

**DEMANDE DE RENSEIGNEMENT NO 2  
D'HYDRO-QUÉBEC DISTRIBUTION  
À LA FCEI ET À L'UNION DES  
MUNICIPALITÉS DU QUÉBEC**



**INTERROGATORIES FOR DRS. KRYZANOWSKI & ROBERTS**

**Référence: Testimony of Dr. Lawrence Kryzanowski and Dr. Gordon S. Roberts, January 2003**

**Question No.1**

Please provide a list of all the non-telephone utility rate cases in which you have testified on rate of return matters in the last five years. Provide the name of the jurisdiction, the year, the company for which you provided a recommended return on equity, your return on equity recommendation, your common equity ratio recommendation, the return on equity authorized, and the common equity ratio authorized in that case. Please also provide the prevailing yield on long-term Canada bonds at the time of preparing these testimonies.

**Question No.2**

Please provide a list of college-level finance or economics courses you have taught in the last two years or are currently teaching and a list of textbooks/readings used in these courses. If no such courses were taught in the past two years, please provide the same information for the courses last taught.

**Question No.3**

**a)** Is it Drs. Kryzanowski & Roberts' opinion that utility stocks have become less risky, more risky, or as risky as in the past. Is Drs. Kryzanowski & Roberts' response equally applicable to electric, gas, and telephone utilities?

**b)** Is it Drs. Kryzanowski & Roberts' opinion that electric utility stocks have become less risky, more risky, or as risky as natural gas distribution and pipeline utilities?

**Question No.4**

P.32 "ROE for canadian utilities and comparisons with allowed rates of return showed that regulators are typically generous to utilities " Is this comment applicable to all types of utilities?

**Question No.5**

In arriving at your recommended structure of capital of 34% for HQ Distribution what is the relative importance you assigned to the various information available on your sample of canadian utilities:

- Allowed or real equity equity structure
- Gas vs electric utilities
- Credit rating
- Size of the company
- Other info ?

#### **Question No.6**

Since we do not have access to stock guide, can you provide us with the information used in arriving at the % equity data in schedule 3?

#### **Question No.7**

In choosing your sample of 9 utilities to establish your recommendation on capital structure, why did you choose companies such as ATCO and Fortis, but excluded companies such as Gaz Metropolitain, Union Gas ?

#### **Question No.8**

Please discuss how the following factors affect the business risks of Hydro-Québec Distribution:

- i. the characteristics of the Quebec economy (cyclicality, resource sector, growth, etc.)
- ii. HQ Distribution's competitive position vs gas, oil.

#### **Question No.9**

P.30 of your testimony line 21, " Are there any other risks faced by HQ Distribution?" ». You do not mention the risks related to bad receivables. Why?

#### **Question No.10**

Does Drs. Kryzanowski & Roberts's recommended return (ROE) of 8.50% assume the maintenance of Hydro-Quebec's existing capital structure or does it assume Drs. Kryzanowski & Roberts's recommended capital structure? Please state the recommended ROE under both Hydro-Quebec's existing capital structure and the recommended capital structure.

**Question No.11**

P.65 : "For 30 year rolling time period Stocks are less risky than bonds or cash" . In light of this statement, do you think a prudent and knowledgeable investor with a long term view should invest 100% in stocks ?

**Question No.12**

Given the various empirical estimates of the market risk premium summarized on page 141 of Appendix C (2.9%, 4.4%, 3.2%, 3.3%, 4.8%, etc), please explain Drs. Kryzanowski & Roberts's rationale of using a market risk premium of 4.7%. What weight, if any, should be accorded to the market risk premium estimates reported in Appendix C?

**Question No.13**

Please provide the computational details of the beta estimates shown on Schedules 15 and 16. Over what period were they measured? What market index was employed? What holding period returns were used (daily, weekly, monthly)? Are the betas adjusted or unadjusted? If unadjusted, please provide the adjusted betas.

**Question No.14**

Does Drs. Kryzanowski & Roberts agree with the proposition that equity risk premiums tend to increase as bond yields decline and shrink as bond yields rise? If so, why? If not, why not?

**Question No.15**

Do Drs. Kryzanowski & Roberts advocate the use of automatic rate of return adjustment formulas such as the ones reported on Schedule 19. If so, why? If not, why not?

**Question No.16**

Given the gas/electric beta of 0.29 reported for the recent 1991-2000 period, how do Drs. Kryzanowski & Roberts rationalize the use of a beta of 0.50 in their implementation of the CAPM in light of these reported results?

**Question No.17**

Given the average beta of 0.37 for the ten utilities shown in the bottom row of Schedule 16 and the two rolling averages of 0.47 and 0.32, how do Drs. Kryzanowski & Roberts rationalize the use of a beta of 0.50 in their implementation of the CAPM in light of these reported results?

**Question No.18**

Given the recent rolling average beta of 0.34 reported at the bottom right of Schedule 15, how do Drs. Kryzanowski & Roberts rationalize the use of a beta of 0.50 in their implementation of the CAPM?

**Question No.19**

a) Please provide in electronic form the computational details and relevant spreadsheets for the DCF studies shown on Schedules 12 and 13, summarized on Schedule 15.

b) Please provide the results of the same study using earnings growth rather than dividend growth rates.

**Question No.20**

20) Please provide a copy of the document referred to on Page 60 line 2.

**Question No.21**

Please provide a copy of the document referred to on Page 60 footnote 31.

**Question No.22**

To what market professionals are Drs. Kryzanowski & Roberts referring to on page 64 lines 10-12? Please provide supporting documentation, relevant literature and empirical studies which support that statement.

**Question No.23**

From the discussion on page 102 lines 1-25, please enumerate the errors and conceptual mistakes referred to in the Brealey & Myers best-selling corporate finance textbook. Please also provide any corrections of such errors in the form of an errata sheet in the aforementioned text insofar as it pertains to the implementation of the CAPM.

**Question No.24**

Please provide the work papers, supporting documentation, relevant literature and empirical studies which support your statement on Page 51 lines 10-12 that the use of the geometric average is becoming conventional wisdom.

**Question No.25**

Please provide the work papers, supporting documentation, relevant literature and empirical studies which support your statement on Page 56 lines 1-3 that Canadian investors are less risk averse.

**Question No.26**

In the discussion on page 57, is it Drs. Kryzanowski & Roberts's contention that "aggressive accounting" increases or decreases the market risk premium? Please provide a rationale for your answer.

**Question No.27**

On the basis of the historical betas reported on Schedules 15 and 16, are we to conclude that the risks of Gas/Electrics and Pipeline utilities have decreased substantially in the last decade? Is it Drs. Kryzanowski & Roberts's contention that energy utility stocks have become less risky than in the past?

**Question No.28**

It is not clear on the basis of the statement on page 33 lines 24-29 and on page 34 lines 1 and 2 if Drs. Kryzanowski & Roberts are recommending that the Regie raise HQ Distribution's rates over the medium term so as to bolster financial profitability or if they think on the contrary that rates will not have to be raised because of the "good prospects for higher returns" derived from their analysis of the Strategic Plan. Could you please clarify?

**Question No.29**

From page 34 line 14, how many electricity distribution companies exist in Canada?

**Question No.30**

From Page 6 lines 6-6, please provide support and substantiate Drs. Kryzanowski & Roberts's contention that consumer confidence is strong.

**Question No.31**

Please document the flotation costs incurred in the past by Hydro-Quebec in raising common equity capital.

**Question No.32**

Please provide the currently authorized ROEs and authorized common equity ratios for each of the nine companies listed on Schedule 4.

**Question No.33**

a) Are there any investor-owned or publicly-owned regulated utilities in 1) Canada, 2) in North America with an allowed rate of return on common equity that is equal to, or less than, what Drs. Kryzanowski & Roberts recommend in this proceeding? If so, provide a list of such utilities.

**Question No.34**

a) Are the beta estimates shown on Schedules 15 and 16 and raw (unadjusted) betas?

b) If unadjusted betas are reported, please show the results of Schedules 15 and 16 using adjusted betas. using the standard definition of Adjusted Beta (Adjusted Beta = 0.3333 + 0.6666 x Raw Beta),

**Question No.35**

Please provide a summary of Drs. Kryzanowski & Roberts's rate of return on common equity conclusions and recommendations for HQ DISTRIBUTION in the following format:

	<b>Recommendation</b>		
	low	high	
<b>Equity Risk Premium</b>			
Market Risk Premium (MRP)	x	x	x
Relative Risk Adjustment (RRA) to MRP for Risk of HQ Distribution		x	x
Equity Risk Premium for HQ Distribution (MRP x RRA)			x
Long-Canada Yield	x	x	x
Cushion, add-ons, etc.	x	x	x
Total	x	x	x
<b>Overall Recommendation</b>			<b>X</b>