Q. Reference: Dr. Cleary's Evidence, Page 21, Lines 10-25

Please confirm that the Alberta Utilities Commission recently rejected Dr. Cleary's quantitative analysis in its 2018 Generic Cost of Capital Order, stating at paragraph 271:

> ***"As discussed in Section 9.3.3, because of issues identified with Dr. Cleary's quantitative based comparison of the business risks of the affected utilities and U.S. utilities, the Commission is not convinced that there is substantial evidence on which to exclude the use of U.S. proxy groups."***

A. Confirmed. Dr. Cleary would further note that in that same decision, the Alberta Utility Commission (AUC) stated on page 131 that it could not discern a preferred quantitative approach to dealing with business risk due to the wide number of approaches used by the various experts during those proceedings:

> "646. The Commission considers that there is no single accepted mathematical way to quantify business risk, as demonstrated by the number of different quantitative analyses undertaken by the parties in this proceeding."

The fact that the AUC did not accept Dr. Cleary's CV(EBIT/Sales) analysis in 2018 does not imply it is not a valid approach. As argued by Dr. Cleary on pages 20-22 of his evidence, the CV(EBIT) is a commonly used measure of business risk in finance. Dr. Cleary used CV(EBIT/Sales)) as the primary measure when evaluating Alberta utilities to account for the high growth in EBIT displayed by those utilities over the over his sample period (2005-2014). In particular, the combined EBIT for the 11 Alberta utilities examined grew at a geometric average annual growth rate of 12.4% over that period, versus an average of 3.9% for the U.S utilities examined. These high growth rates in EBIT distort traditional measures of CV-EBIT. As noted by Dr. Cleary in his current evidence (page 22, lines 8-12):

> "This measure is preferable if there are significant differences in growth rates in EBIT across the different firms being compared. It is a valid measure of business risk, since it measures volatility in the operating profit margins for firms. It also has the advantage that, as a ratio, the expected value and past average values will often coincide since these *profitability margins often tend to gravitate to some long-term average*."

During the current proceedings, Dr. Cleary reports the CV(EBIT/Sales) but also examines the CV(EBIT) measure based on expected EBIT, since NP's average annual growth rate in EBIT of 2.5% is comparable to that displayed by the proxy group utilities examined. So both measures are valid.

Finally, the passage below from the AUC's 2018 decision clearly indicates that it accepted Dr. Cleary's similar analysis indicating "low earnings volatility" as "support for the conclusion that the affected utilities have generally low business risk." In particular, page 111 of Decision 22570-D01-2018 (red and bold added for emphasis) states:

> **"9.3.1 Overall assessment of business risk**
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> 534. Dr. Cleary agreed with the favourable assessment of business risk for the affected utilities included in credit rating reports issued by DBRS and S&P. Dr. Cleary stated that regulated Alberta operating utilities possess low business risk and enjoy solid regulatory support. Dr. Cleary undertook some empirical analysis that purported to support his conclusion that the affected utilities operate in a low-risk environment that enables them to earn above their approved ROEs with very little volatility in income.
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> 535. Part of Dr. Cleary's empirical analysis examined the ability of the affected utilities to earn their approved ROE on a consistent basis from 2005 to 2016, which he described as a bottomline measure of the total risks faced by the utilities. The yearly figures illustrated that the affected utilities earned average and median ROEs above the approved ROE in all years except 2005, when the average ROE was 0.18 per cent below the approved ROE. Dr. Cleary submitted this can be considered the strongest indication that the affected utilities possess low overall risk.
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> **Commission findings**
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> 536. The Commission accepts that the favourable financial performance and **low volatility of earnings** illustrated by Dr. Cleary is **support for the conclusion that the affected utilities have generally low business risk**."