

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

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4 **Do you believe that the current formula would be more reliable in determining a**
5 **fair return on equity if there was a mechanism added which accounted for any**
6 **material sudden drop/increase in the risk free rate?**
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8 A. No. A rapid change in the long-term Canada bond yield could have multiple causes,
9 which may or may not correlate with changes in the cost of equity. In present market
10 circumstances, it is not possible to patch a formula which, in Ms. McShane's view, has
11 been problematic since before the financial crisis, due to the sensitivity of its results to
12 long-term Canada bond yields. Ms. McShane recommends that the use of a formula
13 should remain suspended until interest rates return to more normal levels. At that time,
14 the PUB can reconsider the use of a formula and its appropriate construction.