

## RATE OF RETURN ON SHAREHOLDER'S EQUITY



## 1. SUMMARY OF DECISION D-2003-93

1 In the decision D-2003-93, the Régie provides a ruling on the correct formula for  
2 calculating the rate of return on shareholder's equity and its update within the framework  
3 of phase 2. The Régie approves the following equation as the method for calculating the  
4 rate of return on shareholder's equity:

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$$6 \quad K = RF + \beta(RM - RF)$$

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8 Where K is the expected rate of return the Distributor can expect for its investments. The  
9 rate of return is obtained by taking the sum of the risk free rate of return, RF, plus a  
10 premium for having sustained the incurred risk during the activities being undertaken.  
11 The premium is in proportion to the risk being incurred, as shown by beta,  $\beta$ , and in  
12 proportion to the risk awarded by the market,  $RM - RF$ , for a diversified portfolio.

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14 The Régie specifically requests the Distributor to take into account the following  
15 elements:

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- 17 • In the calculation of the risk free rate of return, the Distributor must from now  
18 on use the method suggested by the Régie, namely:
  - 19 ○ The no risk rate of return is calculated by taking the mid-point of the  
20 three month and twelve month forecasts of the Canadian ten year bond  
21 rate and adding the average of the daily spread between the 10 year  
22 and 30 year Canadian bond rates;

1                   ○ The realization of the no risk rate is to be determined using financial  
2                   forecast of Consensus Forecasts issued in the month preceding the  
3                   filing of evidence.

- 4                   • The  $\beta$  factor is set at 0.55;  
5                   • The market premium is set at 6.19%.

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## **2. Shareholder's equity Rate of Return**

7 Table 1 summarizes the results obtained for the two historic years (if one supposes that  
8 decision D-2003-93 applies to the year 2001), the 2003 base year and the projected year  
9 2004. It is to be noted that the  $\beta$  factor and the risk premium have been fixed for the  
10 analysis period, the Regie having ruled that it is not for the Distributor to present new  
11 detailed evidence on shareholder's equity rate of return.

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13 Recognizing The Regie final decision, the shareholder's equity rate of return requested  
14 by the Distributor for the base year and the projected year equals 8.712%.

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**Table 1**

| <b>Calculation of Approved Rate of Return on shareholder's equity</b> |                |               |               |                |
|---|----------------|---------------|---------------|----------------|
|   | Historic Years |               | Base Year     | Projected Year |
|   | 2001           | 2002          | 2003          | 2004           |
| <b>Risk free rate of return</b>                                       | <b>6.00%</b>   | <b>6.00%</b>  | <b>5.307%</b> | <b>5.307%</b>  |
| Average 10 year Canadian bond rate                                    | N/A            | N/A           | <b>4.750%</b> | <b>4.750%</b>  |
| Three month forecast  |                |               | 4.600%        | 4.600%         |
| Twelve month forecast   |                |               | 4.900%        | 4.900%         |
| Daily spreads in monthly average                                      | N/A            | N/A           | <b>0.557%</b> | <b>0.557%</b>  |
| 10 year Canadian bond rates   |                |               | 4.939%        | 4.939%         |
| 30 year Canadian bond rates   |                |               | 4.382%        | 4.382%         |
| <b>Risk premium</b>   | 3.405%         | 3.405%        | 3.405%        | 3.405%         |
| Market premium  | 6.190%         | 6.190%        | 6.190%        | 6.190%         |
| β factor  | 0.55           | 0.55          | 0.55          | 0.55           |
| <b>Shareholder's equity's Rate of Return</b>                          | <b>9.405%</b>  | <b>9.405%</b> | <b>8.712%</b> | <b>8.712%</b>  |
| (1) : Consensus Forecasts, July 14, 2003                              |                |               |               |                |

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3 The calculation of the risk free rate of return is based on the July 14, 2003 Consensus  
 4 Forecasts data, filed one month before the Regie's decision. Table 2 shows the average  
 5 daily differences of the 10 year and 30 year published Canadian bond Rates.

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7 Lacking a specific method, the calculation of the risk free rate for the base year 2003 was  
 8 made on the same basis as that of the year 2004. The rate derived for 2004 is quite  
 9 comparable to the rate observed in 2003.

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Table 2

| Daily Differences between the 10 and 30 Year Canadian Bond Rate For the Month of June 2003 |               |             |  |              |
|--|---------------|-------------|--|--------------|
|  | Bond Rate (%) |             |  | Differential |
|  | 30 Year       | 10 Year     |  |              |
| 2-Jun-03   | 5.0203        | 4.528       |  | 0.4923       |
| 3-Jun-03   | 4.9653        | 4.4479      |  | 0.5174       |
| 4-Jun-03   | 4.9638        | 4.4331      |  | 0.5307       |
| 5-Jun-03   | 4.9628        | 4.4265      |  | 0.5363       |
| 6-Jun-03   | 4.9438        | 4.3869      |  | 0.5569       |
| 9-Jun-03   | 4.8848        | 4.3031      |  | 0.5817       |
| 10-Jun-03  | 4.8263        | 4.2257      |  | 0.6006       |
| 11-Jun-03  | 4.8468        | 4.2581      |  | 0.5887       |
| 12-Jun-03  | 4.8048        | 4.2065      |  | 0.5983       |
| 13-Jun-03  | 4.7347        | 4.1134      |  | 0.6213       |
| 16-Jun-03  | 4.8062        | 4.2163      |  | 0.5899       |
| 17-Jun-03  | 4.8972        | 4.3217      |  | 0.5755       |
| 18-Jun-03  | 4.9372        | 4.3613      |  | 0.5759       |
| 19-Jun-03  | 4.954         | 4.3832      |  | 0.5708       |
| 20-Jun-03  | 4.9915        | 4.4403      |  | 0.5512       |
| 23-Jun-03  | 4.9848        | 4.3839      |  | 0.6009       |
| 24-Jun-03  | 4.9275        | 4.3739      |  | 0.5536       |
| 25-Jun-03  | 5.028         | 4.4815      |  | 0.5465       |
| 26-Jun-03  | 5.0835        | 4.5734      |  | 0.5101       |
| 27-Jun-03  | 5.1105        | 4.5937      |  | 0.5168       |
| 30-Jun-03  | 5.057         | 4.5501      |  | 0.5069       |
| <b>Average</b>   | <b>4.94</b>   | <b>4.38</b> |  | <b>0.56</b>  |

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