Q. **Capital budget reduction**

Please explain the operation of the 5% reduction in the capital budget for each of 2006 and 2007 setting out for each year what amount is being reduced and how supplemental projects and variances will be affected. The explanation should also address overall impacts of this reduction including what the impacts are on actual capital spending, rate base, depreciation, financing and reporting.

A. Hydro calculated 5% of the PUB approved capital budgets for each year 2006 and 2007 and reduced the plant coming in service by that amount.

	Capital Budget	5% Reduction
2006	$42,636,000	$2,132,000
2007	$37,684,000	$1,884,000

In 2007, forecast average capital assets in ratebase were reduced by $3,074,000 ($2,132,000 + 50% of $1,884,000) and therefore return on ratebase was reduced by 7.4% of the resultant forecast average net book value. Forecast depreciation expense is lower by approximately $135,000 - which is a full year's depreciation on the 2006 reduction and a partial year's depreciation on the 2007 reduction - since this plant was forecast to come in service later in the year rather than on January 1.

This reduction is calculated for rate setting purposes only and will have no effect on actual capital spending. Supplemental projects will continue to be evaluated on their merits and either approved by Hydro or submitted to the Board for approval, as applicable. Reporting on the capital program will continue to be with reference to the approved capital budget and any variances from that approved budget - without reference to the 5% reductions that were made for rate setting purposes.

This approach is consistent with the manner in which reductions to the test year capital budget have been effected for rate setting purposes in previous GRAs.