

**Gaz Metro's Responses to Information Requests no 6 of
the Régie de l'énergie (the Régie) Relative to the
Application for the Approval of the Supply Plan and the Modification
of the Conditions of Service and Tariffs of
the Société en commandite de Gaz Métro**

SHARING MECHANISM FOR OVER- OR UNDER-EARNINGS

19. References: i) B-0183, pp. 3-4;
ii) B-0183, pp. 4-5;
iii) B-0183, p. 5.

Preamble

- i. "Gaz Métro proposes a symmetrical sharing mode for over-earnings ("TP") and under-earnings ("MAG") for distribution according to the following formula:
- 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;
 - The TP/MAG equivalent to the subsequent one hundred (100) basis points of variation with respect to the authorized base rate of return would be shared equally (50/50) between the distributor and the customers, and
 - 100% of the TP/MAG in excess of one hundred fifty (150) basis points of variation with respect to the authorized base rate of return would be allocated to customers."
- ii. "While Gaz Métro is aware that these guidelines focused on the concept of gains and losses of productivity, as part of an eventual target revenue cap, which is adjusted under an automatic indexation formula, Gaz Métro believes that the resulting principles can be transposed to the sharing of the TP / MAG for distribution under a cost of service (COS) regulatory framework. The concept of target revenue cap is then simply replaced by a cost analysis exercise to determine the revenue requirement, which can then be considered as the detailed alternative to the revenue cap established according to a regulatory

method using an incentive mechanism. Thus, as suggested by the decision, the proposal is Gaz Métro assume a reasonable risk to Gaz Métro including a sharing mode symmetric TP / MAG. For consistency between the years 2012-2013 in fashion cost of service and years Subsequent will be treated with the new proposed incentive mechanism, this proposal is identical to that presented in the Phase 3 File R-3693-2009 filed on 30 November 2012. Thus, the incentive to improve the productivity of Gaz Métro would be of the same order in 2013 compared to the proposed mechanism and stable over time, regardless of the fact that the annual income required to be established mode service cost or an indexation formula automatic under regulatory treatment leaner." [Emphasis added]

- iii. "[...] Even without trying to offer a "guarantee "in the short term, the regulatory framework should not cause undue returns, which may be deemed unreasonable.
Gaz Métro considers an impact of 100 basis points over the authorized return is significant and that the distributor will therefore have an incentive during the year to take the best possible actions in its own interest and in that of the customers once the service cost has been established by the Régie."

Questions:

- 19.1 Please specify if other criteria than the concern for consistency led to the choice of sharing method presented.

Response:

The reasoning and justification provided in Exhibit B-0183, Gaz Métro-12, Document 24 are what guided Gaz Métro in its proposal of a sharing mechanism for the year 2012 to 2013.

For further information, see the answer to question 19.4.

- 19.2 Please give details of sharing mechanism(s) used by Gaz Métro prior to the previous incentive mechanism..

Response:

For the mechanism in effect as of October 1st, 1993, Gaz Métro refers the Régie to R-3260-93 of the 1994 rate case, Exhibits GM-18, Documents 1-10 and to decision D-93-51 in Section 3.7.

For the mechanism in effect as of October 1st, 2001, Gaz Métro refers the Régie to R-3425-99 and the decision D-2000-183 (Appendix, p. 15).

For the mechanism in effect as of October 1st, 2007, Gaz Métro refers the Régie to R-3599-2006 and the decision D-2007-47 (Appendix, p. 18).

19.3 If applicable, please describe the method of sharing natural gas distributors comparable with the rates are set based on the cost of service.

Response:

Since the sharing mechanism (SM) in the cost of service was applicable for a single year and for the reasons explained in Exhibit B-0183, Gaz Métro-12, Document 24, Gaz Métro offers the same SM that would be applicable under the new incentive mechanism for productivity gains and losses.

As mentioned, Gaz Métro proposal allocates a reasonable share of the risk to Gaz Métro by including a symmetrical SM for the TP/MAG. Gaz Metro believes that the method of setting rates must ensure a reasonable return on its rate base. Thus, Gaz Métro considers that an impact 100 basis points over the allowed return is significant and that the distributor will have an incentive during the year to take the best possible actions in its own interest and in that of the customers once the cost of service has been established by the Régie.

In this context, Gaz Métro has not evaluated the sharing mode of TP/MAG of other comparable natural gas distributors under COS. However, the proposal is consistent with accepted practices of establishing an acceptable compromise with a "deadband" combined with a "sharing mechanism" of the TP / MAG resulting from rates that are too high or too low, following the analysis of the cost of service in 2013 rate case. The proposal allocates the entirety of a normal risk for variation around the assumed final cost of service, but also allows to adjust the rates for differences in revenues minus cost beyond the "deadband" if it happened that these rates have not been set at a fair and reasonable level to recover the revenue requirement. Gaz Métro's proposal is a balance between symmetrical risk-sharing, but with a safety net for situations where the reality at the end of the year would be vastly different expectations.

19.4 Please elaborate on the concepts of symmetry and the magnitude of earnings sharing mechanism in the context of regulation based on the cost of service versus the application an incentive mechanism.

Response:

The exercise of establishing the authorized revenue requirement, regardless of whether the method is COS or a revenue cap (incentive mechanism) is not an exact science.

The revenue authorized under a COS method is based on a rigorous analysis that is the most accurate possible of the total costs. Once the exercise for the establishment of the revenue requirement is completed, the rate strategy is used to retrieve the revenue requirement determined in accordance with projected volumes in the file, whether under the COS method or the Incentive Mechanism method.

In addition, whether under cost of service or an incentive mechanism, during the review of the annual report, three scenarios can occur:

- 1) actual revenues are identical to the cost of service;
- 2) actual revenues exceed the cost of service and
- 3) real incomes are below the cost of service.

While scenario 1 is unlikely, scenarios 2 and 3 involve two underlying assumptions:

- a) the exercise of establishing the revenue requirement resulted in rates that were too high / low for customers, and / or
- b) the distributor has been able to achieve productivity gains / losses.

Thus, between regulation on the basis of an annual cost of service compared to the application of an incentive mechanism, in effect for a period of five years for example, there are few conceptual differences except for the duration of the risk of setting rates too low or too high. While under a COS type regulation, rates be adjusted annually to reflect the discrepancies, the formulas for setting rates under incentive regulation are not automatically adjusted annually to take into account the actual cost of service in order to increase the power of the incentive for the distributor.

With respect to the specific question of symmetry, Gaz Métro believes that the regulatory framework, whether under the "incentive mechanism" method

or the "cost of service" method, should not have an impact. Regulation may provide protection mechanisms (safety net) and/or promote productivity gains for the distributor with the help of a bonus or a reduction of the return with respect to an authorized reasonable rate. The symmetrical character is not necessary and it is essentially a question of philosophy. The former incentive mechanism was symmetric with respect to the gains / losses of productivity, where customers bore an equal share of losses than gains. However, temporarily, they could bear 100% of the loss until a subsequent reimbursement by the distributor. The former incentive mechanism was not symmetrical with respect to the TP / MAG since Gaz Métro retained only 25% of the TP when it had to bear 50% of MAG. Gaz Métro therefore considers that the symmetry must be considered taking into account the power of the incentive and the initial calibration of the regulatory framework for setting rates and not as a function of the type of regulation.

In regard to the extent of sharing mode, Gaz Métro believes that the range could take into account the existing regulatory framework. In the case of Gaz Métro's proposal, the range supported at 100% by Gaz Métro for the first 50 basis points increases the incentive, as much under cost of service as incentive mechanism. On the other hand, the limit of 150 basis points, where the gains / losses are supported at 100% by customers, could reduce the incentive in cases where the TP / MAG or gains / losses in productivity are significantly higher than the limit. In the context of a COS year, this effect is would only observed for 2012-2013.

Regarding the implementation of the incentive mechanism, this effect would last over time until it is addressed by the clause for the revision for reasons of excessive gains / losses of productivity. In the context of Gaz Métro, we submit that there exists a great deal of uncertainty, as much for the distributor as for the Régie and the client groups, regarding the risks of setting appropriate initial parameters; it is important to maintain a balance with respect to the probability for a distributor to generate a reasonable return. Limiting the extent of the sharing mechanism takes on more importance with the increase in the term of incentive mechanism. This said, the rate-setting exercise under a cost of service is also characterized with uncertainty, particularly because the actual costs incurred and the actual revenues generated are not necessarily equal to the authorized revenue requirement. The importance of limiting the range of performance is therefore necessary to ensure a safety net against the risk that the authorized rates would be over / under-valued, and this, even under cost of service.

Finally, it should be noted that an impact of 100 basis points over Gaz Metro's authorized return is significant and that the distributor will have a very strong incentive to take the best possible actions in its own interest and that of the customers.

Gaz Métro's suggestion is therefore a reasonable protection, that is equitable, and symmetrical with respect to the risk of error in setting the parameters, either in either under cost of service or an incentive mechanism.

- 20 References: i) B-0183, p. 6;
 ii) R-3693-2009, B-0055, pp. 26-27

Preamble

- i. "At the end of the year, TP / MAG for Distribution will be recognized by comparing the revenue actually generated by the approved rates with all the actual cost of service established applying the regulatory principles in effect. By regulatory principles in effect, Gaz Métro refers, in particular, to the application of deferred accounts. For example, Gaz Métro will ensure that it isolates the variations between the budget and the actual cost of the PGEE in order to remit or recover 100% of the variances in the PGEE to customers. By isolating the PGEE from TP / MG in this way at year end, Gaz Métro ensures that unspent sums (that could enable it to increase its base authorized return and vice versa) are not submitted to sharing. "

- ii. " Q.32 Is Gaz Métro of the opinion that this sharing rule increases / decreases the incentive character of the proposal with respect to the rule that prevailed in the last incentive mechanism?
R.32 The range supported at 100% by Gaz Métro for the first 50 basis points increases the incentive. However, the limit of 150 basis points, where the gains / losses become supported at 100% by customers could reduce the incentive, but only where gains / losses in productivity are significantly higher than the limit. Gas Metro believes that, overall, the sharing rule proposed will provide an incentive similar to that of the last incentive mechanism and is superior to a regulatory framework based on cost of service.

In addition, it should be noted that impact of 100 basis points over Gaz Metro's authorized return is significant and that the distributor will have a very strong incentive to take the best actions possible in its own interest and in that

of the customers.”

Questions:

- 20.1 Please specify the application of the proposed sharing mechanism.
20.1.1 Please provide the complete list of deferral accounts for which the differential will be remitted or recovered from customers.

Response:

As mentioned in the evidence, it is important to remember that the proposed sharing mechanism will apply only to the distribution service.

Here is the list of deferral accounts that will be applied during the 2013 year:

- Deferral account related to commodity, compression, transmission and load balancing
- Differences in revenues (late entry into effect of the rates)
 - of Distribution
 - of the Green Fund
 - of transmission and load balancing
- Customer Share of over/under-earnings (TP/MAG):
 - of Distribution
 - transmission and
 - load balancing
- Distributor Share of gain on optimization transactions
 - for transmission and
 - load balancing
- Incentive to achieve the PGEE targets
- Smoothing Accounts
 - Weather and wind (distribution and load balancing)
 - Interest
 - Inventory differentials (waste gas)
- Levelling of revenues and expenses of:
 - Expenses related to the Green Fund
 - PGEE
 - Office of efficiency and energy and innovation (formerly the energy efficiency agency)
- Expenditure under / over or unbudgeted
 - major bad debt

- Gains and losses on use of general installations
- Severance
- Charges related to the Régie
- tax assessments
- Self-insurance
- Intervenor costs
- Cote-Nord (out of base)
- Capital Projects over \$ 1.5 million not approved by the Régie (out of base)
- Miscellaneous
 - Patents (intangible assets)
 - IT developments (intangible assets)
 - Commercial programs (PRC/PRRC)
 - Vacation pay (no addition in 2013)
- CASEP (dirty fuel substitution program – out of base)

For the purposes of the application for the Incentive Mechanism, which could be effective October 1, 2013, please refer to R-3693-2009, Phase 3.

20.1.2 Please specify the nature of any other adjustment required.

Response:

No other adjustments shall be made in the determination of TP / MAG for distribution before the application of the sharing mechanism.