Q. **2013 General Rate Application, Finance**

Page 3.8, lines 5-6 - It is stated that "*increasing Hydro's target ROE to NP's level will be an important step toward achieving the objective of achieving and maintaining a sound financial position*". Is it Hydro's opinion that it does not currently have and did not in the past have a sound financial position? If the answer is yes, provide the support on which it relies for its position.

A. Since 2003, Hydro has had an approved ROE and capital structure below the average of other Canadian regulated utilities, including other Government-owned entities.

Resulting from the 2003 GRA, Hydro's ROE was set at 5.83%. In credit rating reports published over that period, the Dominion Bond Rating Service (DBRS) consistently pointed to the impact this ROE had on Hydro's financial profile. In its 2003 report, DBRS noted that, while it expected Hydro's financial profile to remain "*stable*" over the medium-term, it would be "*much weaker than comparable investor owned utilities*". In that same report, DBRS further noted that while it expected a moderate improvement in the company's financial profile in 2004, it would remain "*much weaker than comparable investor owned utilities*".

From 2005 through to 2006, DBRS continued to point to the negative impact of Hydro's very low ROE on its earnings profile and coverage ratios. In 2005, DBRS noted that Hydro's earnings profile was "*expected to remain weaker than comparable investor owned utilities and many government owned utilities*", and that this was "*mainly due to [Hydro's] low approved* ROE, *5.83%, and [its] high targeted capital structure.*

Resulting from the 2006 GRA, Hydro was granted an ROE of 4.47%. As shown in Chart 3.1 on Page 3.8 of the 2013 General Rate Application, that remains well below the nation-wide average of approximately 9%. In its 2007 report, DBRS noted that Hydro's ROE of 4.47% was "*very low in comparison with similar regulated utilities in Canada [and as such,] cash flow and coverage ratios for the Company will be lower than similarly regulated utilities*".

While marginal profitability resulting from a low ROE can be managed in the short-term, its impacts on the financial profile of the Company cannot be managed in the long-run without negatively impacting the capital structure of the business.

Therefore, the increase in the allowable return on equity to 8.80% will bring Hydro to a point which is in-line with the average for Canadian utilities and to a point that is generally viewed by regulators as being sufficient to maintain a sound stand-alone financial position in the long-term.