

CUB Cross Ex. 1

ICC Docket No. 10-0467

**Commonwealth Edison Company's Response to
Illinois Commerce Commission ("STAFF") Data Requests
MGM 3.01 - 3.12**

Date Received: September 17, 2010

Date Served: October 6, 2010

REQUEST NO. MGM 3.01:

On page 1 of ComEd Exhibit 11.0, Dr. Hadaway notes that he does not presently rely on a CAPM analysis in his risk premium ROE estimates. In preparing for this proceeding, did Dr. Hadaway perform a CAPM analysis for ComEd? If so, please provide that analysis.

RESPONSE:

Yes. In preparing for this proceeding, Dr. Hadaway performed two CAPM analyses: 1) A March 2010 update of the long-term and short-term CAPM analyses he provided in the 2007 case, ICC Docket No. 07-0566, and 2) an update of the Staff CAPM analysis based on Janis Freetly's analysis in ICC Docket Nos. 09-0306-0311. Those analyses are provided in the attachments labeled as MGM 3.01_Attach 1 and MGM 3.01_Attach 2. Dr. Hadaway explained why he did not use the CAPM on pages 26-27 of his Direct Testimony (ComEd Ex. 11.0):

The market data above show that, under present market conditions, potentially all three of the CAPM's principal inputs tend to understate ROE. The risk-free rate, Rf, is understated because, due to the governmental credit market policies and investors' increased risk aversion, the U.S. Treasury rates used for Rf are artificially low. The second input, the expected market risk premium [E(Rm) - Rf] may also be understated as indicated by the continuing widened spreads between Baa and Aa utility yields. Finally, utility beta coefficients have declined because, as shown in Graphs 2 and 3 above, utility stocks have far underperformed relative to the broader market index during the recent stock market recovery. All these factors indicate that CAPM estimates of ROE for utilities are currently understated. For this reason, in the present case I rely on the DCF and other risk premium models to estimate ROE.

OFFICIAL FILE

ICC DOCKET NO. 10-0467
ComEd Exhibit No. 1

Witness _____
Date 11/18/11 Reporter _____

Capital Asset Pricing Model Analysis

Hadaway Docket No. 07-0566 (Mar '10 Update)

Panel 1: Long-Term CAPM Analysis

Risk-free Rate ¹	Value Line Beta ²	Long-Term Ibbotson Risk Premium ³	Cost of Common Equity
4.62%	+ 0.69	x 5.20%	= <u>8.21%</u>

Panel 2: Short-Term CAPM Analysis

Risk-free Rate ¹	Value Line Beta ²	Short-Term Ibbotson Risk Premium ³	Cost of Common Equity
0.11%	+ 0.69	x 7.10%	= <u>5.01%</u>

Summary of Results

Long-Term CAPM Result	8.21%
Short-Term CAPM Result	<u>5.01%</u>
Midpoint CAPM Result	<u>6.61%</u>

No. Company	Beta
1 ALLETE	0.70
2 Alliant Energy Co.	0.70
3 American Elec. Pwr.	0.70
4 Avista Corp.	0.70
5 Black Hills Corp	0.80
6 Cleco Corporation	0.65
7 Con. Edison	0.65
8 DPL Inc.	0.60
9 DTE Energy Co.	0.75
10 Duke Energy	0.65
11 Edison Internat.	0.80
12 Empire District	0.70
13 Entergy Corp.	0.70
14 FPL Group, Inc.	0.75
15 Hawaiian Electric	0.70
16 IDACORP	0.70
17 N.W. Nat'l Gas	0.60
18 NICOR, Inc.	0.70
19 Northeast Utilities	0.70
20 NSTAR	0.65
21 PG&E Corp.	0.55
22 Piedmont Nat'l	0.65
23 Pinnacle West	0.75
24 Portland General	0.75
25 Progress Energy	0.60
26 SCANA Corp.	0.65
27 Sempra Energy	0.85
28 Southern Co.	0.55
29 Southwest Gas	0.75
30 Teco Energy, Inc.	0.85
31 UIL Holdings Co.	0.70
32 Vectren Corp.	0.70
33 Westar Energy	0.75
34 Wisconsin Energy	0.65
35 Xcel Energy Inc.	0.65
Average	<u>0.69</u>

Notes:

¹ Federal Reserve Bank of St. Louis website Jan-Mar 2010 Average Rates; Long-Term rate is "30-Year Treasury Constant Maturity Rate;" Short-Term rate is "3-Month Treasury Bill: Secondary Market Rate."

² Value Line Investment Survey, Electric Utility (East), Feb 26, 2010; (Central), Mar 26, 2010; (West), Feb 5, 2010; Natural Gas Utility, Mar 12, 2010.

³ Ibbotson Associates 2010 Yearbook, page 28, average of Geometric and Arithmetic risk premiums; Long-Term risk premium is difference between "Large Company Stocks" and "Long-Term Government;" Short-Term risk premium is difference between "Large Company Stocks" and "U.S. Treasury Bills."

Capital Asset Pricing Model Analysis

ICC Staff Analysis (Mar '10 Update)

(Based on J. Freetly's Analysis in Ameren Docket Nos. 09-0306-0311)

U.S. Treasury Bonds	
30-Year T-Bond Yield ¹	Effective Yield
4.63%	4.68%

CAPM Estimate of ROE for Staff Group			
Risk-free Rate	Beta ²	Risk Premium ³	Cost of Common Equity
4.68%	+ 0.69	x 7.06%	= <u>9.55%</u>

11.74% Return on S&P 500

¹As of Mar 15, 2010 (<http://research.stlouisfed.org>)

²See Average of Betas from table at right.

³Return on S&P 500 (from "StaffMarketReturnUpdate(3-17-10).xls") less Risk-free Rate.

⁴From Value Line Investment Survey, Electric Utility (East), Feb 26, 2010; (Central), Mar 26, 2010; (West), Feb 5, 2010.

⁵From "StaffBetaUpdate(3-17-10).xls"

No.	Company	Value Line Regression	
		Beta ⁴	Beta ⁵
1	Allele	0.70	0.73
2	Ameren Corp.	0.80	0.75
3	American Electric Power	0.70	0.69
4	Avista Corp.	0.70	0.83
5	Cleco Corp.	0.65	0.62
6	CMS Energy	0.75	0.69
7	Great Plains Energy	0.75	0.81
8	Idacorp Inc.	0.70	0.59
9	Northeast Utilities	0.70	0.64
10	PG&E Corp.	0.55	0.54
11	Pinnacle West Capital	0.75	0.68
12	Progress Energy	0.60	0.56
13	Teco Energy	0.85	0.86
14	Westar Energy	0.75	0.70
15	Wisconsin Energy Corp.	0.65	0.55
16	Xcel Energy Inc.	0.65	0.60
Average		0.70	0.68
			0.69

Average of
Betas