COMMENTS PREPARED BY

BRIGID ROWAN

ECONALYSIS CONSULTING SERVICES

34 King East, Suite 1102, Toronto ON M5C 2X8

AND

JAMES F. WILSON

WILSON ENERGY ECONOMICS

4800 Hampden Lane, Suite 200, Bethesda, Maryland 20814

ON BEHALF OF

OPTION CONSOMMATEURS

PRESENTED IN THE CASE OF

SOCIÉTÉ EN COMMANDITE GAZ MÉTRO’S REQUEST

RELATIVE TO THE RENEWAL OF THE INCENTIVE MECHANISM FOR THE IMPROVEMENT OF THE PERFORMANCE OF GAZ MÉTRO

FILE R-3693-2009 PHASE 3

APRIL 9TH, 2013

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1. THE RÉGIE'S REQUEST FOR COMMENTS

The Régie has asked all participants in the current case (R-3693-2009 – Phase 3) for written comments regarding the following Scenarios:

- The opportunity to ask Gaz Métro (GM) to complete its filing and present a proposal, taking into account a calculation of the revenue cap by rate class, evaluated not in terms of two classes of customers, but as a function of the blocks for each of the rates posted in the current Conditions of Service and Tariffs. The proposal should also include the possibility of an update of the mechanism to account for changes to come in the rate structure ("**Scenario 1**");

- The opportunity to evaluate a proposed incentive mechanism after the decision that the Board will render on modifications to the rate structure ("**Scenario 2**").

2. SUMMARY OF POSITION

Given that we have not had the opportunity to ask IRs in this filing, these comments represent OC's position to date, but are somewhat conditional upon further analysis of the application of the various Scenarios, as well as GM's proposed IM.

Scenario 1 appears to be a significant improvement over GM's proposed Incentive Mechanism (IM) in R-3693-2009 – Phase 3 and is more consistent with Régie decision D-2012-076. But Scenario 1 does also have a number of disadvantages including (a) failure to fully correct the problem of distortion of incentives/rewards related to net customer additions within the D1.1 rate sub-blocks; and (b) increased complexity/regulatory burden. Consequently, OC supports Scenario 2 at this time. OC supports consideration of a more granular incentive mechanism, as under Scenario 1, to be implemented once the rate restructuring is completed.

Given that a new rate vision will be filed in the 2014 rate case, an incentive mechanism that provides a revenue cap by rate block (as proposed in Scenario 1) should be evaluated following the Régie's decision on modifications to the rate structure (as proposed in Scenario 2). This is not just a matter of regulatory efficiency; the implementation of an incentive mechanism by rate block prior to the restructuring of rates may even result in distortions in the rate restructuring proposal (i.e. GM could promote ways of restructuring rates that would benefit the Distributor through the incentive mechanism instead of being guided by the principles of fair and reasonable ratemaking). Scenario 2 will be further discussed in Section 0 below.

In light of the above, given the choice between Scenario 1 and GM's IM Proposal in this filing, OC supports Scenario 1. Given a choice between Scenarios 1 and 2, OC supports Scenario 2. However, Scenarios 1 and 2 are not necessarily mutually exclusive. Scenario 2 simply postpones consideration of an IM until after a Régie decision regarding the new rate vision is rendered. At such a time, OC would recommend evaluating an alternative IM (such as Scenario 1) to that proposed by GM.

Sections 3 and 4 below further detail our position on Scenarios 1 and 2. And Section 5 proposes a third scenario, "**Scenario 3**," an alternative approach to customer additions, for the Régie's consideration.

3. SCENARIO 1

OC shares the Régie's concerns as articulated in D-2012-076 (p. 31, paras 123 and 124) related the development of an IM that (a) adequately measures the actual productivity gains for the different rate classes; and (b) does not create distorted incentives to develop the low-margin small-consumption market (to the detriment of larger consumers) without regard to the profitability of these clients. We agree with the Régie that the IM proposed by GM in the current filing fails to adequately address the concerns expressed above. Moreover, in the context of the 2011-2012 Rate Case, OC has already expressed concerns related to the declining profitability in GM's residential market development. In particular, OC is concerned that too much residential marketing effort has been focussed on low-margin, non-heating, luxury gas connections to the detriment of growth projects with higher returns (R-3752-2011 – Phase 2, C-OC-0021, Sections 2.2-2.3, pp. 8-18). Therefore, an IM that provides further incentive to add even more of these low-margin residential customers is not desirable.

Our understanding is that the granularity proposed in Scenario 1 will help to reduce the potential distortion that can be created by net customer additions with characteristics (notably customer mix) that differ significantly from those of existing customers. If net customer additions reflected a similar customer mix as the base year for the IM, there would be much less need for this kind of granularity (i.e. a revenue cap by rate block).

GM's service territory differs from others in North America in terms of both its low customer density and the heterogeneity of the customer mix. Natural gas has a low saturation (share of the energy market), and the existing customer base is relatively small. The customer mix of net customer additions can be very different than the customer mix for existing customers – and this is true across rate classes and rate blocks, and within rate classes and blocks.[1]

Potential for distorted incentives relates to both customer additions and customer retention. GM can influence both customer additions and retention through marketing and retention programs. Therefore an IM that provides distorted incentives relative to net new customer additions for a certain customer group (e.g. small-volume customers) can encourage GM to focus marketing efforts on this group and to increase the retention of customers in this group to the detriment of other more profitable customers.

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[1] A dramatic recent example of changes in net customers can be found in D1.1 a/b sub-blocks (0-1095m^3): the budget variance between the 2012 and 2013 rate cases shows an increase of 30.7% or over 17,000 net customer additions (R-3809-2012, Phase 2, B-0254, GM-18, Doc 1, GM Answer to Régie IR 31.1, p. 102, line 1). OC is quite concerned that an IM characterized by distortions related to net new customer additions could further encourage this existing growth trend in low-margin low-consumption sub-blocks to the detriment of more profitable growth.

Through the establishment of a revenue cap by rate block, Scenario 1 appears to be a significant improvement over GM's proposed Incentive Mechanism (IM) in R-3693-2009 – Phase 3 and is more consistent with Régie decision D-2012-076. This Scenario attempts to reduce the potential distortion that can be created by net customer additions that differ significantly from the existing customer mix.

Scenario 1, however, has a number of potential disadvantages including (a) the failure to fully to correct the problem of distorted incentives related to net new customer additions within the D1.1 rate sub-blocks; and (b) complexity/regulatory burden. As outlined in footnote 1, during 2012, there was dramatic net customer growth in very small volume customers within the D1.1 a/b sub-block. Given that Scenario 1 provides a revenue cap by rate block (e.g. D1.1) and not sub-block (e.g. D1.1 a/b), it is possible that under this Scenario, GM could still be over-compensated for net customer additions in the D1.1a/b sub-block; these are the very small-volume low-margin customer additions that have been of concern to the Régie and several intervenors including OC.

Scenario 1 may have a disadvantage in terms of increased complexity and regulatory burden. It may be challenging to calculate a revenue cap per rate block, particularly if GM plans to create even smaller rate blocks as part of its rate vision. Moreover, OC has expressed concern that GM does not have a load research program (R-3752-2011 – Phase 2, C-OC-022, pp. 9-10) and thus GM's existing rate blocks and any prospective sub-divisions of these rate blocks (notably in D1.1) may be based on inadequate load data. Consequently, the calculation of a revenue cap by rate blocks, which are based on inadequate load data, may not be the optimal approach. The other challenge is that there may be significant customer migration between rate blocks (and even classes), which may create distortions in an IM with a revenue cap by rate block. Finally, regulatory burden may be increased because of the added complexity of administering a revenue cap for each rate block. And added complexity can also increase the risk of unintended consequences. We do not believe these are insurmountable challenges, but there is a regulatory cost in terms of added complexity.

4. SCENARIO 2

Scenario 2 suggests that an IM proposal should be evaluated after the Régie renders a decision regarding the modifications to the rate structure to be proposed as part of the rate vision in the 2014 rate case. As indicated above, Scenario 2 does not preclude consideration of Scenario 1 following a rate restructuring. However, an incentive mechanism that provides a revenue cap by rate block (as proposed in Scenario 1) should be evaluated following the Régie's decision on modifications to the rate structure (as proposed in Scenario 2). In other words, it would be inefficient to pursue Scenario 1 now given that rate restructuring will be considered in the 2014 rate case. This is not just a matter of regulatory efficiency; it is a matter of sound regulation: the implementation of an incentive mechanism by rate block prior to the restructuring of rates may even distort the rate restructuring proposal (i.e. GM could promote ways of restructuring rates that would benefit the Distributor through the incentive mechanism instead of being guided by the principles of fair and reasonable ratemaking).

As such, if the Régie wishes to implement a more granular IM (for instance with a revenue cap by rate block or rate class such as Scenario 1), the evaluation of such a mechanism should take place after a Régie decision on rate restructuring.

5. SCENARIO 3: AN ALTERNATIVE APPROACH TO CUSTOMER ADDITIONS

OC also wishes to suggest an additional approach to addressing the problem pertaining to customer additions ("**Scenario 3**") for the Régie's consideration. This approach could reduce the need for a high level of granularity in the customer groups. In Scenario 3, new customers would initially be treated under cost of service (and excluded from the incentive mechanism) for at least a full annual cycle (i.e. a period which would allow GM to determine or estimate the mix of new customers and the actual cost to serve them). After this period, these customers would then be included under the IM. This approach could reduce the need for a very granular breakdown of customer groups within the IM; and thus reduce the complexity/regulatory burden of determining a revenue cap for all of the various rate blocks within GM's rate structure. If feasible, this could be a more effective way to address potential distortions related to net customer additions than through a high level of granularity of the breakdown of customer groups within an IM (as per Scenario 1).

This approach could be used with different IM proposals with varying levels of granularity in terms of customer breakdown. For instance, at the lowest level of granularity, this approach could use the two customer categories defined in GM's IM proposal for existing customers (PMD or VGE). However, unlike GM's IM proposal, applying this approach might successfully address the concerns that exist regarding distortions related to net customer additions.

If this approach is feasible, it may be acceptable to implement an IM with two broad customer categories (PMD and VGE as defined in GM's proposal) prior to the Régie's decision on modifications to the rate structure; and there might be little if any need to modify the IM following the modifications to the rate structure.

At a medium-to-high level of granularity, this approach could be applied to an IM with a breakdown of customers by rate class (*catégorie tarifaire*) or even rate block (*palier tarifaire*) (as in Scenario 1).[2] A hybrid of Scenario 3 and Scenario 1 (i.e. Scenario 3 applied to a more granular breakdown of customers by rate class or rate block) would have to be implemented following a rate restructuring proposal (i.e. under Scenario 2). The temporary segregation of new customers under Scenario 3 would address the

[2] A strict interpretation of D-2012-076 may conclude that the two broad customer categories in GM's proposed IM are not rate classes (*catégories tarifaires*) and therefore further granularity would be required to be consistent with the decision. However, as discussed in Section 3, our understanding is that further granularity was suggested by the Régie in D-2012-076 in order to avoid the distortion created by net customer additions, with characteristics (notably customer mix) that differ significantly from those of existing customers. And it is this distortion that Scenario 3 seeks to address and correct. Thus, although this Scenario can work as an add-on to an IM with a higher level of granularity, a higher level of granularity paired with Scenario 3 may not be necessary; and may simply add an increased layer of complexity.

distortion problem identified for the D1.1. sub-blocks in Scenario 1.[3] A hybrid of Scenario 3 and Scenario 1 might also require less granularity than a revenue cap per rate block (e.g. a revenue cap per rate class or even a revenue cap as applied to another less granular breakdown of customers).

We suggest that the Régie consider the use of the approach suggested in Scenario 3 as an add-on regardless of the level of granularity of the IM because the approach could be the most effective way to address potential distortions related to net customer additions.

[3] As discussed in Section 3, one of the potential disadvantages of Scenario 1 is the failure to fully to correct the problem of distortion related to net new customer additions within the D1.1 rate sub-blocks.