COST OF SHORT-TERM DEBT

1.0 PURPOSE

This evidence provides the details of OPG's annual short-term borrowing and associated costs for the test period determined using the methodology approved by the OEB in EB-2007-0905. It also provides actual short-term debt costs for 2007 - 2009 and budgeted costs for 2010.

2.0 DESCRIPTION OF SHORT-TERM DEBT

The short-term debt component of OPG's capital structure reflects its forecast amount of short-term borrowings, and the cost of capital reflects its forecast short-term borrowing cost.

OPG's short-term debt is comprised of the same two main sources of short-term financing described in EB-2007-0905 at Ex C1-T2-S3. OPG's commercial paper program and accounts receivable securitization program remain its two main sources of short-term financing.

OPG's commercial paper program is used to fund intra-month working capital requirements. OPG expects to continue to use this source of financing in 2011 and 2012. OPG borrowed, on a daily basis, an average of $30.9M in 2007, $1M 2008 and $17.2M in 2009. OPG forecasts that a daily average borrowing of $43M is required to finance OPG's normalized intra-month working capital requirements in the test period.

In addition, the bank credit facility continues to be used primarily as the backstop to the commercial paper program. In the event that OPG is required to draw on the bank credit facility, it provides OPG with the ability to borrow by way of bankers' acceptances if OPG is unable to re-issue its commercial paper in the market place. The bank facility is $1B in size, comprised of a $500M 364-day tranche and a $500M multi-year tranche commencing May 2008 and expiring May 2013 as was discussed in EB-2007-0905. Three years of the five-year tranche remain.

OPG's other primary source of short-term financing is its accounts receivable securitization program with the Royal Bank of Canada, under which it sold $300M of receivables from January 2007 to April 2009, at which point the amount was reduced to $250M. The accounts receivable securitization program is in effect until 2010, but OPG expects to continue this program after 2010. OPG's forecast reflects continued borrowing of $250M under this program throughout the 2011 - 2012 test period.

The $250M is a portion of the month-end accounts receivable balance owing to OPG from the IESO for the prior month (OPG's month-end accounts receivable balances have ranged from $308M to $544M during the period January 2007 to April 2009). The accounts receivable securitization balance of $250M rolls over on a monthly basis and is supported by the amount of the IESO monthly payment. By selling its receivables, OPG is in essence borrowing money in advance of the monthly receipt from the IESO and the interest is the cost of that borrowed money. Under this program OPG continues to service the receivables and pays a short-term cost of funds on a monthly basis to an independent trust.

3.0 SHORT-TERM DEBT COST

As described in EB-2007-0905, OPG's borrowing rate under the commercial paper program is market-based, comprised of a 10 basis point dealer fee and a corporate spread over the bankers' acceptances rate for OPG.

There has been significant credit tightening since August 2007 causing short-term borrowing cost on bankers' acceptances to increase. The indicative corporate spread on OPG's short-term borrowings increased from 3 basis points to 20 basis points in the latter part of 2007. The market has normalized over the 2008 - 2009 period and the spread is currently priced around 5 basis points over bankers' acceptance. OPG's forecast over the test period is based on the current corporate spread of 5 basis points.

OPG has used the Global Insight forecast as the basis for the bankers' acceptances interest rate forecast after adjusting for the spread differential between bankers' acceptances and the yield on treasury securities. For 2010 the bankers' acceptances rate used is 0.46 per cent, for 2011 it is 1.79 per cent and for 2012 it is 3.28 per cent.

The pricing under the bank credit facility is market-based, and subject to OPG's credit rating, the amount drawn and the term of the financing. Amounts are drawn first under the 364-day tranche and then under the multi-year tranche. Based on OPG's current credit rating of A-, if the 364-day tranche is drawn in excess of 66 per cent of the total amount of this tranche ($0.5B), the margin added to the bankers' acceptance rate is 200 basis points (i.e., 2.0 per cent) otherwise the margin is 190 basis points for this tranche. If the multi-year tranche (three year remaining term) is drawn in excess of 50 per cent (i.e., 50 per cent of $0.5B), the margin added to the bankers' acceptance rate is 55 basis points (i.e., 0.55 per cent) otherwise the margin is 50 basis points.

The cost of borrowing under the bank credit facility is more expensive than either OPG's commercial paper or securitization program. OPG did not borrow funds through this facility in 2007, 2008 or 2009 and has not forecast borrowing under this facility in 2010, 2011 or 2012. The bank credit facility is forecast to cost $4M in each of 2010, 2011 and 2012, which is $1.6M lower than the actual cost of $5.6M in 2009. Credit facility costs are expected to be maintained at this level reflecting the new norm in this market. As discussed in EB-2007-0905 Ex. C1-T2-S3, these costs are included with OPG's short term debt costs, as the bank credit facility is required to support OPG's commercial paper program.

The cost of the accounts receivable securitization program, consisting of the banker's acceptance rate for OPG plus a program fee of 0.775 per cent, is forecast to be $6.9M in 2011 and $10.6M in 2012. Although the accounts receivable securitization program is slightly more expensive than OPG's commercial paper program, it represents an alternative form of financing, and a more permanent component of OPG's short-term debt which does not fluctuate month to month.

The cost of borrowing over the bankers' acceptances rate has increased from nil to about 70 basis points on average over the 2007 to 2009 period and the spread is currently priced around 20 basis points over bankers' acceptance. OPG's forecast over the test period is based on the current corporate spread of 20 basis points.

From a liquidity perspective, the availability of different sources of financing provides flexibility in managing short term funding by allowing the borrower to manage use of their overall facilities. The securitization program allows OPG to diversify its source of liquidity at a reasonable cost.

Ex. C1-T1-S3 Table 2 summarizes OPG's forecast company-wide cost of short-term debt.

4.0 ALLOCATION TO REGULATED OPERATIONS

OPG has applied the allocation methodology approved by the OEB in EB-2007-0905. In summary, the ratio of the construction work in progress and non-cash working capital amounts (fuel inventory and materials/supplies) for OPG's regulated operations to the total construction work in progress and non-cash working capital amounts reported in OPG's audited financial statements is used as the basis for allocating company-wide short-term borrowing. This allocation ratio reflects OPG's use of short-term borrowing to finance its working capital requirements and to assist with managing the cash flow variability of capital projects.

For all company-wide, short-term borrowing prior to December 31, 2009, the allocation ratio is determined based on actual year-end values in that year. Consistent with the approach approved in EB-2007-0905, OPG is using the most recent actual audited information available at the time evidence was developed to determine the allocation factor for OPG's short-term debt for 2009 - 2012. OPG has used asset and liability balances from its last audited financial statements as this approach is consistent with the asset values that are readily available, the amounts are independently verified, the approach is simple and transparent. The allocation ratio has changed over the 2007 – 2009 time period, as reflected in Ex. C1-T1-S3 Table 1, owing to the changing relative proportion of construction work in progress ("CWIP") as the Niagara Tunnel project progressed. The 2009 ratio is representative of the ratio going forward.

The 2009 ratio of 64.7 per cent, described in Ex. C1-T1-S3 Table 1, was applied to OPG's short-term debt amount for 2009 - 2012 and the resulting short-term debt cost is reflected in the capitalization and cost of capital evidence provided in Ex. C1-T1-S1 Tables 1 - 4. The 2008 ratio of 56.3 per cent, described in Ex. C1-T1-S3 Table 1, was applied to OPG's short-term debt amount determined in Ex. C1-T1-S3 Table 2 for 2008 and the resulting short-term debt cost is reflected in the capitalization and cost of capital evidence provided in Ex. C1-T1-S1 Table 5. The 2007 ratio of 57.1 per cent, described in Ex. C1-T1-S3 Table 1, was applied to OPG's short-term debt amount determined in Ex. C1-T1-S3 Table 2 for 2007 and the resulting short-term debt cost is reflected in the capitalization and cost of capital evidence provided in Ex. C1-T1-S1 Table 6.