

January 21, 2002

BACKGROUNDER
Input Price Index for 2002

The Input Price Index (IPI) is used to measure the change in input costs to the typical LDC in Ontario and is the basis for the adjustment to distribution rates under the Board's current Performance-Based Regulation (PBR) Plan for Ontario's LDCs. The input costs are of three major types: capital costs (i.e., investment in hard assets such as transformers, poles, conductor, land, buildings, vehicles, etc.), labour costs, and materials and other purchased services.

The electricity distribution business is a capital intensive business, and the cost structure of a typical Ontario LDC reflects this. The cost structure of a typical Ontario LDC is 50% capital, 35% labour, and 15% materials and other purchased services.

The actual IPI is a weighted average of three indexes that measure the change in prices for the three major input costs. The index is based on 1988 = 100. The value of the index and its percentage change from the previous year is listed in the table below:

| Year | IPI | % change |
|------|---------|----------|
| 2000 | 114.380 | 2.4% |
| 2001 | 114.786 | 0.4% |

Over the past year, input prices as measured by the IPI, increased by 0.4%. This results from a decrease in the price of constructing new distribution assets and a decline in interest rates. Labour and materials prices sustained slight increases over the period.

The Board estimates that capital costs attributed to the IPI have decreased by over 5 per cent last year, primarily due to the decline in long bond yields and capital construction costs for distribution systems. The Board passes through only 50 per cent of this change (as stipulated in Board Decision with Reasons RP-1999-0034); therefore the capital index portion of the IPI declined by just over 2.5 per cent.

Average labour costs were estimated to increase just over 2 per cent last year, and materials and other purchased services increased by just under 3 per cent.

This results in the overall IPI increasing by 0.4 per cent over the past year.

A description of the calculation is shown in the table on the following page:

Calculation of Input Price Index (IPI) for Electricity Distributors' Price Cap

| | Bond Rate ¹ | Deprec | CAP ² | P _k | Capital Index 1988=1 | % chg | Labour Index ³ 1988=1 | % chg | Materials Index ² 1988=1 | % chg |
|------|------------------------|--------|------------------|----------------|-------------------------|--------|-------------------------------------|-------|--|-------|
| 1988 | 10.23% | 0.0567 | 109.4 | 0.174 | 1.00 | --- | 1.00 | --- | 1.00 | --- |
| 1998 | 5.30% | 0.0567 | 138.8 | 0.152 | 0.88 | | 1.30 | | 1.30 | |
| 1999 | 5.55% | 0.0567 | 142.6 | 0.160 | 0.92 | 5.08% | 1.31 | 0.66% | 1.33 | |
| 2000 | 5.89% | 0.0567 | 145.8 | 0.169 | 0.97 | 5.38% | 1.34 | 2.10% | 1.36 | 2.61% |
| 2001 | 5.47% | 0.0567 | 143.3 | 0.160 | 0.92 | -5.30% | 1.37 | 2.33% | 1.40 | 2.81% |

| Weights | | IPI | % chg |
|-----------|--------|------|--------|
| Capital | 0.5011 | | |
| Labour | 0.3514 | 1988 | 100.00 |
| Materials | 0.1475 | | |
| | 1.0000 | 1999 | 111.66 |
| | | 2000 | 115.62 |
| | | 2001 | 114.71 |

Board Method, Capital Index limited to 50% of observed change, as per RP-1999-0034

| | Capital Index | % chg | Labour Index | % chg | Materials Index | % chg |
|------|---------------|--------|--------------|-------|-----------------|-------|
| 1999 | 0.920 | | 1.31 | | 1.33 | |
| 2000 | 0.944 | 2.69% | 1.34 | 2.10% | 1.36 | 2.61% |
| 2001 | 0.919 | -2.65% | 1.37 | 2.33% | 1.40 | 2.81% |

| | IPI | % chg |
|------|---------|-------|
| 1988 | 100.00 | --- |
| 1999 | 111.661 | |
| 2000 | 114.380 | 2.4% |
| 2001 | 114.786 | 0.4% |

Notes:

- (1) Source: Bank of Canada
- (2) Calculated from Statistics Canada Data
- (3) Source: Labour Settlements Data

For further information, contact Stephen Motluk, Strategic Services (416) 440-8126