Q. Vander Weide Evidence (page 39) – For his CAPM analysis, Dr. Vander Weide refers to an Ibbotson SBBI 6.6 percent risk premium on the market portfolio, which is stated to be measured from the difference between the return on the S&P 500 and the income on 20 year treasury bonds. Why would the risk premium derived from the general group of firms in the S&P 500 (6.6%) be less than the required equity risk premium on an equity investment in much safer utility stocks as derived by Dr. Vander Weide's Ex Post Premium Method – 6.7% (p. 35) and his Ex Ante Risk Premium Estimate – 7.7% for his electric utility group (p. 38) and 8.1% for his natural gas group?

A. With regard to the comparison of the 6.6 percent ex post risk premium result for the S&P 500 and the 6.7 percent average ex post risk premium result for the two Canadian utility groups, there is no way to tell why the results differ. The results simply reflect the average actual ex post risk premiums experienced by investors in these groups over the three different time periods. The data presented in Dr. Vander Weide's written evidence comparing the ex post risk premiums on the Canadian utilities to the ex post risk premium on the S&P/TSX Composite over the 1956 – 2011 and 1983 – 2011 time periods is not affected by a mismatch of data periods, and hence, may be more predicative of expected future returns. Dr. Vander Weide's evidence that Canadian utilities investors have earned more than investors in S&P/TSX Composite over these two periods is consistent with at least three hypotheses: (1) Canadian utilities are more risky than the Consumer Advocate suggests in this interrogatory; (2) the CAPM does not explain the returns that have been generated in the Canadian market place; and (3) the S&P/TSX Composite is a poor surrogate for the market index of all risky Canadian securities. Each of these explanations support the conclusion that Newfoundland Power's current allowed ROE is considerably less than its required ROE.

With regard to the comparison of the 6.6 percent ex post result for the S&P 500 and the two ex ante risk premiums for U.S. utilities, it is also not possible to tell why the forward looking risk premiums for utilities are greater than the ex post returns on the U.S. market index. Because there is no way to tell whether the ex post results understate the "true" required risk premium or the ex ante results overstate the "true" required risk premium, Dr. Vander Weide believes that the Board should consider both the ex post and the ex ante evidence presented in his written evidence.