

1 **Q. Evidence of Ms. McShane, Two factor model, Pages 60-67: Please confirm that Ms.**
2 **McShane is recommending that the Board set an allowed ROE in part based on**
3 **factors she cannot explain since she includes a 2.5% “unexplained” return on her**
4 **model on page 63.**

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6 A. Ms. McShane confirms that the development of the relative risk adjustment, in part,
7 reflects the portion of the utility return that historically has been unexplained by the
8 market or bond return factors. The objective of using a relative risk adjustment is to
9 estimate the expected or required return. Calculated Canadian utility betas have
10 persistently underestimated utility returns; that persistent underestimation needs to be
11 recognized. The explicit recognition of the value of the intercept in the equation
12 demonstrates the utility risk premium is approximately 0.75 of the market risk premium,
13 much closer to the adjusted than to the raw betas.