Reference: Volume 3, Cost of Capital Report by James Coyne

Q. Volume 3, Cost of Capital Report by James Coyne, page 80. In Mr. Coyne's opinion are there revisions to the last approved automatic adjustment formula that could be made to appropriately reflect current market conditions and determine a fair return? If yes, explain the revisions and, if not, explain why not?

A. While it might be helpful to include a component in the ROE formula related to changes in utility bond yields, that change would not alleviate the concerns with the low interest rate environment. As discussed in Concentric's report, equity investors consider more than just government and utility bond yields when setting their return requirements. An adjustment formula that is only based on changes in government bond yields will not fully capture all factors that are considered by equity investors. These other factors include, but are not limited to, volatility in stock and bond markets, credit spreads, the risk that inflation may be higher than currently expected, changes in Beta coefficients for utilities, changes in the market risk premium, changes in utility growth rates, and changes in utility valuation levels.