Q. Dividend Policy: Grant Thornton 2000 Annual Financial Review of Hydro – page 9.

At page 9 of the referenced report, it states: “The dividend policy approved by the Board of Directors of Hydro in November, 1995 provides for the payment of dividends annually up to 75% of net operating income provided such payment will not cause the debt:equity ratio to fall below 80:20.”

a. Please provide a copy of the Hydro Board of Directors November 1995 policy referenced in this quote.

b. Please confirm if the above quote is accurate. If it is accurate, explain with examples from Hydro’s books since 1995 how any payment of dividend acts to reduce the debt:equity ratio. If it is not accurate, please provide a corrected statement.

c. Please indicate the impact of Hydro’s dividends on its debt:equity ratio for each year since the above policy was adopted and for the forecasted years 2001 and 2002.

d. Please indicate if you are aware of any amendments to the above November 1995 policy. If so, please indicate each time the policy was amended and what the amended policy was in each instance.

A. a. Please see attached excerpt from the minutes of the Board of Directors of Hydro which details the November 1995 dividend policy.

b. The above quote is an accurate representation of the 1995 dividend policy as detailed in the excerpt from the Board minutes. The quote from our report includes the wording “…. provided such payment will not cause the debt:equity ratio to fall below 80:20” whereas the policy wording is “… provided that such payment shall not cause deterioration in the existing debt/equity ratio…”. The wording “fall below 80:20” is used in the context of a “deterioration” of the ratio. It does not refer to a reduction in the ratio (eg. to 75:25) which would be viewed as an improvement in the debt:equity ratio.

Also, our description of the policy is more specific with regards to the debt:equity ratio as it is our understanding that is was Hydro's intent to utilize its target debt:equity ratio of 80:20 once achieved. This is also consistent with the advice provided to Hydro by Scotia McLeod Inc. at the time the policy was established (refer to response to NP-169).

The second part of this question asks for an explanation with examples, of how any payment of dividends acts to reduce the debt:equity ratio. The payment of dividends reduces the retained earnings and equity of the company which has the effect of increasing the debt:equity ratio above what it otherwise would be.

c. In the response to IC-66(Rev) Hydro has provided a calculation of the impact of the dividends paid since 1995 on the 2002 test year capital structure and debt:equity ratio. Using their calculation of the cumulative impact of dividends on debt and equity, we have calculated the year end regulated debt:equity ratios for each of the years 1995 to 2002 as follows:

1995	80.4/19.6	
1996	80.4/19.6	
1997	78.2/21.8	
1998	75.0/25.0	
1999	74.8/25.2	
2000	73.9/24.5	(Employee future benefits 1.6%)
2001	74.5/23.9	(Employee future benefits 1.6%)
2002	74.9/23.5	(Employee future benefits 1.6%)

d. The November 1995 dividend policy was amended/replaced with a revised policy which was approved by the Board of Directors of Hydro on May 12, 2000. Please see the attached excerpt from the minutes of the Board of Directors of Hydro which details the revised dividend policy.

Due to an oversight in finalizing our 2000 Annual Financial Review report, our comments on the dividend policy were not updated to reflect these revisions approved on May 12, 2000.