September 14, 2009

VIA RESS and COURIER

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

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli,

Re: Board Consultation on Cost of Capital (EB-2009-0084)
Presentation of Great Lakes Power Transmission LP

We are counsel to Great Lakes Power Transmission LP ("GLPTLP") in the above-noted matter. Enclosed please find a copy of GLPTLP's presentation for the upcoming stakeholder consultation sessions.

GLPTLP has made this submission using RESS and has sent three hard copies to the Board via courier.

Yours truly,

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Stakeholder Conference Presentation on the Cost of Capital

Prepared at the Request of:

Great Lakes Power Transmission LP

September 14, 2009

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Why important to get ERP Formula right

Formula broken demonstrated by
- Unrealistic and counter-intuitive values it produces
- Increased utility business risk since specified

Formula suffers from overly simplistic nature
- Fails to consider LCB and utility equities different
  - Declines in LCBs don’t result in declines in utility ROEs

NEB suggested that Formula broken

Viable alternatives to existing ERP model perform better
Power Advisory engaged by Great Lakes Power Transmission LP to provide independent assessment of Board’s ERP Formula (Formula)

Report found that Formula broken

- While current market conditions exacerbate Formula’s shortcomings, it provided inadequate returns for considerable time
- Formula’s deficiencies will not be remedied when credit markets heal
- There are viable alternatives to current ERP Formula that perform better
Why important to get Formula right

- Fair ROE needed for both public and private investors
  ✓ Important to compensate existing asset base fairly
  ✓ Essential for private investors given increased competition for capital
  ✓ Critical for discretionary investment

- Fair ROE necessary to ensure efficient investment decisions
  ✓ Particularly allocation of investment between wires, generation and CDM
The unrealistic ROE values it has produced:

✓ 39 basis point premium relative to long-term debt
  • Inadequate compensation for equity risks
✓ Declined by 56 bp when equities subjected to unprecedented volatility
  • Volatility of utility equities over last 12 months increased at almost twice rate of S&P 500
  • Suggesting utility stocks more, not less risky

Dow Jones Utility Average vs S&P 500 over the last 12 Months
Amount of risk faced by regulated utilities increased significantly since Formula first adopted

- Increased revenue risk from greater uncertainty regarding future electricity demand
  - From CDM and unprecedented declines of major electricity consuming industries

- Magnitude of capital requirements (significant portion of ratebase at risk) and phasing required to get major new transmission facilities in service quickly increase risks

- These increased risks not reflected in ROEs produced by Formula
The ERP Formula suffers from:

- Simplistic nature of Formula in light of amount of investment to which it applies
  - Assumes changes in utility ROEs explained solely by change in Long Canada Bond rates
  - Long Canada Bonds distinctly different instrument than equities
    - Utility equities have different and greater risks
  - Net result Board’s Formula missing critical variables that influence required returns for utility equities
Factors that led to declines in Long Canada Bonds (LCBs) do not all result in declines in utility ROEs
- Declines in inflation
- Declines in inflation risk premiums
- Declines in bond interest rate premiums

LCB yields have declined significantly
- Prior to November 2008 LCB yields were below 4% for one month, since then yields have been below 4% every month, but one

Failure to reflect critical explanatory variables in Formula overstate relationship between LCB rates and utility ROEs
NEB suggested that ERP Formula broken

- NEB found that world changed, but Formula had not
  - Significant changes in financial markets and general economic conditions
  - Increased globalization of financial markets resulting in greater competition for capital

- Formula relied on a single variable: LCB yield
  - Changes in TQM cost of capital may not be captured in LCB yields
  - Casting doubt on fundamentals underlying formula

- Alberta and BC evaluating their ERP formulas
  - Indicating concern with formula’s performance
Formula should include additional explanatory variables that reflect determinants of required utility ROEs

Two models performed better than existing ERP model
1. Corporate BAA bonds used as explanatory variable
2. Long Government Bonds and Volatility Index

Both should be relatively easy to implement
✓ No consensus forecast for these variables

There are viable alternatives to current ERP Formula that perform better
In sum, ERP Formula needs to be fixed without delay

- ROEs produced critical to attract capital given increased competition for capital
  - Essential to fund Ontario’s looming capital requirements
    - Both legacy and new build

- There are viable alternatives to current ERP “model” that perform better