

1 **Q. Reference Evidence of Laurence Booth dated September 25, 2018**

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 3 **Page 45, lines 19-24: Dr. Booth states that he makes an adjustment to his**  
 4 **“simple” CAPM estimate and adds a 50% adjustment for credit spreads of**  
 5 **0.18% for current market conditions. Is Dr. Booth aware of any Canadian**  
 6 **regulator that has applied or considered the application of a credit spread**  
 7 **adjustment in their allowed ROE conclusions since the Board’s last decision in**  
 8 **2016 on a fair return for Newfoundland Power? If yes, please provide details**  
 9 **of such decision.**

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 11 A. No. The credit spread adjustment was first mooted in the aftermath of the financial crisis.  
 12 This was when utility bond yields increased just as formula allowed ROEs decreased as  
 13 LTC yields fell, in a huge “rush for safety.” The OEB then incorporated such an  
 14 adjustment, as did other boards as they fine-tuned their ROE adjustment formulae. I have  
 15 been recommending such an adjustment since 2010 on the basis that it makes the ROE a  
 16 little more sensitive to capital market conditions, but evens out over the business cycle.

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 18 On January 14, 2016, the OEB issued a staff report on its ROE formula and concluded<sup>1</sup>

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 20 Based on the results of this review, OEB staff has concluded that the methodology  
 21 adopted in late 2009 has worked as intended. Movement in the parameters have  
 22 followed macroeconomic trends and activity, and have not resulted in excessive or  
 23 anomalous volatility. While there is more volatility observed in the financial performance  
 of utilities, these are largely due to other reasons<sup>1</sup>.

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 25 The OEB formula is below and explicitly adjusts for 50% of the change in the utility bond credit  
 26 spread.

Return on Equity (formula)	$ROE_t = 9.75\% + 0.5 \times (LCBF_t - 4.25\%) + 0.5 \times (UtilBondSpread_t - 1.415\%)$ , where $ROE_t$ is the Return on Equity for year $t$ , $LCBF_t$ is the Long Canada(30 year Government of Canada) Bond (yield) forecast for year $t$ , and $UtilBondSpread_t$ is the spread between 30-year A-rated Utility Corporate Bond yields and Long Canada Bond Yields. The data for $LCBF_t$ and $UtilBondSpread_t$ are derived from Consensus Forecasts, and from Statistics Canada/Bank of Canada and Bloomberg LP data for the month 3 months in advance of the first effective date of the cost of capital parameters. Thus, for cost of capital updates effective January 1, September data are used.
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26 Although this is not a new adoption of the credit-spread adjustment, it does reflect a review and  
 27 continued adoption.

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<sup>1</sup> OEB staff report, EB-2009-0084, review of the cost of capital for Ontario’s regulated utilities.