Q. Reference: CA-NP-61

Mr. Coyne indicates that leverage increases risk. Can he confirm that if there is no risk then leverage cannot magnify the absence of risk? Further can Mr. Coyne indicate in his professional judgment how many years of earning in excess of the allowed ROE by a Canadian utility would it take to convince him that in fact there is no underlying risk to magnify?

A. A fundamental principle of finance is that more leverage in the capital structure increases a company's financial risk, which represents the risk that a company may not have adequate cash flows to meet its financial obligations. In Mr. Coyne's view, there is risk associated with every investment. The fact that a utility has been able to earn its allowed ROE in the past does not necessarily indicate whether the utility will continue to be able to do so in the future. Furthermore, the ability to earn the allowed ROE is not the only indicator of the risk associated with an investment. For example, a higher percentage of debt in the capital structure increases the risk that the utility will not be able to meet interest payment obligations on that debt. Likewise, owners of common stock are always subject to the risk that they are the residual claimants on the company's assets, meaning that, in the event of bankruptcy, the common shareholders are the last group to receive payment.