

Décision D-2006-34

Application to modify its rates and certain conditions for the distribution of electricity during the rate year beginning April 1, 2006

SUMMARY

In September 2005, the Distributor filed with the Régie de l'énergie du Québec an application to modify its rates and certain conditions for the distribution of electricity during the rate year beginning April 1, 2006.

For regulatory purposes, the Distributor (Hydro-Québec when carrying on electricity distribution activities) is a distinct and independent entity. Under the *Act respecting the Régie de l'énergie*, it may apply for changes to its rates in order to cover its capital and operating costs, including a reasonable return, as determined by the Régie, on capital expenditures related to electricity distribution in Québec. These costs constitute the Distributor's "revenue requirement."

For 2006, the Distributor's revenue requirement is \$10,051 million, necessitating additional revenues of \$463 million and therefore an average rate increase of 5.3% for the 2006-2007 rate year.

Application for rate averaging

The Distributor proposed to the Régie that the rate increase on April 1, 2006 be limited to 3% and that a rate averaging system be put in place in order to recover the balance of the Distributor's additional revenue requirement, which is \$203 million. This balance would be charged to a deferral account bearing interest at 7.75%. The cost of financing the \$203 million balance incurred in 2006 but not recovered in the rates and averaged forward to 2014 could amount to \$100 million.

Going forward, the Distributor expects rate increases of 12.2% in 2007, 5.8% or less from 2008 through 2011, and decreases from 2012 to 2014. Therefore, under this scenario, annual rate increases of 3% for eight years would be used to pay down in full the accumulated charges in the deferral account, including \$868 million in financing costs. In the Régie's view, this interest charge would provide no tangible benefit to consumers during this period.

The averaging of costs directly related to serving consumers in 2006 would also send a false pricing signal, since more than 75% of the requested rate increase is related to the acquisition on the market of post-heritage electricity, the price of which can be three times higher than heritage electricity.

The Régie recognizes that any rate increase exerts additional pressure on the disposable income of low-income consumers. Nevertheless, the Régie believes it is desirable that consumers know the real cost of the electricity they consume, enabling them to make informed choices and encouraging them to adopt energy conservation behaviours.

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The Régie therefore rejects rate averaging. Instead, it authorizes the Distributor to recover its additional revenue requirement for 2006 by increasing its rates by an average of 5.3% as of April 1, 2006. For the average residential customer, this increase will translate into additional expenses of \$5 to \$8 per month.

The impact of the rate increase could be mitigated by energy conservation programs designed to promote more efficient energy use by consumers. The increase is less than the price increases that have affected all other forms of energy, including heating oil, gasoline and natural gas.

Cost of supply, cost of service, classes of consumers

Electric power consumption in Québec now exceeds the heritage pool of 165 TWh. To meet demand for electric power in 2006, the Distributor plans to buy more than \$700 million of post-heritage electricity at an average of 8.8¢/kWh, approximately three times the average cost of heritage pool electricity, determined to be 2.79¢/kWh pursuant to the *Act respecting the Régie de l'énergie*.

The *Act respecting the Régie de l'énergie* provides that the acquisition cost of electricity is to be attributed in full to the various classes of consumers according to their consumption characteristics, that is, utilization factors and power losses attributable to the transmission and distribution system. For 2006, the cost of post-heritage electricity has been allocated to the various classes of consumers in the same proportions as the cost of heritage pool electricity. The Régie will study the allocation method for post-heritage supply costs in greater detail in the next rate case.

Depending on the cost allocation method adopted in the future, the level of cross-subsidization that some classes of consumers benefit from or support may be changed. In this case, the Régie will have to reconcile the various objectives stipulated in the *Act respecting the Régie de l'énergie*: to fix rates on the basis of costs, to send the right price signals, and to honour its obligation not to modify the rates applicable to a class of consumers in order to alleviate cross-subsidization (subsection 52.1). The Régie will consider this issue when the Distributor files its next rate application.

Capital expenditures

The Régie authorizes capital projects of less than \$10 million in an aggregate amount of \$579.5 million, as requested. These projects are in addition to those already authorized. Planned capital expenditures for 2006 total \$696.1 million.

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Rate of return

The Régie sets the return on the rate base at 7.75%.

Distributor's efficiency and benchmarking

The Régie considers the components of the Distributor's revenue requirement for 2006 to be reasonable.

Since the Distributor is a monopoly and deals with other divisions of Hydro-Québec for a significant portion of its supplies of goods and services, the Régie maintains the requirement that the Distributor engage in benchmarking in order to compare its costs with those of other industry players. The Régie considers the results of the Distributor's efficiency analyses to be generally acceptable and takes note of the Distributor's desire to contain increases in its process costs to less than the inflation rate.

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Rate structures

The Régie approves rate changes that are consistent with gradual rate structure reform in order to send a better price signal.

The Régie also approves a new interruptible power option for customers in the Medium Power category to replace the old rates MR and BT.

In view of the post-heritage supply environment, the Régie considers it timely to open a discussion on a thorough overhauling of rate structures in order to better reflect long-term marginal costs.