Q. Vander Weide Evidence – In Dr. Vander Weide's March, 2012 evidence, he stated that investors were "painfully aware" that regulators in some jurisdictions have been unwilling at times to set rates that allow companies an opportunity to recover their cost of service in a timely manner and earn a fair and reasonable return on investment. Dr. Vander Weide further stated, "As a result of the perceived increase in regulatory risk, investors will demand a higher rate of return for electric utility operating in those jurisdictions. On the other hand, if investors perceive that regulators will provide a reasonable opportunity for the company to maintain its financial integrity and earn a fair rate of return on its investment, investors will view regulatory risk as minimal."

If, in jurisdictions where there is perceived to be increased regulatory risk, investors will demand a higher rate of return, please confirm that it is it also true that all else equal, investors in utilities in jurisdictions where such risk is minimal will not demand a higher return?

A. The answer to this question depends on how regulatory risk is defined. If regulatory risk is correctly defined as the utility's ability to maintain its financial integrity and earn a fair return on its investment, then Dr. Vander Weide agrees that investors in utilities doing business in jurisdictions where the risk of earning less than a fair return on investment is minimal will not demand a higher return. However, if regulatory risk is incorrectly defined as simply having access to cost recovery and rate stabilization mechanisms, then Dr. Vander Weide does not agree with the statement in the question. Cost recovery and rate stabilization mechanisms generally increase a utility's ability to earn its allowed return; but they do not necessarily increase a utility's ability to earn a fair return on investment. To grant utilities an opportunity to earn a fair return on investment, regulators must set the allowed return on investment equal to the return investors expect to earn on other investments of similar risk.