Q. At page 12 Mr. Cicchetti asserts that "equity investors require a risk premium over the cost of debt," please:

(a) Confirm that Mr. Cicchetti is referring to government of Canada debt costs not corporate debt costs, since it is not conceptually correct to compare promised yields with expected rates of return. If not why not.

(b) Confirm that at several times in the past Canadian utility regulators have allowed fair ROEs less than the Government of Canada long term bond yield, since bond yields contain protection from inflation in the yield both in terms of the expected rate of inflation and any inflation risk premium.

(c) Please confirm that the Brigham, Shome and Vinson paper referred to looked at US risk premia and showed that they declined with significant inflation due to the factors mentioned in (13b) above, if not why not.

(d) Please confirm that the idea that equity requires a higher rate of return than Government bond yields is true on an after tax basis. However, with different tax treatment the before personal tax cost of debt can exceed the equity cost.

(e) Given 13(d) above has Mr. Cicchetti done any analysis of the differences in the tax code in Canada between different sources of investment income and whether the tax treatment is the same as in the US as is implicitly assumed by using estimates from the US capital market.

(f) Can Mr Cicchetti confirm that preferred shares in Canada routinely sell on lower yields than equivalent maturity government of Canada debt due to the differential tax treatment despite being unambiguously riskier? If not can he explain in detail why he feels this is not relevant to recommending a fair ROE for a dividend rich utility like Newfoundland Power?

A. (a.) Mr. Cicchetti is not referring solely to Government of Canada debt. The equity of a company is riskier than the debt of a company by definition.

(b.) Confirmed that Canadian regulators have allowed ROE’s less than the Government of Canada long-term bond yield.

(c.) Not confirmed. Brigham, Shome, and Vinson looked at U.S. risk premia and noted the inverse relationship between interest rates and risk premiums. There is nothing in the paper related to allowed Canadian ROE's or the reasons for those allowed Canadian ROE's.

(d.) Confirmed that equity requires a higher rate of return than Government bond yields on an after tax basis. Mr. Cicchetti is not aware of any situation where the before or after tax cost of a utility's debt is greater than the cost of its common equity.

(e.) Mr. Cicchetti reviewed the relevant differences in the tax codes and was fully aware of them when making his recommendation.

(f.) Confirmed.