Q. Referring to page 48, lines 1-2: Please explain why a “cushion, or safety margin, for unanticipated capital market conditions” is needed by Crown Corporation that does not raise capital in public equity markets.

A. The concept of safety margin is intended to recognize that:

(a) the consistent application of the cost of attracting capital test (risk premium and DCF) results in the book value of common equity, in principle, would lead to a market/book ratio of 1.0;

(b) a decline in the market/book ratio to below 1.0 is an indicator of loss of financial integrity;

(c) a minimal allowance for financing flexibility provides a cushion or safety margin to provide the opportunity for the utility to maintain its financial integrity, as defined above, in the face of volatile market conditions, e.g., unanticipated increases in interest rates;

(d) although Hydro does not raise equity in the capital markets, the allowed return should provide a similar ability to maintain its financial integrity, albeit notionally, as defined above, to a utility which does raise equity capital in public markets. The Province, as a shareholder, should have a reasonable expectation to achieve a similar value for its investment as if it had invested in an alternative similar risk venture with a transparent market value.