

- Q. The following table sets out for the last three mortgage bond issues by Newfoundland Power the bond interest rate, the then current Long Canada Bond Yield and the resulting spread between the bond interest rate and the Long Canada Bond Yield.

NEWFOUNDLAND POWER BOND ISSUES
1996, 1998 & 2002

	Series	Bond Rate	Long Canada	Spread
1996	AA	8.90	8.22	0.68
1998	AI	6.80	5.50	1.30
2002	AJ	7.52	5.67	1.85

The spread increased from 68 basis points in 1996 to 185 basis points in October of 2002. How did the increase in the spread between Newfoundland Power bond issues and the Long Canada Bond Yields affect Dr. Kalymon's recommendation that the appropriate range for the equity risk premium is 2.5% to 3.00%.

- A. **The increase in spread for Newfoundland Power bonds over Long Canada bond yields is consistent with the observed increases in spread for corporate bonds of lower grade relative to higher grades as shown in Schedule 31. These higher spreads reflect growing concern over corporate default risks in the economy and the flight of capital to safer investments in the debt markets. The same principle in equity markets has lead to a flight of investment capital into less risky equity investments such as regulated utilities. This flight to lower risk equity investments would suggest that equity risk premiums for low risk stocks have narrowed over those for average risk investments.**