

Volume 2: Cost of Capital: Expert Opinion of Mr. James Coyne – Return on Equity**Q. Volume 2, Cost of Capital Report, page 50, lines 1-8.**

- a) **Has the Risk Premium methodology been accepted by any Canadian regulator besides the BCUC? If yes, explain whether any adjustments were made and what weighting was given to this methodology in determining the fair return for the utility. Has any Canadian regulator rejected the use of the Risk Premium methodology in determining the fair return for a utility? In the response provide references to the decisions referred to.**
- b) **Explain the strengths and shortcomings of the Risk Premium methodology.**

- A. a) Concentric is aware that the Risk Premium methodology has been explicitly accepted by the BCUC, and implicitly by the Ontario Energy Board (“OEB”) as it relied on the risk premium results of several experts in setting the current risk premium in the OEB’s formula rate of return.¹ The BCUC ultimately determined that it was appropriate to give equal weight to the multi-stage DCF, CAPM and Risk Premium models in setting the authorized ROE for FortisBC Energy Inc. and FortisBC Inc. This is consistent with the approach Concentric has used in arriving at our recommended ROE for Newfoundland Power in this proceeding.

The Alberta Utilities Commission (“AUC”) rejected the risk premium approach using either government or utility bond yields in its October 2023 decision in the generic cost of capital proceeding (Decision 27084-D02-2023). However, the AUC adopted an adjustment formula in that same decision that is based on the fundamental principle of the risk premium model, which is that the risk premium varies depending on the level of interest rates. Several of the parameters in the AUC formula are tied directly to the risk premium model, such as the adjustment factor that is used to adjust the authorized ROE for a given change in government bond yields.

- b) The BCUC discussed the strengths and shortcomings of the Risk Premium method at page 117 of its September 2023 Order G-236-23 as follows:

The strengths of the Risk Premium Model outweigh its shortcomings. The Panel finds that a strength of the Risk Premium Model is its theoretical validity and stability. We also find that this model is easy to understand. A weakness of the Risk Premium Model is the circularity of the model, due to its reliance on prior regulatory decisions. However, the Risk Premium Model is not the only model that can be prone to similar circularity risks. For instance, in the DCF model, prior regulatory decisions on the proxy companies’ authorized ROEs are likely to influence the inputs to the model such as utility stock prices. Consequently, the Panel considers that circularity concerns alone do not justify eliminating reliance on the Risk Premium Model, or any particular model, for determining the appropriate

¹ See the EB-2009-0084, Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, December 11, 2009, page 38.

1 *ROE for FEI and FBC. Instead, it is a factor in the overall consideration of*
2 *model results.*

3
4 The Risk Premium method has also been accepted in several U.S. jurisdictions,
5 including California, Florida, Georgia, North Carolina, Virginia, West Virginia,
6 Wisconsin and the Federal Energy Regulatory Commission.