CONCENTRIC
ENERGY ADVISORS

Panel 1 Presentation

Intragaz Limited Partnership

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I. Principles of Just and Reasonable Rates

A. Establishing rates that provide a reasonable opportunity for the regulated company to recover its costs is the single most important principle of reasonable public utility rates (see Gaske, p. 17)

> "… one standard of reasonable rates can fairly be said
> to outrank all others in the importance attached to it
> by experts and public opinion alike – the standard
> of costs of service …"[1]

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1. Bonbright, Danielsen and Kamerschen, *Principles of Public Utility Rates,* Public Utilities Reports, Inc. (Arlington, VA: 1988), p. 109.

I. Principles of Just and Reasonable Rates

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"In the regulation of private utility companies, and even in the ratemaking practices of publicly owned plants, the determination of general rate levels is likely to take precedence over the determination of specific rate schedules; and there the most directly pertinent costs are the total costs, including the overhead costs. In other words, **the cost principle is taken to mean that rates as a whole should cover costs as a whole.**"[2]

2. Bonbright, Danielsen and Kamerschen, Principles of Public Utility Rates, Public Utilities Reports, Inc. (Arlington, VA: 1988), p. 116.

I. Principles of Just and Reasonable Rates

B. Just and Reasonable Rates Must provide an opportunity to earn a reasonable return (section II A)

1. The Fair Return standard establishes cost-of-service as the minimum rate set by regulators;

2. Must be set on a stand-alone basis (section II B);

3. Must be forward-looking (section II C);

I. Principles of Just and Reasonable Rates

C. It is incorrect to suggest that the Fair Return standard does not apply if the regulator does not use cost of service.

1. A well-known principle related to the fair return standard says that:

   "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."[3]

2. It does not matter whether the Régie uses cost-of-service, or avoided cost, or any other method – the result reached must provide rates that are adequate to meet the Fair Return standard.

3. *Federal Power Commission v. Hope Natural Gas Company* (320 U.S. 591, 602 (1944)); also quoted at paragraph [186] of Régie de l'énergie, D-2009-156, Décision, Gaz Métro, (December 7, 2009).

I. Principles of Just and Reasonable Rates

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3. Thus, as noted by Bonbright, et al., the Capital Attraction Standard is "… only a standard of minimum rates";[4]

4. This standard is consistent with Régie precedent:

"[192] Like operating costs, the return allowed the shareholder is one of the elements of the distributor's costs of service. The rate established by the Régie must, under the Act and the jurisprudence, ensure that there are sufficient revenues to cover all of those costs."[5]

4. Bonbright, Danielsen and Kamerschen, *Principles of Public Utility Rates,* Public Utilities Reports, Inc. (Arlington, VA: 1988), p. 95.
5. Régie de l'énergie, D-2009-156, Décision, Gaz Métro, (December 7, 2009).

I. Principles of Just and Reasonable Rates

D. The primary goal of public utility regulation is to (i) ensure adequate and reliable service at (ii) reasonable rates:

1. Ensuring adequate and reliable service is at least as important as any other goal;

2. Ensuring adequate and reliable service requires that regulated rates meet the "Capital Attraction" standard;

3. Rates based on the utility's cost of service, including a fair rate of return, will
   a. attract capital,
   b. promote adequate and reliable service, and
   c. ensure reasonable rates.

I. Principles of Just and Reasonable Rates

E. The Avoided Cost method was adopted to promote adequate and reliable service because a gas distribution rate of return, even with an incentive adder, was too low to attract capital to a storage project.

1. The Régie would not allow a regulated gas distribution company to develop the storage field because the Régie believed that storage was too risky for a gas distribution company to undertake;

2. The Régie offered a 5-year rate of return premium for any independent investors willing to develop storage in Québec, but a gas distribution return with a temporary premium was inadequate to attract capital for a storage project;

I. Principles of Just and Reasonable Rates

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3. The Régie then offered to set rates equal to an estimate of the avoided cost that existed at the time because it found that an even larger return premium was required to attract investment in storage.

4. An <u>independent</u> company developed the storage fields based on the Régie's offer of regulated rates that offered higher rates of return than an LDC.

5. The Régie offered higher rates ***<u>because the Régie believed that it was in the public interest to develop storage in Québec.</u>*** [6]

6. Gaske, p. 31

I. Principles of Just and Reasonable Rates

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6. The Régie did not offer avoided cost rates as a "reward" for Intragaz – it did so because lower rates would not attract capital. Avoided cost rates were necessary to meet the capital attraction standard:

   "The Régie retains the avoided costs methodology … because, for the moment, and in this precise situation, … it is "the only one that allowed attraction of a promoter interested in developing the project and to commit contractually". [7]

7. Intragaz invested to develop storage facilities in Québec with a *reasonable expectation that the investments would be recoverable* through the ratemaking process.

7. Régie Order D-94-06 (page 11, translation).

I. Principles of Just and Reasonable Rates

F. Avoided Cost Rates Should Not Be Confused With Market-Based Rates

1. There is no reason to presume that the avoided cost rate was a market-based rate.

2. There is no evidence that the avoided cost rate was intended to shift future market pricing risks to Intragaz. If that was the purpose of avoided cost rates, the storage rates would have been de-regulated and Intragaz would have charged market-based rates.

3. Intragaz was not affiliated with Gaz Métro when the storage facility was developed. Thus, the parties could have negotiated a market-based rate as high as the market would bear. But that is not what happened. Instead, the Régie set the rates.

4. Intragaz' rates were never unregulated or market based. As a result it is entitled to regulated rates that recover its costs.

I. Principles of Just and Reasonable Rates

G. In the 2011 Intragaz rate proceeding, the Régie said that it did not have a sufficient record to set cost-of-service rates. This proceeding provides the evidence that the Régie requires.

II. Proper Rate Base for Cost-of-Service Rates

A. A proposal to adjust the cost-of-service rate so that it produces the same result as an Avoided Cost rate is simply a proposal for the Régie to unjustly disallow Rate Base and deny a Fair Rate of Return.

II. Proper Rate Base for Cost-of-Service Rates

B. "Prudent Investment" and "Used and Useful" are the two standards that are applied in determining whether assets are included in the rate base:

1. Prudent Investment Standard

2. Used-and-Useful Standard (Useful in Québec)

3. Because Intragaz' investments meet those two standards, there is no reasonable regulatory principle that should cause a reduction in rate base or a cost disallowance for Intragaz.

C. Section 50 of the Régie Act requires that the rate base be set using original cost.

III. Incorrect Applications of Economic and Regulatory Principles

A. It is incorrect to suggest that regulated rates need to cover only the marginal expenses of a utility to keep it in business.

1. Regulated companies invest in fixed-cost assets first, and then recover the fixed costs later in rates.

2. Adoption of a ratemaking principle that allows only the recovery of marginal expenses would make the entire sector of regulated companies untenable because they could not invest in assets to serve the public and expect the regulator to set rates that would recover fixed costs.

III. Incorrect Applications of Economic and Regulatory Principles

B. Adopting the cost of service method without an adjustment to the value of Intragaz' assets would not be a retrospective modification of the sharing of risks.

1. The most important risks occurred during development of the storage fields and the Régie made sure that ratepayers did not share those risks by preventing gas distribution companies from developing these storage fields.

2. Development risks are passed and it is now too late for cost-of-service rates to "retrospectively" shift development risks to ratepayers.

III. Incorrect Applications of Economic and Regulatory Principles

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3. Intragaz' rates would be fixed on a forward-looking basis to reflect its current and future risks.

4. Like every company that charges cost-of-service rates, Intragaz will retain significant risks that will not be shifted to ratepayers.

5. Intragaz was never allowed to charge market-based rates and never had market pricing risk.

6. The Régie did not offer avoided cost rates as a "reward" for Intragaz – those rates appear to have been **<u>the lowest rates that would meet the Fair Return standard by attracting capital</u>** for a service that the Régie wanted for the public interest.