Re: p. 4, lines 1-4

Dr. Vilbert states, referring to Ms. McShane's evidence, "Note that she makes no adjustment in the return on equity in going from 15.27 percent to 25 percent equity and only a slight adjustment in going to a capital structure with 40 per equity.

(a) Please specify the return on equity that Dr. Vilbert has concluded that Ms. McShane has estimated at a 40% common equity ratio, and please provide the references relied on in Ms. McShanes' testimony for that conclusion.

Response:

Please refer to Ms. McShane's written evidence page 54, lines 1-16 in which she discusses Hydro's stand-alone target capital structure and allowed return on equity. The table on that page computes the return on the rate base using Hydro's embedded cost of debt (8.35%), a capital structure including 40 percent equity and a cost of equity of 9.75 percent. The question on page 54, lines 1-4 is "What approximate level of utility interest coverage is indicated *at your recommended stand-alone target capital structure and allowed return on equity for Hydro* commensurate with that recently allowed other Canadian utilities? [emphasis added]"

Dr. Vilbert interpreted that question and answer including the table to be Ms. McShane's recommendation for Hydro at a 40 percent equity ratio.

Re: p. 4, lines 1-4

(b) Please provide the references relied on to conclude that Ms. McShane has made any estimate of the return on equity at a 25% equity ratio.

Response:

Please refer to page 21, lines 14-16 of Ms. McShane's written evidence on which she recommends that "in the medium-term, the Company should seek to move its capital structure ratios to approximately 70-75% debt and 25-30% equity." She mentions no adjustment to her recommended return on equity for the change in capital structure in this section of her written evidence.

See also page 14 of Mr. William E. Wells' evidence. Relying on the advice of Hydro's financial experts, he specifies a target "debt/equity ratio of 60/40 and a ROE of 11% to 11.5%." Additionally, the Application, on page 6, paragraph 14, subpart (9), requests that the Board set financial targets of the following:

Return on Equity - 11% to 11.5%,
Debt/Equity Ratio - 60:40 and
Return on Rate Base - 9.5%.

As discussed in Dr. Vilbert's evidence on p. 5, decisions regarding capital structure and the required return on equity may (wrongly) be made separately without recognizing their inherent connection. Hydro's requests cited above seem to validate that concern.