Q. Evidence of Dr. Vander Weide: Fair rate of return standard Pages 6-10: Dr. Vander Weide (A15) discusses why economists measure the cost of capital based on market values and states that "the historic book value is entirely irrelevant." Is this why he does not present comparable earnings evidence of the type developed by Ms. McShane?

A. No. Dr. Vander Weide's discussion of the fair rate of return standard explains: (1) why economists measure the cost of equity, cost of debt, and capital structure based on market values; and (2) why investors will not have an opportunity to earn a fair return on capital if market values are used to measure the regulated company's cost of equity, and book values are used to measure the equity component of the regulated company's rate base. Although Dr. Vander Weide only presents cost of equity evidence based on market values, he agrees with Ms. McShane's testimony (page 83):

> The comparable earnings test, which measures returns in relation to book value, is the only test that can be directly applied to the equity component of an original cost rate base without an adjustment to correct for the discrepancy between book values and current market values. Neither the equity risk premium results nor the DCF results, if left without adjustment, recognizes the discrepancy. The 50 basis point financing flexibility adjustment that has typically been adopted by Canadian regulators only minimally addresses the discrepancy.