DEMANDE DE RENSEIGNEMENTS N° 1 DE GAZIFÈRE : DEMANDE RELATIVE AU RENOUVELLEMENT DU MÉCANISME INCITATIF, À LA FERMETURE RÉGLEMENTAIRE DES LIVRES POUR LA PÉRIODE DU 1ER JANVIER 2009 AU 31 DÉCEMBRE 2009, À L'APPROBATION DU PLAN D'APPROVISIONNEMENT POUR L'EXERCICE 2011 ET À LA MODIFICATION DES TARIFS DE GAZIFÈRE INC. À COMPTER DU 1ER JANVIER 2011

PHASE 2 - TAUX DE RENDEMENT

Question 1.0

Preamble: At page 13, Dr. Booth states:

> In total the TSX dropped almost ⅓ over the course of the NEB decision, which may have coloured the NEB's decision to adopt an after tax weighted average cost of capital approach (ATWACC).

Request: What in Dr. Booth's view would be the connection between the state of the capital markets and the decision to adopt the ATWACC model? Does the ATWACC model address the state of the capital markets in a way that the traditional ROE/capital structure approach does not?

Question 2.0

Preamble: At page 13, Dr. Booth indicates that the NEB explained that its ATWACC award was equivalent to a 9.7% ROE on a 40% common equity ratio, where both represented a significant increase and states that "a prime driver in allowing TQM a higher ROE and common equity ratio was increased business risk, which means that drawing comparisons for a benchmark utility is difficult."

Request:

a. Would Dr. Booth confirm that TQM's allowed common equity ratio previously was 30% and its allowed ROE was equal to the NEB's multi-pipeline formula ROE, which was 8.46% and 8.72% in 2007 and 2008 respectively?

b. Does Dr. Booth have an opinion on how much of the increase in the return would be justifiable based on an increase in business risk alone?

c. Given the allowed capital structures of other gas pipelines regulated by the NEB and the multi-pipeline ROEs, is it Dr. Booth's view that the NEB now regards TQM as of significantly higher business risk than, for example, TCPL Mainline or Foothills? Please explain.

Question 3.0

Preamble: At page 15, Dr. Booth states:

The BCUC adjusts for changes in risk in both the common equity ratio and allowed return. In TGI's case this increased risk was a reflection of increasing competition from electricity, increased land claims and the possible implications of the BC government's carbon tax policy.

Request:

a. Does Dr. Booth conclude that the BCUC increased TGI's ROE due to increased risk?

b. If yes, please provide evidence from the BCUC decision that this was the case.

c. If the response to part a is yes, and if the incremental equity risk premium of FortisBC relative to TGI remained unchanged, would this imply that the BCUC also considered that FortisBC's risk had increased?

Question 4.0

Preamble: At page 31, Dr. Booth provides a graph of default spreads.

Request:

a. Please explain what Dr. Booth means by default spread in the context of this graph.

b. Please provide the source of the data provided in the graph and describe the specific indices used to measure the default spreads.

c. Please provide the yields (monthly, if monthly, or weekly if weekly) for each of the indices that were used to calculate the default spreads.

<u>Question 5.0</u>

Preamble: At page 31, lines 13-14, Dr. Booth states: "This 'flight to quality' is a regular part of the business cycle."

Request:

a. During a 'flight to quality' do the yields on long-term government bonds typically decrease? Please explain.

b. When there is a 'flight to quality', does this typically mean that the costs of riskier forms of capital increase? Please explain.

c. If the responses to parts a and b are yes, and the allowed return on equity tracks the yield on long-term government bonds, please explain if, over a business cycle, the allowed return would rise when the cost of equity falls and falls when the cost of equity increases.

<u>Question 6.0</u>

Preamble: At page 34, Dr. Booth provides a graph of yields since January 2008.

Request: What proportion of the A index included on the graph is represented by utility debt issues?

<u>Question 7.0</u>

Preamble: In footnote 18 on page 34, Dr. Booth states: "Note that liquidity in the equity market usually increases during crises as there is more disagreement among investors."

Request: Please explain why liquidity increases when there is more disagreement among investors.

<u>Question 8.0</u>

Preamble: At page 45, lines 21-25, and page 46, lines 1-4, Dr. Booth uses the ratio of standard deviations as a measure of risk.

Request: Would Dr. Booth please explain if it is appropriate to use ratios of standard deviations of both accounting and market returns as measures of risk and if not, why not?

<u>Question 9.0</u>

Preamble: At page 52, Dr. Booth states:

It has been known for some time that the CAPM, when used with Treasury Bill yields as the risk-free rate, tends to give low estimates for certain types of securities, which is partly why for regulatory reasons it is normally used with the long Canada bond yield.

Request:

a. Please explain to which types of securities Dr. Booth is referring.

b. Please provide all evidence of which Dr. Booth is aware that demonstrates that the use of long-term government bonds fully adjusts for the low estimates cited in the preamble.

c. Similarly, please provide all evidence of which Dr. Booth is aware that demonstrates that the use of long-term government bonds does not fully adjust for the low estimates.

Question 10.0

Preamble: At page 52, Dr. Booth states:

> However, this practice caused many of the problems in regulatory awards in the mid 1990s when the long Canada bond yield was so high due to inflation concerns, government deficits and the large risk premium embedded in government bond yields, which did not have a counterpart in the equity market.

Request:

a. Please explain what Dr. Booth means by "problems in regulatory awards".

b. Please specify to what regulatory awards Dr. Booth is referring and over what period of time did the problems referenced persist.

Question 11.0

Preamble: At page 53, lines 10-11, Dr. Booth states: "Overall, I judge utility stocks to have about half the exposure to the equity market as the average stock and half the exposure to the bond market as the long Canada bond."

Request: In light of the above statement that utility stocks have approximately had half the exposure to the bond market as the long Canada bond, please explain how this is consistent with the recommendation that there be a 75% adjustment to changes in the long Canada bond yield in the ROE formula.

Question 12.0

Preamble: At page 54 Dr. Booth states, referring to recent Canadian decisions discussing utility betas: "Of these only that of the BCUC appears to be outside of a reasonable range and probably reflected their view that the business risk of Terasen Gas Inc had increased."

Request: Please provide evidence from that decision which supports the view that the decision regarding beta reflects the view that the business risk of Terasen Gas had increased.

<u>Question 13.0</u>

Preamble: At page 63, lines 7 to 20, Dr. Booth states "if the adjustment coefficient is set at 0.5, the overall required return on the market is independent of the LTC yield, which renders the whole notion of a risk premium over the LTC yield moot."

Request: Please confirm that the conclusion drawn is a function of the assumption that the relevant beta is 0.50. If this cannot be confirmed, please explain why not.

<u>Question 14.0</u>

Preamble: At page 66, footnote 39, Dr. Booth states: I can't find support in the Scotia Capital A yield series to support such low spreads.

Request: Please provide the data for the Scotia Capital A yield series to which Dr. Booth refers.

<u>Question 15.0</u>

Preamble: At page 72, with respect to the histogram and lines 2-9 where Dr. Booth states: "First, many of the lower rated companies are also rated "excellent" in terms of business risk (even some with junk bond ratings) so this is not a main determinant of their bond rating."

Request:

a. Please define "lower rated."

b. How many lower rated companies have excellent business risk profiles?

Question 16.0

Preamble: Appendix B, page 3, lines 25-28.

Request: Please provide a copy of the referenced paper "Report on Canadian Economic Statistics, 1924-2009", March 2010.

Question 17.0

Preamble: In Appendix B, Schedule 8, Dr. Booth provides the result of a regression.

Request: Please provide all data necessary to replicate the regression results presented in Schedule 8.

Question 18.0

Preamble: At page 34, Dr. Booth states, "However, what has to be emphasised is that current A spreads are now under 160 bps, while utility spreads at 130 bps are below corporate A spreads and back to where they were at this stage in the last slowdown and recovery in 2002"

Question: Please provide documentation for the corporate and utility spreads respectively.