



*Cornerstone Hydro Electric Concepts Association Inc.*

---

---

Ontario Energy Board  
P.O Box 2319  
27<sup>th</sup> Floor  
2300 Yonge Street  
Toronto ON  
M4P 1E4

RECEIVED

JUL 7 2006

ONTARIO ENERGY BOARD

To: John Zych  
Board Secretary

Dear Mr. Zych

**Re: Proposals for Cost of Capital and 2<sup>nd</sup> Generation Incentive Regulation  
EB-2006-0088 and EB-2006-0089**

Thank you for allowing us to make comments on the Draft Staff Report: Cost of Capital and 2<sup>nd</sup> Generation Incentive Regulation for Ontario's Electricity distributors. Cornerstone Hydro Electric Concepts Incorporated (CHEC) is a cooperative of 16 of Ontario's Local distribution companies.

We have several concerns particularly with the Staff's proposed 36% common equity level as a common capital structure for all LDCs.

Risk is an important consideration in calculating Cost of Capital, however, there are many other important components that should be taken into consideration. There are many differences between Local Distribution Companies. Differences that exist are urban versus rural populations, high growth vs. little or no growth communities, brand new facilities versus replacement of older facilities, etc. These differences point to a need to have flexibility in the rate design process to ensure the rate making process considers the capital requirements of these diverse organizations.

For example, when the initial rate of return was formulated, the cost of power was to be a pass through and LDCs were not to be held liable for bad debts. This is clearly not the case. Perhaps the Board and Board Staff should take this into consideration which would likely result in a requirement to increase common equity versus decreasing it.

The establishment of a common capital structure to avoid imposing barriers to consolidation within the electricity distribution sector will have little effect. The current capital structures have not impeded consolidations in the past and we expect will not factor heavily in future consolidation decisions.

Reference and comparison to the gas industry is not relevant in this case. The gas industry in the Province of Ontario is much more stable than the electricity sector from a regulation standpoint. In terms of size, the gas market has predominately large equal sized organizations versus the electricity market where LDCs range in size from very small to very large. Where a 36% common equity share

---

---



## *Cornerstone Hydro Electric Concepts Association Inc.*

---

---

may be appropriate for the very large gas organizations it is not appropriate for the LDC electricity sector for the reasons provided in this letter.

In order for LDCs to move to a higher debt component consideration should also be given to the impact on the bank covenants required of the LDCs. Many LDCs could be put in a position where those covenants may not be met resulting in large penalties from the banking institutions again impacting negatively on the LDC and its consumers.

This proposal would definitely mean a reduction in revenue for most LDCs. This reduction in revenue combined with an industry where costs continue to rise puts the LDCs at greater financial risk. As the projection for interest rates rises, the cost of servicing existing debt increases putting a greater burden on the LDCs.

The final outcome of a common equity for all LDCs would likely result in an industry where fairness and reasonableness standards will not be met. A common equity process is also inconsistent with the Lazar and Prisman report where it stated there is no common view as to the appropriate capital structure.

In closing, we feel this is the time to increase flexibility within our industry. This report does exactly the opposite. We should be implementing programs that lead to a more stable electricity industry rather than increasing LDC risk and decreasing consumer confidence.

Respectfully

A handwritten signature in cursive script that reads 'David S. Proctor'.

David S. Proctor, CGA  
CHEC Finance Coordinator  
1087 Caledon / E. Gara Townline  
Caledon, ON  
L7K 0G5