

1 **Volume 1, Section 3 – Finance**
2

3 **Q. (page 48, line 4 and footnote 12, and Volume 2, Tab 3: Actuarial Valuation of**
4 **Defined Benefit Pension Plan) The discount rate used to present value the**
5 **Company’s defined benefit pension obligations is forecasted to remain at its 2006**
6 **level of 5.25% in 2007 and 2008. Please show how the Company’s actuary**
7 **determined the 5.25% discount rate for 2006 and, in particular, what “equity risk**
8 **premium” the actuary used to forecast the future returns for the equity component**
9 **of the Company’s defined benefit pension plan assets.**

10
11 **A. *Discount Rate***

12 The discount rate used to present value the Company’s defined benefit pension
13 obligations is determined on December 31st each year for the coming year.¹ The
14 discount rate is determined, in accordance with Generally Accepted Accounting
15 Principles ("GAAP"), by reference to high quality AA corporate debt instruments with
16 terms to maturities similar to the duration of the Company’s pension plan obligations.²

17
18 The discount rate determined as of December 31, 2006 and used in the calculation of
19 pension expense for 2007 was 5.25%.³ Market yields on AA corporate debt instruments
20 as of March 31, 2007 were consistent with those as of December 31, 2006. This supports
21 the assumption used in preparing the Company’s prefiled evidence that a 5.25% discount
22 rate continue to be used for purposes of estimating pension expense for 2008.⁴

23
24 ***Equity Risk Premium***

25 The Company’s defined benefit pension plan assets are comprised of investments in
26 equities (approximately 60%) and fixed income, or debt, securities (approximately 40%).
27 The assumption with respect to the long-term return on pension plan assets is determined
28 by management based on best estimates which considers asset mix allocations as well as
29 aggregate historical and expected returns on plan assets.

¹ The measurement date at which the actuarial valuation of the Company’s pension plan is based.

² CICA Handbook, Section 3461.

³ Unchanged from the discount rate used in the calculation of pension expense for 2006, determined as of December 31, 2005.

⁴ The actual discount rate to be used in calculating pension expense for 2008 will not be known until December 31, 2007.