ELECTRICITY PROCUREMENT COSTS TRANSFER PRINCIPLE FOR VOLUMES IN EXCESS OF THE HERITAGE ELECTRICITY SUPPLY

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1. CONTEXT OF THE REQUEST

The Distributor, in the context of the Phase 1 of Request R-3492-2002, filed the principle for the transfer of the costs of supply for the Régie's approval. Through this principle, the Distributor applied for the recognition in the cost of service of the Distributor as well as their transfer, without loss or profit, in the customer's rates, of certain costs out of the direct control of the Distributor along with any variation to them. This principle was introduced to put in place a mechanism allowing the reflection in the Distributor's cost of service, in a simple, fast and effective way, of all unforeseen variations in the cost of supply related to Heritage supply as well the volume of electricity that is in excess of this supply.

In its Decision D-2003-93, the Régie considered pertinent the authorization of this principle for the modifications to the costs of the heritage electricity and recognized the possibility, for the Distributor, of recording in a deferred expense account any unforeseen variation, when fixing rates, of the costs of supply of Heritage electricity by category of consumers resulting from an update of the rates of Appendix I by the Régie or the government.

In the same decision, the Régie does not take any position regarding the application of this principle beyond the Heritage electricity supply. It is true that, at this point, the Heritage electricity supply was not forecasted to be exceeded for the projected pilot year.

The most recent forecasts, as shown in Hqd-03, Document 2, indicate that starting in 2005, the full volume of Heritage electricity should be normally attained. At this time, the Distributor will have to ensure at all times the maintenance of the balance between electricity supply and demand and fully assume all the costs and all risks associated with his procurements.

The deliveries will be managed in real time and in an integrated fashion without distinguishing the origin of the demand and without any possibility to associate to this demand a contract or a specific price. This type of a dynamic management aims to allow the Distributor to globally optimize its purchases with a view to ensure the lowest supply cost to Quebec's customers.

Yet, the requirements along with their real procurement costs are subject to significant forecasting and climatic risks and the financial impacts from any discrepancy in volumes and purchase prices are potentially very high and largely exceed the normal scope of the business risk allowed for a regulated entity.

1.1 The Position of Société en commandite Gaz Métropolitain

In Decision D-2003-93, the Régie established a parallel between the business risk of SCGM and that of the Distributor. On this topic, it noted that the Distributor's business risk was lower than that of a comparable gas or electric company[1].

However, with respect to procurement, without the adoption of a recognized regulatory mechanism, the Distributor's business risk is far larger than that of SCGM. Indeed, natural gas rates completely reflect the purchasing cost of the molecule. The principle of a quasi-automatic adjustment of the customers' invoices makes it possible to integrate any fluctuation in the price of natural gas on a monthly basis for the volumes they consume. The gas distributor does not have to bear the risk on the volumes of purchased gas. Finally the residual risk associated with the climatic risks is accounted for specifically by the " stabilization account for temperature". Consequently, SCGM never faces a loss or profit from the costs of its procurements in terms of price, since they recover any price variation

[1] Reference: D-2003-93, page 51

in the rates, or in terms of volume and climatic risks. For all the potential risks linked to its gas purchases, SCGM therefore possess a series of mechanisms allowing the mitigation of these risks, which is not the case of the Distributor.

Moreover, it is already established that the procurement costs of the volumes in excess of the Heritage electricity supply will be larger than the cost of Heritage electricity.

1.2 The Position of the Distributor

Before elaborating on the specific situation of the Distributor, it is important to briefly point out the basis for the calculation of the procurement cost in projected pilot year 2005:

- Supply costs are estimated from the forecasts of demand under normal temperature conditions;
- Total supply costs are obtained by adding the cost of the Heritage electricity supply and cost of the post-Heritage electricity supply established from the best available estimates. In the specific case of year 2005, these costs were calculated for the Heritage portion at 2.79 ¢/kWh. For the post-Heritage portion, the cost of supply is based on an estimate of the market price that should be obtained for the short-term demand to be satisfied during the year 2005. The resulting post-Heritage cost is 7.5 ¢/kWh;
- No provision covering climatic and forecasting risks is included in the procurement costs;
- Procurement costs for the projected pilot year combining the Heritage and post-Heritage purchases are allocated among consumer categories

according to their characteristics of consumption, thus obtaining an average cost of supply per category;

- This average cost corresponds to the Distributor's revenue for the supply element.

However, the Distributor cannot take into account before they are realized, the real time price and volume variations. Thus, in the cases where the actual procurement requirements are higher than forecasted, the Distributor is ensured to pay marginally more than the cost of the Heritage electricity for his purchases in excess of that supply. Especially during peak periods, electricity Distributors will have to fulfill procurement requirements simultaneously on the market, resulting in pressures that will increase the market price. Admittedly, the revenue related to the procurement portion of the tariffs will increase, but they will never absorb the increase in the costs of supply, the first being evaluated on the basis of average revenues anticipated for this component, the latter on the marginal cost.

In the reverse case where the actual demand is lower than the forecasted requirements, the Distributor will use all the flexibility offered by its contracts or their price formula, if necessary, to minimize the financial impacts of the reduction in sales. In the best case, the Distributor will be able to avoid a market purchase, thus largely compensating, in a symmetrical way, the loss of revenues associated with the supply. However, in several cases the cost savings may be only partial, since they will be linked to exercising of options to reduce the volumes purchased or the payment of a fixed premium.

Hence, the financial impact associated with these risks is not symmetrical and vary according to several parameters, like market prices, signed contracts and price formulas.

The result of the preceding paragraphs is to show that there are systematic differences between supply costs and revenues, differences due to

unpredictable variations in quantities and prices. Contrary to SCGM, the Distributor at this time does not have any mechanism enabling him to mitigate these risks, or desire to adjust the customer's invoices several times during the year.

Admittedly the Distributor could have proposed the creation of an annual provision which would allow him to adjust the forecasts to protect against the risk of colder temperature and increased demand. However this solution has not been adopted since it goes against the principle of transferring without loss or profit the actual procurement costs incurred by the Distributor.

It is in this regard that the Distributor requests that the transfer principle applies fully to the post-Heritage procurement costs and that Hydro-Quebec Distribution be authorized to establish a regulatory mechanism allowing to recover from its clients the real costs of supply without incurring any loss or profit.

In the absence of recognition of the principle of transfer of the post-Heritage procurement costs, the Distributor will unduly support any variation between the revenues anticipated to be received for the procurement portion (established on the basis of the average cost) and the real procurement costs (established on the basis of marginal cost).

1.3 Legal and regulatory environment

This request fits perfectly in the legal and regulatory environment surrounding the consideration of the costs of electricity procurements exceeding the volume of Heritage electricity.

Thus, the Act with respect to the Régie de l'Énergie in article 52.1 recognizes that the procurement costs are an integral component of the Distributor's cost of service. In addition, article 52.2 lays down the methodology to establish the cost

of supply. It is specified that the cost of supply is established by adding the cost of the Heritage electricity, the real cost of the procurement contracts for the Quebec markets that exceed Heritage electricity and those of the blocks of energy determined by government regulations. Thus the procurement costs include all the Distributor's transactions to satisfy the requirements of the Quebec market.

2 RISKS ASSOCIATED WITH SUPPLY

Beyond the volume of Heritage electricity, it is the responsibility of the Distributor to meet the energy demand of Quebec customers, and that for each hour of the year. To fulfill this obligation, the Distributor must be in position to:

- maintain at all times the balance between energy supply and demand;
- face unforeseen requirements caused by the forecast and climatic risks;
- fulfill any sudden deficit of supply;
- apply different strategies to manage supplies as contained in the procurement plan in order to match demand for supply at the lowest available cost.

For the Distributor, it is a very demanding mandate that implies high levels of risks and requires a maximum of flexibility in managing supplies.

2.1 Quantity Risks

The Distributor's supply requirements are established on the basis of forecasted demand under normal climatic conditions for the average scenario. These requirements cannot account for climatic and demand risks which, by nature, are unpredictable and in the case of the climatic risk are known only a few hours in advance.

The climatic risk is short-term, with an amplitude that varies from one month to another, one year to the other, in one direction (colder temperature) or another (hotter temperature). This risk involves time variations in the demand consumption profile under normal climatic conditions. Pursuant to R-3470-2001, the climatic history of the last 30 years applied to the structure of consumption of 2005 shows that the standard deviation of the impact of the climatic risk is 1.9 TWh. Further, during the coldest reported winter, the demand could be almost 4 TWh higher than during the average year. Conversely, the hottest reported winter would result in lower demand of approximately 4,8 TWh.

Such variations, if they occurred, would cause considerable financial impact on the Distributor without the possibility of recovery in the current regulatory environment. On the one hand, these costs cannot be integrated into the Distributor's cost of service for the projected pilot year used for rate making which is based on an average scenario of demand. In addition, there is currently no regulatory mechanism that allow to record these variations as deferred expenses and to recover them from the customers.

As an example, table 1 below illustrates a case where the Distributor would have to buy 1.9 TWh more at a price of 7.5 ¢/kWh while the revenues

from the supply component were anticipated at 2.79 ¢/kWh. A net loss of 89 M$ would be associated with this deviation of 1.9 TWh.

Table1

ILLUSTRATION OF The LOSS OF EARNINGS

ASSOCIATED with the UNFORESEEN PURCHASES OF 1,9TWh

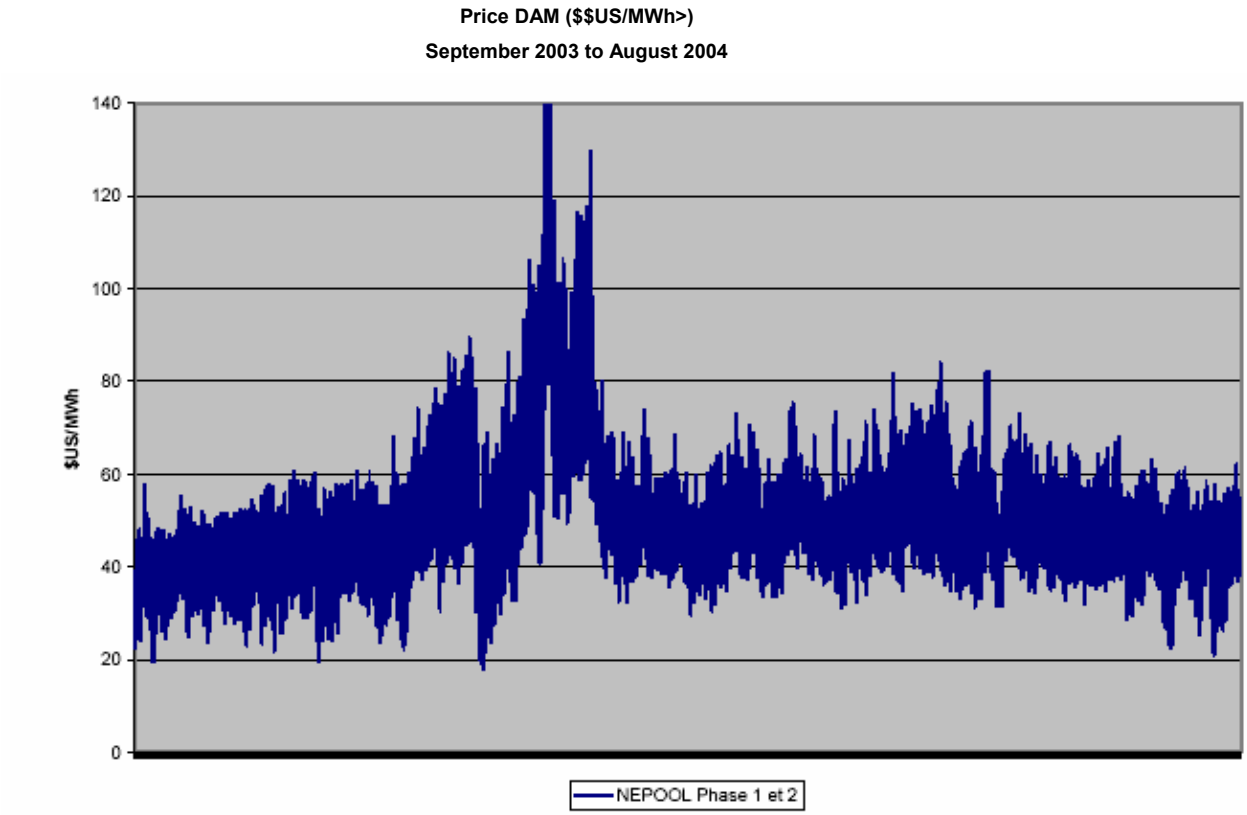
Example	
Standard deviation	1.90 TWh
Purchase price of the non-forecasted quantities	7.50 ¢/kWh
Revenues associated with the supply component	2.79 ¢/kWh
Cost of purchase of the additional quantities	142.50 M$
Anticipated revenue associated to supply	53.01 M$
Lost profit	**89.49 M$**

A similar demonstration can be made for any variation of the non-forecasted demand. Indeed, the scenarios for the average and low forecasted demand of the year 2005 indicate a variation of +/- 6 TWh from the forecast for the average demand scenario with a standard deviation of 4,6 TWh.

The unpredictability of the quantities and their suddenness cause the Distributor to simultaneously buy at the marginal cost the additional quantities of energy in the short term markets when the weather is colder than forecasted and to use the option of reducing the quantities, for the quantities in excess, if it gets warmer and if the conditions of the contracts allow it.

2.2 Risks associated with the level and volatility of the prices

The prices of electricity in the short-term markets are often very volatile. As an indication, the large variability of the prices in the NEPOOL market during the period from September 2004 to August 2004 is illustrated by the following graph:



1

2.3 Specific risks of the long term supply agreements

2 In the case where the Distributor enters into supply agreements
3 approved by the Régie following a tender process, the known elements are
4 primarily the level or the formula for the price, the quantities, the
5 time when the supply is available and the location of the suppliers. These
6 elements are included in the process of preparing the rate case and are
7 integrated in the cost of supply for the projected pilot year.
8
9 Completely unforeseeable uncertainties and residual types of risk remain. Among
10 those are the following:
11 • The equipment of the supplier under the contract breaks down. At the
12 time of an equipment breakdown, the energy not supplied will not be

paid for by the Distributor. However, the Distributor will have to compensate for this loss

- through short-term supply, resulting in additional non-forecasted costs. When equipment breakdowns results in the non-respect of performance obligations, the supplier exposes himself to penalties based on the cost of energy in the short term markets;
- Fluctuations of some price components, such as inflation, fluctuations of the exchange rate when the price is related to a foreign currency, and fluctuations of gas or fuel prices, when the price is established as a function of these energy sources. The principle of including price formulas indexed with different indices was recognized by the Régie in its decision D-2002-169. This recognition must go hand in hand with the introduction of a mechanism for allowing these adjustments to be reflected in the required revenue and the consumers' rates.

In the context of the Distributor's supply, it is these costs and Quantities increases or reductions that should be recognized in the principle of the transfer of the supply costs for supply volumes beyond that of the Heritage volume of electricity, neutralized to account for revenue effects.

These risks, the important monetary stakes and the characteristics related to the Distributor's electricity procurements, make it absolutely necessary that the principle of the transfer of the costs be recognized, given the Distributor's objective simply resides in the just treatment of the costs supported for ensuring the procurement of electricity in Quebec.

3 PROCUREMENTS TARGETED BY THE REQUEST

In order to satisfy the demand for electricity beyond the volume of Heritage electricity, the Distributor possesses two main sources of supply :

- Long-term procurements and the energy blocks determined by the government;
- Short-term procurements of electricity, including interruptible electricity and the purchases confirmed as part of the framework agreement to be concluded with Hydro-Quebec Production.

3.1 Long-term electricity procurements

At the time of the first invitation for long-term tenders launched in February 2002 for a block of 1200 MW available as of 2006, the Distributor entered into three long-term procurement agreements:

- A 20-year contract with Transcanada Energy (TCE) for base[2] electricity starting on September 2006 for 507 MW and 4.1 TWh/year. The unit cost of this contract in year 2007 amounts to 6 ¢/kWh;
- A 20-year contract with Hydro-Quebec Production for base electricity of 350 MW and 2.9 TWh/an beginning in March 2007. The unit cost of this contract in 2007 is 5.5 ¢/kWh;
- A 20-year contract with Hydro-Quebec Production for "cyclable"[3] electricity starting in March 2007 for 250 MW amounting to 2.1TWh/year. In year 2007 the unit cost of this contract is 7,4 ¢/kWh.

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[2] [2] Base Electricity: Used to meet the requirements: firm in capacity and energy, present at almost every hour of the year and not very prone to the risks. Base Electricity is characterized by a high operating time ratio.

[3] "Cyclable" Electricity: Electricity of the flexible type, which makes it possible to follow the daily cycles of requirements. This type of electricity can be generated by the same equipment as that for the basic service.

Pursuant to the Act, the Distributor had these contracts approved by the Régie (D-2003-159). The average price of the combination of these three contracts, when recognized by the Régie, is 6,1 ¢/kWh, implying a much higher price than the average cost of supply of 2.84 ¢/kWh which is used for rate making. This price is also subject to various index formulas.

Other procurement sources must also be considered in meeting the Distributor's long-term demand. These are the energy blocks determined by the government. More specifically, a first block of wind power of 2.5 TWh with delivery scheduled to begin in 2011. In addition, the Distributor entered into two agreements totaling 39.4 MW of electricity produced from biomass with deliveries starting in 2008. The first contract is signed with Kruger Inc. for 19 MW including 3 MW delivered on a monthly basis and the second one is with Bowater Forestry Products of Canada Inc. for 20.4 MW including 3.4 MW delivered on a monthly basis. The price of these two contracts over 20 years is 6.7 ¢/kWh. Like the long-term contracts, these contracts include index mechanisms and indices. These contracts were approved by the Régie in its decision D-2004-115.

Considering that all the long-term electricity procurements will start after the year 2005, the discrepancies on these procurements will be reflected in the account to be created, at the proper time.

3.2 Short term supply of electricity

Hydro-Quebec Distribution has four major short-term electricity procurement types that it intends to manage in a dynamic way according to the prices of these different sources, the requirements to be met and any other business operational constraints to be taken into account in real time:

- Short-term electricity procurement through tender: this category includes the tenders for requirements covering from 3 months to one year;
- Short term electricity procurements without tender: this category represents the procurement agreements of less than three months for which the Distributor requested the Régie to be exempted from the tender process (request R-3539-2004);
- Procurements sourced through interruptible electricity option used to increase flexibility in managing unpredicted peak load demands, an option the Distributor requested the Régie to renew (request R-3538-2004);
- And the framework agreement with Hydro-Quebec Production (currently in negotiation).

3.2.1 Short-term electricity procurements through tender

In general, between the launching of a long-term tender and the first delivery, it takes approximately 66 months. The Distributor must therefore envisage tenders for short-term supply if additional requirements are foreseen within this delay. These tenders cover various horizons and can be launched at various times in the course of a year. The Distributor launched the first tender for short-term supply in May 2004 for a total capacity of 250 MW and 2.2 TWh/year deliverable during the period from January 1 to December 31,

2005. An examination of the offers received reveals that the closing price in American dollars is of 5.7 ¢US/kWh, which is approximately 7.5 ¢CDN/kWh (on the basis of the average exchange rate forecasted for 2005). To meet the demand forecasted for 2005, the Distributor will launch new tenders for short-term supply by the end of the year 2005.

The Distributor being unable to predict the final price of these new tenders, the projected procurement cost was evaluated on the basis of the recently granted short-term contract and the prices on the one-year forward market. Considering these various prices, the Distributor evaluates that the price of 7.5 ¢Can/kWh should be the average price to meet all the requirements for short-term supply for the year 2005. However, any discrepancy relating to the fluctuation of the components inherent in this contract or any other contract to be signed subsequently cannot be foreseen at this point. Through the principle of transfers of the costs of electricity procurements, the Distributor aims to recover the discrepancies of all sources (price, exchange rate and quantities). Within the framework of HQD-5, Document 6, the Distributor proposes a treatment of the exchange rate risk. However, even active management of the exchange rate risk cannot avoid fluctuations of the exchange rate affecting the real cost of electricity procurements.

3.2.2 Short term electricity procurements without tender

Beyond the requirements identified several months in advance, imbalances can result between the short-term supply and demand. These imbalances come in part from the variation of demand arising from climatic risk or the difference between the forecasted and the real demand and partly from the contracted suppliers' faults caused, for example, by equipment breakdowns. In order to face these possibilities, the Distributor must complement the sources identified above with very short-term electricity procurements (less than 3 months) as

the requirements arise. For this procurement category, the Distributor started a process with the Régie to receive an exemption from the tender process in these specific cases (Request R 3539-2004).

The quantities and the prices associated with this electricity supply present a very high level of unpredictability. For this reason, the Distributor requires that the totality of the extra costs be recognized in the principle of transfer of the electricity procurement costs. In all cases, only the net costs of the revenue effects anticipated from the supply will be considered.

3.3 Interruptible electricity option

To obtain a certain flexibility in the management of unpredicted peak load demands and of the energy requirement, the Distributor proposed an interruptible electricity option offered to large consumers. The Régie approved this option on December 3, 2003. In Request R-3538-2004, currently under examination, the Distributor requests that this option be prolonged for a two year period going from December 1, 2004 to November 30, 2006.

This option allows the release of capacity and energy through the interruption of the consumption of large industrial customers for a period of three to five hours. The payment for the interruptions to the customers is a function of number of megawatt/hours interrupted.

In its decision D-2003-224 relating to this option, the Régie authorized the Distributor to charge the costs associated with this option in a deferred expense account. This account is the subject amongst other things of a request for renewal of the interruptible electricity option (R-3538-2004).

The Distributor reiterates that the risk of extreme climatic conditions cannot be predicted and that the costs associated with the interruptible electricity option should be, as a matter of principle, recognized and recovered in its rates.

Considering that interruptible electricity is used to meet Quebec's needs, no loss of revenues is associated with this option.

3.4 Framework Agreement with Hydro-Quebec Production

The framework agreement between Hydro-Quebec Production and Hydro-Quebec Distribution aims to cover the residual needs not fulfilled by other types of procurements. The energy imbalance considered after the fact represents one example where the agreement could apply.

The Distributor will file with the Régie, in due time, this agreement for its approval.

The use of this framework agreement by the Distributor will be completely unpredictable, it therefore foresees to request the Régie to recognize these costs and to recover them in the rates.

4 OBJECTIVES AND METHODS

4.1 Summary of the request

In summary, the Distributor seeks in the current request that the whole set of variations of all nature in the costs of electricity procurements be recognized and recovered within the rates. Variations associated with short-term or long-term contracts, with or without tender, the recourse to the interruptible electricity option and the framework agreement, even if the certain variations are not yet tangible since they will arise only in the relatively distant future, are targeted by this request. Discrepancies due to the variations in quantities and the various price components, including the exchange rate, are also covered by the request.

There is a real risk of under or over billing that militates in favor of introducing the principle of "pass on" for the supply and which exposes the Distributor to a business risk that cannot be compared to that of SCGM, notably due to a structural discrepancy between the costs of electricity procurements and the revenues from that supply and in the absence of a mechanism of monthly adjustment like that available to SCGM.

4.2 Objectives

Hydro-Quebec Distribution pursues several objectives in this request:

1. To achieve the recognition for the principle of transfer of electricity supply costs beyond the volume of Heritage electricity, without loss or profit;
2. To be allowed to recover the additional costs of electricity procurement;
3. To transfer the net costs of electricity procurement of the revenues in the cost of service of the Distributor and in the consumers' rates;
4. To be allowed to put in place a simple, fast and effective mechanism for allowing the transfer of non- forecasted net costs of electricity procurements to the cost of service of the Distributor and to recover them via the customers' rates.

4.3 Calculation of the net discrepancies

The calculation of the net discrepancies includes the following three main steps:

4.3.1 Calculation of the discrepancies in the cost of electricity procurement

Discrepancies of all nature, as previously stated, like long-term and short-term procurements, with or without tender, the recourse to the interruptible electricity option or the framework agreement, in volume and in price between the projected costs of electricity procurement for the pilot year and the actual costs, will be accounted for in only one account.

On the whole, for a given actual year, the share of the discrepancies attributed to variations (upward or downward) in volume as well as those attributed to variations in price (upward or downward) will be distinguished for each component of the discrepancy.

To allow the Régie to follow the evolution within a given year of the costs of supply associated with the non-forecasted short term purchases of less than three months, the Distributor commits itself to transmitting to the latter on a regular basis all the information relating to any short-term purchase on the markets. Those information include the price, the quantities and the suppliers.

In addition to the information within a given year, the Distributor also proposes, for all the components of the costs of electricity supply of a given year, to provide the Régie with an annual statement identifying the discrepancies between the signed contracts and the extra costs not forecasted at the time when the rate case was filed.

4.3.2 Calculation of the revenue discrepancies

Although the invoicing of Hydro-Quebec is integrated and does not allow a direct measurement of the portion of the revenues received from supply,

the application of the cost allocation methodology by consumer category approved by the Régie in its Decision D-2003-93 will allow the measurement of the relevant discrepancies. The average unit cost of supply for all consumer categories will be used to calculate the amounts associated with the recovery of the procurement costs. On the basis of the principle that the rates allow to fully recover the costs, the average cost of supply corresponds to the portion for the supply of the rates in force.

The revenue discrepancies will be equal to the product of the upward or downward variations in volume identified during the calculation of the discrepancies in procurement costs in *4.3.1*, by the average supply cost. These revenue discrepancies will also be recorded in the account previously mentioned, counterbalancing the cost variations.

4.3.3 Calculation of the net discrepancies

These are the net discrepancies of the revenue portion collected for the supply that the Distributor seeks the Régie to recognize. The net discrepancies will be obtained from the difference between the variations of procurement costs and the revenue discrepancies.

4.4 Methods of transfer of the costs beyond the Heritage electricity

The establishment of the methods of transfer must include the following contextual elements:

- the calculation of the discrepancies occurring during a given pilot year (for example: projected costs for the year 2005) will be done on the basis of the real cost of procurements incurred that year (real costs for 2005);
- taking into account the flexibility offered in the management of the Heritage decree, we will not be able to get precise and final results within a year before

December 31 of the actual year (2005), meaning after the filing of the rate case of the following year (2006).

Consequently, the following methods of transfer are suggested :

- That the total upward or downward net discrepancies be reflected **completely** in a subsequent rate case;
- for the moment, two options of integrating these variations are considered:

Option 1:

- In this option, the calculation of the total net discrepancies will be done on the basis of the real data over 12 months obtained over the period from January 1 to December 31. In this option, the discrepancies will be integrated in the rate case of the second subsequent filing.

Option 2:

- According to the second option, the calculation of the total net discrepancies will be done on the basis of two readings:
    - A first reading, at mid-year, of real net discrepancies in which would be identified the actual net discrepancies in the long-term and short-term procurement costs, with or without tender except for those associated to the framework agreement. The discrepancies associated with this first reading will be integrated in the subsequent rate case.
    - The second reading will be carried out at the end of the year and cover the net discrepancies associated with the second part of the year, with the framework agreement as well as any adjustment which would be required with respect to the first reading, if necessary. These discrepancies will be integrated in the rate case of the second subsequent filing.

- At the time of any request to recognize the discrepancies in the required revenue of the Distributor, he will file with the Régie all the supporting materials for the analysis of the request;
- If there is no rate case filed every year, the Distributor could cumulate the extra costs of electricity procurement over one or more years.

4.5 Accounting treatment

In terms of accounting, it is proposed to create a deferred expenses account where the net discrepancies of electricity procurements would be recorded together with all the discrepancy sources identified previously.

The Distributor proposes the integral transfer to this account, of the deferred expenses account already existing for the interruptible electricity option for which the Distributor requested the renewal, considering that there is no revenue discrepancy on the recovered portion that is attributable to him.

The following elements will be entered in this deferred expenses account, including, respectively:

- the net discrepancies previously described, starting at the time when the costs are incurred;
- the interest on these amounts, at the average rate of the cost of capital, calculated monthly starting at the time when the net discrepancy is noted till the time of its recovery in the rates of the Distributor as part of a subsequent rate case.

From the regulatory point of view, it is the cumulative balance of this account that the Distributor will request the Régie to recognize and integrate in its cost of service and its rates.

4.6 Allocation of the costs among consumer categories

The Distributor proposes that the cumulative balance of the deferred expenses account be treated as procurement costs which include the global treatment of the costs of the Heritage and post-Heritage supply. The allocation of the procurement costs among the different categories of consumers will be done according to the method recognized by the Régie in its decision D-2003-93 by adding the product of the volumes of each category to the costs allocated respectively to these categories.

In short, Hydro-Quebec Distribution intends that the Régie, during the case relating to the establishment of the Distributor's cost of the services for the year 2005, decides on the following:

1. recognition of the principle allowing the Distributor to reflect the costs of electricity procurement beyond the volume of the Heritage electricity without loss or profit in the cost of service;
2. recognition of the net cost discrepancies for contracted volumes following a tender procedure and the net costs of non-forecasted volumes as well as the rate impacts in which they result according to the methods discussed in this document;
3. the authorization to create a deferred expenses account in which would be collected the whole net discrepancies of procurements, including the balance of the account carried for the interruptible electricity option, bearing interest at the average rate of the cost of capital;
4. the authorization to reflect the balance of this deferred expenses account in a subsequent rate case.