

September 14, 2009

Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, ON - M4P 1E4

Via Board's web portal and by courier

Dear Board Secretary:

**Re: Board File No. EB - 2009- 0084
EDA's Presentation at Stakeholder Conference - Consultation on Cost of Capital**

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (LDCs). The EDA represents the interests of over 80 publicly and privately owned LDCs in Ontario.

The EDA would like to provide the attached presentation slides that it intends to use for its presentation at the stakeholder conference scheduled for September 21, 2009.

Yours truly,

“Original Signed”

Maurice Tucci
Policy Director, Distribution and Regulation

Attached: EDA Presentation Slides
dp:



The Voice Of Ontario's Electricity Distributors



**PRESENTATION TO THE OEB
ON BEHALF OF
THE ELECTRICITY DISTRIBUTORS ASSOCIATION**

**KATHLEEN McSHANE
PRESIDENT
FOSTER ASSOCIATES, INC.
SEPTEMBER 21, 2009**

Ensuring A Fair Return



- Explicit recognition of the relationship between capital structure and return on equity
- Stand-alone principle should be respected for purposes of setting both the ROE and capital structure
- Both the Initial ROE and the automatic adjustment formula should be reset
 - Formula ROEs too low
 - ROE/bond yield relationships not captured in current formula

Establishing the Initial ROE



- Need for comprehensive review
- Reliance on multiple cost of equity tests applied to comparable risk companies
- Benchmarking test results against other relevant indicators of a fair return
- Application of informed judgment
- Initial ROE can be expressed in terms of an equity risk premium

Modifying the Automatic Adjustment Formula



- Empirical analysis indicates:
 - Relationship between ROE and long-term Canada bond yields is approximately 50%
 - Positive relationship between ROE and spreads between long-term utility and Canada bond yields
- Modify formula to incorporate these relationships

$$\text{ROE}_{\text{New}} = \text{ROE}_{\text{Initial}} + 50\% \times (\Delta \text{Forecast GOC BY}) + 50\% \times (\Delta \text{Corp. BY Spread})$$

Implications of Proposed Formula



	Forecast Long Canada Underlying NEB ROE	Change in Forecast Long Canada from 1995	NEB ROE per RH-2-94	Sept/Oct Corporate Yield Spread	Change in Corporate Yield Spread from 1995	ROE with 50% Change in Long Canada and 50% Change in Corporate Yield Spread
1995	9.25		12.25	0.71		
1996	8.03	-1.22	11.25	0.42	-0.29	11.50
1997	7.14	-2.11	10.67	0.27	-0.45	10.97
1998	6.53	-2.72	10.21	0.28	-0.43	10.68
1999	5.69	-3.56	9.58	0.99	0.27	10.61
2000	6.12	-3.13	9.90	0.94	0.23	10.80
2001	5.73	-3.52	9.61	1.56	0.84	10.91
2002	5.63	-3.62	9.53	1.31	0.60	10.74
2003	5.98	-3.27	9.79	1.32	0.61	10.92
2004	5.68	-3.57	9.56	0.97	0.26	10.59
2005	5.55	-3.70	9.46	0.98	0.26	10.53
2006	4.78	-4.47	8.88	0.96	0.25	10.14
2007	4.22	-5.03	8.46	1.07	0.36	9.91
2008	4.55	-4.70	8.71	1.18	0.47	10.13
2009	4.35	-4.90	8.57	2.58	1.87	10.73
Average 1996-2009			9.6			10.7

Safeguards



- **Trigger**
 - If formula ROE is +/- 200 basis points from the recalibrated Initial ROE, process in place for comprehensive review
- **Dead band**
 - Adjustments to ROEs embedded in rates, subject to dead band, for changes in Initial and formula ROEs
- **Specified Schedule for Review**
 - Subject to review once every 5 years
 - Earlier review if warranted by changes in economic and capital market conditions