level is shown to be 8.50% to 9.00% under current market conditions for a mid-range target of 8.75%. The actual guarantee fee of the Province of 100 basis points on the actual total debt of Hydro can then be seen as providing some compensation for the effective equity risk involved. Analysis of the required return on rate base is as follows:

| | Structure | Cost | Fee | Total |
|---|---|---|---|---|
| Debt | | | | |
| Funded | 83.38% | 7.134% | | 5.948% |
| Pre-funded | (23.38%) | | | |
| Deemed | 60.00% | | 0.5% | 0.300% |
| Equity | | | | |
| Funded | 15.07% | 8.75% | | 1.319% |
| Guaranteed | 23.38% | | 1.616% | 0.378% |
| Empl. Benefits | 1.55% | 0% | | 0% |
| Deemed | 40.00% | | | |
| Total Rate Base | 100.00% | | | 7.945% |

The above calculation indicates that the target return on rate base for Hydro in the future should be limited to the level of 7.945%. Such a return on rate base would provide an interest coverage ratio of 1.34 [=(7.945/5.948)] excluding the guarantee fees. While this level of return exceeds that projected under the proposed rate structure for the test year 2002, the Board should restrict future rate base returns to the levels indicated. Such target levels of rate base returns would provide for fair compensation to the Province based on market investor requirements for risks comparable to that of Hydro.

(Revised November 9, 2001)