Re: Interest costs to be charged on fuel and hydraulic variation, Page 4, lines 9-10

Q. If these balances are assumed to be financed solely by short-term debt would you agree that to be consistent one would recalculate the cost of capital to be recovered in rates excluding that proportion of short-term borrowing, thereby increasing the cost of debt for purposes of determining an appropriate WACC and Return on Ratebase.

A. The suggested adjustment appears to be reasonable with respect to at least the new RSP. The "new RSP" balances reflect a short-term variable balance that fluctuates over time, and may at various times reflect positive and negative values. There is no basis to consider this account a long-term asset that is financed by long-term debt and equity, and as a result no basis to consider the account to attract weighted average cost of capital (WACC) interest rates. Likewise, it is not appropriate for Hydro to credit the account (i.e. pay) WACC interest rates for positive balances in the account (i.e., reflecting amount owed to ratepayers) when this situation does occur. As a result, the portion of Hydro's debt that is calculated to be financing ratebase should exclude any short-term debt that is financing the new RSP.

The old RSP is clearly locked in or crystallized at a certain date in time, and amortized over five years. In this way, it may be viewed as more representative of a longer-term asset such as a computer that would be capitalized and depreciated over a similar period. The old RSP balance should not be treated the same way as the new RSP balance discussed above – the current treatment does appear reasonable for the old RSP balance.