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BY E-MAIL AND WEB POSTING

November 15, 2010

To: All Licensed Electricity Distributors and Transmitters
All Gas Distributors
Ontario Power Generation Inc.
All Registered Intervenors in 2011 Cost of Service Applications

Re: Cost of Capital Parameter Updates for 2011 Cost of Service Applications for Rates Effective January 1, 2011

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 2011 rate year cost of service applications for rates effective January 1, 2011. The ROE and the LT and ST debt rates are collectively referred to as the Cost of Capital parameters.

Every year, the Board updates the Cost of Capital parameters for use in setting rates for natural gas and electricity utilities for the coming rate year. As the Board has received applications requesting January 1, 2011 effective dates for rate changes, the Board has decided to advance its determination of the values for the Cost of Capital parameters based on the data available three months in advance of the January 1, 2011 date.

The updated Cost of Capital parameters are calculated based on the formulaic methodologies documented in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the “Report”), issued December 11, 2009.

Based on the methodologies set out in the Report and September 2010 data from the Bank of Canada, *Consensus Forecasts* and Bloomberg LLP, the Board has determined that the updated Cost of Capital parameters for 2011 cost of service rate applications for rates effective January 1, 2011 are summarized in the table below. While short-term rates have risen generally in line with changes in the Bank of Canada rate, results for the long-term debt rate and ROE due to changes in bond yields reflect lessened confidence in the pace of the global economic recovery. The Board considers these Cost of Capital parameter

values and the relationships between them reasonable and representative of market conditions at this time.

Cost of Capital Parameter	Value for 2011 Cost of Service Applications for January 1, 2011 rate changes
ROE	9.66%
Deemed LT Debt rate	5.48%
Deemed ST Debt rate	2.43%

These values will be applied by the Board in its consideration of 2011 electricity cost of service applications for rates effective January 1, 2011. A summary of the calculations of the Cost of Capital parameters is attached.

For rates with effective dates subsequent to January 1, 2011 (e.g. May 1, 2011) during 2011, the Board will use the September 2010 survey from Canadian banks for the spread over the Bankers' Acceptance rate of 3-month short-term loans for R1-low commercial customers for the short-term debt rate, but will update the cost of capital parameters based on data from the Bank of Canada, *Consensus Forecasts*, and Bloomberg LLP for three months prior to the effective date, per the methodologies documented in the Report.

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.

Yours truly,

Original Signed By

Kirsten Walli
Board Secretary

Attachment

Attachment: Cost of Capital Parameter Calculations
(assuming January 1, 2011 implementation date for rate changes)
Return on Equity and Deemed Long-term Debt Rate

Step 1: Analysis of Business Day Information in the Month

Month:		September 2010			
Day		Bond Yields (%)		Bond Yield Spreads (%)	
		Government of Canada 10-yr	A-rated Utility 30-yr	30-yr Govt over 10-yr Govt	30-yr Util over 30-yr Govt
1	1-Sep-10	2.85	3.50	0.65	1.56
2	2-Sep-10	2.87	3.52	0.65	1.57
3	3-Sep-10	2.95	3.57	0.62	1.54
4	4-Sep-10				
5	5-Sep-10				
6	6-Sep-10				
7	7-Sep-10	2.81	3.47	0.66	1.53
8	8-Sep-10	2.92	3.53	0.61	1.58
9	9-Sep-10	2.97	3.56	0.59	1.51
10	10-Sep-10	2.97	3.55	0.58	1.53
11	11-Sep-10				
12	12-Sep-10				
13	13-Sep-10	2.95	3.54	0.59	1.53
14	14-Sep-10	2.94	3.52	0.58	1.57
15	15-Sep-10	2.96	3.54	0.58	1.53
16	16-Sep-10	2.97	3.55	0.58	1.52
17	17-Sep-10	2.93	3.50	0.57	1.54
18	18-Sep-10				
19	19-Sep-10				
20	20-Sep-10	2.94	3.50	0.56	1.55
21	21-Sep-10	2.89	3.48	0.59	1.55
22	22-Sep-10	2.87	3.43	0.56	1.53
23	23-Sep-10	2.83	3.41	0.58	1.54
24	24-Sep-10	2.86	3.42	0.56	1.53
25	25-Sep-10				
26	26-Sep-10				
27	27-Sep-10	2.80	3.38	0.58	1.50
28	28-Sep-10	2.74	3.33	0.59	1.55
29	29-Sep-10	2.74	3.33	0.59	1.54
30	30-Sep-10	2.75	3.35	0.60	1.51
31					
		2.88	3.48	0.594	1.539

Sources: Bank of Canada Bloomberg L.P. ① ②

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

Source: Consensus Forecasts	Publication Date: September 13, 2010
September 2010	3-month: 3.100 12-month: 3.600 Average: 3.350 %

Step 3: Long Canada Bond Forecast

10 Year Government of Canada Consensus Forecast (from Step 2)	③	3.350 %
Actual Spread of 30-year over 10-year Government of Canada Bond Yield (from Step 1)	①	0.594 %
Long Canada Bond Forecast (LCBF)	④	3.944 %

Step 4: Return on Equity (ROE) forecast

Initial ROE		9.75 %
Change in Long Canada Bond Yield Forecast from September 2009		
LCBF (September 2010) (from Step 3)	④	3.944 %
Base LCBF		4.250 %
Difference		-0.306 %
0.5 X Difference		-0.153 %
Change in A-rated Utility Bond Yield Spread from September 2009		
A-rated Utility Bond Yield Spread (September 2010) (from Step 1)	②	1.539 %
Base A-rated Utility Bond Yield Spread		1.415 %
Difference		0.124 %
0.5 X Difference		0.062 %
Return on Equity based on September 2010 data		9.66 %

Step 5: Deemed Long-term Debt Rate Forecast

Long Canada Bond Forecast for September 2010 (from Step 3)	④	3.944 %
A-rated Utility Bond Yield Spread September 2010 (from Step 1)	②	1.539 %
Deemed Long-term Debt Rate based on September 2010 data		5.48 %

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
(assuming January 1, 2011 implementation date for rate changes)
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.	Average Spread over 90-day Bankers Acceptance (basis points)		Date of input
Bank 1	125.0	bps	Sept., 2010
Bank 2	125.0	bps	Sept., 2010
Bank 3	112.5	bps	Sept., 2010
Bank 4	150.0	bps	Sept., 2010
Bank 5	125.0	bps	Sept., 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	150.0	bps
Low estimate	112.5	bps

C.	Average annual Spread	125.000	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	1.250	%	①
Average Bankers' Acceptance Rate	1.177	%	②
Deemed Short Term Debt Rate	2.43	%	

Step 2: Average 3-month Bankers' Acceptance Rate

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

Month:	September 2010	
Day	Bankers' Acceptance Rate (%) 3-month	
1	1-Sep-10	1.03 %
2	2-Sep-10	1.03 %
3	3-Sep-10	1.08 %
4	4-Sep-10	
5	5-Sep-10	
6	6-Sep-10	
7	7-Sep-10	1.12 %
8	8-Sep-10	1.20 %
9	9-Sep-10	1.20 %
10	10-Sep-10	1.20 %
11	11-Sep-10	
12	12-Sep-10	
13	13-Sep-10	1.20 %
14	14-Sep-10	1.20 %
15	15-Sep-10	1.20 %
16	16-Sep-10	1.20 %
17	17-Sep-10	1.20 %
18	18-Sep-10	
19	19-Sep-10	
20	20-Sep-10	1.20 %
21	21-Sep-10	1.21 %
22	22-Sep-10	1.20 %
23	23-Sep-10	1.20 %
24	24-Sep-10	1.21 %
25	25-Sep-10	
26	26-Sep-10	
27	27-Sep-10	1.21 %
28	28-Sep-10	1.20 %
29	29-Sep-10	1.21 %
30	30-Sep-10	1.21 %
31		
		1.177 %
		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.