

Rating Agency	Short-term Debt	Long-term Debt
Standard & Poor's Rating Services (S&P)	A-1	A
Dominion Bond Rating Service (DBRS)	R-1(middle)	A(high)
Moody's Investors Service (Moody's)	Prime-1	Aa3

1

2 The most recent rating agency reports are provided in Exhibit A, Tab 11, Schedule 1.

3

4 **3.0 COST OF THIRD PARTY LONG TERM DEBT**

5

6 The Distribution business' third party long term debt is \$2,326 million for 2008. The
7 effective cost of third party long term debt is calculated as the weighted average cost of
8 embedded third party debt, new third party debt and forecast third party debt planned to
9 be issued in 2007 and 2008. This cost includes the amortization of issuance costs. The
10 weighted average cost of third party long term debt rate for 2008 is 5.71%. Details of
11 Hydro One Distribution's third party long term debt portfolio for the 2007 bridge year
12 and 2008 test year are identified at Exhibit B2, Tab 1, Schedule 2, Pages 4 and 5.

13

14 The amount of each Hydro One Networks Inc. debt issue that is mapped to the
15 Distribution business is based on its most recent forecast of borrowing requirements.
16 Borrowing requirements are mainly driven by debt retirement, capital expenditures net of
17 internally generated funds, and the maintenance of its capital structure. For example, in
18 March 2007 Hydro One Inc. issued \$400 million of 30 year notes with a coupon rate of
19 4.89%, of which \$160 million was mapped to Hydro One Distribution as shown on line
20 21 of Exhibit B2, Tab 1, Schedule 2, Page 5. The interest rates of debt issues mapped to
21 the Distribution business as shown in Exhibit B2, Tab 1, Schedule 2 are equal to the
22 actual interest rates on debt issued by Hydro One Networks to Hydro One Inc., and by
23 Hydro One Inc. to third party public debt investors.

1 **3.1 Embedded Third Party Debt**

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3 The Board has determined in its Cost of Capital Report that for embedded debt, the rate
4 approved in prior Board decisions shall be maintained for the life of each active
5 instrument, unless a new rate is negotiated, in which case it will be treated as new debt.
6 Hydro One Distribution's embedded third party long term debt, which was issued during
7 the period from 2000 to 2005, is shown on lines 1 to 16 of Exhibit B2, Tab 1, Schedule 2,
8 Page 5. The rates on these embedded debt issues were approved by the Board as part of
9 RP-2005-0020.

10
11 **3.2 New Third Party Debt**

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13 The Board has determined in its Cost of Capital Report that the rate for new debt that is
14 held by a third party will be the prudently negotiated contract rate. This would include
15 recognition of premiums and discounts. The following discusses new third party debt
16 issued during 2006 and 2007, which are shown on lines 17 to 21 of Exhibit B2, Tab 1,
17 Schedule 2, Page 5.

18
19 In March of 2006, Hydro One issued \$300 million of 10-year notes with a 4.64% coupon
20 rate of which \$90 million was mapped to Hydro One Distribution as shown on line 17 of
21 Exhibit B2, Tab 1, Schedule 2, Page 5.

22
23 In April of 2006, Hydro One Inc. issued \$250 million of 30-year notes, of which \$62.5
24 million was mapped to Hydro One Distribution as shown on line 18 of Exhibit B2, Tab 1,
25 Schedule 2, Page 5. The offering was a re-opening of the 5.36% coupon bond originally
26 issued in May 2005 bringing the total outstanding in that series to \$600 million.

1 In August of 2006, Hydro One Inc. issued \$150 million of 10-year notes with a 4.64%
2 coupon rate, of which \$90 million was mapped to Hydro One Distribution as shown on
3 line 19 of Exhibit B2, Tab 1, Schedule 2, Page 5.

4
5 In October of 2006, Hydro One Inc. issued \$75 million of 40-year notes with a 5.00%
6 coupon rate, of which \$45 million was mapped to Hydro One Distribution as shown on
7 line 20 of Exhibit B2, Tab 1, Schedule 2, Page 5.

8
9 In March of 2007, Hydro One Inc. issued \$400 million of 30-year notes with a 4.89%
10 coupon rate, of which \$160 million was mapped to Hydro One Distribution as shown on
11 line 21 of Exhibit B2, Tab 1, Schedule 2, Page 5.

12 13 **3.3 Forecast Third Party Debt**

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15 The issuance of 5, 10 and 30 year debt will be the main financing to meet Hydro One
16 Distribution's forecast borrowing requirement of \$205 million remaining for 2007 and
17 \$434 million for 2008. For planning purposes it is assumed that debt issuance will be
18 evenly distributed over the standard 5, 10 and 30 year terms which are preferred by
19 investors.

20
21 The following table lists the fixed rate medium term notes Hydro One Distribution plans
22 to issue in 2007, as shown in lines 22 and 23 of Exhibit B2, Tab 1, Schedule 2, Page 5.
23 The remainder of the third party debt to be issued during 2007 is assumed to be issued as
24 5 and 10 year debt, as a 30 year issue was completed during March 2007.

1

2007		
Principal Amount (\$Millions)	Term (Years)	Coupon
102.5	5.5	4.47%
102.5	10	4.71%

2

3 The following table lists the fixed rate medium term notes Hydro One Distribution plans
 4 to issue in 2008, as shown on lines 24 to 26 of Exhibit B2, Tab 1, Schedule 2, Page 5.

5

2008		
Principal Amount (\$Millions)	Term (Years)	Coupon
144.7	5.5	4.77%
144.7	10	5.01%
144.7	30	5.37%

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7 **3.4 Interest Rates for 2007 and 2008 Forecast Debt Issues**

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9 Distribution business borrowing will be financed at market rates applicable to Hydro
 10 One Inc. The following table summarizes the derivation of the forecast Hydro One Inc.
 11 yield for each of the planned issuance terms for 2007 and 2008.

12

	2007		2008		
	5-year	10-year	5-year	10-year	30-year
Government of Canada	4.13%	4.20%	4.43%	4.50%	4.55%
Hydro One Spread	0.34%	0.51%	0.34%	0.51%	0.82%
Forecast Hydro One Yield	4.47%	4.71%	4.77%	5.01%	5.37%

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14 Each rate is comprised of the forecast Canada bond yield plus the Hydro One Inc. credit
 15 spread applicable to that term. The 10-year Government of Canada bond yield forecast
 16 for 2007 and 2008 is based on the May 2007 Consensus Forecasts. The 5 and 30-year
 17 Government of Canada bond yield forecasts are derived by adding the April 2007
 18 average spreads (5-year to 10-year for the 5 year forecast and 30-year to 10-year for the
 19 30-year forecast) to the 10-year Government of Canada bond yield forecast. This
 20 derivation is consistent with the Board's methodology in establishing the forecast of the

1 30-year Government of Canada yield, in the formula based return on common equity
2 approach for regulated utilities. Consistent with this methodology, Hydro One's credit
3 spreads over the Government of Canada bonds are based on the average of indicative new
4 issue spreads for April 2007 obtained from our MTN dealer group for each planned
5 issuance term.

6 7 **3.5 Treasury OM&A Costs**

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9 Treasury OM&A costs are incurred to:

- 10
11 • execute borrowing plans and issue commercial paper and long-term debt;
12 • ensure compliance with securities regulations, bank and debt covenants;
13 • manage the company's daily liquidity position, control cash and manage the
14 company's bank accounts;
15 • settle all transactions and manage the relationship with creditors; and
16 • communicate with debt investors, banks and credit rating agencies.

17
18 These costs are \$1.1 million for 2008 as shown on line 28 of Exhibit B2, Tab 1, Schedule
19 2, Page 5.

20 21 **3.6 Other Financing-Related Fees**

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23 Column (e) of Exhibit B2, Tab1, Schedule 2 (ie. Premium, discount and expenses)
24 represents the costs of issuing debt. These costs are specific to each debt issue and
25 include commissions, legal fees, debt discounts / premiums on issues or re-openings of
26 issues relative to par, and hedge gains / losses.

1 Other financing related fees, \$0.4 million in 2008, identified on line 29 of Exhibit B2,
2 Tab 1, Schedule 2, Page 5, include the Distribution allocation of Hydro One Inc.'s annual
3 credit rating agency, letter of credit, banking, custodial and trustee fees.

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