

AVERAGE RATE FOR THE COST OF PROSPECTIVE CAPITAL

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The update of the cost of prospective capital for the reference year 2005 according to the method approved by the Régie in its D-2003-93 decision appears in table 1 below.

The Distributor thus asks the Régie for approval of an average rate of the cost of prospective capital of **7.15%** for the projected year 2005.

Table 1
CALCULATION OF THE AVERAGE RATE OF THE COST OF PROSPECTIVE CAPITAL
YEAR 2005

		2005
Capital Structure		
	Liabilities	65.00%
	Equity	35.00%
	Total	100.00%
Structure of Debt Capital (1)		
	Fixed debt 30 year \$CA	56.00%
	Fixed debt 5 year \$CA	24.00%
	Variable debt \$CA	20.00%
	Total	100.00%
Average Short Term Rate		
	Bankers acceptances 3 months	3.46%
Average Long Term Rate		
	Hydro Quebec 30 year obligations in \$CA	6.27%
	Hydro Quebec 5 year obligations in \$CA	5.27%
Rate of return on equity		
		9.24%
Prospective Cost of Debt		
	Long term financing	4.78%
	Short term financing	0.69%
	Guaranteed expense	0.50%
	Incurred expense	0.06%
Rate for the cost of perspective capital		
	Liabilities	3.92%
	Equity	3.23%

Note 1: corresponds to the desired debt structure

2 USE OF THE AVERAGE RATE OF THE COST OF PROSPECTIVE CAPITAL

The cost of prospective capital is used to evaluate the profitability of the projects and their impact on electricity rates. It reflects the conditions which will prevail when the investments will be carried out. Its use allows comparison of projects that are distinguished by the level as well as the distribution of the monetary flows that are associated with them. The application of the prospective cost of capital thus allows the making of good economic choices between several concurrent investment options.

Moreover, within the framework of phase 2 of Demand R-3492-2002, the Coalition gathering the AQCIE/CIFQ, the FCEI/UMQ, the FCSQ, OC and the UPA requested to the Régie that the financial expenses be capitalized at the average rate of the cost of prospective capital and not at the average rate of return on the rate base. According to the Coalition, the decision to add investments taken on the basis of prospective rates, it was logical that the corresponding financial expenses also be capitalized at the same rate.

In the D-2004-47 decision, the Régie responded to this request of the Coalition by distinguishing the financial expenses relating to the evaluation of investment projects from those undertaken for the purposes of rate making exercise. For the purposes of evaluation of investment projects, the Régie decided that the Distributor had to use, from now on, the average rate of the cost of prospective capital, as suggested by the Coalition. With regard to the capitalization of the financial expenses within the framework of rate making exercises or the establishment of the required revenue, the Régie retained the proposal of the Distributor to use the average rate of return on the rate base as presented in the accounting conventions for fixed assets as at HQD-08, document 1.

Following this decision, the Distributor uses from now on the average rate of the cost of prospective capital for the evaluation of the profitability of investment projects and also the average rate of the cost of capital on the rate base for purposes of the capitalization of financial expenses associated with the evaluation of the said projects.