

## **ECONOMIC INDICATORS**

### **1.0 INTRODUCTION**

Appendix A of Exhibit A, Tab 14, Schedule 1 provides the costing assumptions underlying the 2008 Business Plans. This exhibit provides additional background with respect to these assumptions.

### **2.0 ECONOMIC INDICATORS**

#### **2.1 Distribution Cost Escalation for Construction, Operations and Maintenance**

The Distribution Cost Escalation for Construction, Operations & Maintenance provides a broad average measure of the industry-wide yearly price changes by tracking a representative basket of equipment and labour for these areas of business. This basket of goods is comprised of the following types of equipment and labour:

- Operation;
- Supervision and Engineering;
- Load Dispatching;
- Station Expenses;
- Lines;
- Meters;
- Customer Installations;
- Maintenance;
- Structures;
- Station Equipment;
- Overhead Lines;
- Underground Lines;

- Line Transformers; and
- Miscellaneous.

The data in Table 1 was provided by Global Insight, Power Planner, Third-Quarter 2006.

**Table 1**

	Historic			Bridge	Test
	2004	2005	2006	2007	2008
Distribution Cost Escalation for Construction (%)	5.8	8.0	7.9	3.7	1.9
Distribution Cost Escalation for Operations & Maintenance (%)	5.0	5.9	6.5	3.5	0.9

The Distribution Cost Escalation for Construction, Operations & Maintenance is used as a planning tool to predict expenditure level changes for distribution materials and services.

## **2.2 Consumer Price Index**

The Consumer Price Index (CPI) provides a broad measure of the cost of living. Through the monthly CPI, Statistics Canada tracks the change in retail price of a representative shopping basket of about 600 goods and services from an average household's expenditure: food, housing, transportation, furniture, clothing, and recreation.

Hydro One Distribution operates wholly in the Province of Ontario, Canada. As a result, the CPI–Ontario exhibits the inflationary environment in which Hydro One Distribution operates. The CPI forecast is from Global Insight's November 2006 forecast and can be found in Table 2.

**Table 2**

	Historic			Bridge	Test
	2004	2005	2006	2007	2008
CPI – Ontario (%)	1.9	2.2	1.8	1.5	1.9

The CPI is used as a planning tool to forecast expenditure level changes for items such as fleet and sundry costs.

### **2.3 Exchange Rate (CDN\$/US\$)**

Table 3 provides the 2004, 2005 and 2006 average exchange rates based on actual daily closing rates. The exchange rate forecast for 2007 and 2008 is based on the Global Insight October 2006 Long-Term Forecast and Analysis.

**Table 3**

	Historic			Bridge	Test
	2004	2005	2006	2007	2008
Exchange Rate (CDN\$/US\$)	1.301	1.212	1.134	1.135	1.116

While the exchange rate forecast is not directly used to forecast costs or other variables, it is an important variable affecting the performance of the Canadian and Ontario economies.

### **3.0 INTEREST RATES**

Interest rate forecasts are used to determine the cost of capital for Hydro One Distribution as described in Exhibit B1, Tab 1, Schedule 1.

**3.1 Long-Term Debt Rates**

Table 4 contains Hydro One Inc.'s historical and forecast long-term interest rates. For 2004, 2005 and 2006 each rate is derived by adding the average actual daily closing Government of Canada bond yield for the applicable term (i.e. 5 year, 10 year or 30 year) to the corresponding Hydro One Inc. average actual credit spread.

**Table 4**

	Historic			Bridge	Test
	2004	2005	2006	2007	2008
<b>5-Year</b>					
Government of Canada %	3.81	3.58	4.10	4.13	4.43
Hydro One Credit Spread %	0.33	0.31	0.33	0.34	0.34
Hydro One Bond Interest Rate %	4.15	3.89	4.43	4.47	4.77
<b>10-Year</b>					
Government of Canada %	4.58	4.07	4.21	4.20	4.50
Hydro One Credit Spread %	0.54	0.50	0.51	0.51	0.51
Hydro One Bond Interest Rate %	5.12	4.57	4.72	4.71	5.01
<b>30-Year</b>					
Government of Canada %	5.13	4.43	4.27	4.25	4.55
Hydro One Credit Spread %	0.84	0.81	0.83	0.82	0.82
Hydro One Bond Interest Rate %	5.98	5.24	5.10	5.07	5.37

For 2007 and 2008, each rate is derived by adding the forecast Government of Canada bond yield to the corresponding Hydro One Inc. credit spread. The 10-year Government of Canada bond yield forecast for 2007 and 2008 is based on the May 2007 Consensus Forecasts. Other rates and spreads are determined as described below.

The 5 and 30-year Government of Canada bond yield forecasts are derived by adding the April 2007 average spreads (5-year to 10-year for the 5 year forecast and 30-year to 10-year for the 30-year forecast) to the 10-year Government of Canada bond yield forecast. This derivation is consistent with the Board's methodology in establishing the forecast

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

### 6 7 **3.2 Deemed Long-Term Debt Rate**

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9 The deemed long-term debt rate is calculated as the Long Canada Bond Forecast plus the  
10 average spread on "A/BBB" rated corporate bonds as per the *Report of the Board on Cost*  
11 *of Capital and 2<sup>nd</sup> Generation Incentive Regulation for Ontario's Electricity Distributors*,  
12 December 20, 2006 (Cost of Capital Report). The forecast for 2007 and 2008 is shown in  
13 Table 5 below. The 30-year Government of Canada forecast is obtained from Table 4  
14 above and is added to the April 2007 average spread between 30-year Government of  
15 Canada bonds and the Long-Term Average Weighted Bond Yield (Scotia Capital Inc.) –  
16 All Corporates from the Bank of Canada.

17  
**Table 5**

	<b>Bridge</b>	<b>Test</b>
	<b>2007</b>	<b>2008</b>
30-year Government of Canada %	4.25	4.55
All Corporates Long-Term Bond Spread %	1.14	1.14
Deemed Long-Term Debt Rate %	5.39	5.69

### 18 19 **3.3 Deemed Short-Term Debt Rate**

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21 The deemed short-term debt rate is the average of the 3-month bankers' acceptance (BA)  
22 rate plus a fixed spread of 25 basis points, as per the Cost of Capital Report.

1 The 3-month BA rates shown for 2004, 2005 and 2006 in Table 6 below are the average  
 2 of the actual daily closing rates for each respective year. The forecast for 2007 and 2008  
 3 is based on the May 2007 Consensus Forecasts of the Government of Canada 3-month  
 4 treasury bills, adjusted by the April 2007 average spread between 3-month BAs and 3-  
 5 month treasury bills.

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**Table 6**

	Historic			Bridge	Test
	2004	2005	2006	2007	2008
3-month BA Rate %	2.30	2.81	4.16	4.39	4.49

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8 **3.4 Allowance for Funds Used During Construction**

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10 For construction work in progress (CWIP), Hydro One Distribution capitalizes interest at  
 11 the Scotia Capital Inc. All Corporate Mid-Term Average Weighted Bond Yield as per the  
 12 methodology approved by the Board in its letter dated November 28, 2006 in proceeding  
 13 EB-2006-0117.

14

15 For 2007 and 2008, this is calculated in Table 7 as the 10-year Government of Canada  
 16 forecast from the above table plus the April 2007 average spread between the 10-year  
 17 Government of Canada bond yield and the Scotia Capital Inc. Mid-Term Average  
 18 Weighted Bond Yield (Scotia Capital Inc.) – All Corporates from the Bank of Canada.

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**Table 7**

	Bridge	Test
	2007	2008
10-year Government of Canada %	4.20	4.50
All Corporates Mid-Term Bond Spread%	0.60	0.60
All Corporates Mid-Term Yield%	4.80	5.10

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1 **4.0 INCOME AND CAPITAL TAX RATES**

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 3 The historical and forecast tax rates are presented in Table 8. Please refer to Exhibit C2,  
 4 Tab 6, Schedule 1, for the calculation of Hydro One Distribution’s income taxes and  
 5 Exhibit C2, Tab 4, Schedule 1, for forecast year capital taxes.

6  
 7 **Table 8**

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	Historic			Bridge	Test
	2004	2005	2006	2007	2008
Federal Tax Rate (%)	21.00	21.00	21.00	21.00	20.50
Federal Surtax Rate (%)	1.12	1.12	1.12	1.12	n/a
Provincial Rate (%)	14.00	14.00	14.00	14.00	14.00
<b>Total Statutory Tax Rate (%)</b>	<b>36.12</b>	<b>36.12</b>	<b>36.12</b>	<b>36.12</b>	<b>34.50</b>
Large Corporation Tax Rate (%)	0.200	0.175	n/a	n/a	n/a
Capital Tax Rate (%)	0.300	0.300	0.300	0.285	0.285

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 10 **5.0 LABOUR ESCALATION RATES**

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 12 Appendix A of Exhibit A, Tab 14, Schedule 1 provides the labour rate escalation  
 13 assumptions for Hydro One Distribution’s three compensation categories: the Society of  
 14 Energy Professionals (“Society”), the Power Workers Union (“PWU”) and Management  
 15 Compensation Plan (“MCP”) staff.

16  
 17 For Management Compensation employees, escalation factors were provided by Hydro  
 18 One Distribution senior management. Details regarding management compensation are  
 19 provided in Exhibit C1, Tab 3, Schedule 2.

1 Escalation factors for PWU and Society staff reflect the current collective agreements,  
2 which both were effective April 1, 2005. (There is a new Society Agreement in place  
3 which is consistent with the 2008 escalation factors presented in Exhibit A, Tab 14,  
4 Schedule 1, Appendix A.)

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## 6 **6.0 COST RATES FOR BENEFITS**

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8 Appendix A of Exhibit A, Tab 14, Schedule 1 provides the benefit cost rates or payroll  
9 burden assumptions incorporated in the 2008 Business Plan. These rates are applied to  
10 the forecast labour rates.

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12 The "burden rate," expressed as a percentage, estimates employee current and future cost  
13 rates for benefits which are attributable to labour in the current period, and allocates such  
14 costs across Hydro One legal entities. The benefit costs include:

15

16 (a) Other post-retirement benefits (OPRB), such as future health and dental costs;

17 (b) Other post-employment benefits (OPEB), such as long-term disability;

18 (c) Supplementary pension plan (SPP);

19 (d) Pension (funding) contributions;

20 (e) Employee benefit costs during active employment; and

21 (f) Statutory benefit payments, such as CPP, EI, etc.

22

23 Cost items (a) through (d) are actuarially determined by Hydro One Inc.'s external  
24 actuaries, Mercer Consulting Inc., using assumptions recommended by the actuaries and  
25 accepted by Hydro One Inc.'s management. Assumptions are determined with reference  
26 to past experience and industry norms.

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1 Cost item (e) is based on estimates from Mercer, and from Hydro One Inc.'s insurance  
2 provider Great West Life, as to anticipated escalation factors of health and dental costs.  
3 These estimates are compared to past experience.

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5 Cost item (f) is based on government schedules of premium rates for CPP, EI, etc.

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