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## BY E-MAIL AND WEB POSTING

February 24, 2010

To: All Licensed Electricity Distributors and Transmitters  
All Gas Distributors  
Ontario Power Generation Inc.  
All Registered Intervenors in 2010 Cost of Service Applications

### Re: **Cost of Capital Parameter Updates for 2010 Cost of Service Applications**

The Ontario Energy Board (the "Board") has determined the values for the Return on Equity ("ROE") and the deemed Long-Term ("LT") and Short-Term ("ST") debt rates for use in the 2010 rate year cost of service applications.

On December 11, 2009 the Board issued its *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*. The Report sets out the Board's approach to the cost of capital, and the methods the Board will use to determine the values for the ROE and the deemed LT and ST debt rates (collectively, the "Cost of Capital parameters") for the purpose of setting utility rates. At the time of that Report, the ROE formula was reset resulting in a base ROE of 9.75%.

Based on the methods set out in that Report, the Board has determined that the updated Cost of Capital parameters for 2010 cost of service rate applications are summarized in the table below. The 10 basis point increase in the ROE reflects rising bond yields in the market since the issuance of the Report. The Board considers these Cost of Capital parameter values and the relationships between them reasonable and representative of market conditions at this time and for the 2010 rate year.

<b>Cost of Capital Parameter</b>	<b>Value for 2010 Cost of Service Applications (assuming May 1, 2010 implementation date for rate changes)</b>
ROE	9.85%
Deemed LT Debt rate	5.87%
Deemed ST Debt rate	2.07%

These values will be applied by the Board in its consideration of 2010 electricity Cost of Service applications. A summary of the calculations of the Cost of Capital parameters is attached.

All queries on the cost of capital parameters should be directed to the Board's Market Operations hotline, at 416-440-7604 or [market.operations@oeb.gov.on.ca](mailto:market.operations@oeb.gov.on.ca).

Yours truly,

*Original Signed By*

Kirsten Walli  
Board Secretary

Attachment

## Attachment: Cost of Capital Parameter Calculations

### Return on Equity and Deemed Long-term Debt Rate

#### Step 1: Analysis of Business Day Information in the Month

Month:		January 2010				
Day	Bond Yields (%)			Bond Yield Spreads (%)		
	Government of Canada 10-yr	30-yr	A-rated Utility 30-yr	30-yr Govt over 10-yr Govt	30-yr Util over 30-yr Govt	
1	1-Jan-10					
2	2-Jan-10					
3	3-Jan-10					
4	4-Jan-10	3.60	4.10	5.61	0.50	1.51
5	5-Jan-10	3.56	4.08	5.57	0.52	1.49
6	6-Jan-10	3.62	4.14	5.60	0.52	1.46
7	7-Jan-10	3.63	4.15	5.62	0.52	1.47
8	8-Jan-10	3.59	4.11	5.57	0.52	1.46
9	9-Jan-10					
10	10-Jan-10					
11	11-Jan-10	3.61	4.14	5.55	0.53	1.41
12	12-Jan-10	3.55	4.09	5.50	0.54	1.41
13	13-Jan-10	3.61	4.14	5.53	0.53	1.39
14	14-Jan-10	3.55	4.09	5.47	0.54	1.38
15	15-Jan-10	3.49	4.05	5.41	0.56	1.36
16	16-Jan-10					
17	17-Jan-10					
18	18-Jan-10	3.47	4.04	5.39	0.57	1.35
19	19-Jan-10	3.48	4.04	5.41	0.56	1.37
20	20-Jan-10	3.42	4.01	5.41	0.59	1.40
21	21-Jan-10	3.39	4.00	5.37	0.61	1.37
22	22-Jan-10	3.37	3.99	5.38	0.62	1.39
23	23-Jan-10					
24	24-Jan-10					
25	25-Jan-10	3.38	4.00	5.37	0.62	1.37
26	26-Jan-10	3.36	3.97	5.35	0.61	1.38
27	27-Jan-10	3.35	3.96	5.34	0.61	1.38
28	28-Jan-10	3.33	3.93	5.32	0.60	1.39
29	29-Jan-10	3.34	3.94	5.34	0.60	1.40
30	30-Jan-10					
31	31-Jan-10					
		3.49	4.05	5.45	0.564	1.406

Sources: Bank of Canada    Bloomberg L.P.

#### Step 2: 10-Year Government of Canada Bond Yield Forecast

Source:	Consensus Forecasts	Publication Date:	January 11, 2010
January 2010	3-month	12-month	Average
	3.700	4.100	3.900 %

#### Step 3: Long Canada Bond Forecast

10 Year Government of Canada Concensus Forecast (from Step 2)	3.900 %
Actual Spread of 30-year over 10-year Government of Canada Bond Yield (from Step 1)	0.564 %
<b>Long Canada Bond Forecast (LCBF)</b>	<b>4.464 %</b>

#### Step 4: Return on Equity (ROE) forecast

Initial ROE	9.75 %
Change in Long Canada Bond Yield Forecast from September 2009	
LCBF (January 2010) (from Step 3)	4.464 %
Base LCBF	4.250 %
Difference	0.214 %
0.5 X Difference	0.107 %
Change in A-rated Utility Bond Yield Spread from September 2009	
A-rated Utility Bond Yield Spread (January 2010) (from Step 1)	1.406 %
Base A-rated Utility Bond Yield Spread	1.415 %
Difference	-0.009 %
0.5 X Difference	-0.004 %
<b>Return on Equity based on January 2010 data</b>	<b>9.85 %</b>

#### Step 5: Deemed Long-term Debt Rate Forecast

Long Canada Bond Forecast for January 2010 (from Step 3)	4.464 %
A-rated Utility Bond Yield Spread January 2010 (from Step 1)	1.406 %
<b>Deemed Long-term Debt Rate based on January 2010 data</b>	<b>5.87 %</b>

#### References on Calculation Methods:

- **Return on Equity:** Appendix B of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.
- **Deemed Long-term Debt Rate:** Appendix C of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.

## Attachment: Cost of Capital Parameter Calculations

### Deemed Short-term Debt Rate

**Step 1: Average Annual Spread over Bankers' Acceptance**

Once a year, in January, Board staff contacts prime Canadian banks to get estimates for the spread of short-term (typically 90-day) debt issuances over Bankers' Acceptance rates. Up to six estimates are provided.

A.	over 90-day Bankers Acceptance		Date of input
Bank 1	200.0	bps	January, 2010
Bank 2	162.5	bps	January, 2010
Bank 3	200.0	bps	January, 2010
Bank 4	150.0	bps	January, 2010
Bank 5	162.5	bps	January, 2010
Bank 6			

B.	Discard high and low estimates If less than 4 estimates, take average without discarding high and low.	
Number of estimates	5	
High estimate	200.0	bps
Low estimate	150.0	bps

C.	Average annual Spread	175.000	bps	①
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**Step 3: Deemed Short-Term Debt Rate Calculation**

Calculate Deemed Short-term debt rate as sum of average annual spread (Step 1) and average 3-month Bankers' Acceptance Rate (Step 2)

Average Annual Spread	1.750	%	①
Average Bankers' Acceptance Rate	0.321	%	②
<b>Deemed Short Term Debt Rate</b>	<b>2.07</b>	<b>%</b>	

**Step 2: Average 3-month Bankers' Acceptance Rate**

Calculation of Average 3-month Bankers' Acceptance Rate during month of January 2010

Month:	January 2010	
Day	Bankers' Acceptance Rate (%) 3-month	
1	1-Jan-10	
2	2-Jan-10	
3	3-Jan-10	
4	4-Jan-10	0.32 %
5	5-Jan-10	0.35 %
6	6-Jan-10	0.33 %
7	7-Jan-10	0.33 %
8	8-Jan-10	0.32 %
9	9-Jan-10	
10	10-Jan-10	
11	11-Jan-10	0.32 %
12	12-Jan-10	0.32 %
13	13-Jan-10	0.32 %
14	14-Jan-10	0.32 %
15	15-Jan-10	0.32 %
16	16-Jan-10	
17	17-Jan-10	
18	18-Jan-10	0.31 %
19	19-Jan-10	0.31 %
20	20-Jan-10	0.31 %
21	21-Jan-10	0.31 %
22	22-Jan-10	0.35 %
23	23-Jan-10	
24	24-Jan-10	
25	25-Jan-10	0.31 %
26	26-Jan-10	0.31 %
27	27-Jan-10	0.31 %
28	28-Jan-10	0.32 %
29	29-Jan-10	0.32 %
30	30-Jan-10	
31	31-Jan-10	
		<b>0.321 %</b> ②

Source: Bank of Canada / Statistics Canada  
Series V39071

**Reference on Calculation Method:**

- Appendix D of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.