September 8, 2009

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
Suite 2700
Toronto, Ontario, M4P 1E4

Dear Ms. Walli:

Re: EB-2009-0084 – Written Comments of the London Property Management Association and the Building Owners and Managers Association of the Greater Toronto Area

INTRODUCTION

This letter is in response to the Board’s July 30, 2009 letter related to the Consultation on Cost of Capital – Issues List (EB-2009-0084). Three paper copies have been provided to the Board and an electronic version has been file through the Board’s web portal at www.errr.oeb.gov.on.ca.

These are the written comments of the London Property Management Association (LPMA) and the Building Owners and Managers Association of the Greater Toronto Area (BOMA) identifying their views and positions on the listed issues. The questions posed by the Board in its July 30, 2009 letter to participants are provided below, along with the views and positions of BOMA and LPMA.

In the responses to the questions posed by the Board, BOMA and LPMA will make reference to the December 20, 2006 Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario’s Electricity Distributors. In the comments provided below this is referred to as the 2006 Report.
BOMA & LPMA, along with a number of other ratepayer groups, asked Professor Laurence D. Booth to consider the questions outlined in Attachment B to the Board’s letter of July 30, 2009. As indicated below, BOMA & LPMA have adopted the responses and analysis provided by Dr. Booth for many of the questions posed by the Board. For some questions, BOMA & LPMA have provided additional comments that they believe are important for the Board to consider.

**PRELIMINARY COMMENTS**

1) Need for Review in Light of Current Financial Markets

In its’ reply letter (August 20, 2009) to Mr. Warren the Board stated that the Board’s consultation was prompted by the state of the financial markets. The Board further stated that it

“is satisfied that further examination of its policy regarding the cost of capital is warranted to ensure that, on a going forward basis, changing economic and financial conditions are accommodated *if required* (emphasis added).”

BOMA & LPMA believe it is important that stakeholders understand where the financial markets are today. Based on the August, 2009 Consensus Forecast, the average of the 3 month and 12 month forecast for 10-year Government of Canada bond yields is 3.70%. The actual average difference between the 10-year and 30-year Government of Canada bond yields in the month of August was approximately 50 basis points. This yields a long Canada bond forecast to be used in the determination of the return on equity and the deemed long-term debt rate of 4.20%. Application of the Board’ return on equity formula yields return on equity of 8.38%.

It is the understanding of BOMA & LPMA that the differential between the yield on long-term Government of Canada bonds and that on long-term corporates has narrowed significantly since the Board set the rates for the 2009 rebasing applications. In particular the differential was approximately 390 basis points based on the figures used in the February 24, 2009 letter from the Board that provided the 2009 cost of capital updates for
the 2009 cost of service applications. BOMA & LPMA believe that this differential is currently about 200 basis points or even less.

Based on a differential of 200 basis points and the long-term Government of Canada yield forecast of 4.2%, the deemed long-term debt rate would be 6.2%.

The following table illustrates the return on equity, deemed long-term debt rate, both as determined by the Board, and forecasted yield on long-term Government of Canada bonds, as well as the differential between the deemed long-term debt rate and the long-term Government of Canada yield and the differential between the return on equity and the deemed long-term debt rate for 2008, 2009 and that based on current financial market conditions (August, 2009).

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>August</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Equity</td>
<td>8.57%</td>
<td>8.01%</td>
<td>8.38%</td>
</tr>
<tr>
<td>Deemed Long-Term Debt Rate</td>
<td>6.10%</td>
<td>7.62%</td>
<td>6.20%</td>
</tr>
<tr>
<td>Forecasted Long-Term GoC Yield</td>
<td>4.456%</td>
<td>3.714%</td>
<td>4.20%</td>
</tr>
<tr>
<td>Differential – Deemed vs GoC (basis points)</td>
<td>164.4</td>
<td>390.6</td>
<td>200.0</td>
</tr>
<tr>
<td>Differential – ROE vs Deemed (basis points)</td>
<td>247</td>
<td>39</td>
<td>218</td>
</tr>
</tbody>
</table>

In the Board’s original letter on the Cost of Capital in Current Economic and Financial Market Conditions dated March 16, 2009 the Board noted that the spread between the Return on Equity and the Long-Term Debt rate declined to 39 basis points in 2009, from a spread of 247 basis points as of the comparable date in 2008. As the above table illustrates, the current financial market parameters are much more similar to those of 2008 than to those of 2009. In particular, the spread between the return on equity and the long term debt rate has increased to 218 basis points, a level very similar to that of 2008. Similarly the differential between the deemed long term debt rate the yield on the long Canada bonds (i.e. the corporate vs long Canada differential) is now at approximately 200 basis points rather than more than the 390 used to set the rate for 2009 applications, and much closer to the differential in 2008.
In other words, the financial market conditions that prompted the Board’s consultative process in March of this year to a large extent no longer exist and, as such, no accommodation is required for the current financial market conditions.

It is the submission of BOMA & LPMA that the Board does not need to make any adjustments to the calculations of the cost of capital parameters as a result of “Current Economic and Financial Market Conditions”. As illustrated above the current financial market conditions are substantially different than they were when the Board initiated this consultative. Moreover, the current financial conditions are very similar to what existed when the cost of capital parameters were set for 2008. The Board did not express any concern with those cost of capital parameters.

The Board may want to put in place a process that could be utilized if economic and financial market conditions deviate beyond some “normal” range. This process could be as simple as suspending the calculation of the cost of capital parameters for a given year and extending the use of the parameters from the previous year. Another simple process would be to extend the one month of actual data for calculating the differential between 10-year and 30-year Government of Canada bond yields, the long-term corporate differential and the 3 month bankers’ acceptance rate. All of these inputs are used by the Board in determining the cost of capital parameters. Extending the period of actual data used to 3, 6 or even 12 months would help dampen any temporary or abnormal financial market conditions.

Either of these approaches would result in substantial stability for the distributors in future unstable economic and financial times.

2) Implementation Timing of Any Change Deemed Necessary
In its June 18, 2009 letter the Board indicated that any changes resulting from this consultative process would not be applied to the 2009 parameter values. The Board did indicate that it anticipated that any changes to the policy made as a result of this review would apply to the setting of rates for 2010 rate year.
BOMA & LPMA submit that such an approach would be unfair to both distributors and to their ratepayers. Not all distributors have had their cost of capital parameters updated to reflect financial markets as they exist when they rebase in the current round of incentive rate making. Some distributors rebased in 2008 and 2009, while others will rebase in either 2010 or 2011.

BOMA & LPMA do not believe it would be fair and just to alter course mid-term in the current IRM generation. Those distributors that rebased in 2008 and 2009 have used the current methodology. Allowing those who have not yet rebased to use a new methodology that the Board may develop in the next few months would not be fair to the distributors or to their ratepayers.

Adopting a new methodology that could potentially have significant impacts on the revenue requirement may also provide an incentive to those distributors to rebase in 2008 or 2009 to file a new cost of service application prior to their next scheduled rebasing application for 2012 or 2013 rates if the new methodology allowed a higher return on equity and/or deemed long term debt. Alternatively, if the new methodology (which may include a change to the capital structure) were to result in lower cost of capital parameters, distributors would be free to stay out until their next scheduled rebasing application. In both instances, ratepayers are the losers and the distributors are the winners.

BOMA & LPMA submit that if the Board determines that changes should be made to the methodology, then the resulting changes should not be implemented until the 2012 rate rebasing applications. This would ensure that all distributors (and by extension, their ratepayers) have been treated the same, under the current methodology. With the next round of rebasing scheduled to begin for the 2012 rate year, this would be the proper time to implement any methodological changes on a going forward basis. Implementation at that time ensures the equitable treatment for all distributors and their ratepayers through the third generation of IRM. The new methodology would be applicable at the start of the fourth generation.
QUESTIONS AND ANSWERS

1. What method(s)/test(s) might the Board formally consider to determine whether the return on capital meets: (i) the comparable investment standard; (ii) the financial integrity standard; and (iii) the capital attraction standard?

BOMA & LPMA support the analysis and recommendation of Dr. Booth in his Comments.

2. Is the current deemed capital structure appropriate? If not, what alternative(s) might the Board consider?

No, the current deemed capital structure is not appropriate when it comes to the deemed long-term and deemed short term debt components of the capital structure for the electricity distributors. The capital structure used by the natural gas utilities and approved by the Board in their individual rate cases is appropriate. The methodology employed by the natural gas distributors should be used by the Board to set the long-term and short term debt components of their capital structures. BOMA & LPMA support the current 40% deemed equity component of the capital structure for the electricity distributors.

The Board has a long history of determining the cost of capital, including the capital structure of the regulated natural gas distributors in Ontario (Enbridge Gas Distribution (EGD), Union Gas (Union) and Natural Resource Gas Limited (NRG)).

As the Board noted in the 2006 Report (page 9) the use of short-term debt “has been included in rate setting for natural gas distributors. In the gas sector, am amount referred to as “unfunded short-term debt” is calculated o balance total financing with rate base.”

This means that the capital structure used by the Board for each of the three gas distributors reflects a deemed equity component, actual long-term debt, with the remaining amount needed to balance to rate base being the “unfunded short-term debt”. BOMA & LPMA note that the short-term debt can includes both funded and unfunded short-term debt.
It is useful to look at the components of rate base and the capital structure for each of EGD, Union and NRG. The last cost of service hearings for all three of these distributors was based on 2007 test year filings (EB-2006-0034 for EGD, EB-2005-0520 for Union, EB-2005-0544 for NRG).

The allowance for working capital for gas distributors is similar to that used for the electricity distributors with two key differences. Gas distributors has a significant need for working capital associated with gas in storage. Gas distributors are required to reduce their working capital allowance by the amount of customer security deposits. Adjusting for these two differences, the working capital allowance for EGD represented 0.9% of its total approved rate base. The corresponding figures for Union and NRG were 1.9% and 0.9%, respectively.

A review of the Board approved capital structure for the three gas distributors shows that the short-term debt component was similar to the magnitude of the working capital allowance share of rate base. In particular, the EGD short-term debt component of the capital structure was 1.68% while Union had a (4.48)% component of short-term debt and NRG had (1.10)%. The negative short-term debt components of the capital structure for both Union and NRG reflected the “lumpiness” of additional long-term debt that was required for test year and future growth.

In the 2006 Report, the Board deemed a short-term debt component to be fixed at 4% of rate base. Prior to this there was no short-term debt component of rate base. The Board stated that short-term debt is generally less expensive than long-term debt and generally provides greater financing flexibility.

BOMA & LPMA submit that the use of a 4% deemed short-term debt component was adequate for the time. However, it is submitted that this 4% figure is no longer justified. BOMA & LPMA submit that the level of short-term debt included in the capital structure should be done more in line with that for the gas distributors. In other words, the amount
of short-term debt should approximate the working capital allowance component of rate base. In the 2006 Report the Board stated (page 10)"

"As a general principle for ratemaking purposes, the Board believes that the term of the debt should be assumed to be similar to the life of the assets that are to be acquired with that debt. This suggests that, in theory, for an industry with long-lived assets, the majority of debt should be long-term. However, in reality, some short-term debt is a suitable tool to help meet fluctuations in working capital levels."

The working capital allowance is an allowance for cash flow associated with lead and lags associated with OM&A and cost of power expenses relative to when revenues are collected from customers. Clearly the working capital allowance is a short-term financing requirement, unlike funds required to install poles, lines or stations. BOMA & LPMA support the general principle as stated by the Board in the 2006 Report. So the question then becomes, what is the level of the working capital allowance component of rate base for the electricity distributors and is it similar to that of the gas distributors, or close the deemed 4% level set by the Board in the 2006 Report. The answer to both questions is a resounding no!

As shown in the table in the following page, which is derived from the Board Decisions of a majority of the 2009 cost of service rebasing applications, no electricity distributor has an allowance for working capital that makes up only 4% of its total rate base. The lowest working capital allowance component of rate base is 10.9%, while the largest component is more than 28%. The average working capital allowance component of rate base over the sixteen distributors included in the table is 19.0%, nearly 5 times the deemed short-term component of 4% of the capital structure.

BOMA & LPMA submit that the current deemed short-term component of the capital structure is too small. It should be more in line with the working capital component of rate base, as it is for the gas distributors.
<table>
<thead>
<tr>
<th>File Number</th>
<th>Name of LDC</th>
<th>Total Rate Base ($</th>
<th>Allowance for Working Capital ($)</th>
<th>As % of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>EB-2008-0247</td>
<td>Weiland Hydro-Electric System Corp.</td>
<td>26,931,529</td>
<td>6,087,875</td>
<td>22.6%</td>
</tr>
<tr>
<td>EB-2008-0246</td>
<td>Tillsonburg Hydro Inc.</td>
<td>8,686,283</td>
<td>2,443,661</td>
<td>28.1%</td>
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<tr>
<td>EB-2008-0245</td>
<td>Thunder Bay Hydro Electricity Distribution Inc.</td>
<td>75,533,273</td>
<td>13,480,846</td>
<td>17.8%</td>
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<tr>
<td>EB-2008-0244</td>
<td>PowerStream</td>
<td>526,814,170</td>
<td>69,727,507</td>
<td>13.2%</td>
</tr>
<tr>
<td>EB-2008-0237</td>
<td>Niagara-on-the-Lake Hydro Inc.</td>
<td>21,857,011</td>
<td>2,377,354</td>
<td>10.9%</td>
</tr>
<tr>
<td>EB-2008-0236</td>
<td>Midland Power Utility Corporation</td>
<td>12,211,648</td>
<td>2,977,065</td>
<td>24.4%</td>
</tr>
<tr>
<td>EB-2008-0250</td>
<td>Westario Power Inc.</td>
<td>33,968,175</td>
<td>6,100,922</td>
<td>18.0%</td>
</tr>
<tr>
<td>EB-2008-0248</td>
<td>West Coast Huron Energy</td>
<td>5,107,346</td>
<td>1,225,478</td>
<td>24.0%</td>
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<tr>
<td>EB-2008-0234</td>
<td>Lakeland Power Distribution Ltd.</td>
<td>15,951,283</td>
<td>3,373,403</td>
<td>21.1%</td>
</tr>
<tr>
<td>EB-2008-0233</td>
<td>Innisfil Hydro Distribution Systems Limited</td>
<td>22,869,989</td>
<td>3,433,548</td>
<td>15.0%</td>
</tr>
<tr>
<td>EB-2008-0227</td>
<td>EnWin Utilities Ltd.</td>
<td>199,803,077</td>
<td>28,174,420</td>
<td>14.1%</td>
</tr>
<tr>
<td>EB-2008-0226</td>
<td>COLLUS Power Corp.</td>
<td>16,289,243</td>
<td>4,575,993</td>
<td>28.1%</td>
</tr>
<tr>
<td>EB-2008-0225</td>
<td>Centre Wellington Hydro</td>
<td>9,039,502</td>
<td>2,118,338</td>
<td>23.4%</td>
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<tr>
<td>EB-2008-0222</td>
<td>CNPI - Gananoque</td>
<td>7,736,765</td>
<td>866,332</td>
<td>11.5%</td>
</tr>
<tr>
<td>EB-2008-0223</td>
<td>CNPI - Fort Erie</td>
<td>37,465,252</td>
<td>4,072,026</td>
<td>10.8%</td>
</tr>
<tr>
<td>EB-2008-0221</td>
<td>Bluewater Power Distribution Corporation</td>
<td>47,830,944</td>
<td>9,931,607</td>
<td>20.9%</td>
</tr>
</tbody>
</table>

Average: 19.0%

In the 2006 Board Report, the Board provided a number of reasons for setting the deemed short-term debt component at 4% of rate base.

The Board stated (page 11):

"Short-term debt is optimally used as an interim solution for managing a firm's financing requirements. It may fluctuate, although generally within a limited range. Using a firm's actual short-term debt component would be administratively challenging given the number of electricity distributors and the associated volume of data that would need to be reported and verified."

BOMA & LPMA submit that this should no longer be a reason to deem a short-term debt component at 4% of rate base. Using the working capital allowance (a short-term need for financing) component of rate base provides a reasonable proxy for the level of short-term debt that should be included in a distributors capital structure. This data is already provided by the distributors in their rate base evidence. There is no administrative challenge. Moreover, as shown in the above table, there is a wide variation in the level of short-term financing needed to financing the working capital allowance among distributors. This variation should be reflected in their revenue requirement. It should
also be noted that the working capital allowance does not fluctuate significantly from year to year.

In the 2006 Report, the Board also stated (page 10)

"Rates on short-term debt can be more volatile than rates on long-term debt and therefore the Board believes it is in the interests of distributors and ratepayers for the amount of short-term debt to be set at a deemed level."

BOMA & LPMA accept this statement, but only if the deemed level is close to a level of short-term debt that coincides with the general principles for ratemaking purposes that the term of the debt should match the life of the assets that are to be financed by the debt. The allowance for working capital is not a long term asset, it is a need for short term capital to manage cash flow. As such, the deemed level should be set at or near the level of the working capital allowance component of rate base.

BOMA & LPMA do not accept the statement that it is in the interest of ratepayers to have a deemed short-term debt component of rate base that is obviously too low. In fact, BOMA & LPMA submit that the opposite is true. Ratepayers are actually paying more than they should because of the low deemed short-term debt component of 4%. This is because many distributors are allowed to increase the revenue requirement for “phantom” long-term debt. This “phantom” long-term debt is the difference between the deemed long-term debt (56% of rate base) and the actual amount of long-term debt held by the distributor. Appendix A to these Comments show that a number of 2009 cost of service rebasing distributors have substantial amounts of “phantom” debt. Appendix A quantifies this level of deemed long-term debt in excess of the actual level of long-term debt in column (c).

If the Board allowed only the actual long-term debt in the capital structure, as it does with the gas distributors, the “phantom” long-term debt would be treated as short-term debt and would attract the deemed short-term debt rate rather than the weighted average long-term debt rate. This creates excess interest that has been included in the revenue requirement, as shown in column (f) of Appendix A.
This excess interest for the 11 distributors shown amounts to a total of more $5 million. This is $5 million being paid in rates by ratepayers of these 11 distributors for costs that do not exist!

Moreover, when this excess interest, or more accurately, excess revenue requirement is divided by the deemed level of equity, column (h) shows that these distributors are earning significant excess returns on equity over and above the 8.01% approved by the Board for 2009. On average, the excess is nearly 300 basis points above the approved level.

BOMA & LPMA submit that this result, which falls out of the application of the methodology of the 2006 Report, should not be maintained. The Board should immediately change the capital structure for the 2010 and 2011 rebasing electricity distributors to more closely match that used by the Board for the gas distributors.

Specifically, BOMA & LPMA recommend that the Board adopt the following capital structure on a going forward basis:

- Deemed equity component of 40%;
- Actual long-term debt component for the distributor;
- Short-Term debt component equal to rate base less deemed equity less actual long-term debt.

This approach ensures that ratepayers are not paying for phantom long-term debt costs while ensuring that distributors are allowed to recover their actual long-term debt costs. Distributors can still earn a return on short-term debt that is in excess of their actual costs because at least some of the short-term debt may be unfunded. Distributors are, in effect, rewarded with this excess revenue (with no associated cost) for finding ways to manage their cash flows without borrowing fully for this purpose. BOMA & LPMA submit that this is an acceptable cost for ratepayers, unlike deemed interest on phantom long-term debt.
Finally, the Board should clearly indicate to the electricity distributors that the short-term debt component of their capital structure should be in line with the working capital allowance component of their rate base. Deviations would only be acceptable when a distributor has “lumpy” capital additions that may require the addition of more long-term debt than would normally be expected.

3. Should the approach to setting cost of capital parameter values differ depending on whether a distributor finances its business through the capital markets or through government lending such as Infrastructure Ontario or through bank lending? If so, what would be the implications, if any, of doing so?

No. Why would it matter where the money comes from? From the ratepayer's point of view the only concern is the cost of the capital that flows into the revenue requirement. Ratepayers do not care if the money comes through the capital markets, from Infrastructure Ontario or through bank lending any more than they care if the money came through the Bank of Montreal or the Royal Bank of Canada.

What is of concern to ratepayers is that regulated distributors are paying a fair cost of capital. In other words, if financing is available through government lending at a lower rate than through another source such as bank lending or affiliate financing, then the distributor should be required to obtain the financing through the least expensive source. This is no different than the procedures that should be followed by a distributor when it seeks to purchase services as part of its OM&A costs or to purchase goods under its capital expenditure program.

Affiliate debt that has a fixed rate and term should be treated the same as third party debt. That is, it should be the least cost option available to the distributor when the financing was put into place. This embedded cost of debt - whether affiliate or third party - would then continue to be included in the future cost of debt for the remaining life of the financing or until it is replaced with new financing, at an equal or lower cost.

This is the current approach of the Board as set out in the 2006 Report. In particular, the 2006 Report stated that:
"The Board has determined that for embedded debt the rate approved in prior Board decisions shall be maintained for the life of each active instrument, unless a new rate is negotiated, in which case it will be treated as new debt."

BOMA and LPMA would suggest that if a new rate is negotiated, it should be clear that the new rate should result in an equal or lower cost to ratepayers. There is no justification, for example, of replacing affiliate debt at one rate with affiliate or third party debt at a higher rate.

In the 2006 Report the Board also set a cap on the rate for new affiliated debt. The Board determined that the allowed rate would be the lower of the contracted rate and the deemed long-term debt rate, as defined by the Board in the 2006 Report. BOMA and LPMA support the continuation of this approach.

BOMA and LPMA believe that changes should be made to the way that the Board deals with affiliate debt that is callable on demand. In the 2006 Report the Board determined that for all variable rate debt and for all affiliate debt that was callable on demand, it would use the current deemed long-term debt rate.

BOMA & LPMA submit it is inappropriate to consider debt that is callable, often with less than 365 days notice, as long-term debt. Such debt should be considered short-term debt since it is callable in a short period of time. Distributor affiliates should not be allowed to charge a long-term debt rate on debt that is, in fact, short-term in nature. Consistent with the short-term nature of the affiliate callable debt, the Board should apply a short-term debt rate to it. If an affiliate wishes to earn a long-term debt rate on the money it lends to the distributor then it should lend such money on a long-term basis.

As noted above in the response to Question 2, BOMA & LPMA believe that the capital structure for the electricity distributors should be adjusted to reflect the deemed level of equity and the actual amount of long-term debt. The remainder of the rate base would be financed through short-term debt, both funded and unfunded. The funded component of short-term debt would reflect any actual short-term debt that the distributor has in place.
This would include callable debt. Callable affiliate debt would have its rate determined in a similar manner to that used by the Board for new affiliate long-term debt in the 2006 Report. In particular, callable affiliate debt would have an allowed rate that is the lower of the contracted rate and the deemed short-term debt rate. Unfunded short-term debt would be defined as rate base less the deemed equity, actual long-term debt and funded short-term debt. It would have the weighted average funded short-term debt rate applied to it. If a utility had no funded short-term debt, then the Board deemed short-term debt rate would be applied to the unfunded short-term debt.

4. **Does the analysis in the Concentric Report provide a reasonable foundation for satisfying the comparable investment standard?**

BOMA & LPMA support the response and analysis provided by Dr. Booth.

In particular, BOMA & LPMA support the comment by Dr. Booth that the Concentric report has little substantive discussion of the impact of regulation, the use of deferral and variance accounts and frequency of rate reviews. There is no analysis on the degree of unbundling by the US gas distributors relative to those in Ontario. Ontario distributors have a variance account that treat gas costs as a pass through costs. It is unclear if this is the case for all US gas distributors used in the Concentric report. If a distributor is at risk for gas cost changes, then they may be entitled to a higher return on equity. In Ontario, distribution rates are adjusted on an annual basis, either through a cost of service review or the through the application of an incentive regulation mechanism. It is not clear how many of the US distributors included in the Concentric report have their rates adjusted on an annual basis.

At page 3 of the report, Concentric states that the report is not a comprehensive examination of the ROE for any specific company. BOMA & LPMA submit that without a comprehensive examination that deals with the regulatory environment, including frequency of adjustments, availability of deferral and variance accounts, and so on, no valid conclusions can be drawn.
5. If not, what might the Board use as a comparator group?

BOMA & LPMA strongly support the recommendation of Dr. Booth that a fair return stems from the Canadian capital market.

6. Were the Board to only consider the use of Canadian utilities as a comparator group, is there an issue with circularity, given that the ROEs of these utilities are, and have been established by a mechanism similar to that currently used by the Board?

BOMA & LPMA support the response provided by Dr. Booth.

7. Should the ERP approach be reset given that when the formula was first established the reference bond rate was 8.75%?

BOMA & LPMA do not believe that there is any reason to reset the ERP approach. However, should the Board determine that a resetting should be investigated, BOMA & LPMA support the response of the Dr. Booth that such a resetting should not be done in the absence of a full hearing.

8. Should the ERP approach be reset on a regular basis (e.g., every 4 or 5 years) to mitigate the issues described in the 1997 Compendium?

BOMA & LPMA support the response and analysis provided by Dr. Booth.

9. How might the Board address the potential issues arising from the application of the current methodology as a single, point-in-time calculation?

BOMA & LPMA support the response provided by Dr. Booth. The forecast of long-term bond yields is not heavily influenced by temporary market conditions.

However, the Board may want to consider adjusting the methodology used to calculate the differential between the actual 30-year Government of Canada bond yield and the actual rate for the 10-year Government of Canada bond yield. The Board currently uses a period of one month to calculate this differential, which is then added onto the 10 year bond forecast as published in Consensus Forecasts. The Board may wish to consider whether an average of one month of data is appropriate or whether a longer term average
should be used, such as 3 months, 6 months or 12 months. The use of a longer term average would mitigate the impact of any short term economic and financial market conditions and provide a more stable figure. At the same time, a longer term average will also lag behind actual interest rates if there is a downward or upward trend over time.

If the Board determines that a longer time period should be used to calculate the differential between the 30-year and 10-year Government of Canada bond yields used in the determination of the return on equity, then BOMA & LPMA submit that the Board should also use the same methodology for determining the deemed long-term and short term debt rates. In particular, the same number of months should be used in determining the differential between the corporate bond yield and the long-term Government of Canada bond yield used to determine the deemed long-term debt rate. Similarly, the same number of months should be used to determine the deemed short term debt rate using the 3-month bankers' acceptance rate.

10. How should the Board establish the initial ROE for the purposes of resetting the methodology?
BOMA & LPMA support the response provided by Dr. Booth. If the Board decides to establish an initial ROE for the purposes of resetting the methodology, a full hearing should be initiated.

11. Is the government (of Canada) bond yield the appropriate base upon which to begin the return on equity calculation?
BOMA & LPMA support the response provided by Dr. Booth.

12. What is the relationship between corporate bond yields and the corporate cost of equity? Is this relationship sustainable?
BOMA & LPMA support the analysis and conclusions provided by Dr. Booth.

In addition, BOMA & LPMA have provided comments and responses to Questions 2 and 3 above, that if adopted by the Board, would significantly reduce the need for the use of a deemed long-term debt rate. The BOMA & LPMA proposals would eliminate the use of
deemed long-term debt rate for all affiliate debt that is callable on demand. The deemed
long-term debt rate would only be used as a ceiling on new affiliated debt and for
variable rate debt.

BOMA & LPMA also submit that the Board should provide all stakeholders with
additional information related to the data that is available from TSC Inc. related to long-
term bond yields. The Board currently uses the Long-Term Bond Yields – All
Corporates in the calculation of the long-term debt rate. It is not known whether there are
other data series that could be used such as, for example, Long-Term Bond Yields – All
Utilities. If an indicator other than All Corporates is available and more closely related to
regulated distributors, then that information could prove useful. As noted above under
"Preliminary Comments" the current (August 2009) long Canada bond yield of 4.2%,
combined with the corporate bond differential of about 200 basis points would suggest a
deemed long-term debt rate of approximately 6.2%. However, a review of the
information available through the National Post at the end of August and early September
shows that the yield on Hydro One debt with maturity dates in 2030 and 2032 are
approximately 5.2%, a full percentage point below that implied by the deemed long-term
debt calculation.

13. Does the current approach used by the Board to calculate the ERP remain
appropriate? If not, how should the ERP be calculated?

BOMA & LPMA support the response of Dr. Booth.

14. Should the Board adopt a dead band? If so, what should the range of the dead
band be?

BOMA & LPMA support the response provided by Dr. Booth. Further, BOMA &
LPMA submit that the adoption of a dead band will only slow down the regulatory
process since the location within the dead band would need to be examined in detail in
every cost of service application for utility specific circumstances.
15. **Should the Board adopt trigger mechanism(s). If so, how often should the Board review the methodology?**

BOMA & LPMA support the response provided by Dr. Booth. As noted, the distributors have an effective means to request a review of the methodology if they cannot attract capital on fair and reasonable terms.

16. **What is the appropriate test(s) to ensure the FRS is met (e.g. corroborating results for reasonableness relative to other benchmarks or through other methods)?**

BOMA & LPMA support the analysis and response provided by Dr. Booth. The Board has not been provided with any evidence from any distributor in Ontario of financial hardship due to the current allowed return on equity.

17. **What information might the Board need to definitively determine that market conditions are having an effect on the variables used by the Board's cost of capital methodology?**

BOMA & LPMA support the response provided by Dr. Booth. In addition, BOMA & LPMA submit that it is important to distinguish between the “ring fenced” utility inability to raise capital on fair and reasonable terms and the ability of the shareholder to raise the capital required. Some municipal owners may be constrained on the amount of capital they can raise to invest as equity or affiliate debt in their utility. BOMA & LPMA submit that any such constraint is not the result of market conditions. A higher return on equity would not solve the municipal constraints.

18. **Should the Board consider monitoring indicators like these on an on-going basis to test the reasonableness of the results of its cost of capital methodology?**

BOMA & LPMA support the analysis and recommendation of Dr. Booth.

19. **What other key metrics used by financial market participants to determine whether financial markets conditions are or are not “normal” might the Board consider?**

BOMA & LPMA support the comments provided by Dr. Booth.
Sincerely,

Randy Aiken
Aiken & Associates

Consultant to BOMA
Consultant to LPMA
# Appendix A

To BOMA & LPMA Comments

<table>
<thead>
<tr>
<th>File Number</th>
<th>Name of LDC</th>
<th>Deemed Long Term Debt</th>
<th>Actual Long Term Debt</th>
<th>Deemed Debt in Excess of Actual</th>
<th>Long Term Debt Rate</th>
<th>Short Term Debt Rate</th>
<th>Excess Interest</th>
<th>Deemed Equity</th>
<th>Excess Return on Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>EB-2008-0247</td>
<td>Weiland Hydro-Electric System Corp.</td>
<td>14,192,916</td>
<td>13,499,453</td>
<td>693,463</td>
<td>7.62%</td>
<td>1.33%</td>
<td>43,619</td>
<td>11,661,352</td>
<td>0.37%</td>
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<tr>
<td>EB-2008-0246</td>
<td>Tillsonburg Hydro Inc.</td>
<td>4,575,065</td>
<td>0</td>
<td>4,575,065</td>
<td>7.62%</td>
<td>1.33%</td>
<td>287,772</td>
<td>3,763,767</td>
<td>7.65%</td>
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<tr>
<td>EB-2008-0237</td>
<td>Niagara-on-the-Lake Hydro Inc.</td>
<td>11,518,645</td>
<td>10,358,946</td>
<td>1,159,699</td>
<td>6.04%</td>
<td>1.33%</td>
<td>54,622</td>
<td>9,464,066</td>
<td>0.56%</td>
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<tr>
<td>EB-2008-0236</td>
<td>Midland Power Utility Corporation</td>
<td>8,435,539</td>
<td>3,122,519</td>
<td>3,313,020</td>
<td>4.64%</td>
<td>1.33%</td>
<td>109,061</td>
<td>5,287,644</td>
<td>2.07%</td>
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<tr>
<td>EB-2008-0250</td>
<td>Westario Power Inc.</td>
<td>17,901,228</td>
<td>13,785,942</td>
<td>4,115,286</td>
<td>5.82%</td>
<td>1.33%</td>
<td>194,775</td>
<td>14,708,220</td>
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<tr>
<td>EB-2008-0248</td>
<td>West Coast Huron Energy</td>
<td>2,690,030</td>
<td>984,454</td>
<td>1,705,576</td>
<td>7.62%</td>
<td>1.33%</td>
<td>108,539</td>
<td>2,213,013</td>
<td>4.90%</td>
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<tr>
<td>EB-2008-0234</td>
<td>Lakeside Power Distribution Ltd.</td>
<td>8,406,320</td>
<td>3,487,500</td>
<td>4,918,820</td>
<td>5.16%</td>
<td>1.33%</td>
<td>186,391</td>
<td>6,906,906</td>
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<td>EB-2008-0233</td>
<td>Innisfil Hydro Distribution Systems Limited</td>
<td>12,052,484</td>
<td>9,038,894</td>
<td>3,043,590</td>
<td>5.28%</td>
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<td>181,094</td>
<td>7,902,705</td>
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<td>EB-2008-0227</td>
<td>EnWin Utilities Ltd.</td>
<td>111,889,723</td>
<td>53,255,073</td>
<td>58,633,750</td>
<td>6.77%</td>
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<td>3,189,676</td>
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<td>EB-2008-0226</td>
<td>COLLUS Power Corp.</td>
<td>8,584,431</td>
<td>2,810,170</td>
<td>5,774,261</td>
<td>6.63%</td>
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<td>EB-2008-0221</td>
<td>Bluewater Power Distribution Corporation</td>
<td>25,190,964</td>
<td>10,729,036</td>
<td>8,461,328</td>
<td>7.62%</td>
<td>1.33%</td>
<td>532,218</td>
<td>20,726,743</td>
<td>2.57%</td>
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</tbody>
</table>

Average 5,186,403 2.94%