

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 2010 and 2011 test years.

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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 approved by the Board as part of the  
12 Settlement Agreement in its December 18, 2008 Decision on Hydro One Distribution's  
13 Rate Application (EB-2007-0681) and is consistent with the Board's December 20, 2006  
14 Cost of Capital Report.<sup>1</sup> The 60% debt component is comprised of 4% deemed short  
15 term debt and 56% long term debt.

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17 The Board has recently initiated a review of the existing Cost of Capital policy as a result  
18 of the current economic and financial market conditions (EB-2009-0084). If, as a result  
19 of the Board's review, changes are required to the return on common equity, long term  
20 debt rate and/or deemed short term debt rate, it is assumed that these values will be  
21 reflected in the Board's final decision on this application.

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<sup>1</sup> *Report of the Board on Cost of Capital and 2<sup>nd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors*, Ontario Energy Board, Docket No. EB-2006-0088/EB-2006-0089, issued December 20, 2006.

1     **3.0     RETURN ON COMMON EQUITY**

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3     Hydro One Distribution is requesting a return on equity (“ROE”) of 8.11% for the 2010  
4     test year and 9.09% for the 2011 test year per the Board’s formulaic approach in  
5     Appendix B of the Cost of Capital Report. The returns are based on the Long Canada  
6     Bond Forecast for 2010 and 2011, using the April 2009 Consensus Forecast. Hydro One  
7     assumes that the ROE for each test year will be updated in accordance with the Cost of  
8     Capital Report, upon the final decision in this case. Specifically, for 2010, the Board  
9     would determine the ROE for Hydro One Distribution based on the September 2009  
10    Consensus Forecasts and Bank of Canada data which would be available in October 2009  
11    for the September 2009 period. For rates effective January 1, 2011, the Board would  
12    determine the ROE based upon the September 2010 Consensus Forecasts and Bank of  
13    Canada data which would be available in October 2010 for the September 2010 period.

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15    **4.0     DEEMED SHORT-TERM DEBT**

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17    The Board has determined that the deemed amount of short-term debt that should be  
18    factored into rate setting be fixed at 4% of rate base, and that the deemed short-term debt  
19    rate be based on the three-month bankers’ acceptance rate plus a fixed spread of 25 basis  
20    points based on the existing Cost of Capital policy. Variable rate debt which pays  
21    interest based on the bankers’ acceptance rate, has been included as part of the deemed  
22    short term debt amount of 4%. The deemed short-term rate is 1.19% for 2010 using the  
23    April 2009 Consensus Forecast and 2.76% for 2011 using the April 2009 Global Insight  
24    forecast. Hydro One assumes that the deemed short term debt rate for each test year will  
25    be updated in accordance with the Cost of Capital Report, upon the final decision in this  
26    case. Specifically, for 2010, the Board would determine the deemed short term debt rate  
27    for Hydro One Distribution based on the September 2009 Bank of Canada data which  
28    would be available in October 2009. For rates effective January 1, 2011, the Board

1 would determine the deemed short term debt rate based upon the September 2010 Bank  
2 of Canada data which would be available in October 2010.

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4 **5.0 LONG-TERM DEBT**

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6 The Board has determined that the deemed amount of long-term debt that should be  
7 factored into rate setting be fixed at 56% of rate base. The long term debt rate is  
8 calculated to be 5.72% for 2010 and 5.72% for 2011. The long term debt rate is  
9 calculated as the weighted average rate on embedded debt, new debt and forecast debt  
10 planned to be issued in 2010 and 2011 as discussed in Exhibit B1, Tab 2, Schedule 1.  
11 Details of Hydro One Distribution's long-term debt rate calculation for the 2010 and  
12 2011 test years are identified at Exhibit B2, Tab 1, Schedule 2, pages 5 and 6. A detailed  
13 discussion of Hydro One Distribution's debt and forecast interest rate support is provided  
14 at Exhibit B1, Tab 2, Schedule 1. Historical long-term debt cost information is filed at  
15 Exhibit B2, Tab 1, Schedule 2, pages 1 to 3.

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17 As Hydro One Distribution has a market determined cost of debt, the weighted average  
18 long term debt rate is also applied to any notional debt that is required to match the actual  
19 amount of long term debt to the deemed amount of long term debt consistent with the  
20 Board's Decision in EB-2008-0272.

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22 **6.0 COST OF CAPITAL SUMMARY**

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24 Hydro One Distribution's 2010 rate base is \$4,836 million which results in an after-tax  
25 required return of 6.49%. The 2011 rate base is \$5,146 million, which results in an after-  
26 tax required return of 6.95%, as shown in Table 1, below:

**Table 1**  
**2010 and 2011 Cost of Capital**

Amount of Deemed	2010				2011			
	(\$M)	%	Cost Rate (%)	Return (\$M)	(\$M)	%	Cost Rate (%)	Return (\$M)
Long-term debt	2,707.9	56.0%	5.72%	154.8	2,881.6	56.0%	5.72%	164.7
Short-term debt	193.4	4.0%	1.19%	2.3	205.8	4.0%	2.76%	5.7
Common equity	1,934.2	40%	8.11%	156.9	2,058.3	40.0%	9.09%	187.1
<b>Total</b>	<b>4835.6</b>	<b>100.0%</b>	<b>6.49%</b>	<b>314.0</b>	<b>5,145.7</b>	<b>100.0%</b>	<b>6.95%</b>	<b>357.4</b>

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