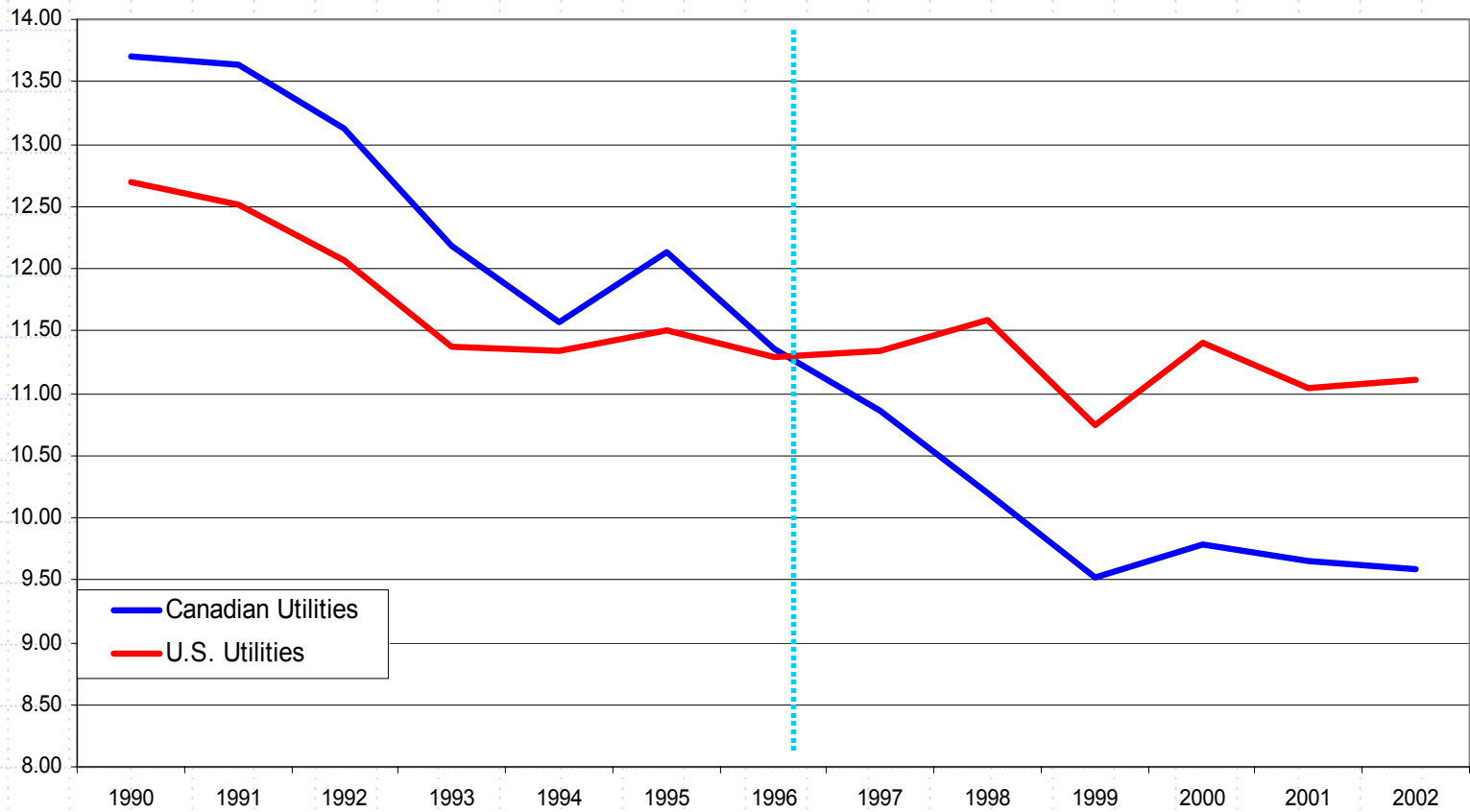




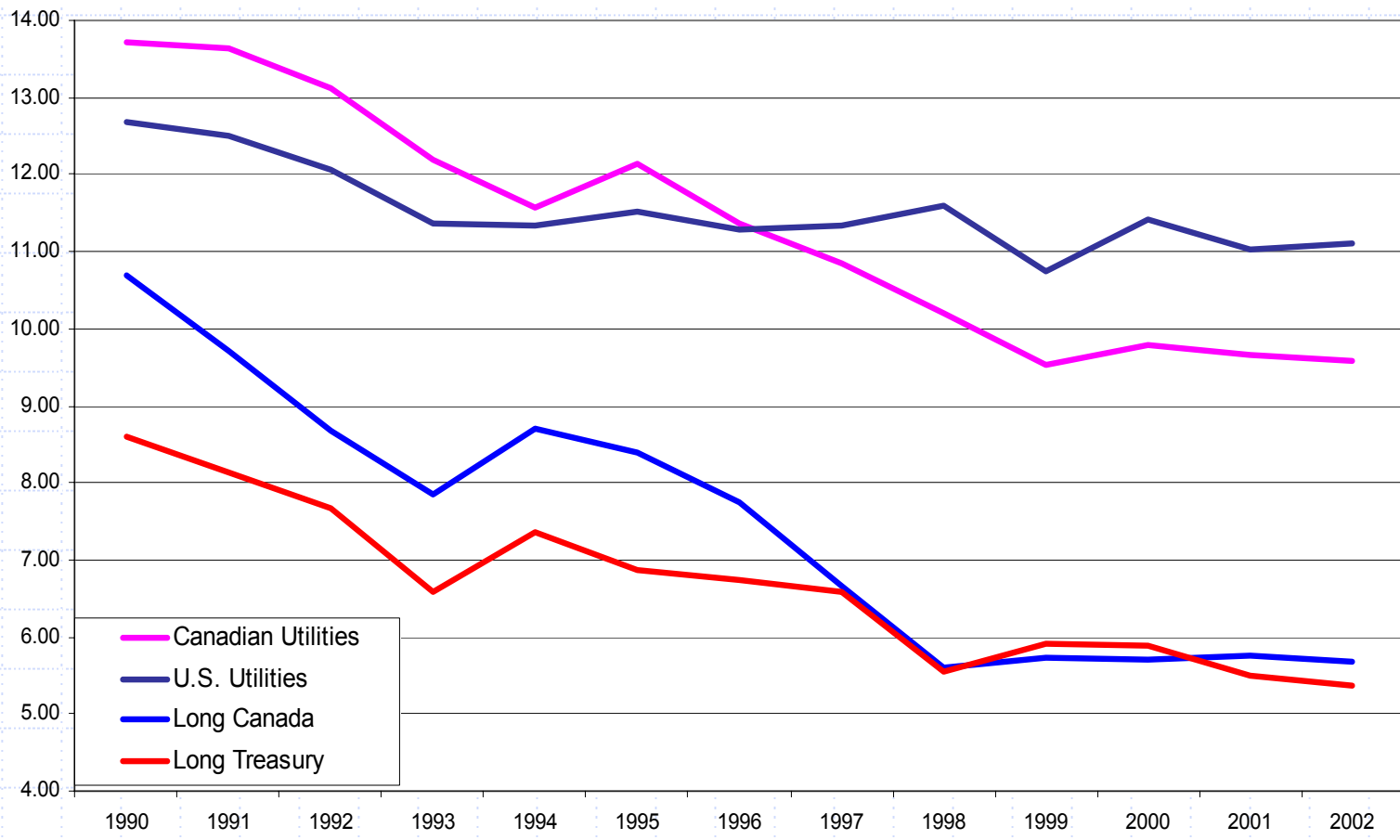
# UTILITY COST OF CAPITAL CANADA vs. U.S.

**KATHY McSHANE**  
**FOSTER ASSOCIATES**  
MAY 7, 2003

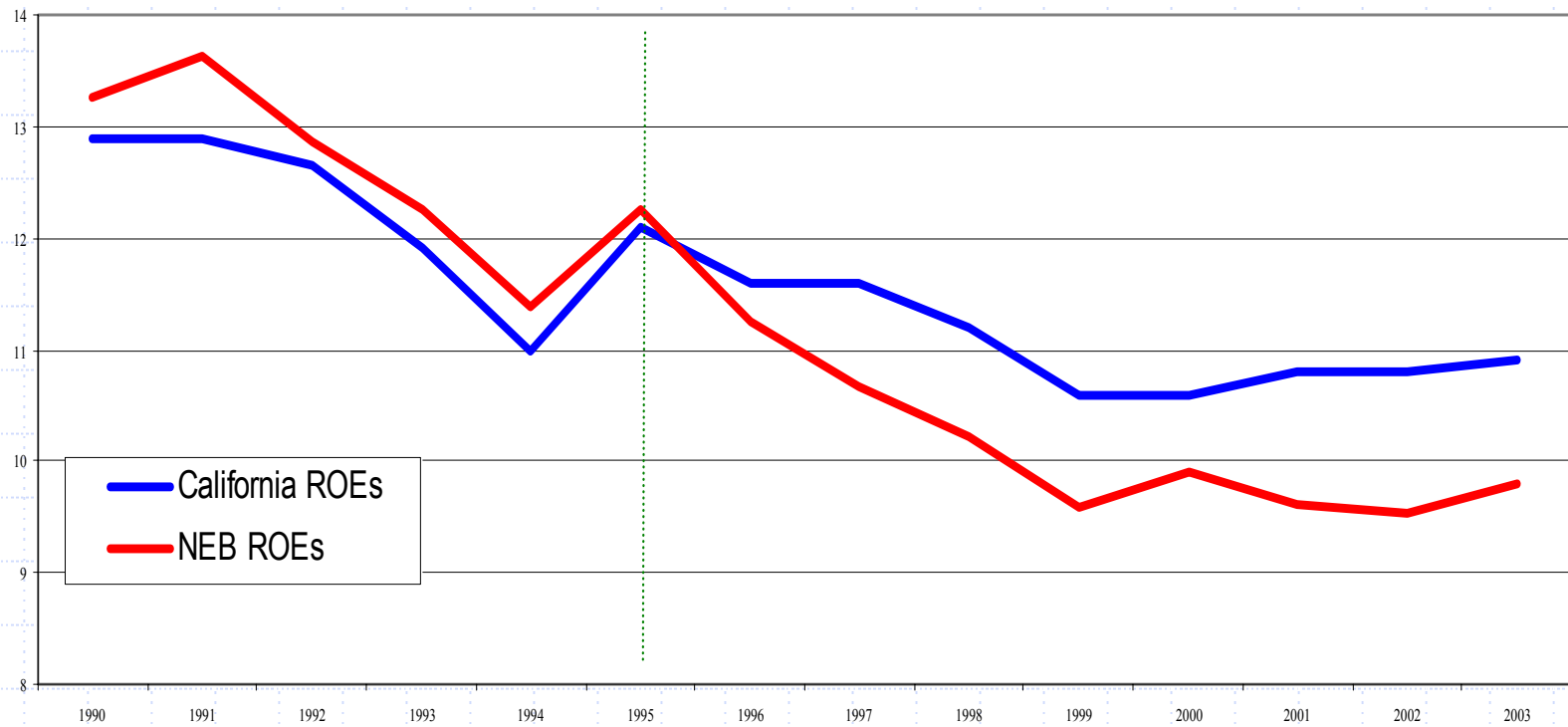
## Comparison Between Allowed ROEs for Canadian & U.S. Utilities



## Canadian & U.S. Allowed Utility Returns & Long Government Bonds



## Comparison of NEB ROEs to California ROEs



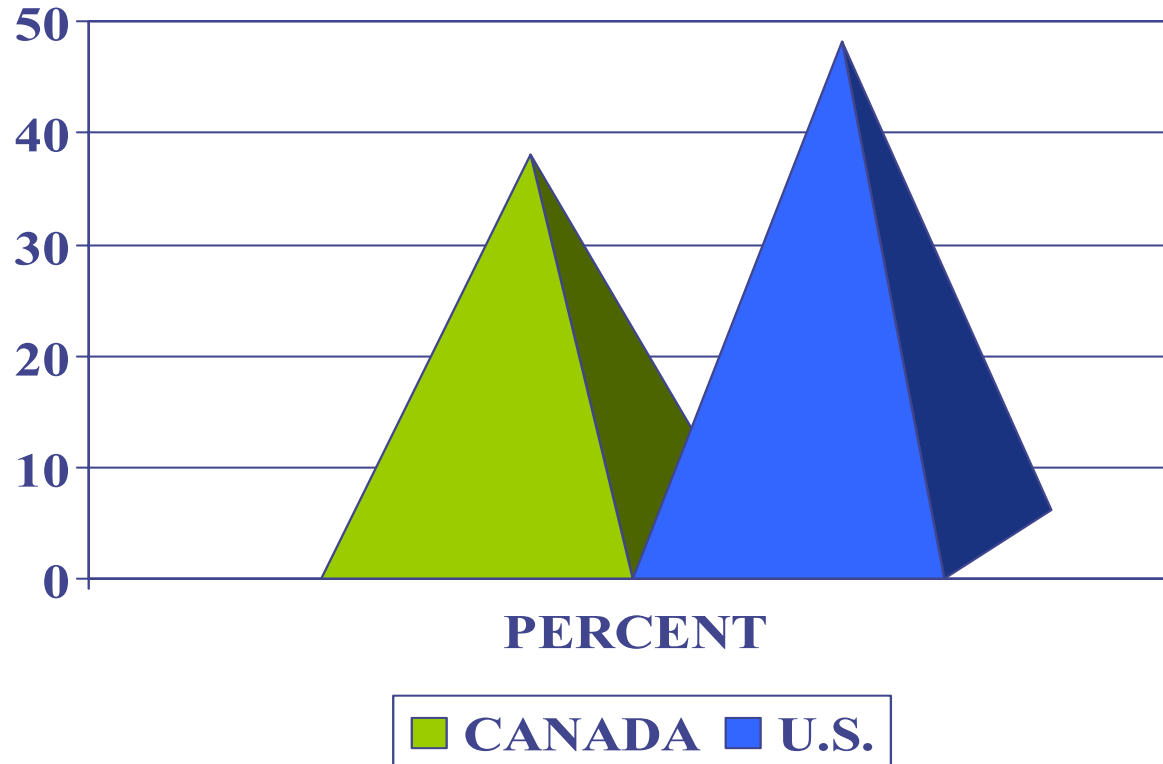
# POSSIBLE REASONS FOR DIFFERENCES:

- ◆ **Risk**
- ◆ **Financial Markets**
- ◆ **Taxes**
- ◆ **Regulatory Methodology**

# RISK

- ◆ **Business Risk**
- ◆ **Regulatory Risk**
- ◆ **Financial Risk**
  - **Capital Structures**
  - **Debt Ratings**

# ALLOWED EQUITY RATIOS



# FINANCIAL MARKETS

- ◆ **INTEREST RATES / INFLATION**
- ◆ **COUNTRY RISK**
- ◆ **MARKET SEGMENTATION**
- ◆ **TAXES**

# TAXES

## ◆ Taxability of Shareholders

- Institutions
- Individuals

## ◆ Tax Differences

- Dividend Tax Credit
- Capital Gains Tax

# METHODOLOGY

## CAPITAL ASSET PRICING MODEL

$$\text{ROE} = \text{Risk-Free Rate} + \text{Beta}(\text{Market Risk Premium})$$

Vs.

## DISCOUNTED CASH FLOW

$$\text{ROE} = D/P + g$$

# IMPLICATION OF ROE METHODOLOGIES

## **CAPM/AUTOMATIC ROE ADJUSTMENT**

$\Delta$  in ROE = 75-80%  $\Delta$  in Long Canadas  
= Interest Rate Sensitivity of ROE

## **DISCOUNTED CASH FLOW**

$\Delta$  in ROE = 25-35%  $\Delta$  in Long Treasuries  
= Greater Stability of ROE