

1 **Q. Opinion on Capital Structure and Return on Equity**  
2 **Kathleen McShane – Volume 3**

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4 **Please confirm that you believe the main reason that the current automatic**  
5 **adjustment formula no longer works is entirely due to current financial market**  
6 **conditions, specifically the significant decline in the risk free rate.**  
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8 A. Ms. McShane's analysis even before the onset of the financial crisis showed that the  
9 utility cost of equity was materially less sensitive to changes in the long-term  
10 Government of Canada bond yield than implied by the 80% sensitivity factor in the  
11 automatic adjustment formula and there was a positive relationship between the spreads  
12 between yields on long-term utility and government bonds. In other words, her analysis  
13 indicated that the formula was not operating properly then. The problems with the  
14 existing formula have been exacerbated by the significant decline in long-term  
15 government bond yields since the end of 2009.