

1 **ECONOMIC INDICATORS**

2
3 **1.0 INTRODUCTION**

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5 Appendix A of Exhibit A, Tab 14, Schedule 1 provides the costing assumptions
6 underlying the 2009 Business Plan. This exhibit provides additional background with
7 respect to these assumptions.

8
9 **2.0 ECONOMIC INDICATORS**

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11 **2.1 Distribution Cost Escalation for Construction, Operations and Maintenance**

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

- 17
18 • Operation;
19 • Supervision and Engineering;
20 • Load Dispatching;
21 • Station Expenses;
22 • Lines;
23 • Meters;
24 • Customer Installations;
25 • Maintenance;
26 • Structures;
27 • Station Equipment;
28 • Overhead Lines;
29 • Underground Lines;
30 • Line Transformers; and
31 • Miscellaneous.
32

1 The data in Table 1 was provided by Global Insight's December 2008 forecast.

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4

Table 1

	Historic			Bridge	Test	
	2006	2007	2008	2009	2010	2011
Distribution Cost Escalation for Construction (%)	7.9	3.7	4.8	1.8	1.3	1.3
Distribution Cost Escalation for Operations & Maintenance (%)	6.5	3.5	2.1	2.7	(0.1)	1.0

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

10 **2.2 Consumer Price Index**

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

16

17 Hydro One Distribution operates wholly in the Province of Ontario, Canada. As a result,
18 the CPI-Ontario exhibits the inflationary environment in which Hydro One Distribution
19 operates. The CPI forecast is from Global Insight's December 2008 forecast and can be
20 found in Table 2.

21

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Table 2

	Historic			Bridge	Test	
	2006	2007	2008	2009	2010	2011
CPI – Ontario (%)	1.8	1.5	1.6	1.0	2.0	2.0

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

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6 **2.3 Exchange Rate (CDN\$ per US\$)**

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8 The historic rates in Table 3 are the average exchange rates for 2006, 2007 and 2008
 9 from the Bank of Canada. The exchange rate forecast for 2009, 2010 and 2011 is based
 10 on the November 2008 edition of *Consensus Forecasts*.

11

Table 3

	Historic			Bridge	Test	
	2006	2007	2008	2009	2010	2011
Exchange Rate (CDN\$ per US\$)	1.134	1.075	1.066	1.200	1.162	1.054

14

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

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19 **3.0 INTEREST RATES**

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

23

3.1 Long-Term Debt Rates

Table 4 contains Hydro One Inc.'s historical and forecast long-term interest rates. For 2006, 2007 and 2008 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	
	2006	2007	2008	2009	2010	2011
5-Year						
Government of Canada %	4.10	4.21	3.06	1.74	2.04	3.34
Hydro One Credit Spread %	0.33	0.44	1.34	1.74	1.74	1.74
Hydro One Bond Interest Rate %	4.43	4.65	4.40	3.48	3.78	5.08
10-Year						
Government of Canada %	4.21	4.27	3.61	2.80	3.10	4.40
Hydro One Credit Spread %	0.51	0.60	1.49	1.97	1.97	1.97
Hydro One Bond Interest Rate %	4.72	4.87	5.10	4.77	5.07	6.37
30-Year						
Government of Canada %	4.27	4.31	4.06	3.55	3.85	5.15
Hydro One Credit Spread %	0.83	0.89	1.69	2.31	2.31	2.31
Hydro One Bond Interest Rate %	5.10	5.20	5.75	5.86	6.16	7.46

For 2009, 2010 and 2011 each rate is comprised of the forecast Canada bond yield plus the Hydro One Inc. credit spread applicable to that term. The ten-year Government of Canada bond yield forecast for 2009, 2010 and 2011 is based on the April, 2009 Consensus Forecasts. The five- year and 30-year Government of Canada bond yield forecasts are derived by adding the April, 2009 average spreads (five-year to ten-year for the five-year forecast and 30-year to ten-year for the 30-year forecast) to the ten-year Government of Canada bond yield forecast. Hydro One's credit spreads over the Government of Canada bonds are based on the average of indicative new issue spreads

1 for April, 2009 obtained from the Company's MTN dealer group for each planned
2 issuance term.

3.2 Deemed Short-Term Debt Rate

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

9 For 2009 the Deemed Short-Term Debt Rate as prescribed by the OEB on February 24,
10 2009 was 1.33%. The forecast 3-month BA rate for 2010 is based on the forecast
11 Government of Canada 3-month treasury bill rates from the April 2009 *Consensus*
12 *Forecasts* adjusted by the April 2009 average spread between 3-month BAs and 3-month
13 treasury bills. The forecast 3-month BA rate for 2011 is from the April 2009 *Global*
14 *Insight*.

16 **Table 5**

	Bridge	Test	
	2009	2010	2011
3-month BA Rate %	1.08	0.94	2.51
25 basis point spread %	0.25	0.25	0.25
Deemed Short-Term Debt Rate %	1.33	1.19	2.76

3.3 Allowance for Funds Used During Construction

21 For construction work in progress (CWIP), Hydro One Distribution capitalizes interest at
22 the All Corporate Mid-Term Average Weighted Bond Yield as per the methodology
23 approved by the Board in its letter dated November 28, 2006 in proceeding
24 EB-2006-0117.

1 The 2009, 2010 and 2011 rates are calculated as the 10-year Government of Canada
 2 forecast from Table 4 plus the April 2009 spread between the average actual 10-year
 3 Government of Canada bond yield and the average DEX Mid Term Corporate Bond
 4 Index - Yield inferred from the graph on www.pcbond.com.

5
 6 **Table 6**

	Bridge	Test	
	2009	2010	2011
10-year Government of Canada %	2.80	3.10	4.40
All Corporate Mid-Term Bond Spread	3.30	3.30	3.30
CWIP Account Rate %	6.10	6.40	7.70

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 9 **4.0 INCOME AND CAPITAL TAX RATES**

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

14
 15 **Table 7**

	Historic			Bridge	Test	
	2006	2007	2008	2009	2010	2011
Federal Tax Rate (%)	21.00	21.00	19.50	19.0	18.0	16.5
Federal Surtax Rate (%)	1.12	1.12	nil	nil	nil	nil
Provincial Rate (%)	14.00	14.00	14.00	14.00	14.00	14.00
Total Statutory Tax Rate (%)	36.12	36.12	33.50	33.00	32.00	30.50
Capital Tax Rate (%)	0.300	0.225	0.225	0.225	0.075 ⁽¹⁾	nil

17 (1) Rate change effective January 1, 2010 and is eliminated July 1, 2010. This represents the weighted average

1 **5.0 LABOUR ESCALATION RATES**

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3 Appendix A of Exhibit A, Tab 14, Schedule 1 provides the labour rate escalation
4 assumptions for Hydro One Distribution's three compensation categories: the Society of
5 Energy Professionals ("Society"), the Power Workers Union ("PWU") and Management
6 Compensation Plan ("MCP") staff.

7
8 For Management Compensation employees, escalation factors were provided by Hydro
9 One senior management. Details regarding management compensation are provided in
10 Exhibit C1, Tab 3, Schedule 2.

11
12 Escalation factors for PWU and Society staff reflect the current collective agreements,
13 (PWU effective April 1, 2008 and Society effective July 1, 2007).

14
15 **6.0 COST RATES FOR BENEFITS**

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17 Appendix A of Exhibit A, Tab 14, Schedule 1 provides the benefit cost rates or payroll
18 burden assumptions incorporated in the 2010 Business Plan. These rates are applied to
19 the forecast labour rates.

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

- 24
25 a) Other post-retirement benefits ("OPRB"), such as future health and dental costs;
26 b) Other post-employment benefits ("OPEB"), such as long-term disability;
27 c) Supplementary pension plan ("SPP");
28 d) Pension (funding) contributions;
29 e) Employee benefit costs during active employment; and

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

2

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

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

11

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