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 <u>market.operations@ontarioenergyboard.ca</u>.

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

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

Lond Preduct (a) Lond Preduct (b) Convertige (b) September 2011 2.400 2.750 % September 2011 2.400 2.750 % Convertige (b) Convertige (b) Convertige (b) Convertige (b) Convertige (b) Convertige (b) September 2011 2.450 Convertige (b) Convertige (b) Convertige (b) Convertige (b) Convertige (b) Convertige (b) Converti	Month:	Septer	nber 2011					Source: Consensus Publication Date: September 12, 2011
Day Canada Utility over 10-yr Gov	Bond Yields (%) Bond Yield Spreads (%)					Bond Yield S	Forecasts	
Day 10-yr 30-yr 3			Governm	ent of	A-rated	30-yr Govt	30-yr Util	
1 1.58p-11 2.39 3.04 4.62 0.65 1.58 2 2.58p-11 2.30 2.96 4.55 0.66 1.59 3 3.5ep-11 2.30 2.96 4.55 0.66 1.59 5 5.58p-11 2.24 2.92 4.51 0.68 1.59 6 6.58p-11 2.21 2.96 4.50 0.68 1.59 7 7.58p-11 2.21 2.84 4.41 0.70 1.60 10 10.58p-11 2.11 2.81 4.41 0.70 1.60 11 11.58p-11 2.02 2.84 4.43 0.67 1.58 11 11.58p-11 2.02 2.84 4.43 0.64 1.59 15 15.58p-11 2.02 2.84 4.65 0.64 1.61 16 16.58p-11 2.10 2.87 4.46 0.67 1.58 18 19 9.58p-11 2.10 2.84 4.41 0.67 1.58 19 19.58p-11 2.10 2.8			Canad	da	Utility	over 10-yr	over 30-yr	September 2011 2.600 2.900 9 2.750 %
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2.20 2.85 4.46 0.652 1.605 Sources: Bank of Canada Bloomberg L.P. Image: Construction of the second secon		30-Sep-11	2.16	2.77	4.41	0.62	1.64	Step 5: Deemed Long-term Debt Rate Forecast
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			2.20	2.85	4.46		1.605	
		Sources:	Bank of Cana	ada	Bloomberg L.P.	0	0	A-rated Utility Bond Yield Spread September 2011 (from Step 2 1.605 %
Deemed Long-term Debt Rate based on September 2011 data 5.01 %								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 Step 2: Average 3-month Bankers' Acceptance Rate

Calculation of Average 3-month Bankers'

Acceptance Rate during month of September

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.

А.		over 90-day		Date of input
		Bankers		
		Acceptance		
	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			
В.	Discard high and low e	estimates		
	If less than 4 estimate and low.	s, take average wit	hout d	iscarding high
	and low.			
	Number of estimates	5		
	Number of estimates	5		
	High estimate	100.0	bps	

C.	Average annual	90.833 bps	0	
	Spread			

85.0 bps

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 %	0
Average Bankers' Acceptance Rate	1.173 %	0
Deemed Short Term Debt Rate	2.08 %	

Mont	h:	September 2011
		Bankers'
		Acceptance Rate
		(%)
ſ	Day	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 22	21-Sep-11	1.19 %
	22-Sep-11	1.18 %
23 24	23-Sep-11 24-Sep-11	1.18 %
24 25	24-Sep-11 25-Sep-11	
25	26-Sep-11	1.18 %
20	27-Sep-11	1.17 %
28	28-Sep-11	1.17 %
20	29-Sep-11	1.17 %
30	30-Sep-11	1.17 %
31	2P	
		1.173 %
		0
Source	Bank of Canada	/ Statistics Canada
	Series V39071	

Reference on Calculation Method:

Low estimate

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