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April 17, 2009

Ms. Kirsten Walli, Board Secretary
ONTARIO ENERGY BOARD
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2009-0084: The Cost of Capital in Current Economic and Financial Market Conditions.

This letter is submitted in response to the Board's March 16, 2009 invitation to comment on whether the cost of capital parameters published by the Board for 2009 Electricity Distribution Cost of Service applications warrant adjustment as a result of current economic and financial market conditions.

Scope of IGUA's consideration.

IGUA's March 23, 2009 letter requesting cost eligibility in this process noted that the Board is seeking comment related to certain narrow cost of capital issues as they pertain to the 23 electricity distributors whose rates are subject to rebasing for the rate year commencing May 1, 2009. It was further noted that IGUA's primary concern in relation to this consultation is that determinations made by the Board remain confined to those 23 electricity distributors referenced in the Board's March 16th notice, and in the particular exigencies of the current economic climate.

Accordingly, IGUA has significantly restricted its consideration of this matter. IGUA has not attempted to address the particular questions posed in the Board's March 16th notice pertaining to the 23 electricity distributors. As a general caution, however, IGUA notes that the fiscal circumstances of Ontario's two main gas distributors would likely be completely different from those of the 23 electricity distributors. Consideration of the impact, if any, of the current economic and financial market conditions on Ontario's two major gas distributors would have to be based on very different circumstances than those considered in this process. In particular:

- The gas distributors are each significantly larger than any Ontario electricity distributor.
- Whereas the electricity distributors are municipally owned, the gas distributors are each part of significantly larger, diversified, and publicly traded private sector utility and resource sector companies.
- The gas distributors have recently entered into 5 year incentive regulation plans, the terms of which have largely resulted from comprehensive settlements with representatives of their ratepayers.
- Both gas distributors have recently announced significant over-earnings in 2008.
- The gas distributors do not have any of the major infrastructure renewal issues that are commonly discussed in relation to Ontario's electricity distributors.

In short, the nature of the Ontario gas distributors and their businesses is entirely different from that of the 23 electricity distributors in respect of whom this consultation has been convened. Any consideration of gas distributor cost of capital would need to proceed from a very different set of assumptions and circumstances, and along very different lines of inquiry, than have been engaged by the Board's March 16th notice. IGUA has not undertaken any such consideration, and understands that neither will the Board in this process.

General comment on economic circumstances.

IGUA did participate in a meeting of ratepayer representatives at which comment was sought from Dr. Lawrence Booth on the questions raised by the Board in its notice. That discussion included consideration of the basic economic drivers behind, and economic implications of, the inputs for determination of the electricity distribution cost of capital parameters in issue in this consultation. In an attempt to be helpful IGUA offers some general observations on these matters.

The Board's basic concern, as expressed in its invitation to comment, is that the spread between the Return on Equity and the Long-Term Debt rate has declined to 39 basis points, from 247 basis points as of the comparable date in 2008.

Under the current economic conditions, the long-term Canada bond yield has fallen. This reflects lower interest expectations in the long-term, relative to an expectation of increasing interest rates in response to inflationary pressures in the short term. As a result, the calculated ROE has fallen from 8.57% in 2008 to 8.01% for 2009. This accounts for roughly 30% of the narrowing of the spread between ROE and the Long-Term Debt rate.

The balance of the narrowing of the spread between ROE and the Long-Term Debt rate results from an increase in the deemed long-term debt rate. The long-term date rate, calculated as the Long Canada Bond Forecast plus an average spread with "A/BBB" rate corporate bond yields, has rising from 6.10% to 7.62% as a result of an increase in corporate bond yields.

In the current economic circumstances, increase in the yields (i.e. the cost of issuing) on corporate bonds of lower creditworthiness (i.e. BBB rated) can be expected, as bondholders look for greater return from riskier investments. The rapid rise in A corporate bond yields is, however, somewhat atypical. It has been observed[1] that the contraction of liquidity in the corporate bond market has resulted from the withdrawal of many market makers in this segment resulting in a significant liquidity premium for A rated corporate bonds. A similar contraction of liquidity has not been observed in equity markets. In fact, equity market liquidity has significantly increased in the current economic circumstances.[2]

Having noted all of this, the basic question that the Board should consider is whether there is some reason that the cost of capital parameters for 2009 electricity cost of service applications resulting from application of the established formula provide will not provide sufficient opportunity for electricity distributors to continue capitalize their businesses.

All observations indicate that there is no crises in respect of the ability of utilities in general to attract capital. Indeed, the relative utility stock prices observed in the atypical markets of the last several months indicate a "flight to quality", resulting in a very strong ability of utilities to attract capital.[3] IGUA will leave for consideration by others any circumstances peculiar to the 23 electricity distributors that would be cause for concern.

Conclusion.

The current economic and financial conditions are clearly atypical, and likely transitory. In any event, there is no apparent equity liquidity issue, particularly related to utility equities.

IGUA will leave to others more directly concerned consideration of any particular fiscal exigencies that might face the 23 electricity distributors in issue as a result of use of the current cost of capital parameters over their upcoming 3 year IRM term. In general, IGUA suggests that any change in the Board's basic approach to setting cost of capital in response to the current volatile, and likely transient, financial markets is unnecessary.

Yours truly,
MACLEOD DIXON LLP

Ian A. Mondrow

c. Murray Newton, IGUA

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[1] *Fair Return for an Alberta Utility*, Evidence of Lawrence D. Booth before the Alberta Utilities Commission, March 2009, at pages 3 (2nd full bullet) and 93 through 95. *[Note: This proceeding in which the referenced document has been filed is in progress, and the evidence referenced has not been tested as of the date of these submissions.]*
[2] IBID.
[3] IBID, at pages 2 (2nd bullet) and 81.