Q 66.1 What would be the effect on revenue requirement for 2002 of applying the overall cost of capital to Construction Work In Progress? How does this differ from the effect on revenue requirement of using the embedded cost of debt? What regulatory precedents in North America support utilization of the weighted cost of capital as the return to be applied to CWIP? (KCM, p. 11, lines 1 - 9)

A. 66.1 The return applied to CWIP would not affect revenue requirement in 2002.

If the embedded cost of debt of 8.0% had been applied rather than the 7.4% weighted average cost of capital, net interest expense would have decreased by $686,000, and margin would have increased by the same amount in 2002. The return on ratebase and total revenue requirement for 2002 would remain the same. However, in the case of CWIP, the value of the asset that is ultimately added to the ratebase would increase by $686,000. Please refer to the response to NP-83.

The following regulatory jurisdictions in Canada utilize an overall cost of capital:

National Energy Board
Alberta
British Columbia (West Kootenay Power)
Prince Edward Island
Nova Scotia
Northwest Territories
Yukon

Although there is no rate base/rate of return regulation in Saskatchewan, SaskPower accrues Allowance for Funds used During Construction (AFUDC), not capitalized interest.

In the U.S., the Federal Energy Regulatory Commission uses an overall cost of capital. With respect to state regulation, although Ms. McShane has not done a state-by-state review, it has been standard utility practice to apply an AFUDC rate to CWIP, which recognizes that CWIP is financed with all sources of capital. A number of states actually include all or part of CWIP in rate base, which then by extension, earns an overall rate of return.

In principle, if CWIP is deemed to be financed with debt only, but the rate base is deemed to be financed with the whole capital structure, the debt deemed to be financing CWIP is being double-counted.