

**ALLOCATION METHODOLOGY OF THE COST
OF SERVICE OF THE DISTRIBUTOR**

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1. CONTEXT

1.1. Decision of the Régie

1 In the current request, the Distributor files the allocation of its cost of service by category of
2 consumer, for the years 2003, 2004 and 2005. The allocation of the costs of service is carried
3 out according to the method approved by the Régie in its decisions D-2003-93 and D-2004-47
4 of the rate case R-3492-2002.

5
6 The Régie indicated in its decisions that it accepted as being in global conformity with the norms
7 of practice, the methodology proposed by the Distributor
8 as well as the functions to which the costs are attached. The Régie indicated
9 also that methodological process proposed by Distributor
10 corresponds to that generally used by electricity companies. Furthermore,
11 the Régie made a point of highlighting its satisfaction with regard to the modifications made by
12 mentioning that the cost allocation methodology reflects more precisely causality links and that
13 the development of such a study is a process that requires, to reach its full maturity, further
14 analyses and discussions.

15
16 The Régie had come to a conclusion regarding certain elements of the cost allocation
17 methodology. However, in its decision D-2004-47, it deferred the treatment of certain subjects to
18 later cases. Thus, the Régie enumerated the subjects that were to be covered during
19 later rate cases, in particular:

- 20
- 21 • The allocation of the non-Heritage procurement costs;
 - 22
 - 23 • The allocation of the transmission costs of the Distributor following the
 - 24 examination of the cost allocation study of TransÉnergie;

- 1 • The allocation of the costs of the autonomous networks;
- 2
- 3 • The allocation of the costs of demand management and
- 4 emergency rates;
- 5
- 6 • The classification between the subscription and capacity components of the
- 7 medium and low tension network;
- 8
- 9 • The factors of classification.

10

11 With regard to the determination the transmission costs allocation methodology, the Distributor
12 suggests that the case be treated at a more convenient time when the Régie will be treating the
13 rate case of the Carrier and that it will have made a decision with regard to the allocation
14 methodology of the customers' costs, namely the local charges and the point-to-point service.

15

16 In addition, the Régie initially wished to explore in workshops certain subjects before presenting
17 them in a hearing. For this purpose, the Régie authorized the formation of a technical committee
18 and required the Distributor to organize meetings made up of the Distributor's staff, the
19 interested stakeholders and members of the Régie technical staff; as was undertaken. From
20 April 30th to July 7th; five (5) meetings were organized. The technical committee, of an advisory
21 type, had a mandate to discuss the cost allocation methodology with an objective of coming to a
22 common understanding of the stakes that can be represented by each of the topics.

23

24 Several subjects were discussed, in particular those mentioned specifically by the Régie, i.e. the
25 allocation of the costs between the subscription components and the average network capacity
26 of the medium and low tension networks, the allocation by function of expenditures, including
27 classification factors, the allocation of the costs of the autonomous networks and the allocation
28 of

1
2 the supply cost of post-Heritage electricity. The other subjects discussed were the various
3 recommendations of Mr. W Harper, consultant of Option Consommateur and the presentation
4 format for the cost allocation study.

5
6 Concerning the presentation format, the Régie wanted an improvement allowing for better
7 identification of the methodological modifications in relation to the preceding rate cases and in
8 support of a greater effectiveness of the regulatory process. In this respect, the Distributor
9 identifies clearly in the present evidence any new modification of a methodological nature for
10 each of the stages of cost allocation and shows separately the impacts related to the
11 methodological modifications, and additionally, the impacts associated with base data updates
12 (chapter 8). Also, some stakeholders have suggested certain modifications to the presentation
13 during the technical workshops that the Distributor has integrated.

14
15 Moreover, the Régie required of the Distributor, before it made any final ruling on certain more
16 complex methods, to provide further explanations, in the next rate cases, regarding the methods
17 and the calculation of the classification factors and the allocation used in the cost allocation
18 methodology. These topics were the subject of a detailed presentation during the technical
19 workshops and now make up part of the evidence along with the two additional appendices,
20 which present detailed enumeration of the classification and allocation factors, in replacement of
21 the old table 9 of the previous request R-3492-2002, Hqd-8, Documents 2, 3 and 4.

22
23 Finally, the Distributor had to provide data related to consumption profiles of the various rate
24 categories including, amongst others, the maximum monthly capacity requirement, the volumes
25 of monthly consumption, the monthly coincidental peaks, monthly non-coincidental peak and

1 the losses. The collection of these data is currently presented in the third appendix.

1.2. Changes to the allocation method

2 The changes brought to the allocation methodology are divided into three categories. The first
3 category concerns changes related either to new elements that are added to cost allocation, or
4 either elements that have not been reviewed by the Régie. They are the following elements:

- 5
- 6 • Heritage and post-Heritage procurements
 - 7 • Autonomous networks;
 - 8 • Consumption management and emergency energy rates;
 - 9 • Costs of generators;
 - 10 • Internal use and construction sites' consumption;
 - 11 • Taxes
- 12

13 The second category relates to the modifications to the allocation methodology that was
14 presented in the last rate case. One should note that all these modifications were the subject of
15 discussion at the time of the last rate case and at the technical meetings.

16 The topics are the following:

- 17
- 18 • Classification of the subscriptions and capacity components;
 - 19 • Corporate expenses;
 - 20 • Working capital balance;

- 1 • Management of subscriptions;
- 2 • Connection fees.

3

4 Finally the last elements modified of the allocation methodology are of an informative nature in
5 the sense that they do not have any monetary impact on the allocation of the cost of service but
6 were the subject of the Régie's decisions. These are the following elements:

7

- 8 • Characteristics of consumption;
- 9 • Allocation and classification factors.

10

1.3. Content of the evidence

11 The current document contains information on each change mentioned above that were made
12 to the method. Moreover, at the end of this document, tables indicating the impacts of the
13 modifications made to the cost allocation methodology are presented. The calculation of the
14 Distributor's cost of service allocated by category of consumers is established by including
15 these modifications for the years 2003, 2004 and 2005. The detailed three-year results are
16 produced in the following documents:

17

- 18 • Hqd-12, Document 2, Allocation of the cost of service for the historic year 2003;
- 19 • Hqd-12, Document 3, Allocation of the cost of service for the base year 2004;
- 20 • Hqd-12, Document 4, Allocation of the cost of service of the pilot year 2005.

1 Inside each of these documents, tables 1 to 34 present the detailed results of the cost of service
2 allocation methodology by consumer category. Each document comprises 6 appendices.
3 Appendix 1 (tables 35 and 36) presents calculations used for the establishment of the
4 connection fees. Appendix 2 (tables 37 to 42) shows the calculations allowing to share the value
5 of the fixed assets of the distribution network's equipments according to voltage level.
6 Appendix 3 presents the study of the minimum size network to determine the subscription
7 portion of the distribution network (tables 43 to 47). Appendix 4 shows the characteristics of
8 consumption of each category of consumers. Finally, appendices 5 and 6 contain respectively
9 the detailed description of classification and allocation factors.

10

11 It should be noted that new tables were added (tables 8C, 13A, 14A, 24A, 25A, 26A and 27A) to
12 present more detailed information with the purpose to improve the comprehension of the
13 allocation methods. The numeration of the tables remains the same for this year. On the other
14 hand, one should expect a revision in this respect in future years.

15

2. HERITAGE AND POST-HERITAGE SUPPLY

2.1. Context

16 With the forecasted attainment of the volume of consumption of the Heritage electricity supply in
17 2005, new considerations impose themselves with respect to the allocation methodology of the
18 Production function. The Production function includes the cost of electricity supply, which the
19 Distributor has to acquire in order to meet the demand of the Quebec markets. This cost
20 includes:

- 1 • The procurements associated with the volume of the Heritage electricity. The
2 Distributor acquires this volume from the Producer according to the provisions of
3 the Act;
4
5 • The procurements for the needs of Quebec markets that exceed the Heritage
6 electricity. The Distributor acquires this electricity in the markets from various
7 suppliers, and includes the energy blocks determined by government regulations.
8
9 • The procurements associated with the supply of the customers with consumption
10 management and emergency energy rates for which the Distributor has an
11 agreement with the Producer for the years 2003 and 2004. For 2005, this volume
12 is supplied from the markets, within the requirements for post-Heritage electricity.
13

14 Until now, only the procurement associated with the Heritage electricity volume was considered
15 and the government provided for in regulations the manner in which to allocate this cost to each
16 category of consumers. Indeed, in the second paragraph of article 52.2, the Act specifies that
17 the cost of supply of Heritage electricity is distributed to each category of consumers from the
18 average cost of supply of the Heritage electricity of 2,79 ¢/kWh and corresponds to:

19

20 *"i. for year 2000 to that scheduled in appendix I;*

21

22 *ii. for the subsequent years until the volume of the Heritage consumption reaches*
23 *165 terawatt-hours, to that determined by the Régie following a proposal of the electricity*
24 *Distributor based on appendix I, on the evolution of rate categories and the consumption*
25 *characteristics mentioned in the first paragraph;*

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iii. for the following years, to that set by the government."

The Law also specifies that the volume of Heritage consumption corresponds to volume of consumption of the Quebec markets while excluding the volumes arising from the consumption management or emergency energy rates, from autonomous networks and the volumes supplied by energy blocks determined by government regulation, until reaching 165 TWh. In addition, the costs of supply of the special contracts are established as a residual value after the application of the formula, thereby not affecting the cost of supply of other consumer categories.

Finally, the Act with respect to the Régie de l'Énergie specify the manner in which to establish the total cost of supply per category of consumer in the first paragraph of article 52.2 by adding on the one hand the costs of Heritage electricity, that of the procurement contracts and the energy blocks and, on the other hand, by allocating these costs among consumer categories according to their characteristics of consumption, i.e. utilization ratios and electricity loss rates on the transmission and distribution networks of the consumer categories.

Within the framework of phase 2 of the Distributor's rate case R-3492-2002, the Régie approved the costs of supply of Heritage electricity for the years 2003 and 2004 (D-2004-47). These costs by consumer category are used in the current case for the historic year 2003 and the base year 2004 and applied to the sales according to the new forecast of August 2004 (see

1 Hqd-12, Documents 2 and 3, table 9A). The year 2004 includes an adjustment for the loss rates
2 (see chapter 2.5).

3

4 For the projected pilot year 2005, the Distributor presents to the Régie the costs of supply by
5 category of consumers for the volume of Heritage electricity as well as the allocation of the
6 costs of the procurement contracts for the consumption that exceeds this volume. These costs
7 of supply by category of consumers are presented in Tables B and C of Chapters 2.5 and 2.6 of
8 this document, and shown again in Hqd-12 part, document 4, table 9A.

2.2. The Distributor's Proposal: global treatment

9 The Distributor retains the same treatment for the post-Heritage electricity to that which is made
10 on the level the Heritage electricity, namely a method based on the application of a formula for
11 allocating the supply cost and that is a function of the global characteristics of the consumer
12 categories, that is to say usage ratios and loss rates.

13

14 In this global treatment, the volumes of Heritage and post-Heritage consumption by category of
15 consumers are determined in proportion with the volume of total consumption and the Heritage
16 and post-Heritage costs of supply of the consumer categories are established by applying a
17 formula which integrates the usage ratios and the loss rates based on the Distributor's overall
18 consumption.

19

20 For the projected pilot year 2005, the characteristics of consumption, the volumes and the
21 proportions of sales per category of consumers are presented in Table A. One should note that
22 these volumes of consumption are those of the sales forecast for August 2004, and exclude the
23 volumes associated with the consumption management and emergency energy rates, the

1 volumes of the autonomous networks, as well as the volumes associated with Rapide des
2 Joachims. The GWh related to internal use and construction sites' consumption are added (see
3 Chapter 5.2 of this document).

4

5 The reduction in sales of the special contracts related to the strike at Aluminum Bécancour
6 Inc. (ABI) has a significant impact on the consumption characteristics of the special contracts
7 and also of the Distributor. Since this situation is exceptional, in order to prevent that it impacts
8 the allocation of the Distributor's costs of service, it is necessary, first of all, to take this situation
9 into account when establishing the consumption characteristics and then to adjust, in a second
10 step, the supply costs of Heritage and post-Heritage electricity (calculated by applying the
11 formula and these characteristics of consumption) to ensure a complete allocation of the costs
12 (see Chapters 2.5 and 2.6).

13

Table A
Volumes of total sales and characteristics of consumption
by category of consumers
Projected pilot year 2005

(1)	(2)	(3)	(4)	(5)
Consumer Category	Utilization Factor (%)	Loss rates (%)	Sales (GWh)	Proportion of sales (%)
1 Domestic				
2 Rates D and DM	47,2%	9,3%	54 642	32,4%
3 Rate DH	51,7%	9,3%	4	0,0%
4 Rate DT	80,0%	9,3%	2 635	1,6%
5 Total	-	-	57 281	34,0%
6 Small and average capacity				
7 Rates G and fixed price	62,8%	9,2%	12 604	7,5%
8 Rate G9	68,7%	9,0%	1 092	0,6%
9 Rate M	78,5%	8,5%	26 234	15,6%
10 Rates of street lighting	86,8%	9,3%	554	0,3%
11 Total	-	-	40 485	24,0%
12 Large capacity				
13 Rate L	95,8%	5,5%	52 231	31,0%
14 Rate H	76,9%	6,8%	10	0,0%
15 Special contracts	99,9%	5,2%	18 457	11,0%
16 Total	-	-	70 698	42,0%
17 Total	67,9%	7,5%	168 463	100,0%

1 According to the Distributor's proposal, utilization ratios and loss rates are applied to the volumes of the
2 Heritage and post-Heritage consumption and according to the allocation formula already approved by
3 the Régie.

4

2.3. Reminder of the allocation formula

5 The cost allocation of Heritage electricity is established by using a formula which integrate the
6 characteristics of consumption for the different categories of consumers. This formula was approved by
7 the Régie in its Decision D-2002-221, specifically:

8

9

10

- 1 • Recognized and accepted the formula presented for the allocation of the cost of supply
2 of Heritage electricity by category of consumers;
3
4 • Took note of the application of the allocation formula for the cost of Heritage electricity
5 supply by category of consumers for the year 2001 presented in Appendix I of the Act;
6
7 • Approved the costs of supply of Heritage electricity by category of consumers in ¢/kWh
8 for the year 2002.
9

10 In Hqd-1, Doc.1 of Request R-3477-2001, the Distributor described on page 4 its allocation method:
11

12 *" The suggested allocation methodology has the objective to attribute a cost to each consumer*
13 *category in an equitable way, in accordance with the causality between the characteristics of*
14 *consumption and the cost of the Heritage electricity supply. The consumers associated with Heritage*
15 *electricity are treated on an equal basis (...) "*

16
17 The formula reflects the following principles and concepts:
18

- 19 • Equitable treatment: the same characteristics of consumption imply the application of an
20 equal cost for the various consumer categories;
21
22 • Causality: relation of cause and effect between the clients and the costs incurred to meet
23 the demand;
24
25 • Uniformity: uniform price by category of consumers on all the electricity distribution
26 network, without associating production equipment or procurement agreements with
27 various customers and without consideration to the date of arrival on the network.
28

1 The formula contains three principal components:

2

3 • Cost of the Heritage electricity supply of the Distributor;

4

5 • Energy and capacity portions based on the Distributor's use of the network

6

7 • The differentiation by voltage supply taken into account while integrating an adjustment
8 according to the loss rates.

9

10 The energy and capacity portions are defined from the Distributor's utilization ratios. The utilization
11 ratio reflects the period during which the equipments are used. The excess capacity required to meet
12 the demand is classified as capacity. The utilization ratio is established based on the Distributor's
13 consumption profile. It evolves with time, depending on the changes in the sales by category of
14 consumers. The establishment of the energy and capacity portions from the utilization ratio reflects the
15 production costs allocation methodology, as suggested in the manual of service cost allocation of
16 APPA.¹

17

18 The utilization ratio is established on an annual basis, which allows to reflect the seasonal
19 characteristics of demand. The utilization ratio is the ratio between annual energy consumption and the
20 capacity (or power) during the peak period multiplied by the number of hours in the year. The network
21 peak period is concentrated and sustained on a small number of hours. Taking into account

¹ Public American Power Association, Cost of Service Procedures for Public Power Systems – A Cost Allocation Manual, page IX-6.

1 the 300 hours the most charged during the year allows a more equitable and more stable distribution in
2 the course of the years.

3

4 Accounting for the losses is also necessary, since the cost of supply is calculated on the level of the
5 sales and because delivery to customers is done at various voltage levels on the network.

6

7 The formula's various components are illustrated as follows:

8

Cost CC = (CC Energy Cost) + (CC Power Cost)

= (Distr. Cost x Energy portion x Adj. for losses) + (Distr. Cost x Power portion x Adj. losses x Adj. FU)

9

= [(Distr. Cost x FU Distr. x (1+CC losses) / (1+ Distr. Losses)] + [(Distr. Cost x (1-FU Distr.) x (1+CC losses) / (1+Distr. Losses) x FU Distr. / FU CC)]

= Distr. Cost x (FU Distr. + ((1 - FU Distr.) x FU Distr./FU CC)) x (1+CC losses)/(1+Distr. Losses)

CC: category of consumers; Distr: Distributor

10

11 This formula makes it possible to determine the total cost of supply allocated to each category of
12 consumers.

13

2.4. Justifications of the global treatment

14 The global treatment of the supply cost as proposed in this document was presented and discussed
15 during the technical committee meeting on the Distributor's costs of service allocation methodology by
16 consumer categories. The Distributor emphasized the advantages of this method compared to a
17 treatment at the margin, considering in particular that only this treatment respected the spirit of article
18 52.2 of the Act.

19

20

1 It should be noted that the suggested allocation methodology for the cost of supply for the Heritage and
2 post-Heritage electricity is in continuity with the decisions previously adopted by the Régie. The
3 Distributor rests among other things on the fact that even if article 52.2 of the Act did not specifically
4 determine the allocation method for the post-Heritage electricity, it nevertheless specified an allocation
5 method for all supply costs that is identical to that of the Heritage electricity, which leaves little room for
6 allocation methods that could be applied to post-Heritage electricity.

7

8 The global treatment suggested by the Distributor is in continuity with the current treatment of Heritage
9 electricity that integrates the application of a formula considering utilization ratios and loss rates. The
10 share of consumer categories in the volume of Heritage consumption evolves according to their weight
11 in total sales and the calculation of utilization ratios and loss rates will translate through the years this
12 annual and global evolution of the sales.

13

14 From the point of view of customers' equity, the global treatment reflects the methods applied by the
15 Distributor until today. The cost of service allocation methodology is based on the average cost and
16 Hydro-Quebec has always retained a uniform treatment of the costs regardless of the arrival dates on
17 the network, which means that there is no "first in, first served " principle.

18

19 The suggested treatment also harmonizes some of the Distributor's constraints, which manages
20 procurements according to the total demand curve. The Distributor can move the demand for each hour
21 along the Heritage curve (decree 1277-2001) by taking into account the market conditions for
22 procurements at the margin, but with an objective to optimize of the total cost of supply (management

1 of the sticks). Consequently there is no possible specific pairing of the news loads of the Distributor with
2 the new supplies at the margin.

3
4 On the other hand, a scenario that would fix once and for all for the years to come the cost of supply
5 and the volumes of consumption by category of consumers for the Heritage electricity would inevitably
6 have the incidence of treating distinctly the cost of post-Heritage supply relative to the rest of the
7 supply. This method would make the characteristics of the Heritage electricity consumption of year
8 2005 static, while the characteristics of the Distributor's sales would continue to evolve through the
9 years. The characteristics of the post-Heritage electricity would thus be determined by differential with
10 different results than those of the network. This treatment would make it impossible to apply the formula
11 and the calculation of the characteristics of post-Heritage electricity used until now for the Heritage
12 electricity.

13
14 In conclusion, for the allocation of the supply cost, what was valid for the Distributor's requirements
15 before, will remain the same for the future requirements. The manner in which to allocate the
16 procurement contracts does not change at all the consumption characteristics of the Distributor's
17 customers. The formula is relatively simple to apply and allows a just treatment, equitable and stable for
18 all customers, always in a spirit to allocate average costs.

2.5. Cost of supply of Heritage electricity

20 According to the global treatment, the consumption volumes of Heritage electricity by consumer
21 categories were established as a proportion of the total sales by consumer categories.

1 The utilization ratios and loss rates are the same as those of the Distributor's global profile, since when
 2 using a volume of Heritage consumption proportional to the volume of the total sales, the consumption
 3 characteristics are transposed. After applying the formula, the unitary costs of supply for each
 4 consumer category for the year 2005 are indicated in Table B. The Distributor reiterates that the
 5 utilization ratios and loss rates per consumer category are those presented in Table A and are
 6 calculated by neutralizing the effect of the strike at ABI, first, and second, by applying an adjustment
 7 factor to the supply cost of each category of consumers, thus ensuring a complete distribution of the
 8 supply cost.

Table B

Costs of supply and consumption characteristic of the Heritage electricity by consumer categories
Projected pilot year 2005

	(1) Category of consumers	(2) Utilization Factor (%)	(3) Loss Rates (%)	(4) Unit cost (¢/kWh)	(5) Adjusted Unit cost (¢/kWh) ⁽¹⁾	(6) Sales (GWh)	(7) Proportion of sales (%)	(8) Cost (M\$)
1	Domestic							
2	Rates D and DM	47,2%	9,3%	3,21	3,20	53 972	32,4%	1 728,7
3	Rate DH	51,7%	9,3%	3,10	3,09	4	0,0%	0,1
4	Rate DT	80,0%	9,3%	2,68	2,67	2 603	1,6%	69,5
5	Total	-	-	-	-	56 579	34,0%	1 798,4
6								
								Small and average capacity
7	Rates G and fixed price	62,8%	9,2%	2,89	2,88	12 449	7,5%	358,7
8	rate G9	68,7%	9,0%	2,80	2,79	1 079	0,6%	30,1
9	Rate M	78,5%	8,5%	2,67	2,67	25 913	15,6%	691,3
10	Rates for street lighting and Sentinel.	86,8%	9,3%	2,62	2,61	547	0,3%	14,3
11	Total	-	-	-	-	39 989	24,0%	1 094,4
12	Large capacity							
13	Rate L	95,8%	5,5%	2,46	2,46	51 591	31,0%	1 268,2
14	Rate H	76,9%	6,8%	2,64	2,64	10	0,0%	0,3
15	Special contracts	99,9%	5,2%	2,43	2,43	18 231	11,0%	442,3
16	Total	-	-	-	-	69 832	42,0%	1 710,8
17	Total	67,9%	7,5%	-	2,767	166 400	100%	4 603,5
9	Factor of adjustment of 0,998571 for the effect of the strike at ABI.							

10 The establishment of these costs allocated by consumer categories also presuppose an equal
 11 adjustment of the Heritage volume to 166,4 TWh and an average cost of supply to 2,767 ¢/kWh taking
 12 into account the expected loss rates for 2005, for a total amount of 4 603,5 M\$.

13

1 The adjustment of the volume and cost of supply of Heritage electricity follows from decree 1277-2001
2 that the government adopted on October 24, 2001 concerning the procurement characteristics of
3 Heritage electricity for the Quebec markets in the amount of 165 TWh.

4
5 In this decree, it is stated in particular that "*the volume of the electrical transmission and distribution*
6 *losses corresponds to an average annual rate of 8,4 % of the Heritage electricity volume, according to*
7 *the consumption forecasts at the 2005 horizon and the historic knowledge of the consumption profiles*
8 *of the Quebec markets.*"² It is also indicated that "*The electricity supplier make available an annual*
9 *electricity volume (...), of up to 178,86 terawatthours...*"³, that is, the volume obtained considering a
10 consumption of 165 TWh and a loss rate of 8,4 %.

11 As presented previously in Table A, the loss rate from transmission and distribution is expected to be
12 7,5 % in 2005. The discrepancy between the loss rate mentioned in the decree and that observed in
13 this document was mentioned before by the Distributor during the hearings⁴ and also mentioned in the
14 opinion⁵ issued by the Régie on the energy security with respect to electricity procurements and the
15 contribution of the Suroît (R-3426-2004). Given that it is stipulated in the decree that the electricity
16 supplier must deliver the annual volume of electricity in the amount of 178,86 TWh, the revised loss
17 rate of 7,5 % for 2005 implies that the sales

² Decree 1277-2001, October 24, 2001, article 4.

³ Decree 1277-2001, October 24, 2001, article 5.

⁴ Case R-3426-2004, hearings of May 4, 2004, volume 3, page 189.

⁵ A-2004-01, R-3426-2004 File, page 15.

1 of Heritage electricity adjust themselves at 166,400 TWh and that the resulting average cost for 2005 is
2 of 2,767 ¢/kWh.

3

4 The cost of 2,767 ¢/kWh for 2005 is determined in the following manner. Before as well as after the
5 revision of the loss rate, Hydro-Quebec Production produces 178,860 TWh and receives 4 603,5 M\$:

6

- 7 • On the level of the sales: 165,000 TWh @ 2,790 ¢/kWh = 4 603,5 M\$;
- 8 • On the level of production with a loss rate of 8,4 %:

9

165,000 TWh + losses 8,4 % = 178,860 TWh;

10

4 603,5 M\$ ÷ 178,860 TWh = 2,574 ¢/kWh;

11

- 12 • On the level of the sales with a loss rate of 7,5 %:

13

178,860 TWh with a rate of losses of 7,5 % = 166,400 TWh;

14

2,574 ¢/kWh with a rate of losses of 7,5 % = 2,767 ¢/kWh;

15

166,400 TWh @ 2,767 ¢/kWh = 4 603,5 M\$.

16

17 It should be noted that it is not a matter of modifying the values specified in the Act. The values of
18 165 TWh for sales with a loss rate of 8,4 % and a cost of 2,79 ¢/kWh at a total cost of 4 603,5 M\$
19 remain the benchmark data in the calculation. However, notably with respect to the allocation of supply
20 cost to the sales while accounting for the current loss rate of 7,5 %, it is more appropriate to use the
21 data of 166,4 TWh and 2,767 ¢/kWh always for an amount totaling 4 603,5 M\$, which does not change
22 the commitment of Hydro-Quebec Production. In terms of procurements, it is all the Quebec customers
23 who benefit from this situation.

1 The Heritage consumption volume, the cost Heritage electricity supply as well as the allocation by
2 consumer categories will have to be reviewed every year, if necessary, when there will be changes to
3 the level of inputs, i.e. the utilization ratios and loss rates for the Distributor and the consumer
4 categories.

5
6 For the base year 2004, the Distributor considers appropriate to proceed also with an adjustment of the
7 cost of Heritage electricity supply paid to the Producer for the same considerations. Given the
8 discrepancy between the loss rate of 7,81% in 2004 and the rate of 8,4% of the decree was not
9 considered when the supply costs by consumer categories was established for 2004 in case R-3492-
10 2002, the Distributor proposes a different but equivalent treatment from that of 2005. The procurement
11 cost of for each category of consumers is established by multiplying the cost of supply approved by the
12 Régie (D-2004-47) and the sale volume and applying an adjustment factor of 0,9946, that is
13 1,0781/1,084 (see Hqd-12, Doc. 3, table 9A).

14
2.6. Cost of supply of the Post-Heritage electricity

15 The Distributor's post-Heritage volume of consumption is determined by differential, i.e. by deducting
16 the Heritage volume of consumption from the total sales of the Distributor (excluding the consumption
17 management and emergency energy rates, autonomous networks, Rapide des Joachims and including
18 internal use). For the projected pilot year 2005, the post-Heritage volume of consumption is established
19 at 2 063 GWh, that is 168 463 GWh less 166 400 GWh of Heritage electricity.

20
21 According to the general methodology that the Distributor submits within the framework of the current
22 case, sales by consumer categories are determined as a proportion to the total sales of 2005, i.e. by
23

1 using the proportions as calculated in Table A. The proposed global method also stipulates that the
2 post-Heritage supply costs by consumer category are determined by applying the same allocation
3 formula as for Heritage electricity by using the utilization ratios and loss rates of the categories
4 determined globally, and by applying to the cost of Heritage electricity supply the adjustment related to
5 the effect of the strike at ABI. Also, the global method has for consequence that the post-Heritage
6 electricity, although presented separately, is not treated distinctly of the Heritage electricity, thus
7 ensuring uniform treatment of the costs.

8

9 For the projected pilot year, the post-Heritage average cost of supply per kilowatt-hour to be allocated
10 is estimated at 8,06 ¢/kWh, that is to say 7,50 ¢/kWh multiplied by a rate of losses of 7,5%. The total
11 cost of the post-Heritage procurement is 166,3 M\$ (8,06 ¢/kWh multiplied by 2 063 GWh).

12

13 Table C shows the consumption volumes as well as post-Heritage electricity supply costs by consumer
14 category for the projected pilot year 2005, determined by the global allocation method.

Table C
Costs of supply and consumption characteristics of post-Heritage electricity
by consumer categories
Projected pilot year 2005

(1) Category of consumers	(2) Utilization Factor (%)	(3) Loss Rates (%)	(4) Unit cost (¢/kWh)	(5) Adjusted Unit cost (¢/kWh) ⁽¹⁾	(6) Sales (GWh)	(7) Proportion of sales (%)	(8) Cost (M\$)
1 Domestic							
2 Rates D and DM	47,2%	9,3%	9,35	9,33	669	32,4%	62,5
3 Rate DH	51,7%	9,3%	9,02	9,01	0	0,0%	0,0
4 Rate DT	80,0%	9,3%	7,80	7,79	32	1,6%	2,5
5 Total	-	-	-	-	701	34,0%	65,0
6 Small and average capacity							
7 Rates G and fixed price	62,8%	9,2%	8,41	8,40	154	7,5%	13,0
8 Rate G9 rate	68,7%	9,0%	8,15	8,14	13	0,6%	1,1
9 Rate M	78,5%	8,5%	7,79	7,77	321	15,6%	25,0
10 Rates for street lighting and Sentinel.	86,8%	9,3%	7,62	7,61	7	0,3%	0,5
11 Total	-	-	-	-	496	24,0%	39,5
12 Large capacity							
13 Rate L	95,8%	5,5%	7,17	7,16	640	31,0%	45,8
14 Rate H	76,9%	6,8%	7,71	7,70	0	0,0%	0,0
15 Special contracts	99,9%	5,2%	7,08	7,07	226	11,0%	16,0
16 Total	-	-	-	-	866	42,0%	61,8
17 Total	67,9%	7,5%	-	8,06	2 063	100,0%	166,3

Factor of adjustment of 0,998571 for the effect of the strike at ABI.

2.7. Special contracts

1 In accordance with the provisions of article 52.2, the applicable cost of supply of the special contracts is
2 established as a residual value, namely that of the costs of transmission, distribution and customer
3 services estimated according to the current allocation method by deducting the expected revenue of
4 these contracts. This particular adjustment transmits to the shareholder the earnings loss or profit
5 between the required revenue from the special contracts and the revenue they generate. In this
6 manner, the supply cost applicable to the special contracts does not affect the supply cost of the other
7 categories of consumers.

8

9 The special contracts are a part of the Distributor's consumption. The volume and consumption
10 characteristics of these contracts are included in the supply cost allocation formula.

11

1 This procedure was proposed by the Distributor within the framework of the requests R-3477-2001 and
2 R-3492-2002 with regard to the Heritage electricity, and was accepted by the Régie in its decisions D-
3 2002-221, D-2003-117, D-2003-93 and D-2004-47.

4

5 For the projected pilot year 2005 in the current case, the Distributor uses the same treatment for the
6 special contracts by considering the consumption volume of the special contracts in the global method
7 proposed by the Distributor, including the adjustment for the effect of the strike (see chapter 7.1). Thus,
8 after the determination of the costs of the consumer categories for the Heritage and post-Heritage
9 electricity by applying the formula, the applicable supply cost for the volume of overall consumption of
10 the special contracts is adjusted. This adjustment is presented in column 17 of Table 9A of Hqd-12,
11 Doc.. 4.

12

13 The adjustment for the special contracts of the year 2005 is established as follows:

14

15	Expected revenue	515,3 M\$
16	Less the cost to the Distributor:	
17	Transmission cost	165,5 M\$
18	Cost of customer service	5,6 M\$
19	Cost of supply after adjustment:	344,2 M\$

20

21 For a volume of consumption of 18 457 GWh, the supply cost of the special contracts after adjustment
22 is established at 1,87 ¢/kWh.

23

24

3. AUTONOMOUS NETWORKS

3.1. Context

1 At the preceding rate case of the Distributor⁶, the methodology related to the cost allocation of
2 autonomous networks was not approached in an explicit way, given the numerous subjects that were
3 examined. Moreover, the Régie ruled in its Decision D-2004-47 that this cost allocation would be
4 treated in the next rate cases of the Distributor⁷.

5

6 Since the submission of the first rate case of the Distributor, no change was made to the allocation
7 methodology. On the other hand, a meeting of the technical committee that covered this subject took
8 place on June 9, 2004 and the interveners could express their opinions.

9

10 It is stipulated in the Act with respect to the Régie de l'Énergie in article 2 that the electricity distribution
11 network is formed of " the whole set of installations intended for distribution of electricity starting from
12 the exit of the transformation substations, including the distribution lines of a voltage of less than 44 kV
13 as well as all the equipment located between these lines and the points of connections to the
14 consumers' installations, and, in the case of the autonomous networks of electricity distribution, the
15 whole set of structures, machines, equipment and installations used for producing, transmitting and
16 distributing electricity."

17

18 The territory served by autonomous networks includes 22 towns located in Les Iles de la Madeleine,
19 Nouveau Quebec (north of the 53rd parallel), in Basse-Cote-Nord and Haute Mauricie. Electricity in
20 these villages, is

21

⁶ R-3492-2002 – Request related to the determination of the cost of service of the Distributor and modification of the rates of electricity – Phases 1 and 2.

⁷ Decision D-2004-47, R-3492-2002 case, February 2004, page 104.

1 produced by thermal power stations using diesel fuel like heavy crude oil and light crude oil # 2.⁸
2 Electricity is also produced by a hydroelectric power station at Lac-Robertson, consisting of two turbine-
3 alternator groups. The tariffs of the customers of autonomous networks are identical to those of the
4 connected networks' customers except for those located north of the 53rd parallel.

5

6 In terms of allocating the cost of service, the rate base and the service cost of autonomous networks
7 include the functions of production, transmission, distribution and customer service. These functions,
8 like the Act stipulates, are part of the Distributor's cost of service.

9

10 The allocation method of the cost of service of autonomous networks respects most of the assumptions
11 and rules applied to the connected network. Initially, classification by function is defined as the
12 segregation of amounts of the rate base and the cost of service in the functions of production,
13 transmission, distribution and customer service.

14

15 Once the cost of service is broken down by function, each of the amounts is allocated to the capacity,
16 energy, subscription and case specific components. Finally, the cost of service classified by
17 components is distributed by consumer category according to the allocation factors that are based on
18 the characteristics of consumption of each category. The results of the rate base and the cost of service
19 are presented in Tables 30 to 34 of Hqd-12, Documents 2, 3 and 4. The following chapters present
20 succinctly the methods applied to allocate the autonomous networks' cost of service.

⁸ Hqd-6, Document 1, R-3470-2001, March 2002, page 49.

3.2. Classification by function

1 The classification by function of the rate base of autonomous networks conforms to the methodology of
2 the connected network. Unlike the latter, production and transmission assets appear in the rate base of
3 autonomous networks. Also, production, transmission, distribution and customer service compose the
4 functions of autonomous networks. It should be noted that the function of customer service is not too
5 detailed due to lack of information. Table 30 of Hqd-12, Documents 2, 3 and 4 presents the
6 classification by function of the rate base of autonomous networks.

7

8 Several rules are applicable to the classification by function of the various headings of the rate base.
9 The assets related to the production, transmission, to substations and operational centers and other
10 network assets are directly identified and attributed to their respective functions. As for overhead and
11 underground distribution lines, the classification criteria are those used for the connected network
12 and are based on connection costs (Appendix 1) and the study of the share of the medium and low
13 voltage (Appendix 2), used to distribute these amounts among the functions of medium voltage
14 network, low voltage network and connections.

15

16 The supporting assets are distributed among the functions according to an analysis of the assets as of
17 December 31, 2003 and the amounts are allocated to the functions according to the use of services or
18 average manpower. The amounts allocated to the distribution function are allocated to sub-functions
19 according to net fixed assets of the rate base excluding supporting and intangible assets.

1 Intangible assets are allocated directly to the various functions and Distributed based on net fixed
2 assets excluding intangible assets.

3

4 Pension charges, complementary pension benefits and manpower reduction measures are distributed
5 between the functions according to the total wage bill allocated to each of them and in proportion to the
6 net amount of fixed assets including the intangible assets to each of the distribution functions.

7

8 Commercial programs are allocated directly to production function since they aim to reduce thermal
9 production.

10

11 The method related to the distribution of the cash balance is based on the same method than that used
12 for the connected network, that is according to various rules depending on the headings of the cash
13 balance (see Chapter 6.3 – Cash balance of the working capital).

14

15 The materials, supply and fuel are allocated between the functions based on the inventory analysis as
16 of April 30, 2004. The amount allocated to the distribution function is then allocated among the
17 functions according to net fixed assets of the rate base including intangible assets.

18

19 Table 31 of Hqd-12, Documents 2, 3 and 4 presents the classification by function of cost of service of
20 autonomous networks.

21

22 Direct gross charges, work provisions, received internal invoices, fuel purchases, interests credit for the
23 government reimbursement, issued internal invoices, depreciation, local and school taxes and external
24 invoices issued by operational units are directly allocated to the functions. The amounts related to

1 the distribution function are then distributed to the functions according to the net fixed assets of the rate
2 base including intangible assets. The value of the headings related to support units is distributed
3 according to the average manpower.

4

5 The credit for retirement charges is allocated to the functions according to the total wage bill of each of
6 them and according to the net fixed assets of the rate base including intangible assets among the
7 distribution functions. The rate of return of the suppliers is divided among the distribution functions
8 according to the internal invoices received.

9

10 The allocation of corporate costs among the functions is done according to the corporate rule requiring
11 that 50% of the amount being distributed according to primary operating charges and the other 50%
12 distributed according to the net fixed assets of the rate base excluding intangible assets.

13

14 The tax on capital and the tax on gross income are allocated according to net fixed assets of the rate
15 base including intangible assets. For the projected pilot year 2005, the tax on public services, replacing
16 the tax on gross income and being related only to the assets of production, transmission and
17 distribution, is allocated among the functions according to net fixed assets of the rate base excluding
18 supporting assets and intangible assets. Local and school taxes are allocated directly and distributed
19 according to net fixed assets of the rate base including intangible assets.

20

3.3. Classification by component

21 The rate base and the service cost related to the production function are classified according to a
22 specific treatment that uses both capacity and energy in an integrated manner by the use of the formula
23 used for

1 Heritage and post-Heritage electricity (utilization ratio and loss rates). In addition, during the technical
2 meetings, a sensitivity analysis based on an alternative method, the accounting classification method,
3 was produced. Various assumptions were used to distribute the headings of the cost of service among
4 the capacity and energy components. The final result showed a weak impact of an additional 2,8 M\$ to
5 the required revenue of the *Domestic* consumers' category compared to the status quo.
6

7 As for the transmission function, the amounts of the rate base and service cost are completely
8 classified by capacity. The functions of distribution include the substations and the operations centers,
9 the medium and low voltage networks, the connections and street lighting. The substations and
10 operations centers are completely classified by capacity. The medium and low voltage networks are
11 separated among the components of capacity and subscription according to the minimal size network
12 study. The connections are classified by subscription, except for the portion related to the connection
13 fee allocated to a specific component. Public lighting is the object of a specific classification.
14

15 Customer service function is classified by subscription. Table 32 of Hqd-12, Documents 2, 3 and 4
16 presents the classification by component of the rate base and the service cost of the autonomous
17 networks.
18

3.4. Allocation by category of consumers

19 The allocation of the amounts of the rate base and the service cost of the production function is done
20 by applying the utilization ratio and the loss rates of the equipments. This method allows to reflect the
21 period during which equipment is used (energy). The remainder is set to meet the power requirements.
22 This method has the advantage of being in continuity with the formula applied to

1 the connected network. The allocation of the cost of production is based on the formula used to allocate
2 Heritage electricity among the various categories of consumers. The formula is as follows:

$$\text{Cost CC} = \text{Cost AN} \times (\text{FU AN} + ((1-\text{FU AN}) \times \text{FU AN} / \text{FU CC})) \times ((1+ \text{Losses CC}) / (1+ \text{Losses RA}))$$

CC: category of consumers; AN: Autonomous networks

3

4 The utilization ratio is based on the 300 hours the most charged of the year and loss rates are defined
5 on the basis of the sales and the production of the autonomous networks.

6

7 The rate base and cost of service related to the transmission function are allocated among the
8 categories of consumers according to the annual coincident peak.

9

10 The distribution function includes the functions of substations and operations centers, medium and low
11 voltage networks, connections and public lighting. The allocation criterion of the functions of substations
12 and operations centers, and the capacity component of the medium voltage network is the annual
13 medium voltage non-coincident peak. The allocation of the capacity component of the low voltage
14 network is made by using the annual low voltage non-coincident peak. As for the subscription part of
15 the medium and low voltage networks, the criterion used is the number of subscriptions with,
16 respectively, the medium and low voltage multiplier. The weighted average connection cost, coming
17 from the study of the weighted connections presented in Table 35 of appendix 1, is used to distribute
18 the amounts allocated to the connection function. Finally, street lighting is the subject of a direct
19 allocation. It should be noted that all the allocation criteria used in this section are the same as those
20 used for the connected network.

21

1 As for the customer service function, the criterion used to distribute the amounts of the rate base of and
2 the cost of service is the number of subscriptions without the medium voltage multiplier. Table 33 of
3 Hqd-12, Documents 2, 3 and 4 shows the allocation by category of consumers of the rate base and the
4 cost of service.
5

4. CONSUMPTION MANAGEMENT AND EMERGENCY ENERGY RATES

4.1. Context and general treatment

6 The consumption management rates currently in effect are rate BT, the interruptible electricity option,
7 the real time MR and LR rates, and rate LC. The emergency energy rates are LP and LD.
8

9 In its cost of service allocation methodology, the Distributor applies a different procedure for the
10 customers of the consumption management and emergency energy rates than to other customers of
11 regular rates (domestic, small, medium and large capacity).
12

13 Among other things, in terms of procurements, the Act makes a distinction for all of these rates by
14 excluding them from Heritage electricity. These rates are therefore supplied on the markets according
15 to their characteristics of consumption.
16

17 Moreover, in terms of transmission and distribution costs, the Distributor uses the rate design principles
18 for this type of customers to determine the allocation factors, and not the effective capacities of these
19 customers. The fact that they can on request from the Distributor, interrupt their charge, whether they
20 are present or not in peak period, provides them with the advantage sought relative to other customers.
21 This availability is among the Distributor's management tools to balance supply and demand.

1 In exchange, these customers are given advantageous rates. Thus, only the subscription costs to the
2 distribution network are allocated to them.

3

4 With regard to the consumption characteristics being used to allocate the costs of service, it is
5 important that the characteristics of the consumption management rates do not influence the
6 characteristics of regular rates. Consequently, the interruptions and renewal of the consumer
7 categories are to some extent neutralized, ensuring in this manner that the allocation to regular rates is
8 just, equitable and stable. The consumption characteristics of consumption management rates are
9 presented in Appendix 4 of Documents 2, 3 and 4.

10

11 Finally, in terms of customer service, the consumption management rates assume their share of the
12 costs, when necessary.

13

14 Besides this general treatment relative to consumption management rates, there are certain
15 characteristics applying to each of these rates.

16

4.2. Rate BT

17 Regarding rate BT, the Régie approved in its Decision D-2004-170, the Distributor's proposal to
18 terminate the rate effective April 1st , 2006. The Régie also authorized the application of a transition
19 rate starting April 1st, 2005 for the customers of rate BT using electricity for photosynthesis. Moreover,
20 the Régie allowed to record in a deferred expenses account (DEA) created in virtue of Decision D-
21 2004-47, the deficit caused by the difference between the energy price and the cost of supply
22 recognized to rate BT multiplied by the sales of rate BT times the loss rate for the period from
23 April 1st 2004 to March 31, 2006. The expenditures associated with the payment of the financial
24 incentive, just as those associated with the technical support of the customers of rate BT are also
25 charged to the DEA.

1 The amounts cumulated in the DEA outside the base and capitalized at the Distributor's average rate of
2 cost of capital will be amortized thereafter within a 60 months period starting April 1st, 2006.

3
4 Regarding the allocation of the cost of service, the Distributor applies the Decision of the Régie. The
5 transition rate for photosynthesis no longer constitutes a consumption management rate. Consequently,
6 the costs related to these customers are integrated in the costs of rates D and DM, given that all of
7 these customers will ultimately adhere to rate D. For the remaining customers, the Distributor maintains
8 the cost allocation methodology for rate BT presented in phase 2, except for the allocation of sales and
9 marketing costs. For the years 2004 and 2005, no cost is allocated to rate BT for these functions, the
10 amounts related to these activities being clearly identified and assigned directly to the deferred
11 expenses account.

12 . **4.3. Interruptible electricity option**

13 Considering the real risk of extreme climatic conditions, the Distributor put in place an interruptible
14 electricity option, offered to industrial customers. A request for approval was filed by the Distributor and
15 accepted by the Régie (D-2003-224) for the period from December 1st, 2003 to November 30th, 2004.
16 The creation of a deferred expenses account was authorized, so that the Distributor can record all the
17 costs related to the use of this option. A request for renewal of this option for the period from
18 December 1st, 2004 to November 30th, 2006 was submitted to the Régie on June 25th (R-3538-2004).

1 Because of the conditions of this option, the Distributor ensured it was financially neutral. Indeed, the
2 credit offered to the interrupted customers is based on the New York market price, from which the
3 energy price of rate L is deducted in order to compensate for the loss of revenue resulting from the
4 reduced consumption. However, the credit offered could not be lower than 30 ¢/kWh. The customers
5 concerned continue to assume the cost of capacity according to the structure of rate L.
6

7 When it does not intend to resort to this option, the Distributor would put the option at the discretion of
8 Hydro-Quebec Production, which would then assume the expenses related to its use. The Producer
9 should use this option when:

- 10
- 11 • As long as the volume of the Heritage electricity is not reached;
- 12
- 13 • If it is reached but that the curve of classified capacity is not exceeded at the time of use;
- 14
- 15 • If the interruption is carried out to maintain an activity outside Quebec.
16

17 Thus, it will only be possible at the end of each year to determine which of them, the Distributor or the
18 Producer, must assume the costs related to the use of this option.
19

20 The interruptible electricity option was used twice in January 2004 and the credits offered were
21 considered to be charged to the Producer for the year 2004.
22

23 As for the allocation of the cost of service, the credits offered by the Producer are directly transferred to
24 the customers' invoices, thus not included in the Distributor's required revenue. The program being
25 neutral for the Distributor, the consumption characteristics by customer categories having been
26 interrupted is consequently corrected in order to not affect the allocation of the cost of service for the

1 years 2003 and 2004. For the year 2005, no credit is considered in the forecast mode.

2

4.4. Rates MR and LR

3 Via the rates MR and LR the Distributor offers a real time rate option for the customers of regular rates
4 M and L respectively. These customers are invoiced on the basis of regular rates for reference
5 consumption and only the consumption beyond this reference is invoiced at the hourly price of energy,
6 according to the provisions of articles 96 and 201 of the regulations concerning the rates of electricity.⁹

7

8 For 2005, there is no consumption volume planned for these rates. The marginal levels of consumption
9 with respect to reference consumption of the MR and LR rates were 30 GWh for an amount of 2,8 M\$
10 in 2003, and 18 GWh for an amount of 1,6 M\$ in 2004.

11

12 As for the allocation of the costs, procurement costs on the markets are directly and exclusively
13 charged to the customers concerned.

14

4.5. Rate LC

15 Lastly, rate LC is offered to large capacity customers for which intermittent electricity surpluses are
16 delivered in order to be used as a complement to a fuel-fed boiler. This rate will be treated if necessary,
17 since at present there are no customers who are using it.

⁹ Hydro-Québec's electricity rates and conditions for their application in force April 1st 2004, approved by the Régie de l'Énergie in accordance with decision D-2004-124.

4.6. Rates LD and LP

1 The emergency energy rate LD is offered to the customers whose usual source of energy is temporarily
2 faulty and whose minimum invoiced capacity is 5 000 kW. According to the case, it can be a planned or
3 unplanned interruption. The emergency rate LP applies to customers of rate L who use the electricity
4 delivered as a complement to a fuel-fed boiler.

5

6 In terms of procurement, the cost of supply for 2003 and 2004 of these rates is subject to an agreement
7 between the Producer and the Distributor. For the year 2005, this cost corresponds to the average cost
8 of 8,06 ¢/kWh (see Chapter 2.7 of this document and Hqd-8, Doc. 2).

9

5. OTHER NEW ELEMENTS

5.1. Cost of the generators

10 The costs related to the use of generators are identified for the year 2003. The generators made it
11 possible to meet the Distributor's customers' requirements in order to ensure the continuity of service
12 during the realization of construction and repair work. These amounts are presented in the section
13 *Sales of fuels* of the function "Others" of customer service.

14

15 The Distributor regards these costs as a cost of procurement and allocates them to all the consumers
16 on the basis of the cost of supply according to the Heritage and post-Heritage electricity of each
17 category of consumers and excluding consumption management rates. The relative share of the
18 special contracts is determined before the rebates (see Hqd-12, Documents 2, 3 and 4, page 34, Table
19 27B, column 10). No amount is expected to be charged in 2004 and 2005.

5.2. Internal use and construction sites' consumption

1 The Distributor receives revenues from the sale of electricity to the units of Hydro-Quebec and for the
2 electricity consumption of construction sites. The amounts are taken into account starting in the year
3 2004 in section *Issued Internal Invoices* of the function "Others" of customer service (Hqd-12,
4 Documents 3 and 4, Table 3, column 13). The forecasted amounts are 27,3 M\$ in 2004 and 29,8 M\$
5 in 2005.

6
7 The forecasted revenues by category of consumers are allocated directly to each category (Hqd-12,
8 Documents 3 and 4, Table 29, column 12). These amounts allow to recover the transmission,
9 production and distribution costs to serve these customers.

10

11 Given the revenues from internal use and construction sites are recorded since 2004, the consumption
12 characteristics (sales, coincident peak, non-coincident peak and number of subscriptions with and
13 without multiplier), as well as the number of connections and the kilometers of connections, take into
14 account this use of electricity in 2004 and 2005.

5.3. Taxes

15 The tax on gross income is "en lieu" (in place) of a tax on the production, transmission and distribution
16 equipments of Hydro-Quebec and corresponds to 3 % of the gross income of the company. This
17 amount is allocated to major units of Hydro-Quebec according to the net value of their fixed assets. The
18 costs supported by the Distributor are distributed among the functions according to the same rule of
19 attribution.

1 The tax on gross income will be replaced as of January 1st, 2005 with the tax on public services. This
2 tax is allocated to the major units of Hydro-Quebec according to the net fixed assets in operation
3 excluding fixed assets that are recorded for property taxes (that is to say buildings) and the other fixed
4 assets not subject to this new tax (supporting assets such as rolling materials, office equipment and
5 intangible assets). For 2005, no amount is allocated to the Sales Management Directorate – Large
6 corporations, to the Distributor's corporate units and to the electricity procurement management
7 directorate.

8
9 For the tax on gross income applicable in 2003 and 2004, the method applied in phase 2 of R-3492-
10 2002 is maintained. The procedure proposed for the year 2005, to distribute among the functions the
11 tax on public services aims at reflecting the method of allocation to the major units of Hydro-Quebec.
12 The tax on public services is allocated among the functions according to the net value of fixed assets
13 excluding supporting assets and intangible assets. With regard to the customer service function, the
14 amounts are allocated directly to the measuring sub-function, given that only the measuring assets are
15 affected by the tax on public services.

16

6. METHODOLOGICAL MODIFICATIONS

6.1. Classification between the components of subscription and capacity

17 In its Decision D-2003-93 the Régie agreed to allocate the costs of the distribution network among the
18 technical components of capacity and subscription and to use the minimum size network (MSN) study
19 as the method for classifying the network cost between these two components. Nonetheless, the Régie
20 asked the Distributor to bring certain modifications to its method in phase 2, among them is to take into

1 account the intrinsic capacity on the MSN. While waiting for the Distributor to refine its method, the
2 Régie quantified this capacity as 1 kW per subscriber.

3
4 In Hqd-8, Document 1 filed in Phase 2 of case R-3492- 2002, the Distributor proposed an adjustment
5 method in order to take into account a capacity of 1 kW per subscriber in accordance with the Régie's
6 requirements. The adjusted value of the subscription component was determined by a linear regression
7 from the maximum capacity per subscriber of the distribution network, that is to say 14,2 kVA, and the
8 fictional capacity of the MSN. It should be noted that the maximum capacity by subscriber was
9 determined from the actual set capacity of the distribution network, namely 51 000 MVA, divided by the
10 number of subscriptions with multiplier. The Distributor submitted that the proposed adjustment
11 reducing the portion of subscription component of the distribution network by approximately 4 % to 5 %.

12
13 The Régie accepted in its Decision D-2004-47 the adjustment suggested by the Distributor, while
14 reminding that it is an acceptable compromise for the time being while waiting for the Distributor to
15 refine its method.

16
17 In addition, the Régie noted that in spite of an adjustment of 1 kW by subscriber, the update of the
18 equipment replacement unit costs between Phase 1 and Phase 2 had caused an increase in the cost of
19 the MSN. This sensitivity to fluctuations of the equipment replacement unit costs could influence the
20 stability of the results that are being obtained by this method through time. According to the Régie,
21 there seemed to exist a bias in the estimate of the costs of the MSN, in this case an upward bias
22 related to the assumption that all equipment installed on the network had the same characteristics and
23 costs as the equipment replaced. The Régie was of the opinion that this assumption reflected the

1 adoption of a marginal approach in an average costs allocation method.

2

3 The Régie referred these two subjects to the technical committee on the Distributor's service costs
4 allocation methodology by consumer category.

5

6 The meeting held on June 9, 2004 had two objectives concerning the classification by subscription and
7 capacity components of the distribution network:

8

9 • To find a method which would allow to decrease the impact of a variation of equipment
10 replacement unit costs on the cost of the MSN. A reflection with regard to a marginal
11 approach versus average cost approach was also started;

12

13 • To quantify the acceptable maximum load accessible by customers on the MSN.

14

15 Concerning the first point, and in order to stabilize the allocation factors of the MSN method through
16 time, the Distributor suggests methods to smooth the results in order to avoid significant fluctuations
17 between rate cases. The Distributor proposes on the one hand to proceed with the average unit costs
18 of replacement. The Distributor integrates this method into the historic year 2003 of current case R-
19 3541-2004. Thus, on the first stage the Distributor proceeds with the update of unit costs of the
20 equipment of the MSN. For the year 2003, the costs from the case R-3492-2002 are used again. For
21 the year 2004, these costs are revalued according to the most recent data available and increased to
22 take inflation into account for the projected pilot year 2005. On the second stage, replacement unit
23 costs of each year are recalculated according to an average which accounts for the real data taken in
24 the year 2002 filed in phase 2 of case R-3492-2002 (see Appendix 3, Table 43, columns 2 and 3,
25 Documents 2,3 and 4).

1 On the other hand, at the time of the meeting of the technical committee, the Distributor proposed that
2 the subscription / capacity proportions be revised according to a threshold of release. In support of this
3 proposal, the Distributor submitted that the MSN is a fictional network, and that MSN method is a
4 theoretical means that is used to calculate the fixed component of distribution network's cost. It should
5 be noted that the situation would generally be the same with the other recognized method of
6 extrapolated fixed cost. Thus, unless there is a significant element, it would not be necessary to re-
7 evaluate in each rate case and for each year the percentage of the subscription component. The
8 Distributor suggested a 5 years interval or a variation of 3 % of the subscription proportion.

9
10 Still with the aim of avoiding fluctuations to the results of method through time, the Distributor also
11 requested to the Régie that the application of the threshold of release begins in the historic year 2003
12 of the current case R-3541-2004. Thus, subscription percentages of 42,9% and 23,8% for low and
13 medium voltage networks presented in line 28 of Appendix 3 (Hqd-12, Document 2, Factor FC11B) are
14 rounded (Factor FC11C, line 29), and are used for the classification by component of medium and low
15 voltage networks for the years 2003, 2004 and 2005. It should be noted that the factors of classification
16 of the subscription component for the underground grid presented in Phase 2 were underestimated,
17 because of a revision to the number of kilometers of low voltage underground grid used to determine
18 the value of the conductors according to the voltage level.

19
20 According to the Distributor, all these proposed modifications, whether the application of the average
21 costs of replacement and of a threshold of release, allow to take into account the concern of the Régie
22 regarding the marginal approach in an average costs allocation method.

1 With regard to the second point, that is the adjustment of the capacity of the MSN, the Distributor raised
2 at the time of the technical meeting the complexity inherent in the development of a MSN simulation
3 model that would allow to quantify the capacity conveyed by the MSN. Moreover, the Distributor
4 mentioned that the result of such a simulation would be a distribution of the capacities available to the
5 customers. The distribution network is conceived to meet the maximum demand of the customers. By
6 replacing the range of components by one of only the smallest capacity, the distribution network is no
7 longer ensuring the delivery of even the minimum capacity to all customers. For certain customers, they
8 have the full capacity of the line since they are so to speak, the only ones on this section. For most
9 other customers, MSN is simply insufficient to maintain the necessary tension. In this context, the use
10 of an average data would be inappropriate. The calculation of the MSN capacity could not be refined
11 sufficiently to satisfy the demands exceeding those currently used, as was explained at the technical
12 committee. Nevertheless, the Distributor proposes to maintain the load of 1 kW by subscriber that was
13 used at the time of Phase 2 of case R-3492-2002, in accordance with the Régie's request in its decision
14 D-2003-93. The impact of this adjustment on historic year 2003, basic year 2004 and projected year
15 2005 is presented in Tables 47 of Appendix 3.

16

17 Finally, at the time of the technical meeting, the question of the multiplier of the MSN subscription
18 component was also discussed. In the Distributor's evidence presented during Phase 2, the number of
19 subscriptions without multiplier was used as the allocation criterion of the MSN subscription component

1 for the rate base and the cost of service. During the hearings, questions were raised concerning the
2 use of the number of subscriptions without multiplier in the allocation of the cost of the subscription
3 component and concerning the number of subscriptions with multiplier in the MSN study for the
4 determination of the maximum capacity by subscriber. In order to better harmonize the treatment and
5 reflect the causality links, the Distributor demonstrated to the technical committee that the number of
6 subscribers with multiplier had to be retained in the allocation of the subscription component by
7 consumer category. Table D presents the impact on the required revenue from the proposed
8 modifications.

9

6.2. Corporate expenses

10 Changes were made to the method of distributing corporate expenses. The modifications relate to the
11 following elements: the share of Hydro-Quebec's corporate expenses that is charged to the Distributor;
12 the rate base and the cost of service of the corporate units of the Distributor other than Electricity
13 Procurement Management Directorate; the rate base of the supporting units serving the Vice-
14 Presidency Network.

15

16 For Hydro-Quebec's corporate expenses assumed by the Distributor, these were divided in Phase 2 of
17 case R-3492-2002 according to total charges excluding electricity purchases, fuel and transmission. In
18 the current case, the amounts are allocated to the various functions in a proportion of 50% according to
19 direct gross charges and of 50% according to net fixed assets excluding intangible assets. This
20 modification aims to reflect the allocation method of corporate expenses among Hydro-Quebec's major
21 units retained by the Régie in its Decision D-2004-47.

1 The treatment of the Distributor's corporate units other than Electricity Procurement Management is
2 also modified in the current case. These units include the Office of the President of Hydro-Quebec
3 Distribution and of the Comptroller, Regulatory & Rates Affairs, and the Human resources directorate.
4

5 With regard to the rate base, the assets of the corporate units were presented in Phase 2 in the
6 function "Others" according to headings of the rate base. The rate base of corporate units was
7 allocated in proportion with the allocation of the rate base per consumer category excluding the
8 Distributor's corporate units (see Hqd-8, Documents 2, 3 and 4, page 32, Table 26). The cost of service
9 of the corporate units of the Distributor was allocated in proportion with the allocation of the cost of
10 service by category of consumers, excluding the corporate units of the Distributor (see Hqd-8,
11 Documents 2, 3 and 4, page 32, table 29).
12

13 In the current case, the allocation method is modified in order to reflect the use of services according to
14 the functions as presented in the financial statements related to the President in the charges
15 heading (**note: last sentence unclear in French**). For the rate base, the net value of measuring
16 equipment is allocated directly to the measuring function. For other elements of the rate base, the
17 amounts are allocated to the functions according to the allocation of the "charges" heading of the cost
18 of service (see Hqd-12, Documents 2, 3 and 4, pages 8 and 9, Tables 2 and 3). With regard to the cost
19 of service, the cost of the Distributor's corporate units is recorded to each headings of the cost of
20 service to be later allocated to major units of Hydro-Quebec Distribution according to the use of the
21 services in the "charges" headings.
22

1 For the Network Vice-presidency, the rate base of support units serving the whole Network Vice-
2 presidency is distributed among functions according to average manpower. The amounts are
3 determined by the analysis of the assets for the year 2003. This treatment allows to increase the level
4 of precision of the cost of services allocation method, since the amounts in phase 2 were allocated to
5 the units that were owning the assets and taken into account in the connected distribution network. For
6 autonomous networks, the assets of supporting units are included in the heading Supporting Assets.
7 The amounts are allocated among the functions according to the use of the services or average
8 manpower, derived from an analysis of the assets for the year 2003. In phase 2, a share of the
9 amounts was distributed according to units owning the assets and in the current case, allocated to the
10 functions according to average manpower.

11

12 Table D presents the impact of the modification on the required revenue by category of consumers.

13

6.3. Cash balance of working capital

14 The cash balance belongs to rate base and represents the funds required by the Distributor to finance
15 its current activities. In Phase 2, the cash balance was allocated to the functions according to the
16 allocation obtained from the following elements: direct gross charges, capitalized costs, purchases of
17 fuel and taxes.

18

19 Although the Régie did not rule on this subject, the Distributor proposes to modify the classification
20 method by function of the cash balance following the suggestion of Option Consommateur, as
21 discussed at one of the technical meetings. In the current case, it is proposed that the portion of the
22 cash balance associated with the purchases of electricity and transmission be allocated to the function
23 "Others" (Hqd-12, Documents 2, 3 and 4, page 2, Table 2, column 11). Then, the portion of the cash

1 balance related to purchases of electricity is allocated by category of consumers in proportion to
 2 production costs per category consumers. The portion related to transmission is allocated in proportion
 3 to the cost of transmission according to the categories of consumers (Hqd-12, Documents 2, 3 and 4,
 4 page 2, table 26B, columns 8 and 11).

5
 6 The components of the cash balance other than the electricity and transmission purchases are
 7 allocated by the same methods as the cost of service. The following diagram summarizes the criteria
 8 used.
 9

<i>Components of cash balance</i>	<i>Sections of the cost of service</i>
Maintenance and operating costs	Direct gross charges
Salaries	Salary expenses
Other operating costs	Other direct gross charges
Taxes	Taxes
Capital Tax	Capital Tax
Gross income tax	Gross income tax
Tax on public services	Tax on the public services
Property Taxes	Property Taxes
Effect of taxes on consumption	Direct function and other gross charges
Provisions for bad debts	Cost of the bad debts

10 Table D presents the impact of the integration of this modification according to the categories of
 11 consumers.
 12

6.4. Subscription Management

13 In phase 2¹⁰, the Distributor proposed a method that allocates in a detailed way the subscription
 14 management function by identifying eight areas of activities composing this function. Allocation factors

¹⁰ File R-34920-2002

1 specific to each of these areas of activities were proposed. The allocation factors aim to translate as far
2 as possible the relation between the service requests of and the variation in various areas of activities.

3

4 In its decision, the Régie accepted the proposal of the Distributor and noted that this method improves
5 the transparency of the study and makes it possible to quantify more precisely the links of causality.

6

7 In the case of the three sub-functions, in Phase 2, the allocation criteria were the statistics relating to
8 each area of activities. In a more precise way, the following allocation factors were retained:

9

<i>Sub-functions</i>	<i>Factor of distribution</i>
Subtilization	Number of files treated – Average in 2000 to 2002
Telephone answers	Workload – Year 2002
Complaints and claims	Number of cases handled – Average in 2001-2002

10

11 The calculation of the factors, starting from an average over several years, constitutes a more suitable
12 solution in order to avoid annual fluctuations in the cost allocation. The number of files handled or the
13 workload by consumer category can vary from one year to another in function of particular factors.

14 Consequently, the Distributor proposes to determine the allocation factors according to the three-year
15 moving average for subtilization activities, telephone answers and complaints and claims.

16

1 It is also proposed to apply the same principle to the invoicing sub-function at the stage of the
2 classification per function. The division of the cost of service among the regular invoices and the
3 collection notices could be established from a three-year moving average of the regular invoices and
4 collection notices. In phase 2, the averages were calculated on the basis of the data over the period
5 2000 - 2002 (Hqd-12, Documents 2, 3 and 4, Table 16, columns 8 and 11, line 26).
6

7 Concerning to the function public relations, the latter was divided in phase 2 according to the number of
8 subscriptions of the served customers, that is the customers of small and medium capacity connected
9 to the network. To reflect the decision of the Régie, the rate base and cost of service of this function are
10 distributed on the basis of the energy volume by consumer categories.
11

12 Table D presents the impact of all modifications on the subscription management function, compared to
13 the method suggested in phase 2.

6.5. Connection fee

14 In the method used by the Distributor in phase 2, the connection cost is established by subtracting the
15 value of the latter from the revenues related to connection fees. The available data does not allow to
16 isolate the revenues associated with connection expenses by category of consumers of autonomous
17 networks.
18

19 Option Consommateur recommended in Phase 2 to allocate the revenues related to connection
20 expenses between the connected and autonomous networks. Taking into account the absence of
21 available information, connection expenses by category of consumers are allocated between the
22 connected and autonomous networks according to the number of subscriptions without

1 multiplier, as suggested by Option Consommateur (Hqd-12, Documents 2, 3 and 4, page 18, Table 12,
2 column 9).

3

4 The impact of this modification is relatively small. Table D presents these impacts according to
5 consumer categories.

6

7. CHANGES OF A QUALITATIVE NATURE

7.1. Characteristics of consumption

7 The Distributor's cost of service allocation methodology uses different allocation criteria based on the
8 consumption characteristics of the consumer categories. Starting this year, the different data related to
9 the consumption characteristics are gathered in Appendix 4 of each of three documents (Hqd-12,
10 Documents 2, 3 and 4) in conformity with the decision of the Régie. The Distributor recalls nevertheless
11 that it is not all the monthly data required by the Régie that are used to establish distribution factors.

12

13 The characteristics are drawn from a program measuring the consumption of the various consumer
14 categories and weighted by the sales for each of the three years.

15

16 In terms of the Distributor's cost of service allocation, it is important that these characteristics be as
17 precise as possible and especially, free from any circumstantial event in order to reflect the costs of
18 service per consumer category that are stable but nevertheless evolve with time according to structural
19 and trend elements (see Appendix 4, Table 49).

20

21 For the present case, the characteristics of consumption were corrected especially to exclude a
22 significant event that would have a circumstantial impact in 2004 and 2005 on the Distributor's cost of

1 service allocation by consumer category. It is a strike at one of the customers' of the special contracts
2 category (ABI) that was treated appropriately in our sales forecasts but in terms of cost of service
3 allocation, had the effect of penalizing all the other categories of consumers. The profiles of
4 consumption are thus adjusted to remove the effect of this strike on the sales forecast.

5
6 It is true that all kinds of events occur each year and that they are implicitly part of the forecast while it
7 is impossible to adjust the sales forecast in all cases. On the other hand, when an event is sufficiently
8 significant, that it is clearly quantifiable and has an incidence on the results, the Distributor considers
9 that it is appropriate to carry out an adjustment, something that was made in this case.

10
11 In another order of ideas, customers of the transition rate from rate BT, which is aimed at the
12 photosynthesis users, were regrouped with the customers of rates D and DM that include among others
13 agricultural enterprises.

14
15 With regard to the forecast of the rate of losses, the Distributor expects a rate of 7,5% for year 2005,
16 whereas the forecasted rate in the rate case 2004-05 for year 2004 was 7,8%. This downward revision
17 is explained by the loss rates noted during the last three years, that were inferior to the rates that were
18 previously used in the forecast. As for the allocation of the cost of service, the Distributor integrated this
19 element in the calculation of cost of supply (Chapters 2.5 and 2.6) and allocation factors.

7.2. Factors of classification and distribution

20
21 In Decision D-2004-47 the Régie requires the Distributor to clarify further, in the next rate cases, the
22 methods and calculation of classification and allocation factors used in the cost allocation method.

1 In addition, given the relatively technical character of the allocation by function of expenditures and
2 classification factors, the Régie recommended that this subject be initially explored at a technical
3 meeting. In Decision D-2003-93 concerning the method described in Phase 1, the Régie mentions that
4 it is expecting that the Distributor will provide a more detailed explanation of the distribution of each of
5 the cost headings in the next rate case.

6

7 The classification by function consists of associating to the various accounting items of the rate base
8 and cost of service to the various functions and sub-functions. In the United States, electricity
9 companies account for their costs by function through the use of a uniform accounting system. For
10 example, one can mention *Federal Energy Regulatory Commission*
11 *(FERC) Uniform System* or the *Rural Electrification Administration's Uniform Systems of Accounts*.

12

13 Without using this system of uniform accounting, Hydro-Quebec has put in place a financial information
14 management system, that is to say the SAP system. This system allows in particular the attribution of
15 the total costs to the majority of the functions used for regulatory purposes. The allocation method uses
16 the financial information of this system developed for internal management purposes.

17

18 At the technical meetings, the Distributor described the classification method of the rate base and the
19 cost of service. Appendix 5 presents the technical standard and detailed factors of classification for the
20 rate base, the cost of service and the MSN, as well as a presentation in the form of diagrams.

21

1 Distribution factors allow to allocate the cost of service and the rate base by consumer category. In
2 Appendix 6, the allocation factors used in the cost of service allocation methodology are described.

3

8. IMPACTS OF THE METHODOLOGICAL MODIFICATIONS

4 Table D presents the impacts of the modifications made to the cost of service allocation methodology
5 for the projected pilot year 2005, as described in chapter 6 of this document.

6

7 The modifications were applied to each of the three years to make comparable on the methodological
8 level the allocation of the costs. One should note that the impact from these modifications is the same
9 for the three years.

10

11 For each of the elements, costs of service by consumer category are calculated with and without
12 modification, the differential constituting the impact of the measure.

13

Table D
Analysis of sensitivity of the modifications made to allocation method
Projected pilot year 2005

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Consumer Category	Required revenue before adjustment	Methodological modifications					Required revenue Hqd-12, Document 4
		Classification of the subscription component	Corporate Expenses	Cash balance of working capital	Subscription Management	Connection Expenses	
1 Domestic							
2 Rates D and DM	4 451,3	0,7	(1,5)	(1,9)	(3,2)	0,0	4 445,5
3 Rate DH	0,3	(0,0)	0,0	(0,0)	(0,0)	(0,0)	0,3
4 Rate DT	161,2	(0,7)	0,1	(0,2)	(0,1)	(0,0)	160,4
5 Total	4 612,9	0,1	(1,4)	(2,1)	(3,3)	(0,0)	4 606,1
6 Small and medium capacity							
7 Rates G and fixed price	880,9	(0,2)	0,3	(0,5)	1,5	0,0	882,0
8 Rate G	67,8	(0,0)	0,0	0,1	0,1	(0,0)	67,9
9 Rate M	1 290,6	0,5	(0,1)	1,2	1,6	(0,0)	1 293,8
10 Rates of street lighting and Sentinel	29,9	(0,0)	(0,0)	0,0	0,0	0,0	29,9
11 Rate BT	36,7	(0,0)	0,0	0,1	0,1	(0,0)	36,9
12 Total	2 305,9	0,2	0,2	0,9	3,3	0,0	2 310,5
13 Large capacity							
14 Rate L	1 831,6	(0,3)	1,2	(0,9)	-	(0,0)	1 831,6
15 Rate H	0,7	(0,0)	0,0	(0,0)	-	(0,0)	0,7
16 Rates LD and LP	0,8	0,0	0,0	(0,1)	-	-	0,8
17 Special contracts	515,3	-	-	-	-	-	515,3
18 Total	2 348,5	(0,3)	1,2	(1,0)	-	(0,0)	2 348,4
19 Total	9 267,3	-	-	(2,2)	-	-	9 265,1
20 Reference:		Chapter 6.1	Chapter 6.2	Chapter 6.3	Chapter 6.4	Chapter 6.5	