

1 **COST OF CAPITAL**

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3 **1.0 INTRODUCTION**

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5 The purpose of this evidence is to summarize the method and cost of financing Hydro
6 One Distribution's capital requirements for the 2008 test year.

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8 **2.0 CAPITAL STRUCTURE**

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10 Hydro One Distribution's deemed capital structure for rate making purposes is 60% debt
11 and 40% common equity. This capital structure was determined by the Ontario Energy
12 Board as being appropriate for all distributors in its December 20, 2006 Cost of Capital
13 report.¹ Consistent with the Board's report, there is no adjustment for a preferred share
14 component in rates as determined by the Board. The 60% debt component is comprised
15 of 4% deemed short term debt and 56% long term debt.

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17 **3.0 RETURN ON COMMON EQUITY**

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19 Hydro One Distribution is requesting an equity return for the 2008 test year of 8.64% per
20 the Board's formulaic approach in Appendix B of the Cost of Capital report. The return
21 of 8.64% is based on the Long Canada Bond Forecast for 2008 using the May 2007
22 Consensus Forecast. In accordance with the Cost of Capital report, upon the final
23 decision in this case, Hydro One assumes that the ROE will be adjusted using the
24 January, 2008 Consensus Forecast.

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¹ Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors, Ontario Energy Board (December 20th, 2006) [EB-2006-0088/EB-2006-0089]

1 **4.0 DEEMED SHORT TERM DEBT**

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3 The Board has determined that the deemed amount of short-term debt that should be
4 factored into rate setting be fixed at 4% of rate base, and that the deemed short-term debt
5 rate be based on the forecast 3-month bankers' acceptance rate plus a fixed spread of 25
6 basis points. For 2008 the deemed short term rate is 4.74%, using the May 2007
7 Consensus Forecast. In accordance with the Cost of Capital report, upon the final
8 decision in this case, Hydro One assumes that the deemed short term debt rate will be
9 adjusted using the January, 2008 Consensus Forecast.

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11 **5.0 THIRD PARTY LONG TERM DEBT**

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13 The Distribution business' third party long term debt is \$2,326 million for 2008. The
14 effective cost of third party long term debt is calculated as the weighted average cost of
15 embedded third party debt, new third party debt and forecast third party debt planned to
16 be issued in 2007 and 2008. The weighted average cost of third party long term debt rate
17 for 2008 is 5.71%. Details of Hydro One Distribution's long term debt portfolio for the
18 2008 test year are identified at Exhibit B2, Tab 1, Schedule 2, Page 5. A detailed
19 discussion of the Hydro One Distribution's debt and forecast interest rate support is
20 provided at Exhibit B1, Tab 2, Schedule 1. Historical long term debt cost information is
21 filed at Exhibit B2, Tab 1, Schedule 2, pages 1 – 3, for the 2004 – 2006 period.

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23 **6.0 DEEMED LONG TERM DEBT**

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25 Deemed long term debt consists of the amount of any variable rate debt or affiliate debt
26 callable on demand, as well as any remaining amount required to balance the total
27 financing with the rate base. Consistent with the Board's Cost of Capital report, the
28 deemed long term debt rate is to be applied to any variable rate debt and for any affiliate

1 debt callable upon demand. The deemed long-term debt rate for 2008 is 5.69% based on
2 the approach in Appendix A of the Cost of Capital report, using the May 2007 Consensus
3 Forecast. In accordance with the Cost of Capital report, upon the final decision in this
4 case, Hydro One assumes that the deemed long term debt rate will be adjusted using the
5 January, 2008 Consensus Forecast.

6 7 **7.0 COST OF CAPITAL SUMMARY**

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9 The overall capital incorporated in Hydro One Distribution's 2008 revenue is \$4,382
10 million which results in an after tax required return on rate base of 6.84%.

11 12 **2008 Cost of Capital**

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Particulars	\$ Millions	%	Cost Rate (%)	Return (\$M)
Third Party long-term debt	2,326	53.1	5.71	133
Deemed long-term debt	128	2.9	5.69	7
Deemed short-term debt	175	4.0	4.74	8
Common equity	1,753	40.0	8.64	151
Total	4,382	100.0	6.84	300

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15 Historical, bridge and test year debt and equity summary schedules have been provided at
16 Exhibit B2, Tab 1, Schedule 1.

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