Q. Reference: Page 2, Lines 25-36 and Lines 30-31:

"... it is important to note that the Company's evidence was prepared at a time when the recession and financial conditions were at their worst." And "If there ever was any case for changing the ROE adjustment mechanism that case has now collapsed."

Can Dr. Booth confirm that financial market conditions can justify changing the ROE adjustment mechanism and indicate what financial market conditions, in his professional opinion, might justify changing the ROE adjustment mechanism?

A. The ROE adjustment formula is based on an 80% adjustment to the current long Canada yield, which means that the utility risk premium changes by 20% of the change in the LTC yield. This means that as the LTC yield drops by 1.0% the utility risk premium increases by 20 bps. Other ROE adjustment formulae use a 75% adjustment which would mean a 25 bps increase in the utility risk premium.

In contrast my fair ROE is determined by:

- The forecast long Canada bond yield
- The market risk premium
- The relative risk of the utility
- A cushion or flotation cost allowance

Whether the 20-25 bps increase in the utility risk premium is fair depends largely on whether or not the combination of the beta and the market risk premium increases the utility risk premium to the same degree as the ROE formula. Given that the relative risk of utilities (betas) has generally been declining, due to increased regulatory protection the main driver of the ROE adjustment mechanism is that decreases in the LTC yield are associated with increases in the market risk premium.

Dr. Booth would regard differences between the forecast LTC changes and the current LTC yield and whether the flotation cost allowance should change generally to be relatively minor factors.

As Dr. Booth shows in his testimony, he generally believes that the ROE adjustment mechanisms have got it right: that declines in LTC bond yields have been associated with increases in the market risk premium.