Reference: September 18, 2006 transcript, page 56

MR. TAYLOR: Dr. Lazar, do you feel that there's no evidence or any reason to suggest that there should be a difference, or that there's no good reason to distinguish between the larger and smaller LDCs?

DR. LAZAR: No, I think there are some differences, obviously, in the business environment; just management capabilities between the smaller and larger utilities. And, you know, if we didn't think that it was warranted that different debt/equity structures be in place for the two groups, we wouldn't have recommended it.

So, obviously, we think there are differences, at least the historical financial performance data suggest that there are, and maybe over time things will change. But we don't have any particular evidence. We didn't do an exhaustive analysis to suggest that there will be sort of a convergence among the various utilities regardless of size, and therefore one debt/equity structure would be appropriate for all.

Questions:

1) *To Board Staff:* Given that Board Staff is recommending one debt/equity structure for all LDCs, please explain why Board Staff did not commission Dr Lazar and Dr. Prisman to conduct an analysis to determine whether one debt/equity structure is appropriate for all LDCs?

2) *To Board Staff:* Does Board Staff agree that such an analysis would be of assistance to the Board in determining whether it is appropriate to move from the current deemed debt/equity structures? Why or why not?

3) *To Dr Lazar:* Do you agree that such an analysis would be of assistance to the Board in determining whether it is appropriate to move from the current deemed debt/equity structures? Why or why not?

4) *To Dr. Lazar:* Please confirm that your recommendation for two debt/equity structures is warranted based on risk differences between larger and smaller LDCs.

5) *To Board Staff:* Does Board Staff have any evidence that suggests the current deemed debt/equity structures for LDCs in Ontario are wrong (i.e. do not accurately reflect the risks faced by LDCs)? If so, please provide that evidence.

Reference: September 18, 2006 transcript, page 54

MR. FOGWILL: I mean, you have to look at it from the point of view of why they have a different structure to begin with. Just because we start with a four structure doesn't necessarily mean that's is it proper mode. And we debated this numerous times with both our consultants and amongst ourselves, and we don't have a good reason why there are different structures.

If you've got a good one, let us know.

MR. TAYLOR: Well, your consultants seem to have a good one. I think there was some empirical data that suggested that there were differences above and beyond, or above and below a $300 million rate base.

MR. FOGWILL: I'll let them speak to it in a minute, but my understanding was that they were looking at that more from a transitional point of view than anything else. But if I can get Fred or Elliott to respond.

DR. LAZAR: Fred Lazar, York University. I don't believe we have much to add to our previous comments. As we said, we came to that conclusion based on the actual reported data, the historical data. In a response to one of the questions, yes, the regulatory environment probably did have some impact, although not entirely, because there are still differences in the debt/equity ratios and what were required.

Questions:

1) *To Dr. Lazar*: Please confirm that your recommendation for 2 debt/equity structures was justified based on "actual reported data".

2) *To Dr. Lazar*: According to Mr. Fogwill, as referenced above, your recommendation for 2 debt/equity structures was "more from a transitional point of view than anything else". Is Mr. Fogwill's description of your recommendation correct? Why or why not?

3) *To Dr. Lazar*: If the answer to #2 is affirmative, please explain why your June 14, 2006 report *Calculating the Cost of Capital for LDCs in Ontario* did not indicate that transitional reasons contributed to your recommendation for 2 debt/equity structures.

4) *To Board Staff:* If Dr. Lazar and Dr. Prisman's recommendation for 2 debt/equity structures was <u>not</u> based on transitional reasons, but was rather based on actual reported data, would Board Staff support the debt/equity structures recommended by Dr. Lazar and Dr. Prisman? Why or why not?

Reference: September 20, 2006 transcript, page 120

MR. FOGWILL: I'll go back to some conversations that we had with Dr. Lazar and Dr. Prisman.

We asked them about that. And they said that there's some hint of a differentiation in the data – this is the RRR data that gets filed. But we all acknowledged that the RRR data for 2002, -3, and -4 is still -- has a lot of problems with it.

So aside from that point, in fact, that data is suspect, which was the only element that would provide any support for stratification, in this case, for two – their suggestion - and Ellie, you can correct me if I'm wrong - their suggestion was more of a transitional type of approach.

DR. PRISMAN: That is correct. Then it also kind of reflects the situation, the actual deemed situation in the market at that time.

Questions:

1) *To Dr. Prisman:* Do you agree with Mr. Fogwill that your recommendation for 2 debt/equity structures was "more of a transitional type of approach". Why or why not?

2) *To Dr. Prisman:* If #1 is confirmed, please explain why transitional considerations were not mentioned in your June 14, 2006 report *Calculating the Cost of Capital for LDCs in Ontario* or in Dr. Lazar's June 18, 2006 presentation at the technical conference.

3) *To Dr. Prisman:* Please confirm that the RRR data for 2002, 2003 and 2004 was used as the basis for your report *Calculating the Cost of Capital for LDCs in Ontario*?

4) *To Board Staff:* If question #3 above is confirmed, please explain why "suspect" data was used by your consultants as the basis for their report instead of the 2006 EDR data on file and reviewed by the Board.

5) *To Dr. Prisman and Dr. Lazar*: Please explain how the conclusions in your report *Calculating the Cost of Capital for LDCs in Ontario* would differ if they were based on 2006 EDR data instead of RRR data.

6) *To Board Staff:* Please provide the RRR data used by your consultants in a format that maintains the confidentiality of the LDCs (i.e. redacted).

Reference: September 20, 2006 transcript, page 120

MR. TAYLOR: Just so I understand, then, so is the recommendation, then, of your expert that there be one debt/equity structure or that there be two? Are we looking for something transitional or not?

MR. FOGWILL: Well, they were suggesting the two, and they were suggesting the two because of the fact we were starting with four. And our position was starting with a clean slate and saying, Let's keep it as simple as upon, and we can build the complexity into it. And if there's a reason to add complexity, we will.

In this case, we couldn't find it.

I asked them, Could you substantiate a difference in capital structure? Could you substantiate whether the capital structure should be 35 percent equity, 40, 45, 50, 55? And there's nothing definitive in the literature that says one is better than the other.

DR. PRISMAN: I concur.

Reference: *Calculating the Cost of Capital for LDCs in Ontario* (June 14, 2006), page 21

"Standard & Poor's has no minimum size criterion for any given rating level. However, size does turn out to be significantly correlated to its ratings. The reason: size often provides a measure of diversification, and/or affects competitive position. Small companies are, almost by definition, more concentrated in terms of product, number of customers, or geography. In effect, they lack some elements of diversification that can benefit larger companies. To the extent that markets and regional economies change, a broader scope of business affords protection. In addition, lack of financial flexibility is usually an important negative factor in the case of very small companies. Adverse developments that would simply be a setback for companies with greater resources could spell the end for companies with limited access to funds."

Question:

1) *To Dr. Prisman and Dr. Lazar:* Please provide all background information, reports, data, etc. that you relied on to derive your findings/conclusions contained in the paragraph from your report *Calculating the Cost of Capital for LDCs in Ontario* referenced above.

Reference: September 18, 2006 transcript, page 52

MR. FOGWILL: The objective that we've clearly identified in our paper is to not create any barriers to amalgamation.

Questions:

1) *To Board Staff:* Please list and explain each and every way that a stratified deemed debt/equity structure could represent a barrier to amalgamation?

2) *To Board Staff:* Please provide any evidence and/or concrete examples of differing deemed debt/equity structures acting as a barrier to amalgamation.

3) *To Board Staff:* Please explain how the objective of not creating barriers to amalgamation fits within the Board's mandate to set just and reasonable rates.

Reference: September 18, 2006 transcript, page 10

DR. LAZAR: …In our report we recommend that there be at least two groupings for the LDCs for the purpose of establishing the debt/equity ratio and the cut-off point was about $300 million. We arrived at this largely by looking at the reported accounting information for all the utilities, and, while there were some differences between the very small -- the smallest utilities and some of the so-called medium-sized utilities, in certain areas, when you looked at their existing debt/equity ratios and various measures of financial performance, by and large 300 million seemed to be the cut-off point.

Those below 300 million tended to perform somewhat differently than those in excess of 300 million.

And our view was for the smaller ones, those below 300 million, a 50/50 split would seem appropriate, based this on their actual debt/equity ratios, and observing debt/equity ratios in regulated utility sectors in Canada and the U.S., where we looked at the stet equity ratios with respect to size.

For those in excess of 300 million, a 60/40 debt/equity split seemed to be appropriate.

Reference: September 20, 2006 transcript, page 123

MR. SHPHERD: I wonder if I could ask Dr. Prisman a question. Dr. Prisman, did you see any empirical evidence that there should be stratification?
DR. PRISMAN: No.

Question:

1) *To Dr. Prisman:* Please reconcile your response to Mr. Shepherd’s question above with Dr. Lazar’s explanation as to how you and he concluded that stratified deemed debt/equity structure is appropriate.

Reference: "Rate of Return For Ontario's Electricity Distributors" prepared for the EDA by Christensen Associates Energy Consulting, LLC at page 51

"It is worth noting that progressively higher equity risk premia attend small-sized companies, particularly micro-sized companies like the Canadian distributors."

Question:

1) *To Dr. Camfield:* Please provide the references, data and analyses relied upon in reaching this conclusion.

Reference: “Rate of Return For Ontario’s Electricity Distributors” prepared for the EDA by Christensen Associates Energy Consulting, LLC at page 53

“A flexible approach suggests that the Board codify policy that finds acceptable, for use in determine(sp) electric distribution rates, an overall capital structure of individual LDCs in which the capital structure is found to be reasonable and consistent with prudent financial management. We recommend the Board establish five principles to define the policy for capital structure, as elaborated below.”

Questions:

1) *To Dr. Camfield:* Your proposal allows LDCs the fettered discretion to choose their capital structure within the range of 42-52%, but what mechanics do you propose for that discretion to be implemented?

2) *To Dr. Camfield:* You suggest that the Board should “define criteria for defining the reasonable and prudent capital structure”. Can you advise as to your recommendations to the OEB for what those criteria should be?”