

# Presentation to the Ontario Energy Board Regarding the Cost of Capital EB-2009-0084

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*Presenting on behalf of Enbridge Gas Distribution,  
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# Who Are The Market Opinion Makers?

- Lenders

- Life Insurance Companies, Money Managers, and Pension Funds

- Credit Rating Agencies

- DBRS, Standard & Poor's, and Moody's

- Equity Investors

- Corporate Holding Companies, Pension Funds, Money Managers, Mutual Funds and Retail Investors

- Equity Analysts



# Market Opinion Makers

- Debt and equity analysts provide favorable or unfavorable opinions to institutional and retail investors
  - Large institutions do their own credit and stock research to form their opinions
  - New issues of securities are built around large lead orders from significant “opinion making” institutions
  - Lead orders influence capital availability and pricing
- Opinion makers will determine which regulatory jurisdiction to invest in based on the “Fairness” of the regulatory regime



# What Do Lenders & Investors Look For?

## ○ Lenders

- Financial flexibility – ability to attract debt and equity capital on reasonable terms
- Reasonable coverage of interest by earnings (at least, 2.5x and cash flow, at least 3x)
- Maintain financial integrity (maintain or improve upon existing credit ratings)

## ○ Investors

- Appropriate risk/reward relationship
- Financial flexibility
- Financial integrity

## ○ Lenders and investors want returns to meet the Fair Return Standard



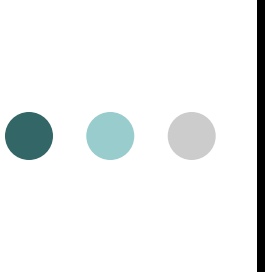
# Fair Return Standard

- Risk/Return Relationship
  - Comparable Investment Standard
  - Opportunity to earn the return available from other enterprises of like risk
  - Expected returns usually derived from comparable earnings test, DCF's and equity risk premium models
- Financial Integrity
  - Financial Integrity Standard
  - Maintain credit ratings, provide dividends and support stock market prices
- Capital Attraction
  - Capital Attraction Standard
  - Ability to attract incremental capital on reasonable terms and conditions



# Fair Return - Investor Beliefs

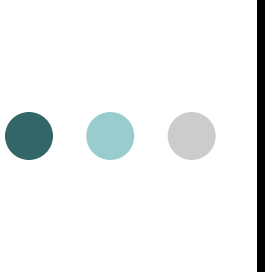
- All 3 standards are important and need to be considered
  - More information leads to better decisions
    - no single model provides the “ANSWER”
  - Each model has strengths and weaknesses
  - Process requires informed judgment
- Market participants focus on the outcome rather than the process used



# ERP / Formula – Market Views

## ○ Likes

- Timely
- Transparent
- Predictable
- Regulatory efficiency
- Eases expansion of regulated sector



# ERP / Formula – Market Views

## ○ Concerns

- Is the formula appropriate?
- Formula calibration
- Ability to capture changes in risk/return environment
- Ability to keep equity levels in touch with ROE's
- Do the results meet the Fair Return Standard and continue to do so over time?





# Capital Market Issues

- Formula is “broken”, focus on companies with low exposure to formula - returns are too low and moving in the wrong direction
- Competition for funds: foreign and domestic infrastructure financing – utilities not competitive
- Removal of limits on foreign investment: relevance of U.S. comparators and U.S. rates of return – greater range of options available today
- Unusual market conditions have existed for a period of time – recent market conditions are not the only issue
- GOC yield versus corporate cost of capital - GOC yield declined to 65 year lows while corporate debt & equity costs are increasing