TREATMENT OF DEFERRAL ACCOUNTS

1 BACKGROUND

The deferral accounts represent assets flowing from the deferral of costs incurred that will be stated as charges in subsequent financial years. The Distributor's deferral accounts were created for various purposes. Some accounts were created in order to allocate to customers benefiting from the implementation of a program the corresponding costs (intergenerational equity). Others were created to allow for subsequent accounting in the revenue requirements for costs incurred during the test year for which the amounts were unforeseen at the time of distribution ratesetting. In this case, the use of the deferral account constitutes a method for recovering costs via the rates.

The deferral accounts can be included in the rate base or not. Below we briefly discuss the respective impact of each of these two treatments on the revenue requirements.

Non-rate-base accounts:

The non-rate-base deferral accounts have no effect on the calculation of revenue requirements. The interest applicable to the account balance (at the average authorized cost of capital rate) is capitalized, i.e., added to the costs recorded in the account. The account balance, including accrued interest, will subsequently be stated in revenue requirements at the time of its disposal.

Rate-base accounts:

The deferred charges included in the rate base enter into the calculation of revenue requirements through amortization and return on rate base. The unamortized balance of the deferral accounts bears interest at the average cost of capital rate and this return is taken into account annually in the cost of service for the purpose of calculating revenue requirements.

In case R-3579-2005,[1] the Distributor asked the Régie for authorization to include the deferral accounts in its rate base upon commencement of their disposal. The purpose of this application was to allow the Distributor to reflect this cost of capital in the rates as well as to facilitate the handling of interest capitalization for certain accounts; namely, where there is overlap over the years between amounts added to the accounts and amounts disposed of. The request thereby made it possible to harmonize the treatment of the deferral accounts with, among other things, work in progress related to tangible and intangible assets.

In decision D-2006-34,[2] the Régie approved the Distributor's application on the grounds of simplification and of uniformity with the deferral accounts already included in the rate base.

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[1] HQD-4, Document 7.
[2] D-2006-34, p. 24.

Section 2 of this document provides an inventory of the deferral accounts approved by the Régie with a description of their nature and treatment.

In addition, Exhibit HQD-9, Document 1 presents the history of the costs recorded in the various deferral accounts.

2 INVENTORY OF ACCOUNTS

2.1 Marketing Programs

These programs essentially relate to the Electrotechnology Implementation Service (SIE) program ended in December 2004, the Revenue Protection Program (PPR), which is nearing completion, and the energy efficiency programs for remote communities.

With the SIE program ended, the costs incurred for the program consist of loan guarantees that enable customers to implement productive electrical technologies with support from the Distributor. The PPR-related costs are designed to build business customer loyalty. Finally, to reduce generation costs, energy efficiency programs were implemented in the remote communities. They are designed to encourage customers to use energy sources other than electricity (mainly heating oil) for space heating and hot water. In broad outline, these programs include financial compensation for the price of heating oil, an annual furnace maintenance program, and assistance for conversion to heating oil systems. These programs are described in the Distributor's 2005 Annual Report.[3]

Few new costs were recorded in the account in 2005–07. The amounts recorded in the deferral account are amortized linearly over a 5-year period starting in the year following the year in which the costs were recorded. This account is included in the rate base under the heading of *Deferred charges,* and the corresponding annual amortization charge is included under the heading *Amortization and downgrading* of Distribution and Customer Service Costs. The financing charges corresponding to the unamortized balance of the account are also included in revenue requirements via the return on rate base calculation.

2.2 Energy Efficiency Plan (PGEÉ)

The PGEÉ comprises a set of energy efficiency programs for residential, commercial, institutional, and industrial customers. The Régie, in decision D-2002-25, approved a deferral account for the plan to allow for allocation of the costs of implementing energy efficiency measures to the customers who will benefit from programs under the plan. Expenses eligible for the deferral account, as defined in decision D-2002-288, include program development and management, training, financial assistance, and communication. The amounts recorded in the deferral account are amortized linearly, over a 5-year period for charges incurred up to 2005, and over a 10-year period for

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[3] Distributor’s 2005 Annual Report, Exhibit HQD-3, Document 1, Appendix 1.

charges incurred from 1 January 2006 onward, pursuant to Régie decision D-2006-56. Amortization begins in the year following the one in which the charges were recorded. The account is included in the Distributor's rate base under the heading *Deferred charges* and the corresponding annual amortization charge is included under the heading *Amortization and downgrading* of Distribution and Customer Service Costs. The financing charges corresponding to the unamortized balance of the account are also included in revenue requirements via the return on rate base calculation.

2.3 Interruptible Load Option

In decision D-2003-224, the Régie authorized the creation of a deferral account for the costs of using the interruptible load option offered by the Distributor to large industrial customers for the period from the winter 2003–04 peak to 30 November 2004. In decision D-2004-213, the Régie renewed the terms of decision D-2003-224 for the period from 1 December 2004 to 30 November 2006. The option entails the customers' commitment to make their power available under certain terms and conditions. In exchange, a credit is offered to companies that have interrupted their load. Under the terms, before the heritage pool volume was exceeded, the option could be made available to Hydro-Québec as regards its generation activities. Beyond the heritage pool volume, the Distributor will use this option to supplement short-term contracts where the available resources are insufficient. The Régie approved the recording in a deferral account of the amounts paid by the Distributor to large industrial customers; these amounts are unknown at the time of ratesetting. To date, no amounts have been recorded in this account and no amounts are projected for 2006 or 2007.

Observing that the option was infrequently used, the Distributor, in a recent motion filed last May under number R-3603-2006, proposed the introduction of a fixed credit for effective interruptible load offered by the customer and a variable credit payable upon use up to a maximum of 100 hours, in order to increase the load reduction potential from 800 to 1000 MW in winter 2006–07.

Regarding this proposal, the Distributor proposed that in future rate cases, the fixed part of the cost of the interruptible load option for large power customers be part of its cost of service, coming under the heading of supply costs. The Distributor also requested approval to record the following amounts in the deferral account created pursuant to decision D-2003-224:

- The difference between the fixed amounts projected in the rate cases and the fixed amounts disbursed, as well as all variable amounts paid for the use of the interruptible load option;

- All fixed and variable amounts for the Distributor's use of the emergency generators.

Furthermore, in its rate application R-3579-2005, the Distributor proposed the creation of an interruptible load option for medium power customers. This proposal is further to the abolition of rates MR and BT and resulted from a commitment by the Distributor to offer, as an alternate solution, an interruptible load option applicable as of 1 April 2006 for medium power customers having load reduction capacity. At the same time, the Distributor requested authorization to record the deferred charges corresponding to this option in the same deferral account authorized in decision D-2003-224, which is devoted to the interruptible load option offered by the Distributor to large industrial customers. In decision D-2006-34, the Régie approved the Distributor's request, in terms of both the implementation of the option itself and the recording of the corresponding charges in the deferral account used for the interruptible load of large power customers.

The deferral account will initially be kept out of the rate base and any balance will be applied to the Distributor's supply costs at time of disposal.

2.4 Transfer of Heritage Pool Supply Costs

In decision D-2003-93, the Régie approved the principle of the transfer of heritage pool supply costs and the creation of a deferral account in which would be recorded the differentials resulting from changes to the heritage pool supply cost for each customer class (Schedule I of the Act) that were unforeseen at the time of ratesetting.

A deferral account was created for this purpose. Any balance in the account would be fully applied to the Distributor's cost of service as a supply cost, without rate stabilization measures, in the year subsequent to its recording or the year following that one. To date, no amounts have been recorded in this account, nor are any amounts planned for 2005 and 2006.

2.5 Pass-Through Account for Post-Heritage Supply Costs

Pursuant to decisions D-2005-34 and D-2005-132, the Régie authorized the Distributor to create a deferral account for all differentials between real and projected data, net of the effect of revenues, resulting from additional costs incurred for post-heritage pool supply that were unforeseeable at ratesetting time. As approved in decision D-2006-34, the amounts recorded in the account are composed of volume and price differentials calculated, like other costs of service, based on real data for a given year, from January 1 to December 31. In the same decision, the Régie accepted the Distributor's proposal to include the differentials observed for a test year into the rate case for the second year following, a treatment applied in 2007 for the 2005 test year.

However, several considerations discussed more fully in Exhibit HQD-4, Document 2, have led the Distributor to propose new methods for calculating and including the differentials. Concerning these new methods, the Distributor proposes an initial estimate of differentials still covering a 12-month period, from January 1 to December 31, but based on 4 real months and 8 projected months. It would correspond to the differentials between the supply costs for a projected test year used for ratesetting purposes and the costs revised after consideration of 4 real months of that same year, now the base year. The differentials thus recorded for a given year will be included in the rate case for the following year. A reading will be taken at the end of that same year when the real results are known so as to determine the final differentials on the basis of 12 real months. The final adjustments necessary to take account of the real differentials over 12 months as well as the corresponding interest will be included in the rate case for the second year following. For these two stages, the Distributor proposes to fully apply the account balance to the Distributor's cost of service without rate stabilization measures.

Thus, in the context of the current case, the account balance as at 31 December 2005[4] as well as the estimated account balance for 2006 based on real data for 1 January to 30 April 2006 and on projected data for the last eight months of 2006 are fully applied to the Distributor's cost of service in 2007 as described in Exhibit HQD-4, Document 2. This latter exhibit also reiterates the detailed calculation of supply costs transferred to the deferral account for these two years.

2.6 Transfer of Transmission Service Cost

The cost of transmission service included in the Distributor's revenue requirements for a given test year conforms to the transmission bill for native load authorized by the Régie. Moreover, in decision D-2003-93, the Régie approved the Distributor's request to authorize the creation of a deferral account for additional transmission service costs resulting from any change in the transmission rate that may occur during the application of the distribution rates for a given test year. This account is justified by the fact that such a change is beyond the Distributor's control and affects an expense item representing nearly 25% of the total cost of service.

Amounts were recorded in this account for the first time in 2006. This account is not in the rate base for the time being. The balance in the account will bear interest until disposal, which is dealt with in Exhibit HQD-4, Document 3.

2.7 Deferral Account for Rate BT

The deferral account relating to the abolition of Rate BT was authorized by the Régie pursuant to decisions 2004-47 and 2004-170. This account contains the differentials between the energy price and the supply cost recognized by the Régie, the costs incurred for financial incentives payable to the customer, and charges associated with technical support offered. In principle, these measures linked to the abolition of Rate BT ended on 31 March 2006. In accordance with decision D-2006-34, the balance of the account is included in the rate base as at the commencement of disposal, i.e., 1 April 2006. The account is amortized linearly over a 60-month period. The Distributor thus includes in its 2006 cost of service an initial portion of the differentials stated since 1 January 2004. Interest applied to the unamortized balance is also added annually to the revenue requirements.

[4] The detailed calculation of supply costs transferred to the deferral account for 2005 is also illustrated in Exhibit HQD-7 Document 1 of the Distributor's 2005 Annual Report.