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Stakeholder Conference Presentation on the Cost of Capital

Prepared at the Request of :

Great Lakes Power Transmission LP

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Overview of Presentation

- 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

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Summary of September 8th Power Advisory Report

- 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

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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

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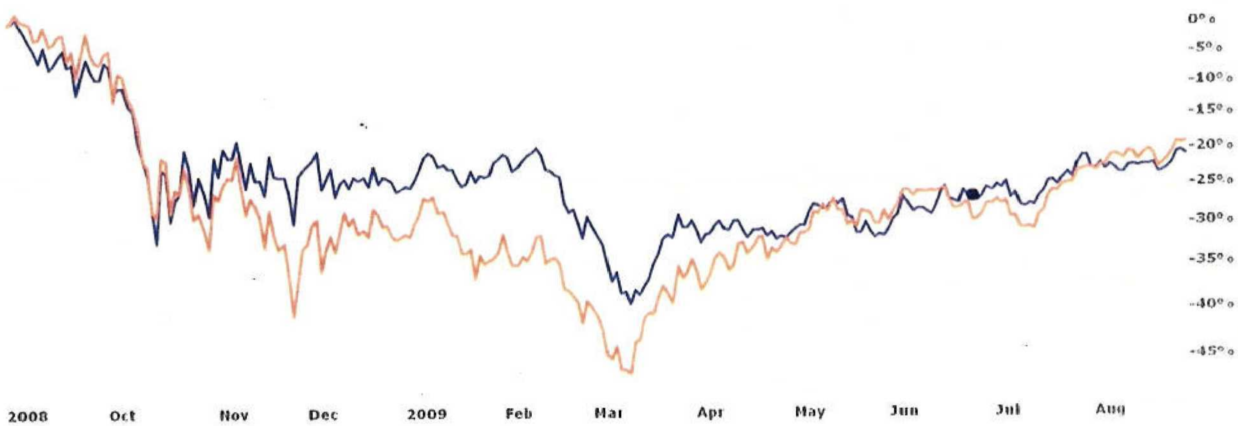
That Formula broken demonstrated by

- 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



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ERP Formula doesn't recognize that

- 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

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The ERP Formula produces ROEs that are too low

- 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

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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

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ERP Formula broken and should be respecified

- 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