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Request from: Public Utilities Regulatory Authority

Question:

(OM&A PFP AND X-FACTOR) Exhibit CLP-PBR-2, p. 43.The Companystates the average capital-to-operations split is 46% to 54%. Describe the significance of this split on the TFP, including its effect on both the Company and ratepayers. In addition, discuss how the Company and ratepayers would be affected if it was a 50/50 split.

Response:

The reported 46% capital / 54% OM&A split represents the relative proportions of the summed implicit capital and OM&A input-price series over the 2005–2024 study period. The split is not an assumed or predetermined weighting, but rather a calculated outcome derived from the aggregated historical data of the 88 utilities included in the Study. The implicit capital and OM&A prices are calculated at the industry level for each year from 2005 to 2024, using aggregated capital and OM&A data and the Study's established methodologies for estimating capital service flows and real input quantities. These implicit prices vary annually, rather than remaining fixed throughout the study period. The reported 46%/54% split represents a single, industry-wide summary calculated by summing the respective annual implicit prices over the full 2005–2024 period and determining their proportions of the combined total.

To understand what this split actually means, we need to take it back to how the implicit prices are calculated. Using capital as an example, we take the real service flow in 1988 dollars and apply the capital quantity index to it. This separates changes in the amount of capital used from changes in the price of capital. If capital in dollar terms appears to be growing, it is for one of two reasons; more capital is being acquired, or the cost of capital has increased. The implicit price calculation attempts to isolate the second explanation by removing the effect of changes in the quantity purchased.

The implicit capital and OM&A prices are calculated annually using the underlying data from the 88 utilities. These prices, together with their respective input quantities, are used in the Fisher Ideal calculation to determine total input growth, which is then compared with output growth to calculate TFP. The 46%/54% split is simply a summary of the implicit prices over 2005–2024. It is not used as a weighting in the calculation and therefore has no direct effect on TFP. However, the underlying annual prices and quantities do influence the results.

A hypothetical 50%/50% split would require artificially adjusting the underlying implicit capital or OM&A prices, as the reported 46%/54% split is a calculated outcome of the historical data rather than an assumed weighting. While such adjustments could alter the relative weighting of inputs and consequently the TFP results, they would not reflect the actual data of the 88 utilities. Accordingly, imposing a 50%/50% split would not provide a meaningful assessment of industry productivity or the sensitivity of TFP to alternative economic conditions.