

Re: p. 34, diagram

Dr. Vilbert shows that the ATWACC of IOUs rises more rapidly than Hydro's at higher levels of debt.

- (a) Could Dr. Vilbert please explain why this is the case?

**Response:**

The reason that the ATWACC increases at high levels of debt is because of the increasing costs of financial distress. See page 29, line 12 through page 30, line 1 and page B-17, line 9 through page B-18, line 10 of Dr. Vilbert's written evidence for a discussion of the costs of financial distress. The graph on page 34 of Dr. Vilbert's written evidence illustrates the effect of the increasing costs of financial distress by showing that the ATWACC increases as the amount of debt in the capital structure exceeds the broad middle range of capital structures. Because of the debt guarantee by the Province, Hydro can use more debt in its capital structure than other companies before the effects of financial distress would begin to be felt and the ATWACC would begin to increase.

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- (b) Could Dr. Vilbert please indicate at approximately what levels of debt the deviation between the IOUs' and Hydro's ATWACC would occur?

**Response:**

Dr. Vilbert can not specify the precise percent of debt in the capital structure that would lead to an increase in the ATWACC for either Hydro or the IOUs. See the response to NLH-19 (b) for discussion of estimating the broad middle range of capital structures for which the ATWACC is constant. See the response to NLH-28, (a) for the reason that the ATWACC of Hydro does not begin to increase until a higher level of debt than for an IOU.