

Re: p. 6, lines 8-9

At this reference Dr. Vilbert states, “Although the ATWACC is constant across a broad middle range of capital structures for investor-owned utilities as well as for Hydro, the before-tax weighted-average cost of capital for Hydro is not.”

- (a) Please explain if Dr. Vilbert believes the ATWACC for an investor-owned utility would be the same at 85% debt as at 60% debt.

**Response:**

If a capital structure with 85 percent debt were outside the broad middle range of capital structures over which the ATWACC is constant, the ATWACC would be higher. In Dr. Vilbert’s experience, investor owned utilities (“IOUs”) that are not in financial distress do not have capital structures with 85 percent debt. No company in Dr. Vilbert’s samples used in his evidence submitted to the National Energy Board (Canadian utilities, U.S. gas local distribution companies or U.S. natural gas pipeline companies) has a capital structure with as much as 85 percent debt. Therefore, the empirical evidence of other utility companies suggests that 85 percent debt would not be in the broad middle range for those utilities, but that conclusion is not definitive for Hydro. Please also see Dr. Vilbert’s written evidence Appendix B page B-37 line 12-17 for a discussion of the impact of business risk on the “broad middle range.” In addition, please refer to pages 28-30 of Dr. Vilbert’s written evidence for the effect of the debt guarantee on Hydro’s capital structure and costs of financial distress. As noted in the written evidence, Hydro is likely to be able to avoid the increase in the ATWACC due to the increased costs of financial distress because of the debt guarantee until higher levels of debt than for an IOU.

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- (b) What does Dr. Vilbert believe constitutes a broad middle range of capital structures for a typical Canadian investor-owned utility?

**Response:**

It is not possible to specify precisely the limits of the “broad middle range of capital structures” but the best evidence for the broad middle range of capital structures over which the ATWACC is constant is the range of market value capital structures of a sample of companies not in financial distress in that line of business. For example, the range of capital structures for the companies in Dr. Vilbert’s sample of Canadian Utilities used in his evidence filed before the National Energy Board is displayed in the table below.

<b>Capital Structure of the Canadian Sample for Dr. Vilbert’s 2001 NEB Filing</b>				
	<b>Common Equity to Market Value</b>		<b>Debt to Equity Ratio (a)</b>	
	<b>5-year average (b)</b>	<b>Most recent (c)</b>	<b>5-year average</b>	<b>Most recent</b>
B.C. Gas	37%	40%	1.74	1.51
Canadian Utilities	47%	49%	1.15	1.05
Emera Inc.	42%	48%	1.39	1.10
Enbridge Inc.	47%	48%	1.15	1.07
Fortis Inc.	42%	40%	1.40	1.53
Gaz Metropolitan and Co.	62%	62%	0.62	0.61
TransAlta Corporation	55%	58%	0.82	0.73
Westcoast Energy Inc.	30%	32%	2.39	2.16

(a) Preferred Stock is treated as debt in the calculation.

(b) The five-year average is used in CAPM models.

(c) The most recent capital structure is used in DCF models. The most recently available capital structure is for the third quarter of 2000.

Note: Currently, no company has more than 8.2 percent preferred equity but some sample companies used to have more preferred equity in their capital structure (up to 13 percent in 1995).