

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



BY E-MAIL AND WEB POSTING

November 10, 2011

To: All Licensed Electricity Distributors and Transmitters
All Gas Distributors
Ontario Power Generation Inc.
All Registered Intervenors in 2012 Cost of Service Applications

Re: Cost of Capital Parameter Updates for 2012 Cost of Service Applications for Rates Effective January 1, 2012

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 2012 rate year cost of service applications for rates effective January 1, 2012. The ROE and the LT and ST debt rates are collectively referred to as the Cost of Capital parameters. 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. The Board considers the Cost of Capital parameter values shown in the table that follows, and the relationships between them, reasonable and representative of market conditions at this time.

Cost of Capital parameters for rates effective January 1, 2012

Based on the methodologies set out in the Report and September 2011 data from the Bank of Canada, *Consensus Forecasts* and Bloomberg LLP, the Board has determined that the updated Cost of Capital parameters for 2012 cost of service rate applications for rates effective January 1, 2012 are:

Cost of Capital Parameter	Value for 2012 Cost of Service Applications for January 1, 2012 rate changes
ROE	9.42%
Deemed LT Debt rate	5.01%
Deemed ST Debt rate	2.08%

Detailed calculations of the Cost of Capital parameters are attached.

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. The Board has normally

updated the parameters once each year for rates effective May 1. Beginning in 2011, in light of certain applications requesting and approved for January 1 effective dates for rate changes, the Board advanced 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. On November 15, 2010, the Board issued a letter announcing updated Cost of Capital parameters for rates effective January 1, 2011. Also in that letter the Board stated that cost of service applications with rates effective May 1, 2011 would have updated Cost of Capital parameters based on data for January 2011. The Board is continuing this approach of calculating and publishing updated Cost of Capital parameters at least twice a year, for effective dates for rates of January 1 and May 1.

For rates with effective dates in 2012, beginning with January 1, 2012, the Board has updated the Deemed ST Debt rate parameters based on: (i) the September 2011 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; and (ii) data for three months prior to the effective date of January 1, 2012 from the Bank of Canada, *Consensus Forecasts*, and Bloomberg LLP, per the methodologies documented in the Report.

Updated Cost of Capital parameters for rates effective May 1, 2012 will be published once data for January 2012 become available.

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@ontarioenergyboard.ca.

Yours truly,

Original Signed By

Kirsten Walli
Board Secretary

Attachment

**Ontario Energy Board
Commission de l'Énergie de l'Ontario**

**Attachment: Cost of Capital Parameter Calculations
(assuming January 1, 2012 effective 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 2011				
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-11	2.39	3.04	0.65	1.58	
2	2-Sep-11	2.30	2.96	0.66	1.59	
3	3-Sep-11					
4	4-Sep-11					
5	5-Sep-11	2.30	2.96	0.66	1.59	
6	6-Sep-11	2.24	2.92	0.68	1.59	
7	7-Sep-11	2.27	2.95	0.68	1.59	
8	8-Sep-11	2.21	2.89	0.68	1.61	
9	9-Sep-11	2.11	2.81	0.70	1.60	
10	10-Sep-11					
11	11-Sep-11					
12	12-Sep-11	2.14	2.81	0.67	1.58	
13	13-Sep-11	2.20	2.84	0.64	1.59	
14	14-Sep-11	2.20	2.85	0.65	1.58	
15	15-Sep-11	2.30	2.92	0.62	1.63	
16	16-Sep-11	2.29	2.93	0.64	1.61	
17	17-Sep-11					
18	18-Sep-11					
19	19-Sep-11	2.19	2.87	0.68	1.59	
20	20-Sep-11	2.20	2.86	0.67	1.58	
21	21-Sep-11	2.12	2.77	0.64	1.61	
22	22-Sep-11	2.02	2.68	0.66	1.64	
23	23-Sep-11	2.08	2.71	0.63	1.58	
24	24-Sep-11					
25	25-Sep-11					
26	26-Sep-11	2.15	2.77	0.62	1.60	
27	27-Sep-11	2.20	2.83	0.63	1.61	
28	28-Sep-11	2.20	2.83	0.63	1.65	
29	29-Sep-11	2.22	2.84	0.62	1.67	
30	30-Sep-11	2.16	2.77	0.62	1.64	
31						
		2.20	2.85	4.46	0.652	1.605

Sources: Bank of Canada Bloomberg L.P.

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

Source: Consensus Forecasts	Publication Date: September 12, 2011
September 2011	3-month: 2.600 12-month: 2.900 Average: 2.750 %

Step 3: Long Canada Bond Forecast

10 Year Government of Canada Concensus Forecast (from Step 2)	3	2.750 %
Actual Spread of 30-year over 10-year Government of Canada Bond Yield (from Step 1)	1	0.652 %
Long Canada Bond Forecast (LCBF)	4	3.402 %

Step 4: Return on Equity (ROE) forecast

Initial ROE		9.75 %
Change in Long Canada Bond Yield Forecast from September 2009		
LCBF (September 2011) (from Step 3)	4	3.402 %
Base LCBF		4.250 %
Difference		-0.848 %
0.5 X Difference		-0.424 %
Change in A-rated Utility Bond Yield Spread from September 2009		
A-rated Utility Bond Yield Spread (September 2011) (from Step 1)	2	1.605 %
Base A-rated Utility Bond Yield Spread		1.415 %
Difference		0.190 %
0.5 X Difference		0.095 %
Return on Equity based on September 2011 data		9.42 %

Step 5: Deemed Long-term Debt Rate Forecast

Long Canada Bond Forecast for September 2011 (from Step 3)	4	3.402 %
A-rated Utility Bond Yield Spread September 2011 (from Step 1)	2	1.605 %
Deemed Long-term Debt Rate based on September 2011 data		5.01 %

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.

**Ontario Energy Board
Commission de l'Énergie de l'Ontario**

**Attachment: Cost of Capital Parameter Calculations
(assuming January 1, 2012 effective 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.	over 90-day Bankers Acceptance		Date of input
Bank 1	85.0	bps	Sept., 2011
Bank 2	87.5	bps	Sept., 2011
Bank 3	100.0	bps	Sept., 2011
Bank 4	85.0	bps	Sept., 2011
Bank 5	100.0	bps	Sept., 2011
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	100.0	bps
Low estimate	85.0	bps

C.	Average annual Spread	90.833	bps	①
----	-----------------------	--------	-----	---

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	0.908	%	①
Average Bankers' Acceptance Rate	1.173	%	②
Deemed Short Term Debt Rate	2.08	%	

Step 2: Average 3-month Bankers' Acceptance Rate

Calculation of Average 3-month Bankers' Acceptance Rate during month of September 2011

Month:	September 2011	
Day	Bankers' Acceptance Rate (%)	
	3-month	
1	1-Sep-11	1.17 %
2	2-Sep-11	1.17 %
3	3-Sep-11	
4	4-Sep-11	
5	5-Sep-11	
6	6-Sep-11	1.17 %
7	7-Sep-11	1.17 %
8	8-Sep-11	1.17 %
9	9-Sep-11	1.17 %
10	10-Sep-11	
11	11-Sep-11	
12	12-Sep-11	1.17 %
13	13-Sep-11	1.17 %
14	14-Sep-11	1.17 %
15	15-Sep-11	1.17 %
16	16-Sep-11	1.17 %
17	17-Sep-11	
18	18-Sep-11	
19	19-Sep-11	1.17 %
20	20-Sep-11	1.18 %
21	21-Sep-11	1.19 %
22	22-Sep-11	1.18 %
23	23-Sep-11	1.18 %
24	24-Sep-11	
25	25-Sep-11	
26	26-Sep-11	1.18 %
27	27-Sep-11	1.17 %
28	28-Sep-11	1.17 %
29	29-Sep-11	1.17 %
30	30-Sep-11	1.17 %
31		
		1.173 %
		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.