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## **BY E-MAIL AND WEB POSTING**

March 3, 2011

**To:** All Licensed Electricity Distributors and Transmitters  
All Gas Distributors  
Ontario Power Generation Inc.  
All Registered Intervenors in 2011 Cost of Service Applications

**Re: Cost of Capital Parameter Updates for 2011 Cost of Service Applications for Rates Effective May 1, 2011**

The Ontario Energy Board (the "Board") has determined the values for the Return on Equity ("ROE") and the deemed Long-Term ("LT") and Short-Term ("ST") debt rates for use in the 2011 rate year cost of service applications for rates effective May 1, 2011. The ROE and the LT and ST debt rates are collectively referred to as the Cost of Capital parameters.

Every year, the Board updates the Cost of Capital parameters for use in setting rates for natural gas and electricity utilities for the coming rate year. The Board has normally updated the parameters once each year for rates effective May 1, 2011. In light of certain applications requesting January 1, 2011 effective dates for rate changes, the Board advanced its determination of the values for the Cost of Capital parameters based on the data available three months in advance of the January 1, 2011 date. On November 15, 2010, the Board issued a letter announcing updated Cost of Capital parameters for rates effective January 1, 2011. Also in that letter the Board stated that cost of service applications with rates effective May 1, 2011 would have updated Cost of Capital parameters based on data for January 2011.

The purpose of this letter is to announce updated Cost of Capital parameters for rates effective May 1, 2011. The updated Cost of Capital parameters are calculated based

on the formulaic methodologies documented in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the "Report"), issued December 11, 2009.

For rates with effective dates in 2011, the Board has updated the Deemed ST Debt rate parameters based on: (i) the September 2010 survey from Canadian banks for the spread over the Bankers' Acceptance rate of 3-month short-term loans for R1-low commercial customers for the short-term debt rate; and (ii) data for three months prior to the effective dates from the Bank of Canada, *Consensus Forecasts*, and Bloomberg LLP, per the methodologies documented in the Report.

### **Cost of Capital parameters for rates effective May 1, 2011**

Based on the methodologies set out in the Report and January 2011 data from the Bank of Canada, *Consensus Forecasts* and Bloomberg LLP, the Board has determined that the updated Cost of Capital parameters for 2011 cost of service rate applications for rates effective May 1, 2011 are:

<b>Cost of Capital Parameter</b>	<b>Value for 2011 Cost of Service Applications for May 1, 2011 rate changes</b>
ROE	9.58%
Deemed LT Debt rate	5.32%
Deemed ST Debt rate	2.46%

The Board considers these Cost of Capital parameter values and the relationships between them reasonable and representative of market conditions at this time. Detailed calculations of the Cost of Capital parameters are attached.

All queries on the Cost of Capital parameters should be directed to the Board's Market Operations hotline, at 416 440 7604 or [market.operations@ontarioenergyboard.ca](mailto:market.operations@ontarioenergyboard.ca).

Yours truly,

*Original Signed By*

Kirsten Walli  
Board Secretary

Attachment

## Attachment: Cost of Capital Parameter Calculations (assuming May 1, 2011 effective date for rate changes) *Return on Equity and Deemed Long-term Debt Rate*

**Step 1:** Analysis of Business Day Information in the Month

Month:		Bond Yields (%)			Bond Yield Spreads (%)	
January 2011		Government of Canada		A-rated Utility	30-yr Govt over 10-yr Govt	30-yr Util over 30-yr Govt
Day		10-yr	30-yr	30-yr		
1	1-Jan-11					
2	2-Jan-11					
3	3-Jan-11	3.12	3.53	4.96	0.41	1.43
4	4-Jan-11	3.18	3.58	4.99	0.40	1.42
5	5-Jan-11	3.28	3.66	5.05	0.39	1.39
6	6-Jan-11	3.23	3.64	5.03	0.41	1.39
7	7-Jan-11	3.19	3.62	5.01	0.43	1.39
8	8-Jan-11					
9	9-Jan-11					
10	10-Jan-11	3.17	3.60	4.99	0.43	1.39
11	11-Jan-11	3.23	3.65	5.04	0.42	1.39
12	12-Jan-11	3.26	3.68	5.06	0.43	1.37
13	13-Jan-11	3.25	3.67	5.05	0.42	1.39
14	14-Jan-11	3.27	3.69	5.09	0.43	1.39
15	15-Jan-11					
16	16-Jan-11					
17	17-Jan-11	3.26	3.69	5.07	0.43	1.39
18	18-Jan-11	3.27	3.71	5.10	0.44	1.39
19	19-Jan-11	3.24	3.69	5.07	0.45	1.38
20	20-Jan-11	3.30	3.74	5.14	0.44	1.40
21	21-Jan-11	3.33	3.75	5.12	0.42	1.37
22	22-Jan-11					
23	23-Jan-11					
24	24-Jan-11	3.32	3.75	5.14	0.44	1.39
25	25-Jan-11	3.27	3.73	5.12	0.46	1.39
26	26-Jan-11	3.31	3.76	5.15	0.44	1.39
27	27-Jan-11	3.28	3.73	5.10	0.45	1.38
28	28-Jan-11	3.25	3.71	5.11	0.46	1.40
29	29-Jan-11					
30	30-Jan-11					
31	31-Jan-11	3.28	3.73	5.13	0.45	1.40
		3.25	3.68	5.07	<b>0.430</b>	<b>1.392</b>

Sources: Bank of Canada      Bloomberg L.P.      ①      ②

**Step 2:** 10-Year Government of Canada Bond Yield Forecast

Source: <i>Consensus Forecasts</i>	Publication Date: January 10, 2011
January 2011	3-month: 3.300      12-month: 3.700      Average: <b>3.500</b> %

**Step 3:** Long Canada Bond Forecast

10 Year Government of Canada Consensus Forecast (from Step 2)	③	3.500 %
Actual Spread of 30-year over 10-year Government of Canada Bond Yield (from Step 1)	④	0.430 %
<b>Long Canada Bond Forecast (LCBF)</b>	④	<b>3.930</b> %

**Step 4:** Return on Equity (ROE) forecast

Initial ROE		9.75 %
Change in Long Canada Bond Yield Forecast from September 2009		
LCBF (January 2011) (from Step 3)	④	3.930 %
Base LCBF		4.250 %
Difference		-0.320 %
0.5 X Difference		-0.160 %
Change in A-rated Utility Bond Yield Spread from September 2009		
A-rated Utility Bond Yield Spread (January 2011) (from Step 1)	②	1.392 %
Base A-rated Utility Bond Yield Spread		1.415 %
Difference		-0.023 %
0.5 X Difference		-0.012 %
<b>Return on Equity based on January 2011 data</b>		<b>9.58</b> %

**Step 5:** Deemed Long-term Debt Rate Forecast

Long Canada Bond Forecast for January 2011 (from Step 3)	④	3.930 %
A-rated Utility Bond Yield Spread January 2011 (from Step 1)	②	1.392 %
<b>Deemed Long-term Debt Rate based on January 2011 data</b>		<b>5.32</b> %

**References on Calculation Methods:**

- **Return on Equity:** Appendix B of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.
- **Deemed Long-term Debt Rate:** Appendix C of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.

**Attachment: Cost of Capital Parameter Calculations**  
(assuming May 1, 2011 effective date for rate changes)

**Deemed Short-term Debt Rate**

**Step 1:** Average Annual Spread over Bankers Acceptance

Once a year, in January, Board staff contacts prime Canadian banks to get estimates for the spread of short-term (typically 90-day) debt issuances over Bankers' Acceptance rates. Up to six estimates are provided.

A.	over 90-day Bankers Acceptance		Date of input
Bank 1	125.0	bps	Sept., 2010
Bank 2	125.0	bps	Sept., 2010
Bank 3	112.5	bps	Sept., 2010
Bank 4	150.0	bps	Sept., 2010
Bank 5	125.0	bps	Sept., 2010
Bank 6			

B.	Discard high and low estimates If less than 4 estimates, take average without discarding high and low.	
Number of estimates	5	
High estimate	150.0	bps
Low estimate	112.5	bps

C.	Average annual Spread	125.000 bps	①
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**Step 3:** Deemed Short-Term Debt Rate Calculation

Calculate Deemed Short-term debt rate as sum of average annual spread (Step 1) and average 3-month Bankers' Acceptance Rate (Step 2)

Average Annual Spread	1.250 %	①
Average Bankers' Acceptance Rate	1.215 %	②
<b>Deemed Short Term Debt Rate</b>	<b>2.46 %</b>	

**Step 2:** Average 3-month Bankers' Acceptance Rate

Calculation of Average 3-month Bankers' Acceptance Rate during month of January 2011

Month:	January 2011	
	Bankers' Acceptance Rate (%)	
Day	3-month	
1	1-Jan-11	
2	2-Jan-11	
3	3-Jan-11	
4	4-Jan-11	1.21 %
5	5-Jan-11	1.21 %
6	6-Jan-11	1.21 %
7	7-Jan-11	1.21 %
8	8-Jan-11	
9	9-Jan-11	
10	10-Jan-11	1.21 %
11	11-Jan-11	1.21 %
12	12-Jan-11	1.22 %
13	13-Jan-11	1.22 %
14	14-Jan-11	1.22 %
15	15-Jan-11	
16	16-Jan-11	
17	17-Jan-11	1.22 %
18	18-Jan-11	1.22 %
19	19-Jan-11	1.22 %
20	20-Jan-11	1.22 %
21	21-Jan-11	1.22 %
22	22-Jan-11	
23	23-Jan-11	
24	24-Jan-11	1.22 %
25	25-Jan-11	1.21 %
26	26-Jan-11	1.21 %
27	27-Jan-11	1.21 %
28	28-Jan-11	1.21 %
29	29-Jan-11	
30	30-Jan-11	
31	31-Jan-11	1.21 %
		<u>1.215 %</u>
		②

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**Reference on Calculation Method:**

- Appendix D of the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities*, issued December 11, 2009.