

1 **Q. Vander Weide Evidence (page 45) – Dr. Vander Weide states that he gives “no**
2 **weight to the results of the CAPM.” In Table 3 – Summary of Cost of Equity results**
3 **he produces the following table:**

4
5 **Summary of Cost of Equity Results**

6

<u>Method</u>	<u>Model Result</u>
Discounted Cash Flow	10.2
Ex Post Risk Premium	9.9
Ex Ante Risk Premium	11.1
Average	10.4

7
8 **Please confirm that the CAPM estimate of 8.05% (based on a risk-free rate of 2.73**
9 **percent, a beta of .73, a market risk premium of 6.6 percent and a fifty basis point**
10 **allowance for flotation costs and financial flexibility – as per Dr. Vander Weide’s**
11 **evidence at p. 40) reduces the average of cost of equity results to 9.8%.**

12
13 A. Dr. Vander Weide confirms that if a CAPM estimate of 8.05 percent is given equal
14 weight with his average DCF, ex post risk premium, and average ex ante risk premium
15 results, the average of these four numbers would be 9.8 percent. However, Dr. Vander
16 Weide notes that he also presented an alternative CAPM estimate of 9.3 percent using a
17 0.92 beta. If one were to use this 9.3 percent CAPM result along with his average DCF,
18 ex post risk premium, and average ex ante risk premium results, the average of these four
19 numbers would be 10.1 percent. In either case, Dr. Vander Weide does not recommend
20 the use of the CAPM at this time for the reasons discussed in his evidence. As he
21 describes there, from his review of the literature, Dr. Vander Weide concludes that the
22 CAPM underestimates the cost of equity for companies with betas significantly less than
23 1.0 and is less reliable the further the estimated beta is from 1.0. From his review of
24 historical risk premiums on utility stocks versus the risk premiums on the market
25 portfolios, Dr. Vander Weide concludes that either: (1) actual utility betas are
26 significantly higher than published historical betas; or (2) the CAPM fails to explain
27 actual utility returns in the marketplace. Thus, Dr. Vander Weide concludes that the cost
28 of equity model results from applying the CAPM should be given little or no weight in
29 estimating Newfoundland Power’s cost of equity in this proceeding.