Q. NLH-85 CA (Re: Page 13, lines 9-11)

Dr. Kalymon states: "Given that the guarantee provides implicit equity support beyond the levels recorded on the balance sheet of Hydro, my analysis of the appropriate returns on the rate base shall assume a deemed capital structure of 40% Equity and 60% Debt". What is the rationale for concluding that the support to debt holders afforded by a guarantee on debt comprising 86% of the capital structure, is equal to exactly 26.13% of additional "implicit" equity.

A. The additional implicit equity was designed to make the risk of Hydro comparable to that of privately owned electric utilities which can operate on a stand alone basis without further guarantees on debt. Clearly, the observed capital structure understates the level of actual equity due to the presence of the guarantee. A commercially viable and cost efficient deemed structure was chosen to analyze the level of return required for risks which are observable in the market.