Consumers Council of Canada and the Vulnerable Energy Consumers Coalition (CCC) and (VECC) INTERROGATORY #2 List 1

Interrogatory

Ref: B1/T3/S1 p. 2 and 7

Issue 4.0
Issue: Cost of Capital/Capital Structure

Topic: Stand alone

Request:

Ms McShane asserts that the stand alone principle means that the cost of capital should be equivalent to what the utility would face raising capital on its own. Would this conclusion continue to hold if the utility were at an ***inefficient*** scale and would not survive if the market were competitive and unregulated? If the answer is yes please explain how regulation then acts as a surrogate for competition. If the answer is no please explain how she would impute financing costs to a utility that could then not access capital on reasonable terms as a stand alone utility.

Response

The stand alone principle is intended to recognize that the cost of capital for a regulated utility should reflect its own inherent risks, not the cost to the shareholder of raising funds, and not the cost of capital of the consolidated operations of a firm, which may include operations that are not of the same risk as the utility operations. It is perhaps obvious that the principle should not be taken to extremes, e.g., breaking down an electric utility into its individual functions and imputing a small size premium to each function. With respect to the imputation of financing costs to a utility that is too small to access capital on its own as a stand alone utility, that is not a relevant consideration for HONI Tx, and has not been a factor in the determination of the capital structure and return on equity.