Q. Pg. 57 - Please explain why the ERP methodology was not used as a primary technique.

A. The "ERP" methodology is not an independent model it is simply a risk premium model. Conceptually you can estimate a risk premium over any security, for example until the early 1990's Dr. Booth estimated risk premiums over preferred share yields since they are taxed on the same basis as common shares so it removes the tax bias of using long Canada bond yields. However, BMO stopped calculating its preferred share index and the rate regulated Telcos Dr. Booth used ceased to be rate regulated.

However, it is dangerous to use a non risk-free security since for bonds the yield is a promised, that is, maximum yield and not an expected yield so an ERP over a corporate bond yield matches apples with oranges.

Further you cannot use actual utility returns since they reflect regulatory lag and the past actions of regulators. That is, in the declining interest rate period experienced since 1981, allowed ROEs have lagged fair market returns leading to an expansion in market to book ratios. As a result, experienced excess utility returns over other securities reflect a failure to lower allowed ROEs, whereas they are used by utility analysts to demonstrate higher risk. However, how a higher stock price and experienced return demonstrates higher utility risk has always been beyond Dr, Booth's understanding!

Note there are only two theoretically sound ways of estimating a fair return: risk premium models and DCF models.