153-193.
13
14 (c.) Mr. Cicchetti has reviewed the basis for allowing ROE's in Canada and
15 agrees.
16
17 (d.) Agreed.
18
19 (e.) Not applicable.