

- 1 **Q. Coyne Evidence: In terms of the financial risk imposed by the use of debt (page**
2 **7) if a company always earns its allowed ROE can Mr. Coyne explain what**
3 **additional risk the use of debt is imposing on the shareholder?**
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- 5 A. As a general premise, secured debt holders have first call on a company's earnings, so the
6 greater the debt, the more risk a common equity shareholder is exposed to, requiring a
7 greater return. A fundamental principle of finance is that leverage creates risk.
8 Regardless of whether the company was historically earning its allowed ROE, there is no
9 guarantee of that return in the future.