Q. Reference: Corporate Finance: Evidence, p. 7 (lines 8-10), where it states *"In his evidence, Mr. Bradbury will describe the specific procedures used to segregate debt and financing costs related to the non-regulated activities from the 2007 Test Year."* Please provide the specific procedures used and show the calculations as to how debt and financing costs related to the non-regulated activities were segregated from the 2007 Test Year.

A. To account for debt relating to non-regulated activities, Hydro created separate debt pools specifically pertaining to: Hydro's investment in Churchill Falls (Labrador) Corporation Limited ("CF(L)Co"), export revenues from recall power and expenditures pertaining to the Lower Churchill Project.

The cash flows associated with these activities are tracked separately and financing costs applied to month-end balances at a rate based on the weighted average cost of capital.

In the case of the CF(L)Co Share Purchase debt, the debt balance relates to Hydro's original investment in CF(L)Co. The ongoing debt balance is adjusted for the following factors:

- Preferred and common dividends paid to Hydro, and
- Dividends paid by Hydro to the Province in respect to cash flows pertaining to Hydro's investment in CF(L)Co.

In the case of net export revenues from recall power, the debt balance is adjusted for the following factors:

- Export sales of recall power,
- Costs pertaining to related power purchases, and
- Related dividends paid to the Province.

In the case of the Lower Churchill Project, the debt balance is a reflection of costs incurred to date in connection with the project to develop the hydroelectric potential of the Lower Churchill River. The notional debt balance is incremented monthly for related financing charges.

Details of forecast debt balances relating to these non-regulated activities and related financing costs for the 2007 test year are outlined below:

($millions)

	Year End 12/31/2006	Year End 12/31/2007	Avg. Balance Outstanding	Financing Cost For 2007
CFLCo Share Purchase	(19.6)	(16.9)	(18.3)	(1.2)
Recall	43.6	54.3	49.0	3.8
LHP	(95.1)	(154.8)	(125.0)	(9.2)
Totals	(71.1)	(117.4)	(94.3)	(6.6)

Note: There is a slight variation in totals when compared to Schedule IV due to minor changes in preferred dividend estimates that were not iterated. There is no impact on overall debt cost of 8.388%.

Hydro's cost of debt is adjusted to reflect the impact of these notional debt balances. This involves a reduction in the total average debt outstanding equal to the average of non-regulated debt, in this case $94 million. Similarly, interest costs are reduced by the total financing costs applicable to the non-regulated debt, in this case $6.6 million. The computation of the weighted average cost of capital utilizes the adjusted cost of debt as arrived at by the above calculation, coupled with a debt to equity ratio that reflects the removal of non-regulated debt.