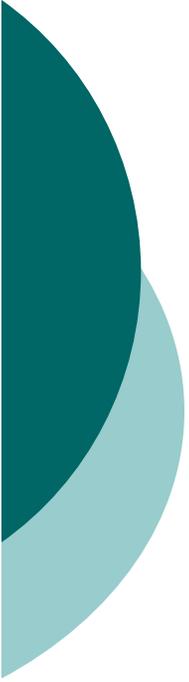




Cost of Capital for Ontario LDCs

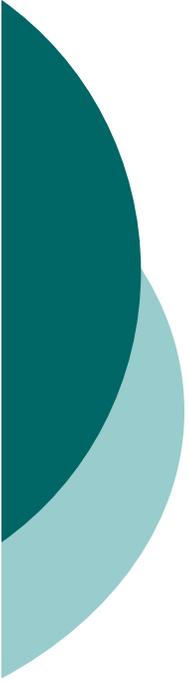
**Presentation on Behalf of
Hydro One Networks**

Kathleen C. McShane, CFA
Executive Vice President
Foster Associates, Inc.
September 2006



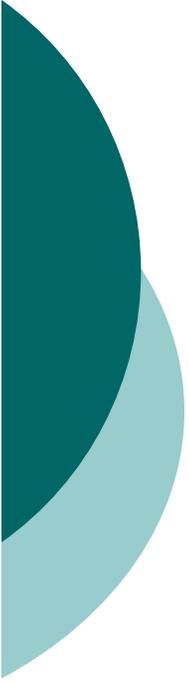
Capital Structure

- Board Staff proposes 60% debt and 40% equity including up to 4% preferred equity for all LDCs
- Common Equity ≠ Preferred Equity
- Appropriate Capital Structure for Hydro One
 - 40% common equity
 - Plus up to 4% preferred equity
- Importance of a strong financial structure and debt ratings
 - Global competition for capital
 - LDC and industry-wide capital requirements



Ability to Attract Capital

- Board's decision will be setting stage for utilities' ability to obtain financing on reasonable terms and conditions
- LDCs' ability to raise significant capital not yet seriously tested
- Debt rating agencies have expressed concern about the potential impact of the Board Staff's proposals on Hydro One's cash flows.
- Importance of attraction of both debt and equity capital



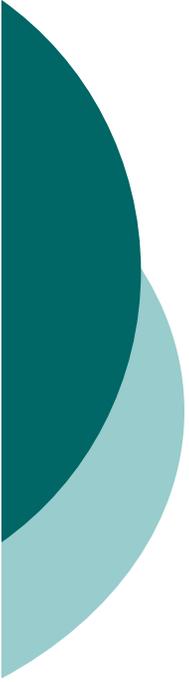
Return on Equity

- Current Methodology
 - Produces return in line with Canadian peers
 - Returns are low relative to U.S. peers
- Proposed Change in Methodology
 - Proposed ROE based on mechanistic application of a single test
 - Return would be well below Canadian peers
 - ROE would not meet comparable earnings standard
 - Ability to access debt capital on reasonable conditions at risk
 - Concerns with Staff's version of CAPM
 - Inputs
 - market return
 - beta
 - risk-free rate
 - Future Results



Approach to Determining ROE

- Use of Multiple Tests
 - All models are simplifications of reality
 - Fair ROE determination requires
 - Analysis of all relevant information
 - Judgment
- Each Test has Strengths and Challenges
 - Capital Asset Pricing Model
 - DCF
 - Comparable Earnings



Recommended Return on Equity

- Fair return for an Ontario LDC
 - 10.5% at a 5.0% Long Canada yield
 - Assumes an appropriate capital structure
- Return should be adjusted using existing automatic adjustment formula.