

1 **Q. Reference pages 29-30: ERP Estimates: Please indicate why Mr. MacDonald would**
2 **base a return for NP at least in part by an index that reflected the internet boom**
3 **and bust and the price behaviour of Nortel?**
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5 *As discussed in Mr. MacDonald's expert report, the Historical method for the ERP*
6 *was selected as it indicates the premium amount by which the selected utility stock*
7 *indices have outperformed bonds for the period under investigation. This provides an*
8 *observed premium which investors in Canadian utilities have earned over an*
9 *investment in a risk free asset. In our professional judgement it is appropriate to use*
10 *the entire period for which the index returns are available as this covers a variety of*
11 *economic cycles and eliminates the difficulty of attempting to select an appropriate*
12 *sub-period. As investment returns are observed to exhibit mean reversion the future*
13 *ERP should tend towards the historical level over time. As such investors in Canadian*
14 *utilities may anchor their return on equity expectations to this observed premium over*
15 *the expected return on the Canadian Long Bond.*
16

17 **A.** Mr. MacDonald notes the Historical ERP references average returns through time. As
18 such the distortion cited is present during both the period of higher and lower equity
19 returns brought on by the internet boom and Nortel.