Consumers Council of Canada and the Vulnerable Energy Consumers Coalition (CCC) and (VECC) INTERROGATORY #20 List 1

Interrogatory

Ref: B1/T3/S1 p. 48

Issue 4.0
Issue: Cost of Capital/Capital Structure

Topic: Utility return estimate

Request:

a) Please confirm that at a forecast 5% long Canada her yield her utility risk premium estimate implies a utility required rate of return of 9.35-9.50%.

b) Please provide Ms. McShane's estimate for her long run inflation rate and the real rate of return comparable to a) above;

c) Please provide Ms. McShane's estimate of the real rate of return on the TSE300/Composite since 1956 and whether her answer in b) above is consistent with these estimate of the realised return on the Canadian equity market.

Response

a) The mid-point of the range is 9.75%.

b) The long-run expected rate of inflation in Canada is approximately 2.0%. The implied real rate of return is 7.6%.

c) The real rates of return in conjunction with the rates of inflation have been as follows:

	Real Rate of Return	**Inflation (CPI)**
1924-2006	8.60	3.11
1947-2006	8.04	4.19
1956-2006	6.85	4.14

Source: CIA

The table below suggests that the achieved risk premiums have been higher when inflation was low and vice versa. The real return implicit in the utility risk premium estimate of the cost of equity is consistent with history.

	Real Return	**CPI**
1920s (1924-1929)	21.55	.32
1930s	5.84	-1.73
1940s	5.55	4.64
1950s	14.03	2.46
1960s	7.99	2.66
1970s	4.28	7.60
1980s	6.56	6.28
1990s	9.37	2.11
1997-2006	8.81	2.04