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ON BEHALF OF

OPTION CONSOMMATEURS

PRESENTED IN THE CASE OF

SOCIÉTÉ EN COMMANDITE GAZ MÉTRO'S APPLICATION

RELATIVE TO THE APPROVAL OF THE SUPPLY PLAN AND THE MODIFICATION

OF THE CONDITIONS OF SERVICE AND TARIFF

AS OF OCTOBER 1ST, 2012

FILE R-3809-2012

PHASE 2

RÉGIE DE L'ÉNERGIE

MARCH 20th, 2012

# TABLE OF CONTENTS

1. MANDATE ........ 4
2. OVERVIEW ........ 6
3. OPERATING COSTS ........ 7
3.1. 2013 Increase in Salaries and Wages ........ 7
3.1.1. Reasonableness of 2012-2013 Salary and Wages Budget ........ 8
3.1.2. Conclusions on Salaries and Wages Increase 2013 ........ 9
3.2. Total Operating Costs for 2013 Relative to the Years under GM's Incentive Mechanism ........ 9
3.3. Benchmarking Of Total Operating Costs for 2013 Based on a Comparison with Three Other Canadian Gas Distributors ........ 10
3.4. Pension Costs ........ 11
3.4.1. Background ........ 11
3.4.2. 2013 Contribution and Transition of Plan ........ 12
3.4.3. Plan Performance in 2012 ........ 13
3.4.4. Conclusions on 2013 Pension Costs ........ 14
4. 2013 REVENUE ........ 15
4.1. Customer and Volume Forecast Methodology for D1 ........ 15
4.2. Analysis of Historic Forecasts ........ 17
4.2.1. 2011-2012 and 2012-2013 Customer and Volume Forecast ........ 17
4.3. Conclusions on Volume Forecasts and 2012-2013 Customers and Volumes for D1 ........ 19
5. AFFILIATE TRANSACTIONS ........ 19
5.1. Overview ........ 19
5.2. Recovery of Costs from Affiliates: Valener and ANR ........ 20

5.3. Use of Standard Labour Rates: Services to EOLE and EOLE 4 ........ 21
5.4. Allocation of Common Costs ........ 23
5.5. Conclusions on Affiliate Transactions ........ 23
6. INTERIM SHARING MECHANISM FOR UNDEREARNINGS AND OVEREARNINGS (TP/MAG) FOR 2013 ..23
6.1. Interim Nature of OC's Position on the SM ........ 24
6.2. The Risk-Mitigation Tools Available to GM are Different in 2013 than Under the IM Proposed for 2014 Onward ........ 25
6.3. Conclusions ........ 25
7. METHOD TO HOLD REGULATED CUSTOMERS HARMLESS IN THE TRANSFER OF THE DEBT FROM THE UNREGULATED ACTIVITES (ANR) TO THE REGULATED ACTIVITIES (DAQ) ........26
7.1. Objective of Proposal is to Hold Ratepayers Harmless ........ 27
7.2. Potential Costs to Ratepayers: Uncertainty of Being Held Harmless Coupled with Increased Complexity and Regulatory Burden ........ 27
7.3. Clear Benefits to GM ........ 28
7.4. Conclusions ........ 29
8. APPLICATION OF A UNIFORM RATE INCREASE IN D1 AND RELATED CONCERNS REGARDING GM'S RATE VISION AND RATE STRATEGY ........30
8.1. Application of a Uniform Rate Increase in D1 ........ 31
8.2. Recommendation Regarding Uniform Rate Increase in D1 ........ 33
8.3. Related Concerns Regarding GM's Rate Vision and Rate Strategy ........ 33
8.4. Conclusions ........ 35

# 1. MANDATE

Following the filing by Société en commandite Gaz Métro (GM or Gaz Métro) of Phase 2 of its application for approval of the Supply Plan and the modification of the Conditions of Service And Tariff (in R-3809-2012), Option consommateurs (OC) retained our services in order to assist OC with its intervention before the Régie, and to produce an analyst report within the context of the case. In accordance with the Régie's directives regarding Phase 2 in D-2013-003, OC specified the hearing subjects on which it intended to present evidence (in C-OC-20). OC has focussed its intervention on the evolution of operating costs with a particular focus on salaries and wages and pension costs. We have also reviewed the customer and volume forecasts and affiliate transactions.

OC also retained Dr. Roger Higgin to provide expert assistance with our intervention on these topics. After a review of GM's responses to the IRs of the Régie and intervenors, Dr Higgin deemed that an expert report was not necessary for evidence covering these topics. As such, Dr Higgin assisted Ms Rowan in the capacity of an expert-consultant in the preparation an analyst report on these topics.

OC also retained James Wilson assist Ms Rowan as an expert-consultant in the review on the proposed interim Sharing Mechanism for underearnings and overearnings (TP/MAG) for 2013.

Following the list of subjects set out in C-OC-20, Econalysis Consulting Services (ECS) has produced an analyst report, which covers the following hearing subjects:

1. Operating Costs
    a. 2013 increase in salaries and wages relative to the years under GM's Incentive Mechanism

b. total operating costs for 2013 relative to the years under GM's Incentive Mechanism

c. benchmarking of total operating costs for 2013 based on a comparison with three other Canadian gas distributors

d. pension costs and a valuation of the pension plan and deficit

2. 2013 Revenue

   a. customer and volume forecast methodology for D1

   b. an analysis of the historic forecasts

3. Other Cost Drivers – Affiliate Transactions

   a. recovery of costs from affiliates: Valener and ANR

   b. use of standard labour rates

   c. allocation of common costs

4. Interim Sharing Mechanism for Underearnings and Overearnings (TP/MAG) for 2013

5. Method to Hold Regulated Customers Harmless in the Transfer of the Debt from the Unregulated Activities (ANR) to the Regulated Activities (daQ)

6. Application of a Uniform Rate Increase in D1 and Related Concerns Regarding GM's Rate Vision and Rate Strategy

We note that Ms Rowan received expert-consultant assistance from Dr Higgin for subjects 1 to 3, and from Mr. Wilson for subject 4.

## 2. OVERVIEW

Rate year 2013 is a rebasing year for GM's new Incentive Mechanism. As the Régie indicated in D-2013-003 (p. 10), no detailed cost of service study has been undertaken for Gaz Metro since the 2000 rate case. As such, all the major components of the cost of service are important elements in this case. Moreover, it is particularly important to scrutinize the components which are subject to significant increases in 2013. OC has therefore focussed its intervention on the operating costs, and particularly on the salary costs (including the pension costs).

The Distribution Revenue Requirement Table in B-216 (GM-7, Doc 1, p. 5) provides an overview of the increase in the various elements of the 2013 Revenue Requirement requested by GM. We focus our evidence on operating costs[1] and, in particular, salary and wages, and pension costs, as these elements are the main drivers of the increases in operating costs.

This evidence will comment in detail on several of the 2013 Revenue Requirement drivers:

- the salary and wages component of operating costs (Section 3.1)
- the pension costs component of operating costs (Section 0)
- forecasts of customers and volumes of gas consumed (Section 4).

We have also reviewed the total operating costs for 2013 relative to the years under GM's Incentive Mechanism (IM). This envelope analysis is discussed in Section 3.2. In Section 3.3, we discuss our attempt to benchmark GM's total operating costs for 2013 based on a comparison with other Canadian gas distributors.

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[1] GM's Operating Costs (*Dépenses d'exploitation*) include Salaries, Benefits, Other Expenses, Capitalization and Corporate Charges. (B-216, Annex 1, p. 1). Salaries, Benefits and Other Expenses are further broken down in B-216, GM Response to OC IR 4.2, pp. 8-9.

We also have comments on cost drivers related to affiliate transactions, including the recovery of costs from affiliates (Valener and ANR), the use of standard labour rates and the allocation of common costs in Section 5.

Sections 6, 7 and 8 depart from operating costs to focus on several different areas of significance for residential consumers.

Section 6 presents our comments and recommendations regarding the proposed interim sharing mechanism for underearnings and overearnings (TP/MAG) for 2013. The methodology to hold regulated customers harmless in the transfer of debt from the unregulated activities to the regulated activities is discussed in Section 7. Finally, Section 8 provides our comments and concerns regarding GM's 2013 rate proposal (specifically the application of a uniform rate increase in D1) and related concerns regarding GM's rate vision and rate strategy.

## 3. OPERATING COSTS

### 3.1. 2013 Increase in Salaries and Wages

Historically (1992-2008), GM Salaries, Wages and Benefits (Total Compensation) has been 15-18% of the total operating costs for Distribution. More recently (2009-2012) this has increased to 20% (B-0261, GM-18, Doc 5, Annex 1 GM Response to OC IRs 4.1, 4.3 and 4.4).

Of the $20.1 million increase in 2013 operating costs, $15.2 million ($20.4 million before capitalization) relates to employment benefits (B-0216, p. 5). And the main share of the employment benefit increase is derived from increases in Post-Employment Retirement Benefits (i.e. Pension) costs of $13.8 million ($18.8 million before capitalization), which GM is requesting in 2013 (B-0171, p. 2).

Salaries and Wages are forecast to increase by <u>$4.9 million</u> or <u>4.5%</u> between 2012 actuals and 2013 budget (B-274, B-0171, p. 2).

1 3.1.1. Reasonableness of 2012-2013 Salary and Wages Budget

2 In order to consider whether the proposed 2012-2013 increase in Salaries and Wages is
3 reasonable, we compare this budget to the Régie-approved historic increases under the
4 Incentive Mechanism Plan.

5 With regard to the $4.9 million (or 4.5%) increase in 2013 Salary and Wages, we have
6 evaluated the reasonableness of this increase by comparing it with several analyses
7 including historic average increases in salaries and wages, as well as total operating
8 costs over the Incentive Plan period (2001-2012).

9 Our analyses defined the average increases in Salaries and Wages over the period of
10 the IM in following ways:

11 • Salaries and Wages Projected and Actual (Current $)
12 • Salaries and Wages Projected and Actual (Constant $)
13 • Salaries and Wages Projected and Actual (CPI-X $).
14

15 In Response to OC's IR 8.1 (B-0261, GM-18, Doc 5, p. 15), GM updated its data on
16 Compensation and other Distribution Expenses for 2012 and 2013.

17 This IR response shows that GM forecast a year end 2012 headcount of 1350 FTE but
18 in fact had not hired 38 positions. It is therefore difficult for us to understand the $1
19 million increase in 2012 Salaries above Budget.

20 For rate year 2013, GM is proposing to increase headcount by 68 positions by year end
21 (as per B-0274, revised GM-12, Doc 16). Given the increase in customers is forecast to
22 be from 188,684 (actuals at the end 2012) to 192,650 (forecast at the end 2013) (B-
23 0261, GM-18, Doc 5, GM's Response to OC's IR 1.1, pp. 1-2), an increase in headcount
24 of this magnitude has not been supported and in our view is too high.

25

1 3.1.2. Conclusions on Salaries and Wages Increase 2013

2 OC finds that the Salary Costs Budget for 2013 (as per B-0175, GM-12 Doc 16) is too
3 high at $183.82 million or about $165 million with no pension cost increase (compared
4 to the 2012 actual of $159 million). Moreover, as indicated, above Salaries and Wages
5 are forecast to increase by $4.9 million or 4.5% between 2012 actuals and 2013 budget.
6 Our view is that these increases are due to a combination of salary increases plus a
7 major increase in headcount (68 positions).

8 Accepting this level of increase will reduce the gains in operating cost productivity
9 realized under the IM Plan, which will be discussed in the next section.

10 We suggest the maximum increase of 2013 Salary Costs (*masse salariale*) be equal to
11 projected inflation of 2.1% (B-0171, GM-12 Doc 12, page 4 line 10). Consequently,
12 Régie should also require GM to offset compensation costs with reductions in the other
13 components of controllable operating costs.

14

15 3.2. Total Operating Costs for 2013 Relative to the Years under GM's Incentive
16 Mechanism

17 Table 3 from Pacific Economics Group's Updated Report (B-0261, GM-18, Doc 5,
18 Annex 2 (question 9.3), p. 82 of the PDF) shows Input Costs and GM Multi Factor
19 Productivity from 2002-2011 under the first generation Incentive plan. Using an index of
20 O&M productivity based on 2001=100 O&M productivity, Table 3 indicates that O&M
21 costs averaged a 0.61 % annual decline over the IM period of 2002-2011[2].

[2] The IM period lasted from 2001 to 2012, but the Pacific Economics Group's Report calculated productivity trends for the ten-year 2002-2011 period (p. 10, PEG Report).

1 Accordingly OC considers that this historic gain in O&M productivity supports our view
2 that an increase in the Salaries and Wages component of OM&A of 4 percent (not
3 counting the pension costs) is too high.

4

5 3.3. Benchmarking Of Total Operating Costs for 2013 Based on a Comparison with
6 Three Other Canadian Gas Distributors

7 OC also asked GM to provide O&M Benchmarking studies in its possession that
8 compared overall OM&A on a per customer and volume of gas distributed to other
9 Canadian Gas Distributors over the IM period 2001-2012. GM responded by referring to
10 UMQ response 2.6.4 to 2.6.6 (GM-18, Doc 8). This response indicated that GM had no
11 data after 2008 and since the older results are no longer relevant, GM was not able to
12 provide this information (B-0261,GM-18 Doc 5, GM Response to OC IR 9.1, p. 17).

13 Accordingly, OC looked at the Total O&M increases experienced by a small peer group
14 of 3 other Canadian gas distributors (all of which were on some form of incentive
15 regulation) over the period 2007-2012 and benchmarked GM OM&A costs per customer
16 and per volume of gas distributed. Unfortunately, most Canadian gas distributors define
17 O&M costs differently than GM's operating costs, which include Salaries, Wages and
18 Other Expenses as per footnote 1. O&M costs for other gas distributors include broader
19 distribution costs. As such, our available data was not comparable.

20 Given GM's inability to provide us with relevant data and our own limitations in sourcing
21 comparable data, it was impossible for us to complete this exercise. We do believe that
22 such a benchmarking exercise would be useful and suggest that the Régie may want to
23 order GM to undertake such an exercise in the context of this case.

24

25

## 3.4. Pension Costs

### 3.4.1. Background

OC notes that the Régie issued a Pension Plan Decision (D-2012-077) on June 2012. This decision approved an amendment to the regulatory accounting policy such that expenses related to post-employment benefits are charged to cost of service according to the *actuarial method* rather than on the basis of actual disbursements. But this decision also refused the creation in the rate base of the requested deferral accounts, as well as their amortization.

OC is not seeking to reopen issues dealt with in the Pension Plan Decision (D-2012-077) in R-3773-2011.The overall approach approved by the Régie is consistent with that adopted in other Canadian jurisdictions. For example, it matches that set out in the Evidence (Exhibit A2/Tab3, Schedule 1) and Settlement Agreement (Exhibit N1/Tab1 pp. 19 and 23) in EB-2011-0354 before the OEB concerning Enbridge Gas Distribution (EGD).

In B-0261 (GM-18 Doc 5 Response) to OC IR 10.2 (p. 19) GM states:

> Pour la préparation du dossier tarifaire 2013, Gaz Métro a déposé une demande de sursis en octobre 2012 afin de maintenir la méthode en fonction des déboursés réels (B-0008). La Régie a accueilli la demande de sursis dans sa décision D-2012-141 et ainsi, Gaz Métro a maintenu l'utilisation des méthodes antérieures pour l'établissement de la charge liée aux avantages postérieurs à l'emploi pour la préparation du dossier tarifaire 2013. (emphasis added)

OC does not agree that the 2013 Pension plan costs should continue to be based on "old methods," that is, on a cash basis (*déboursés réels*). The Régie has clearly accepted USGAAP and the actuarial basis of determining pension costs.

As decided in EB-2011-0354, Enbridge has shifted to USGAAP for 2013. The change resulted in a $90 million accounting difference. In EB-2011-0354, the Enbridge rebasing rate case, it was agreed that a Transition Impact of Accounting Changes Deferral

Account (TIACDA) would be set up. This account amortizes the $90 million amount equally over a 20-year period commencing January 1, 2013.

In addition there is a separate Pension Cost True Up Variance Account (PCTUVA). The PCTUVA trues up forecast and actual Employer Pension contributions based on the performance of the plan(s).

In R-3773-2012, Doc B-0010, Annex A at line 29, GM estimates pension accounting **transitional costs** totalling $45 million from 2013-2017 (5 years) or an average of $5.6 million a year to 2019.

OC asked GM to confirm these accounting and deferral accounts. The Distributor declined to provide this information because it deemed the question irrelevant given that it is using old methods to determine the 2013 cost (B-261, GM-18, Doc 5, GM Response to OC IR 10.2 Question, p. 18).

However to our understanding, there are two important differences between the approaches used by GM and EGD:

- the amortization period of the OPEB[3] transitional deficiency for is five years for GM vs. 20 years for EGD; and
- EGD's use of deferral/variance accounts for the difference between actual and forecast pension costs in each year (PCTUVA).

3.4.2. 2013 Contribution and Transition of Plan

In response to Régie IR 9.4 (B-0254, GM-18, Doc 1, p. 24), GM indicates:

> La charge du régime de retraite de l'année tarifaire 2013 a été estimée à l'aide des rapports d'évaluation actuarielle les plus à jour, soit au 31 décembre 2011. Certaines hypothèses ont également été posées afin de refléter les développements survenus depuis le 31 décembre 2011. Ainsi, la hausse de 18,8

[3] Other Post-Employment Benefits.

> M$ de la charge du régime de retraite s'explique principalement par la modification de certaines hypothèses actuarielles ainsi que par l'impact de l'évolution des marchés sur la valeur des actifs des régimes. Le tableau suivant présente la composition de la charge réelle relative aux régimes de retraite pour l'année financière 2012 et celle prévue au budget pour l'année financière 2013, présentée en référence (i), ainsi que des explications sur les calculs et hypotheses soutenant le budget 2013 […]

The proposed $18.8 million increase in pension costs (from $20.5 to $39.3 million as per B-0274, line 22) is based on estimates from the December 2011 AON Actuarial Reports. These reports were provided as Annexes to Régie IR 9.4 (B-0254, Gaz Métro-18, Document 1 Annexes 1 and 2 (question 9.4), p. 4 of the AON Report (or pp. 132 and 178 of the PDF)).These reports show a significant deterioration in the Plan position at December 2011 for both unionized employees (Annex 1) and management (Annex 2). Consequently, the reports show a requirement for significant contribution increases.

In D-2012-077 (p. 23) in R-3773-2011, the Régie specifically notes that:

> [88] La Régie partage l'avis de S.É./AQLPA qu'à la lumière de la réalité des caisses de retraite d'aujourd'hui, le traitement réglementaire doit tenir compte des rendements qui demeurent fort instables d'une année à l'autre. En effet, dans un contexte d'établissement de tarifs justes et raisonnables, puisque les écarts actuariels découlent de modifications d'hypothèses et dépendent de la volatilité des marchés, la Régie ne reconnaît pas la charge d'amortissement associée à ces comptes, soit le solde net du PTPC.

In response to OC IR 10.8 (B-0261, GM-18, Doc 5, pp. 20-21), GM has provided a comparison of Pension Plan Performance with a peer group for 2009-2011. The graph shows that from 2009-2011 the net plan return for GM has dropped from 16.9% in 2009 to 11.50% in 2010 and 4.6% in 2011

### 3.4.3. Plan Performance in 2012

In an Annex to GM's Reponses to OC IR 10.7 (B-0261, GM-18, Doc 5, Annex 3), GM has requested AON Hewitt to provide an update of the plan performance and evaluation at December 31, 2012.

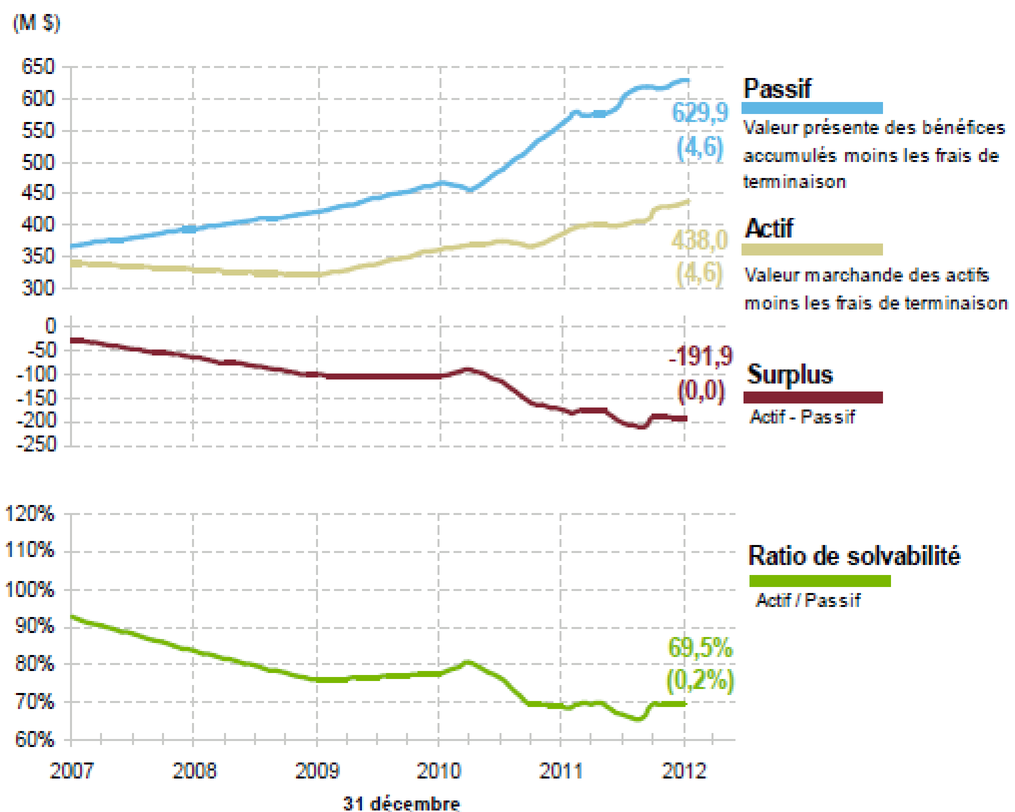
1 The Report concludes (p. 3, or PDF 127) that:

2 Pour l'année 2012, le rendement estimé de la Caisse s'élève à 9,27 % contre
3 8,04 % pour le portefeuille de référence, soit une valeur ajoutée estimée de 1,23
4 %.

5 The Report then provides the following chart (p. 9 or PDF 133) that appears to indicate
6 the decline in plan deficit in 2011 appears to be arrested and the ratio of solvability
7 improved slightly.

## Évolution du surplus – Décembre 2012

**Bilan de solvabilité (31 décembre 2012)**




* Les valeurs entre parenthèses représentent la variation durant le dernier mois.

8

9 3.4.4. Conclusions on 2013 Pension Costs

1 Consideration of the 2013 pension cost increase is made more complicated by GM
2 deferring the transition to USGAAP and Actuarial accounting. OC requests that the
3 Régie push the problem firmly back to GM. From a ratepayer perspective, $18.8 million
4 is too much to absorb into rates for 2013.

5 OC suggests that for 2013, the Régie should direct GM to mitigate the impact of the
6 pension cost increase by the use of a placeholder comparable to the budgeted 2011-
7 2012 pension cost increase (i.e. a $3.8 million increase) until the transition to USGAAP .
8 When GM makes the transition to USGAAP, the deferred balance of the 2013
9 contribution could be trued-up (for example, using a 3 or 5-year rolling average). The
10 deferred balance of the 2013 contribution will be accounted for in a Pension Cost True-
11 Up Variance Account (similar to the one created for EGD) and calculated based on the
12 actuarial method when an up-to-date actuarial report is available.

13 Also when GM moves to USGAAP, we believe that the Régie should direct that the
14 transition costs be amortized over a longer period as has been done in other
15 jurisdictions.

16

17 **4. 2013 REVENUE**

18 4.1. Customer and Volume Forecast Methodology for D1

19 Forecasts of customers and volumes of gas consumed also constitute important
20 elements of the Revenue Requirement. As such, the methodology for determining
21 customer and volume forecasts is discussed, as well as analysis of historic forecasts.
22 GM has not provided any detailed information on how it generates its customer and
23 volume forecasts.

24 In response to OC IR 2.5 (B-0261, GM-18 Doc 5, p. 5), GM indicates it uses historic
25 year data to generate the test year forecasts. GM also indicates the following:

a) The methodology used to establish the Heating Degree Day Forecast is the same one presented in Exhibit R-3690-2009, GM-11, Doc 6.
b) Average Use (AU) per customer by end use is not required for the purposes of establishing the volumes for the small and medium use market – and therefore for the D1 Tariff.

For small and medium use market, forecast volumes for the test year are based on the volumes of the year t-1, to which is added the impact of each of the factors affecting the deliveries. These factors and their impact are defined in Section 5.1.2 of Exhibit B-0062, Gaz Metro-1, Document 1 Phase 1 of the current rate case […]

(OC Translation)

The data provided in Table 14 of B-0062 shows an increase in volumes in 2013 for the small and medium customers followed by a decrease in 2014.The largest component of the change is customer additions and the associated increased consumption (85-90 $10^6$ $m^3$) of these customers in the rate year. These new customers will likely have a lower weather normal average use relative to the average use of existing customers, partly due to their newer more efficient heating and hot water equipment. This factor, which can be added to the other factors listed in Table 14 leads to declining average use for the small volume customers.

This declining average use trend is evident across all North American gas distributors and has been taken into account in Ontario in two ways:

- use of econometric models to estimate customer additions; and use of models to estimate Normalized Average Use per Customer
- use of Average Use True-up Variance Accounts for the small volume classes.

In the response to OC IR 2.5 (B-0261, GM-18 Doc 5, p. 5), GM also indicates:

[…]

c) The Weather Normalized Average Use per Customer can be obtained with the help of the data presented in response to Q1.1 by dividing column (5) by column

(3). For the D1 rate, the results presented at line 2A make it possible to obtain an average volume of 13,221 m³ per customer (2,494,503 m³ / 188,684 customers).

The results presented in the answer to question 1.1 at row 3F make it possible to obtain for the rate D1, an average volume of 13,093 m³ per customer (2,522,282 m³ / 192,650 customers), or an average volume similar to that of 2012. Average Use (AU) per customer by end use is not required for the purposes of establishing the volumes for the small and medium use market – and therefore for the D1 Tariff.

(OC Translation)

This result confirms that the declining average use per customer trend for GM is forecasted to continue in 2013.

4.2. Analysis of Historic Forecasts

We have reviewed GM historic forecasts of customers and volumes for the D1 rate class (B-0254, GM-18, Doc 1, GM Response to Régie IR 31, pp. 101-113).

One important finding is that customer number Projections and Actuals are not symmetrically distributed. There is an average consistent and obvious annual customer addition forecast error of about 1000.

As noted above, our analysis shows that average use per customers has been declining and this trend is expected to continue in 2013.

4.2.1. 2011-2012 and 2012-2013 Customer and Volume Forecast

Since 2011-2012, GM has indicated that the totals calculated for the Tariff 1 customers (D1) must include customers with a transitional rebate who were previously under the Tariff M (DM). A note has been added to this effect on page 4 of the A-0074, Revised Exhibit, R-3831-2012, Gaz Métro-16 Document 1.

In answer to OC IR 1.1, Gaz Metro has corrected the data from lines 1 and 4 (ref (i) and (iii)) of the table provided in the Preamble of OC IR 1 (B-0261, GM-18, Doc 5, pp. 1-2).

1 Gaz Metro has corrected the revenues reported on line 2 of the same table provided in
2 the Preamble of OC IR 1 to bring them on the same basis as the line 1 of this table (that
3 is to say, on the basis of the distribution revenue only). Indeed, the revenue numbers
4 presented to the reference (ii) (of OC IR 1, p. 1) include revenues for all the services,
5 and not just those for the distribution service.

6 Here is the table of the Preamble corrected by including Tariff 1 customers with a
7 transitional rebate (lines 5 and 6 in Exhibit A-0064 and lines 7 and 8 from Exhibit B-
8 0164) as per GM's response to OC IR 1.1 (B-0261, GM-18, Doc 5, pp. 1-2):

| ln | Reference (date(s)) | # Customers | Energy TJ | Volume $10^3m^3$ | Revenues $000 (D) | Revenue c/m$^3$ |
|---|---|---|---|---|---|---|
| 1 | ref (i) (Sept 2012) | 187,906 F<br>188,684 A | n/a | 2,396,907 F<br>2,494,503 A | 402,746 F<br>406,990 A | 16.803 F<br>16.315 A |
| 2 | ref (ii), pp. 2 and 4 (2011-2012) | 187,906 F<br>188,684 A | n/a | 2,396,907 F<br>2,494,503 A | 402,746 F<br>406,990 A | 16.803 F<br>16.315 A |
| 3 | ref (ii), p. 2 (2012-2013) | 192,650 F | 95,569 F | 2,522,282 F | 413,536 F | 16.395 F |
| 4 | ref (iii) (Sept 2013) | 192,650 F | 95,569 F | 2,522,282 F | 413,536 F | 16.395 F |

9

10 The variation between forecast and actual customers and volumes for the past (2011-
11 2012) and forecast 2012-2013 is shown in the following table as per GM's response to
12 OC IR 1.7 (B-0261, GM-18, Doc 5, p. 3):

| Donnée | Unité | 2012 | | 2013 | Variation (%) | | |
|---|---|---|---|---|---|---|---|
| | | Prévision | Réel | Prévision | (4) / (3) - 1 | (5) / (3) - 1 | (5) / (4) - 1 |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| Clients | # | 187 906 | 188 684 | 192 650 | 0,41 % | 2,52 % | 2,10 % |
| Volumes | $10^3m^3$ | 2 396 907 | 2 494 503 | 2 522 282 | 4,07 % | 5,23 % | 1,11 % |
| Revenus | 000 $ | 402 746 | 406 990 | 413 536 | 1,05 % | 2,68 % | 1,61 % |

13

14 This response shows the continuing trend to under forecast customer additions.[4]

[4] The changes to Tariff D1 (to include customers with a transitional rebate who were previously under the Tariff M (DM)) make it difficult to compare historic (up to 2011) and post 2011 (2011-2013) volumes and

### 4.3. Conclusions on Volume Forecasts and 2012-2013 Customers and Volumes for D1

Many Canadian gas distributors (e.g. Union Gas and Enbridge) use econometric models to generate residential (heating/weather-sensitive) class customer additions and Normalized Average Use per Customer (NAC) and Volume forecasts.

OC suggests first that the Régie direct GM develop econometric models to forecast customer additions and NAC for residential/small volume customers. These models would incorporate many of the variables used in the current GM forecast and would be used together with existing methods to improve the accuracy of forecasts within the favorable/unfavorable band.

Second, during the introduction of the econometric models, OC suggests that an Average Use True Up Variance Account should be used to keep both the distributor and ratepayers "whole" from differences in forecast vs. actual normalized average use per customer for the Tariff D1 class.

## 5. AFFILIATE TRANSACTIONS

### 5.1. Overview

As per Annexes 4 to 8 (attached to B-261, GM's Responses to OC IRs 13.5 and 13.6), Affiliate Transactions in evidence in this case include transactions with Valener, Éole, Éole 4, and the non-regulated activities of GM (ANR). These transactions include:

- Rental Agreement for office space
- Corporate Service Charges listed at Schedule 4.51 of the 2010 Service Agreement between the Corporation (Valener) and SCGM and GMLP (inbound services/charges) totalling about $2.8 million.

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revenues. Thus, our analysis presented herein has focussed on customers and volumes in the post 2011 (2011-2013 period).

1 Other costs/charges are summarized in a Summary Table in B-0176 (GM-12, Doc 17,
2 Annex 1, p. 2). The Table lists the following costs:

3 • The provision of services by GM/GMLP to the Corporation (outbound services):
4 $834,000

5 • The provision of services by GM/GMLP to the affiliated Wind generators EOLE &
6 EOLE 4 (outbound Services): $1.214 million

7 • Other charges to ANR (outbound Services): $4.54 million

8 • Net outbound services to ANR for salary and benefits: $6.50 million.

9 The one exception to the above is an inbound charge for 50% of the costs of an
10 executive servicing both GM/GMLP and an affiliate (inbound service): $91,000

11 Of these listed transactions, OC is most concerned about the services provided by
12 GM/GMLP to Valener and to other ANR. These total over $5 million in 2013.

13 The services to the Wind Generators include a schedule of labour rates that is at least
14 directionally more appropriate from a full cost basis, so the remaining issue is an
15 allocation of common costs.

16

17 5.2. Recovery of Costs from Affiliates: Valener and ANR

18 As noted above in reference to the Summary Table on affiliate charges, the services to
19 affiliates by DAQ have reached $6.50 million. <u>In OCs view, the amounts are now
20 significant and of concern to ratepayers.</u>

21 GM is claiming the following in response to OC IR 14.1 (B-261, pp. 29-30):

22 1. The costs are based on time estimates from the individuals providing
23 affiliate services.

1 2. The allocated costs are “fully allocated”.

2 A review of B-0176 and GM’s responses to OC questions indicates that most of the
3 costs recovered from affiliates (Valener and ANR) are allocated based on estimates of
4 % time multiplied by direct salary and benefits costs of the individuals involved in
5 provision of the affiliate services.

6 According to GM’s Response to OC IR 14.5 (B-0261, GM-18 Doc 5, p. 31), here is an
7 example of a method used for allocating salary and benefits costs:

| Hypothèses : <br>- Salaire de base 100 000 $ <br>- Avantages sociaux 60,3 % du salaire de base <br>- Temps consacré à Gaz Métro-daQ 92 % <br>- Temps consacré à Gaz Métro-ANR 8 % | |
|---|---|
| Coûts imputés à Gaz Métro-daQ | Coûts imputés à Gaz Métro-ANR |
| 100 000 $ X 1,603 X 92 % = 147 476 $ | 100 000 $ X 1,603 X 8 % = 12 824 $ |

8

9 This example shows that the recovery charge is a simple time-based allocation of
10 salaries and wages. It does not include overhead related with the employees, which can
11 be up to 100% of the direct salary and wage costs.

12 In OC’s view, the time estimates are also too imprecise and in some cases rounded to
13 the nearest 10%. Also as noted above, the assumption of zero overhead cost burden is
14 inappropriate.

15 The terms for pricing for the provision of services by GMLP to Valener are set out in
16 paragraph 3.1 of the Service Agreement between GMLP and Valener (B-0261, GM-18
17 Doc 5, Annex 6 (question 13.5), pp. 11-12 or PDF 171-172).

18 This provision puts the onus on GMLP to set the “Operating Costs” appropriately
19 without any profit. OC questions that GMLP is appropriately doing this and the result is
20 that services to Valener and other ANR appear to be charged at less than a fully
21 allocated cost.

22 5.3. Use of Standard Labour Rates: Services to EOLE and EOLE 4

23 From the literature, we suggest that standard labour rate includes:

- Payroll Obligations (direct costs *included*)
- Vacation, Sick time, Training etc.
- Support Activities

An example of a fee schedule apparently based on standard labour rates has been provided as part of B-261 (GM-18 Doc 5 Annex 8 (question 13.6), p. 20 or PDF 239):

| Type d'employé | Taux ($ / hr) |
|---|---|
| Service administratif | $60 |
| Services spécialisés - Technique | $85 |
| Services spécialisés - Technique Sénior | $100 |
| Services spécialisés - Ingénierie | $85 |
| Services spécialisés - Ingénierie Sénior | $100 |
| Services spécialisés - Finance | $85 |
| Services spécialisés - Finance Sénior | $100 |
| Services spécialisés - Légal | $85 |
| Services spécialisés - Légal Sénior | $100 |
| Services spécialisés - Communication | $85 |
| Services spécialisés - Communication Sénior | $100 |
| Services spécialisés - Gestion et suivis | $85 |
| Services spécialisés - Gestion et suivis Sénior | $100 |
| Direction | - $0 |

This Table shows the Labour rates agreed to with EOLE and EOLE 4.

OC agrees that the use of standard labour rates for EOLE and EOLE 4 is appropriate, unlike the basis of pricing of the services provided to Valener and other ANR (Response to OC IR 14.5 (B-0261, GM-18 Doc 5, p. 31) above).

However we are concerned that the above rates may not be fully allocated. Moreover, the recoveries appear to be based on salary plus 60%. In costing practice, there should also be an allocation of common costs (see below). Therefore some of these rates may **not be** fully allocated costs.

### 5.4. Allocation of Common Costs

In addition to payroll overhead burden or Standard Labour rates, Fully Allocated Costing of services provided to affiliates requires that a portion of common costs be allocated to affiliates. At a minimum, common costs to be allocated to affiliates include direct costs related to the utility assets, such as office space/rental and computers, and other costs supporting the services.

### 5.5. Conclusions on Affiliate Transactions

We are of the view that the provision of services by GM to affiliates has now reached a level that requires a fully allocated costing study to ensure ratepayers are not paying for the costs of affiliated organizations.

In other jurisdictions, for example in Ontario, the OEB Affiliate Relationships Code for Gas Utilities includes provision for fully allocated costing of shared services (OEB ARC Revised 2010, Sections 2.3.1 and 2.3.11).

OC recommends that the Régie should direct GM to produce a fully allocated costing study for affiliate relationships for the next rate case.

Once the FA (full allocation) method is developed and approved it can be updated periodically by the Company and provide regulatory compliance into the future.

## 6. INTERIM SHARING MECHANISM FOR UNDEREARNINGS AND OVEREARNINGS (TP/MAG) FOR 2013

In B-0183 (GM-12, Doc 24), GM sets out its proposal regarding a Sharing Mechanism (SM) for overearnings and underearnings (TP/MAG). The interim SM for 2013 is proposed as follows:

- 100% of the TP/MAG equivalent to the first fifty (50) basis points of variation with respect to the authorized base rate of return would be allocated to distributor;

1 • The TP/MAG equivalent to the subsequent one hundred (100) basis points of
2 variation with respect to the authorized base rate of return would be shared
3 equally (50/50) between the distributor and the customers, and

4 • 100% of the TP/MAG in excess of one hundred fifty (150) basis points of
5 variation with respect to the authorized base rate of return would be allocated to
6 customers. (B-0183, p. 3, line 19 to p. 4, line7).

7 6.1. Interim Nature of OC's Position on the SM

8 We note that this is the same SM for the TP/MAG related to distribution activities as set
9 out in the context of GM's proposed Incentive Mechanism (IM) in R-3693-2009, Phase 3
10 (for 2014 onward). Given that the calendar and budget in R-3693-2009, Phase 3 have
11 not yet been determined, OC has not yet developed a position regarding the SM in the
12 proposed Incentive Mechanism. As such, any recommendation here applies only to the
13 interim SM for rate year 2013.

14 To evaluate an SM, it is necessary to consider what the outcomes might be under a
15 wide range of circumstances. Potential outcomes will reflect both actions by GM (that it
16 can control), but also exogenous uncertainties (that GM cannot control). We also have
17 some concerns that the proposed SM can create incentives for inefficient risk-taking.

18 To fully consider whether an SM provides good incentives and whether the risk-sharing
19 is fair would require a greater level of detail than is reasonable in the scope of the
20 current case regarding an interim measure. To exercise good judgment about the
21 proposed SM, a full evaluation is required. To facilitate regulatory efficiency, we believe
22 the reasonableness of the proposed SM should be explored in R-3693-2009, Phase 3
23 and not in the current case.

24

1 6.2. The Risk-Mitigation Tools Available to GM are Different in 2013 than Under the
2 IM Proposed for 2014 Onward

3 In response to IRs from UC (B-266, GM 18, Doc 8, Preamble (ii) in IR 8; GM Response
4 to UC IRs 8.5, pp. 21-22; 8.10, p. 23; 8.11, p. 23), GM has indicated that it could use
5 more conservative forecasting (i.e. forecasting that is "easier to beat") to reduce its risk
6 under the expired Incentive Mechanism, which was dependent on forecasts. Moreover,
7 the TP/MAG for rate year 2013 is also dependent on the forecast (to determine the cost
8 of service). As such, the risk mitigation tool available to GM under the expired IM (i.e.
9 conservative forecasting) is also available to GM in the current rate year. Given the
10 conditions set out by the Régie in D-2012-076 (p. 39), which has the objective to
11 decouple the measure of productivity gains in the proposed IM from the forecasts, GM
12 maintains that the same risk mitigation tool will not be available going forward under the
13 new IM (from 2014 onward).

14 As such, GM's ability to mitigate its risk in the current rate year (2013) is much more
15 consistent with the risk mitigation tools available under the old IM (i.e. conservative
16 forecasting) than with GM's ability to mitigate risk under the proposed mechanism (GM
17 Response to UC IR 8.5, pp. 21-22)

18 6.3. Conclusions

19 In light of the above, as an interim measure for 2013, it would be more consistent from a
20 risk mitigation perspective, to apply the SM from the expired IM (i.e. 75/25 for TP and
21 50/50 for MAG). In other words, in order to produce a symmetry in risk-taking due to
22 GM's ability to use conservative forecasting, the SM has to be somewhat asymmetric in
23 favour of the consumers (as was the case in the expired IM).

24 Given that (i) the interim SM for 2013 will only apply for a maximum of four to five
25 months (from the time a decision is rendered in the current case until September 30,
26 2013); and (ii) the purpose of an SM is to provide incentive for better performance, it
27 may not be worthwhile to apply an SM at all in 2013. From the perspective of regulatory

efficiency, the preferred approach may be to assign 100% of TP/MAG to customers, as is common under cost of service regulation.

As such we recommend that the Régie reject GM's interim SM proposal and opt for either:

(i) a renewal of the SM scheme from the expired IM (i.e. 75/25 for TP and 50/50 for MAG) for rate year 2013;

(ii) no SM for rate year 2013 and 100% TP/MAG to customers as is common under cost of service.

## 7. METHOD TO HOLD REGULATED CUSTOMERS HARMLESS IN THE TRANSFER OF THE DEBT FROM THE UNREGULATED ACTIVITES (ANR) TO THE REGULATED ACTIVITIES (DAQ)

We have reviewed B-0150 (GM-11, Doc 7) and GM's related IR responses regarding a methodology to determine an assumed interest rate on a long-term debt obligation in order to hold regulated customers harmless in the transfer of the debt from unregulated activities (ANR) to the regulated activities (daQ). We understand that the objective of this proposal is hold ratepayers harmless. However, short of submitting the proposal to a full review by a finance expert, we are not in a position to determine with certainty that ratepayers will in fact be held harmless. And there is a possibility that ratepayers will be disadvantaged, at the very least in terms of increased complexity and regulatory oversight to attempt to guarantee that ratepayers will actually be held harmless. Meanwhile, it is clear from the IR responses that GM will obtain considerable benefits from this proposal – benefits worth millions of dollars. Given this situation, in order protect ratepayers from the risk of harm (increased costs), we suggest that GM share a portion of the benefits with ratepayers.

### 7.1. Objective of Proposal is to Hold Ratepayers Harmless

OC understands that the objective of this proposal is to hold ratepayers unharmed. According to GM's Response to FCEI IR 5.1 (B-0256, GM-18, Doc 2, p. 29):

> 5.1 Le cas échéant, en quoi votre proposition est-elle avantageuse pour les consommateurs?
>
> **Réponse :**
>
> […]
> La méthodologie proposée par Gaz Métro vise à s'assurer que les clients soient tenus indemnes à la suite du transfert d'une dette allouée aux ANR à la daQ.
>
> L'objectif n'est pas que ce transfert soit avantageux pour les clients, mais bien que ceux-ci soient indifférents au niveau des coûts.

GM's confirms that its goal for this proposal is to hold ratepayers harmless, so they are indifferent. Put another way, GM proposes to set net benefits and net costs to ratepayers at zero.

GM has also indicated in Response to Régie IR 5.3 (B-0254, GM-18, Doc 1, p. 13) that it is unlikely to seek this kind of debt transfer (from ANR to daQ) in the future.

> 5.3 Veuillez indiquer si la présente demande, qui constitue une première, sera une exception et que dans l'avenir, le financement des activités réglementées et non réglementées se feront séparément.
>
> **Réponse :**
>
> Il est fort peu probable qu'un tel transfert de dette entre les ANR et la DAQ se reproduise en raison du fait qu'il n'existe qu'une seule autre obligation émise en devise canadienne […]

### 7.2. Potential Costs to Ratepayers: Uncertainty of Being Held Harmless Coupled with Increased Complexity and Regulatory Burden

1 Without submitting the proposal to a full review by a finance expert, we are not in a
2 position to determine with certainty that ratepayers will in fact be held harmless. We are
3 unable to determine if the debt to be transferred has some material differences in terms
4 of covenants or other characteristics, relative to debt that has been (and could be)
5 allocated to regulated operations. Beyond this uncertainty, there is of course a real
6 regulatory burden associated with the proposed transfer. And this burden could include
7 significant costs to hire experts to properly scrutinize GM's proposal to ensure that
8 ratepayers are actually held harmless.

9 So there is a possibility that ratepayers will be disadvantaged, at the very least in terms
10 of increased complexity and regulatory oversight to attempt to guarantee that they will
11 be held harmless.

12

### 13 7.3. Clear Benefits to GM

14 GM as a whole would receive considerable benefit from the proposed debt transfer,
15 which is presumably why GM is pursuing this proposal in the first place. And this benefit
16 is worth millions of dollars. According to GM's response to OC IR 15.11 (B-0261, GM-
17 18, Doc 5, p. 37), GM estimates the cost to obtain a similar hedge on the market for its
18 US investments to be approximately $18 million in October 2012. Moreover, there would
19 be additional transaction costs related to the hedge for GM.

20 15.11 Has GM estimated the cost to obtain a similar hedge on the market for its
21 US investments? Please explain and provide any numerical estimates, if
22 available.
23
24 **Réponse :**
25
26 Afin d'avoir une protection équivalente à l'émission d'une dette long terme en
27 $ US, Gaz Métro devrait conclure un dérivé financier avec une échéance à long
28 terme auprès d'une institution financière. <u>Gaz Métro a obtenu une indication du</u>
29 <u>coût d'un tel dérivé, soit environ 18 M$ au mois d'octobre 2012.</u> Toutefois, en
30 plus du coût du dérivé, Gaz Métro a également tenu compte des autres aspects
31 qu'implique l'achat d'un dérivé financier, notamment la mise en place d'une

> documentation adéquate, le risque que peut représenter la contrepartie avec laquelle est fait le dérivé ainsi que les coûts additionnels, difficiles à quantifier, tels que des dépôts de collatéral de la part de Gaz Métro et des mouvements de fonds (entrées ou sorties) lors du règlement des dérivés, qui viendraient puiser dans les liquidités de Gaz Métro. Gaz Métro a donc jugé que la meilleure solution était la protection naturelle, autant par sa simplicité que par le fait qu'elle n'encourt aucun coût pour la clientèle de gaz naturel au Québec.
>
> (our emphasis)

The Régie and intervenors are thus presented with a situation, in which:

(i) we are not in a position to determine with certainty that ratepayers will in fact be held harmless and it may not be cost effective to submit the proposal for full review by a finance expert;

(ii) there is a real possibility that ratepayers will be somewhat disadvantaged, at the very least in terms of increased complexity and regulatory oversight to attempt to guarantee that ratepayers will be held harmless;

(iii) GM will obtain considerable benefits from this proposal – benefits valued at over $18 million.

Given this situation, in order protect ratepayers from the risk of increased costs, we suggest that GM share a portion of the benefits with ratepayers.

Under GM's proposal, all of the benefits would be captured by ANR and thus GM's shareholders. But GM's ratepayers have a right to share in these benefits. It cannot be determined with certainty that ratepayers are actually being held harmless; and, in fact ratepayers may be somewhat disadvantaged, at least in terms of increased complexity and regulatory burden.

### 7.4. Conclusions

In light of the above, OC recommends that GM provide ratepayers with a credit of <u>$3 million</u> to share the benefits of the debt transfer (valued at over $18 million), to cover

potential transaction costs associated with increased complexity and increased regulatory burden, and to provide a cushion for the risk of ratepayers not being held harmless.

To the extent that the GM's proposal has some costs/risks for ratepayers, the debt transfer could still be beneficial overall for ratepayers if they are being given some benefits to provide a cushion to absorb any costs/risks. OC believes that it is a reasonable compromise for ratepayers to get some benefits, both to compensate for any potential costs/risks and to provide a reasonable sharing of the benefits going to the shareholder.

If GM does not want to proceed with its proposal to transfer the debt should the Régie direct it to share a portion of the benefits with ratepayers, this would be an acceptable outcome and we would then have the assurance that ratepayers are truly held harmless. Moreover, if GM elects not to proceed under our recommendation for sharing of benefits, it is reasonable to conclude that the benefits of the transaction overall were probably limited, since GM was unwilling to proceed given a quite limited share of benefits ($3 million) flowing to ratepayers. Put another way, if the proposal actually had large benefits (in the order of $18 million according to IR responses), GM would presumably want to proceed even if ratepayers received a considerable share of the benefits.

## 8. APPLICATION OF A UNIFORM RATE INCREASE IN D1 AND RELATED CONCERNS REGARDING GM'S RATE VISION AND RATE STRATEGY

OC is concerned that GM's rate proposal for 2013 is neither appropriate, nor sufficiently transparent. A "quasi-uniform" rate increase across all of the D1 rate blocks ("*paliers*") will in fact change the level of cross-subsidization between small D1 and large D1 customers. Moreover, by applying a uniform variation across D1, GM is in effect,

1 averaging out the FEÉ credit across D1. The lack of transparency related to the 2013
2 rate proposal raises deeper concerns surrounding transparency in rate-making and the
3 application of GM's rate vision. The specific concern related to the uniform rate increase
4 in D1 for 2013 and the deeper concerns are discussed in this following section.

5 8.1. Application of a Uniform Rate Increase in D1

6 In GM's rate strategy document, the Distributor indicates that it is not proposing to
7 correct the cross-subsidization between large and small D1 customers this year as it is
8 still completing its "rate vision" (B-0280 or GM-15, Doc 2, p. 11, lines 11-14). GM then
9 explains that:

> 10 Afin de garder relativement stables les ratios d'interfinancement au tarif D1,
> 11 toutes choses étant égales par ailleurs, Gaz métro propose d'appliquer une
> 12 variation tarifaire quasi uniforme de 7,8% à tous les paliers du tarif D1. (B-0280,
> 13 lines 18-20)

14 The effect of the proposed variations is presented in Table 1 (B-0280, p. 12). According
15 to col (1) of Table 1, D1.1 customers (0-10950 m3/year) should be subject to a revenue
16 variation of 7.3% according to the rate allocation. However, GM is proposing to apply a
17 7.7% variation to these customers according to col (2). GM maintains that it is applying
18 a "quasi-uniform" variation of 7.8% in order to maintain uniform rates of cross-
19 subsidization at all blocks of D1.

20 OC does not understand how a variance of 0.4% between the rate allocation and the
21 proposed revenues for D1.1 customers in Table 1 will maintain uniform rates of cross-
22 subsidization at all blocks of D1. Given that GM expresses its concern for the cross-
23 subsidization of the small D1 customers on a regular basis, an increase in their rate
24 over what the rate allocation would prescribe would appear to be directionally consistent
25 with a modest correction of the cross-subsidization. In answer to an OC IR related to
26 this question (B-0261, GM-18, Doc 5, p. 41, IR Response 17.1) in which we asked GM
27 to explain, using numerical examples, how the rates would be maintained uniform, GM
28 directed us to (B-0264, GM-18, Doc 7, p. 33, IR Response 8.3), which states:

> Gaz Métro n'a pas directement vérifié l'effet de sa proposition tarifaire sur les ratios d'interfinancement, mais juge qu'une approche uniforme permet de limiter les variations tarifaires dans un contexte où il a été décidé de ne pas corriger les niveaux d'interfinancement.

Not only is our question not being answered, but the limited answer seems misleading. Even without complex calculations, mathematics would dictate that if:

- small D1 customers (< 36,500 m3/yr) are subject to a variance of 0.3% between the rate allocation and the proposed revenues; and
- large D1 customers (> 36,500 m3/yr) are subject to a variance of -0.1% between the rate allocation and the proposed revenues; and
- according to GM, large D1 cross-subsidizes small D1,

then these uniform variations would appear to be directionally consistent with a modest correction of the cross-subsidization.

In an attempt to understand what might be driving the uneven pattern of rate allocation from col (1), we reviewed the Rate Allocation Table for 2012/2013 (B-0201, GM-15, Doc 7, p. 1). Col (20) shows the application of a uniform revenue variation of 8.59% across all rate blocks. What appears to be causing the uneven rate allocation (from col (1) of Table 1 in the Rate Strategy document, B-0280, p. 12) is the impact of applying a differentiated FEÉ credit (as per col (24) B-0201 of GM-15, Doc 7, p. 1).[5] We note that the allocations per rate block from col (24) B-0201 of GM-15, Doc 7, p. 1 correspond exactly with the rate allocations presented in col (1), Table 1, B-0280, p. 12.

As such, by applying a uniform variation, GM is in effect, averaging out the FEÉ credit across D1. OC does not believe that proper rate allocation would result in FEÉ credit being applied uniformly.

[5] The effect of the application of the differentiated FEÉ credit is shown in col (24) vs. col (20) in col (24) B-0201 of GM-15, Doc 7, p. 1.

1 According to D-2013-018 (p. 5, Para [9], the Régie views the treatment of the FEÉ
2 accounts as one of the priority issues in this filing (including the inclusion of FEÉ
3 accounts in rates, the treatment of budget overages and the allocation of these costs).
4 OC did not include the treatment of the FEÉ accounts in its hearings subjects, given that
5 UC has planned to review this topic in detail. However, given the controversy
6 surrounding the allocation of the FEÉ accounts by rate class, we are flagging this issue
7 to the Régie. If the result of GM's rate strategy this year is to simply average the FEÉ
8 credit across D1, this negates any deeper upstream consideration and debate of proper
9 allocation for this credit.

10 8.2. Recommendation Regarding Uniform Rate Increase in D1

11 Because of the importance of properly allocating the FEÉ credit by rate class, and OC's
12 more general interest related to transparency in rate-making, OC recommends that the
13 Régie order GM to redo its rate proposal (including B-202, GM-15, Doc 8, Grilles
14 actuelle et proposées and B-203, GM-15, Doc 9) using as input the rate allocation that
15 reflects a differentiated FEÉ credit by rate class (i.e. col (1), Table 1, B-0280, p. 12)
16 instead of the uniform variation proposed (i.e. col (2) of the same Table).

17 8.3. Related Concerns Regarding GM's Rate Vision and Rate Strategy

18 GM's uniform application of the variation, and the lack of transparency surrounding the
19 averaging of the FEÉ credit raise a substantial concern for OC concerning deeper
20 issues related to transparency in rate-making. Lack of transparency can make it
21 challenging (or impossible) for other participants assess judgments that may be
22 questionable and may even contravene acceptable rate-making principles (such as the
23 averaging out of the FEÉ credit). Moreover, it is very inefficient to review how rates are
24 being determined absent sufficient information and a proper explanation of the rate
25 allocation underlying a rate proposal.

26 A central rationale and focus for economic regulation is to restrain monopoly power and
27 price discrimination. Effective regulation is dependent upon access to adequate

1 information. If intervenors have to struggle in every regulatory case to get the basic
2 information on underlying costs, this will be (at best) a very inefficient process, and at
3 worst, will substantially undercut effective regulation.

4 Just and reasonable rates result from two main inputs:

5 (i) just and reasonable revenue requirement

6 (ii) just and reasonable allocation the revenue requirement (and related rates).

7 We are not suggesting that rate-making need to slavishly follow cost allocation. Indeed,
8 rate-making can diverge from cost allocation for a number of reasons recognized in the
9 principles of rate-making, but when there are divergences, they should be properly
10 documented and transparent.

11 GM's proposal is undermining just and reasonable allocation of the revenue
12 requirement by rate class (Point (ii)), and the necessary transparency around
13 divergences from the cost allocation. OC notes GM's Response to TCE IR 13.7 with
14 some concern (B-0264, GM-18, Doc 7, p. 56, IR Response 13.7):

15 13.7 Veuillez indiquer si une élaboration de la répartition tarifaire structurée de
16 quelque façon que ce soit peut empêcher le distributeur de faire quelques
17 propositions tarifaires que ce soit.

18 Dans l'affirmative, veuillez expliquer toutes les raisons pour lesquelles le
19 distributeur en est empêché.

20 **Réponse :**

21 Il existe effectivement une différence entre « Répartition tarifaire » et « Stratégie
22 tarifaire ». Selon Gaz Métro, une stratégie tarifaire lui permettant de positionner
23 les changements dans une perspective globale et d'établir des variations
24 cohérentes avec l'atteinte des cibles fixées dans sa vision ne requiert pas de
25 répartition tarifaire.

26 In this response, GM appears to justify the right to make upfront choices based on its
27 "vision tarifaire", and then to present data on that basis, rather than presenting the data
28 based on underlying cost variation. Put another way, while it might be justified (by

1 various considerations) for the final rate proposal to modify the increases that would be
2 implied by the analysis of the underlying cost of service, it is vital that any such
3 modifications be explicitly presented and justified.

4 In effect, GM has upended the proper ratemaking process. Rather than setting rates
5 that are driven by underlying costs, with potential adjustments applied at the end of the
6 process and explicitly justified, GM is deciding what level of increase it wants to apply
7 (in this case a uniform increase of 7.8% across all D1 paliers) and presenting the
8 underlying data on that basis.[6]

9 8.4. Conclusions

10 OC supports the more rigorous and transparent process for rate-making set out by TCE
11 in its IR13 (B-0264, GM-18, Doc 7, Reference A, p. 52 and Preamble pp. 53-54). We
12 agree with TCE that the current and future rate proposals should present the underlying
13 cost data in a clear and transparent manner and that any modifications from underlying
14 costs should be explicitly presented and justified. The rate allocation table, the rate
15 schedule and other elements of the rate proposal should provide sufficient information
16 for the Régie and intervenors to easily follow the rate-making process.

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[6] As shown in B-0202, GM-15, Doc 8 and B-0203, GM-15, Doc 9, p. 6, the specific changes in Distribution rates proposed by GM are applied solely to the variable portion of Distribution rates (Taux au volume retiré) and are also affected by changes in some other factors (Fonds Vert and Rabais Transitores). The specific increases in variable Distribution rates proposed by GM are not uniform, but in fact vary significantly based on level of consumption (from a high of 10.9% for 0-30 m3/day to a low of 6.7% for 30-100 m3/day). These variances were calculated by comparing the Taux au volume retiré for in 2013 col (10) to the 2012 rate in col (4) in B-0202. Based on the evidence now being provided by GM, it is not possible to determine what specific rates would have been proposed based on underlying costs, as opposed to based on GM's decision to apply a uniform increase across all D1 paliers.