

**Réponses du Transporteur et du Distributeur
à la demande de renseignements numéro 1
de l'Association québécoise des consommateurs
industriels d'électricité et du
Conseil de l'industrie forestière du Québec
(« AQCIE-CIFQ »)**

Partie 1

DEMANDES DE RENSEIGNEMENTS DE L'ASSOCIATION QUÉBÉCOISE DES CONSOMMATEURS INDUSTRIELS D'ÉLECTRICITÉ (AQCIE) ET DU CONSEIL DE L'INDUSTRIE FORESTIÈRE DU QUÉBEC (CIFQ) DANS LE CADRE DU DOSSIER SUR LA DEMANDE D'APPROBATION DU TAUX DE RENDEMENT DES CAPITAUX PROPRES ET DU MÉCANISME DE TRAITEMENT DES ÉCARTS DE RENDEMENT

Demande de renseignements adressée à Hydro-Québec

Premier sujet – Contexte de la demande

1. Référence:

HQTD-1, Doc-1, page 7

Préambule

HQ présente deux tableaux démontrant l'évolution des taux de rendement autorisés des capitaux propres d'HQT, HQD et de trois groupes de référence.

Question:

- 1.1. Veuillez fournir les données utilisées pour préparer ce tableau, en format Excel (.xls). Pour les deux groupes de référence ainsi que pour le groupe des entreprises gouvernementales, veuillez fournir les données propres à chaque entité réglementée ainsi que le facteur de pondération utilisé pour établir la moyenne du groupe.

Réponse :

Les données sont fournies dans le format demandé. Voir fichier HQTD-05-4.1_AQCIE-CIFQ R.1.1 - Données Excel.xls

2. Référence:

HQTD-1, Doc-1, page 8, ligne 25

Préambule

HQ explique que dans la décision D-2012,97, la Régie « reconnaissait la nécessité de traiter les dossiers de révision des politiques financières du Transporteur et du Distributeur conjointement avec celui du MTÉR ».

Question:

2.1. Où la Régie exprime-t-elle la notion de nécessité?

Réponse :

Le 16 mai 2013, la Régie rend sa décision D-2013-075 dans le présent dossier. Dans le paragraphe 4 de celle-ci, elle avise qu'elle procède à l'étude de la présente demande d'approbation du taux de rendement des capitaux propres et du mécanisme de traitement des écarts de rendement par la tenue d'une audience publique.

Conséquemment, la référence aux notions de « nécessité » et de « besoin » n'est plus pertinente au cadre du présent dossier.

3. Référence:

HQTD-1, Doc-1, page 9, ligne 11

Préambule

HQ explique que dans la décision D-2012-119, la Régie soulignait « *le besoin d'examiner de façon simultanée les sujets du traitement des écarts de rendement et de l'établissement du taux de rendement des capitaux propres* »

Question:

3.1. Où la Régie exprime-t-elle la notion de besoin?

Réponse :

Voir la réponse à la question 2.1.

Deuxième sujet – Analyse de risque

4. Référence:

HQTD-1, Doc-1, page 12, ligne 18

Préambule

HQ explique que le risque réglementaire « découle quant à lui des incertitudes sur les décisions de l'organisme de réglementation économique (...) qui peuvent avoir une incidence sur la récupération des coûts et le rendement des capitaux propres. »

Question:

- 4.1. À votre avis, considérant que l'État québécois est (l'unique) actionnaire d'Hydro-Québec, ce risque est-il réduit par l'octroi de pouvoirs extraordinaires au gouvernement par l'article 7 de la *Loi concernant principalement la mise en œuvre de certaines dispositions du discours sur le budget du 20 novembre 2012*, à savoir le droit d'établir les charges - ou charges nettes, selon le cas - d'exploitation aux fins de la fixation des tarifs de ces entités? Veuillez détailler votre réponse.

Réponse :

Le Transporteur et le Distributeur ont le devoir de respecter les lois en vigueur et les Décrets émis par le gouvernement.

Voir également la réponse à la question 2.6 de la demande de renseignement de UC à la pièce HDTD-5, document 10.

5. Référence:

HQTD-1, Doc-1, pages 13-14

Préambule

« Le risque d'affaires du Transporteur résulte essentiellement d'événements fortuits qui auraient un impact à la hausse sur ses coûts au cours d'une année tarifaire. En effet, bien que le Transporteur présente une structure de coûts relativement fixe, il demeure assujéti, à l'intérieur de la période pour laquelle ses revenus requis projetés ont été établis, à une variabilité de certains coûts pouvant entraîner des impacts défavorables notables sur sa performance financière. » (page 13, lignes 1 à 6)

Aux paragraphes suivants, HQ donne des détails sur ces *événements fortuits* ainsi que des éléments qui, à son avis, *sont de nature à favoriser de tels événements*. Il est essentiellement question de bris, défaillances (notamment sur le réseau de télécommunications), dépannage, maintenance et retrait d'actifs.

À la page 14, à partir de la ligne 7, HQ traite aussi de deux autres problèmes qui seraient selon lui exacerbés par une hausse importante du budget des investissements, à savoir la *pression accrue sur les flux de trésorerie* et la *pression exercée sur les échéanciers des projets par les démarches réglementaires*. Il ne semblerait pas que ces autres problèmes aient un impact sur le rendement réel en fin d'année.

Questions:

Aux questions 5.1 à 5.5, nous cherchons à évaluer le risque que représentent les *événements fortuits* mentionnés en préambule.

- 5.1. Nous comprenons du premier extrait cité en préambule que le risque d'affaires du Transporteur résulte essentiellement de la possibilité de réaliser, pour une année donnée, un manque à gagner, c'est-à-dire de voir son bénéfice net réglementé affecté négativement par des coûts qui n'ont pas été pris en compte dans les revenus requis, et donc, dans les tarifs de cette année là. Notre compréhension est-elle correcte? Sinon, veuillez expliquer.

Réponse :

Tel qu'il appert de la section 3 de la pièce HQTD-1, document 1, l'évaluation du risque des Demandeurs, aux fins de la détermination des taux de rendement raisonnables des capitaux propres, reposent sur une analyse comparative de leurs risques avec les pairs de l'industrie.

Afin d'évaluer dans quelle mesure les risques du Transporteur et du Distributeur se comparent à ceux des entreprises de service public, ils ont fait appel à MM. James M. Coyne et John P. Trogonovski. Pour cette évaluation, ces derniers ont pris en considération les profils de risque du Transporteur et du Distributeur, sommairement présentés aux sections 3.2 et 3.3 de la pièce HQTD-1, document 1.

Aussi, il revient à MM. Coyne et Trogonovski, à titre d'experts dans ce domaine, de répondre de la prise en compte ou non, et du poids relatif que les caractéristiques opérationnelles du Transporteur et du Distributeur ont eu dans leur évaluation du risque des divisions réglementées d'Hydro-Québec.

- 5.2. Nous comprenons par ailleurs du reste de cette section que les coûts visés à 5.1 seraient uniquement en lien avec des bris et des défaillances, des activités de dépannage et de maintenance ainsi qu'avec des retraits d'actifs. Notre compréhension est-elle correcte? Sinon, veuillez expliquer en indiquant notamment les autres types de coûts visés à 5.1.

Réponse :

Voir la réponse à la question 5.1.

5.3. Quel est le plus important manque à gagner subi par HQT au cours de la période 2004-2012 en lien avec les coûts visés à 5.1 et 5.2? Le cas échéant, veuillez faire référence aux documents des rapports annuels du Transporteur sur le site internet de la Régie.

Réponse :

Le plus important manque à gagner au niveau des charges nettes d'exploitation, en excluant le coût de retraite, est de 36,4 M\$ pour l'année 2006 (voir la pièce HQT-2, Document 1.1 du Rapport annuel 2006 du Transporteur). Toutefois, le Transporteur n'est pas en mesure au prix d'un effort raisonnable de fournir le découpage demandé. Concernant les retraits d'actifs, le plus important manque à gagner est de 39,2 M\$ pour l'année 2011 (voir la pièce HQT-2, Document 13 du Rapport annuel 2011 du Transporteur).

5.4. Avez-vous réalisé une étude de la variabilité des coûts ou sur le risque en lien avec des bris et des défaillances, des activités de dépannage et de maintenance, des retraits d'actifs et tout autre type de coût mentionné en réponse à 5.2? Si oui, veuillez la déposer.

Réponse :

Non, le Transporteur n'a pas réalisé d'étude sur la variabilité de ces coûts.

5.5. Veuillez identifier, pour les années 2004 à 2012, le montant prévu aux revenus requis ainsi que le montant réel en ce qui a trait aux coûts liés aux bris, défaillances, dépannage, maintenance, retraits d'actifs et tout autre type de coût mentionné en réponse à 5.2.

Réponse :

Voir la réponse à la question 5.3.

5.6. Nous comprenons que les autres problématiques que vous soulevez, à savoir la *pression accrue sur les flux de trésorerie* et la *pression exercée sur les échéanciers des projets par les démarches réglementaires*, n'entraîneraient pas des problèmes de coûts tels que ceux mentionnés aux articles 5.1 et 5.2. Notre compréhension est-elle correcte? Sinon, veuillez expliquer en indiquant de quel ordre de grandeur seraient ces coûts.

Réponse :

Le budget des investissements prévus connaît une hausse importante comparativement à la décennie précédente. Ceci peut se traduire par des difficultés à accéder à des sources de financement pour le programme d'investissement du Transporteur et ainsi occasionner une pression sur le coût du financement. Quant au deuxième volet, à titre d'exemple, un retard dans l'autorisation d'un projet pourrait occasionner des coûts plus importants pour un projet ou engendrer des problématiques chez le client concerné.

5.6.1. Pourriez-vous expliquer de manière plus détaillée de quelle façon ces problématiques affectent votre risque d'affaires?

Réponse :

Voir la réponse à la question 5.1.

6. Référence:

HQTD-1, Doc-1, page 14, ligne 27

Préambule

Vous invoquez la part des ventes faites aux clients industriels pour affirmer que le Distributeur fait face à un risque d'affaires important étant donné que ses ventes sont soumises à de grandes fluctuations.

Questions:

6.1. Devons-nous comprendre que lorsque la part des industriels dans les ventes d'HQD diminue, le risque d'HQD diminue aussi? Autrement dit, si la part des ventes aux industriels, dans l'élaboration des tarifs d'une année donnée, est plus bas que la part des ventes aux industriels dans l'élaboration d'une année antérieure, doit-on conclure que le risque d'HQD a diminué à ce niveau entre ces deux années? Veuillez expliquer.

Réponse :

Voir la réponse à la question 5.1.

6.2. HQD subit-elle un manque-à-gagner lorsque les ventes aux contrats spéciaux sont moindres que prévu pour des raisons autres que climatiques?

Réponse :

Tout écart applicable aux contrats spéciaux est transféré et assumé par l'actionnaire par le biais de l'ajustement des contrats spéciaux.

6.2.1. Si oui, est-il du même ordre que celui subi lorsque la même situation se produit chez un client du tarif L?

Réponse :

Voir la réponse à la question 6.2.

6.2.2. Quel est l'impact, le cas échéant, de ce manque-à-gagner sur le *pass-on* et l'ajustement des contrats spéciaux?

Réponse :

Voir la réponse à la question 6.2.

7. Référence:

HQTD-1, Doc-1, page 15, ligne 11

Préambule

« [B]ien que le Distributeur puisse satisfaire ses besoins en énergie en ayant recours au contrat patrimonial, qui lui procure un approvisionnement de 165 TWh, il doit composer avec les incertitudes des contrats post-patrimoniaux qui prennent de plus en plus d'importance avec les années (possibilités de contestations, délais de réalisation) »

Questions:

7.1. Veuillez expliquer le lien entre ces « incertitudes » et le risque d'affaires du Distributeur.

Réponse :

Voir la réponse à la question 5.1.

7.2. Ces incertitudes peuvent-elles affecter le bénéfice net réglementé du Distributeur? Si oui, veuillez expliquer de quelle manière et l'ordre de grandeur du manque à gagner auquel HQD s'expose.

Réponse :

Voir la réponse à la question 5.1.

8. Référence:

HQTD-1, Doc-1, page 15, ligne 15

Préambule

Hydro-Québec traite *des risques associés à l'étendue de son réseau* de distribution. Nous comprenons qu'il invoque ici le même type de risque que celui invoqué à l'égard du réseau de transport, à savoir la possibilité de voir son bénéfice net réglementé affecté négativement par des coûts imprévus reliés aux facteurs suivants : bris, défaillances, maintenance, dépannage, retrait d'actifs et autres facteurs mentionnés en réponse à 5.2.

Questions:

Par ces questions, nous cherchons à évaluer le risque lié à ces facteurs.

8.1. Notre compréhension est-elle correcte? Sinon, veuillez expliquer énumérant les autres facteurs, le cas échéant.

Réponse :

Voir la réponse à la question 5.1.

8.2. Quel est le plus important manque à gagner subi par HQD au cours de la période 2004-2012 en lien avec ces coûts? Le cas échéant, veuillez faire référence aux documents des rapports annuels du Transporteur sur le site internet de la Régie.

Réponse :

Le Distributeur n'effectue pas de comptabilité par activité mais plutôt par nature comptable. Il ne dispose donc pas de l'information demandée.

8.3. Avez-vous réalisé une étude de la variabilité de ces coûts ou sur le risque en lien avec ces facteurs? Si oui, veuillez la déposer.

Réponse :

Non, le Distributeur n'a pas réalisé d'étude sur la variabilité de ces coûts.

8.4. Veuillez identifier, pour les années 2004 à 2012, le montant prévu aux revenus requis ainsi que le montant réel en ce qui a trait à ces coûts.

Réponse :

Voir la réponse à la question 8.2.

9. Référence:

HQTD-1, Doc-1, page 15, ligne 26

Préambule

« Le Distributeur encourt aussi un risque important en raison de la hausse des comptes en souffrance et de la diminution des ententes de paiement avec sa clientèle résidentielle en période hivernale. »

Question:

9.1. L'adoption d'une nouvelle méthode de calcul de la dépense de mauvaises créances dans le dossier R-3814 a-t-elle permis de réduire ce risque? Veuillez expliquer.

Réponse :

Voir la réponse à la question 9.4 à la pièce HQTD-3, document 1 (B-0020), page 18.

10. Référence:

HQTD-1, Doc-1, page 16, ligne 1

Préambule

« Enfin, il demeure que lors de l'établissement de ses tarifs, le Distributeur fait face au risque de ne pas se faire reconnaître l'ensemble de ses coûts, incluant un rendement raisonnable, et ce, malgré le fait qu'il bénéficie de comptes d'écarts qui lui assurent une protection contre les fluctuations importantes d'éléments qui sont hors de son contrôle. »

Questions:

10.1. Considérant que la Régie rend généralement sa décision avant le 1^{er} avril de l'année pendant laquelle ses tarifs doivent s'appliquer, de quelle façon le bénéfice réglementé du Distributeur est-il à risque dans ce cas précis? Veuillez expliquer.

Réponse :

Le préambule fait référence à des coupures que la Régie peut effectuer au moment de l'établissement des tarifs. Le préambule ne fait aucunement référence à la date à laquelle la décision est rendue.

10.2. Vous dites que *le Distributeur fait face au risque de ne pas se faire reconnaître l'ensemble de ses coûts, incluant un rendement raisonnable*. Veuillez donner un exemple d'un dossier dans lequel la Régie aurait refusé de reconnaître un rendement raisonnable au Distributeur, et expliquer en quoi le rendement autorisé n'était pas raisonnable.

Réponse :

Voir la pièce HQTD-1, document 1, p. 6-7.

11. Référence:

HQTD-1, Doc-1, page 21, ligne 18

Préambule

« L'utilisation d'un même taux de rendement des capitaux propres pour les deux divisions réglementées est justifiable du point de vue d'Hydro-Québec par le fait que l'utilisation de structures du capital différentes prend en compte la différenciation du risque des deux divisions réglementées. Cette façon de procéder n'est pas nouvelle et est utilisée notamment en Alberta. »

Question:

11.1. Veuillez indiquer quelles entités sont réglementées de la sorte, en faisant référence aux décisions appropriées de l'*Alberta Utilities Commission*.

Réponse :

In Decision 2004-052 (the Generic Cost of Capital Decision or GCC Decision) dated July 2, 2004, the Alberta Energy and Utilities Board (EUB or Board) established a single generic Return on Equity (ROE) for all utilities participating in the proceeding. It also adopted a formula approach for determining an annual generic ROE and set common equity ratios for each of the applicant utilities.

Further to the contemplated five year review of the adjustment formula the Alberta Utilities Commission (Commission or AUC) initiated a proceeding on February 21, 2008 to determine whether the ROE formula and/or the common equity ratios should again be reviewed on a generic basis.

After considering the submissions of parties, the Commission issued Decision 2008-051 on June 18, 2008, finding that there was sufficient evidence to warrant a review of the generic ROE level and adjustment formula and of utility capital structures. The Commission determined that capital structures would be considered on a utility-specific basis in a generic proceeding along with the ROE level and adjustment formula.

The Generic ROE for 2009 and 2010 was set at 9.0 percent, and for 2011 was set at 9.0 percent on an interim basis. Utility equity ratios were established as follows :

Segment	Awarded Equity Ratios (%)
Electric and Gas Transmission	
ATCO Electric TFO	36
AltaLink	36
ENMAX TFO	37
EPCOR TFO	37
RED Deer TFO	37
Lethbridge TFO	37
TransAlta	36
ATCO Pipelines	45
Electric and Gas Distribution	
ATCO Electric DISCO	39
ENMAX DISCO	41
EPCOR DISCO	41
ATCO Gas	39
FortisAlberta	41
AltaGas	43
Retailers	
EEAI	39

See: AUC Decision 2009-216 (November 12, 2009)

In Decision 2011-474, 2011 Generic Cost of Capital, the Alberta Utilities Commission (the AUC or the Commission) set the approved ROE for Commission-regulated utilities at 8.75 per cent on a final basis for 2011 and 2012, and on an interim basis for 2013. The Commission also determined that a return to a formula approach for annual adjustments to ROE was not appropriate at that time, but that the matter of a formula approach would be revisited when the Commission initiated a proceeding to establish a final allowed ROE for 2013. The decision also set out common equity ratios for each utility for 2011 and 2012; to remain in effect until changed by the Commission.

Troisième sujet – Autres propositions

12. Référence:

HQTD-1, Doc-1, page 26

Préambule

HQ propose de mettre à jour le coût de la dette en même temps pour HQD et HQT, soit en décembre. À l'appui de cette proposition, HQ invoque la simplicité d'une telle démarche.

Questions:

- 12.1. À quelle fréquence HQ met-elle à jour les informations relatives à sa dette qui sont utilisées par HQT et HQD pour calculer le coût de leur dette?

Réponse :

Présentement, le processus de mise à jour de l'ensemble des données essentielles à l'établissement du coût de dette règlementaire n'est complété qu'au moment de la préparation de la Politique financière qui est déposée dans les dossiers tarifaires. La procédure actuelle ne prévoit aucune actualisation du coût de dette projeté.

La stratégie de financement de l'entreprise, pour sa part, fait l'objet d'une révision dans le trimestre qui précède le début de l'année financière d'Hydro-Québec, soit à l'automne.

- 12.2. Veuillez faire état des difficultés, le cas échéant, découlant d'une mise à jour à deux dates différentes, soit en décembre pour HQT et en mars suivant pour HQD. Si possible, veuillez quantifier la différence en nombre d'heures de travail additionnelles requises ou autrement.

Réponse :

Une mise à jour en mars pour le Distributeur surviendrait trop tard compte tenu du fait que c'est à cette même période de l'année que la Régie doit rendre sa décision sur la demande relative à l'établissement des tarifs.

De plus, la proposition d'effectuer une seule mise à jour de la prévision du coût de la dette pour les Demandeurs permet de ne véhiculer qu'un seul coût de dette prévu sachant qu'il s'agit d'un coût intégré, donc identique aux deux divisions.

Sur cette base, les processus et systèmes budgétaires de l'entreprise sont actuellement établis pour traiter un coût de dette prévu commun aux deux divisions. Par ailleurs, des mises à jour successives, à quelques mois d'intervalle seulement entre celle du Transporteur et celle du Distributeur, résulteraient, très probablement en des prévisions de taux de dette peu différentes. En effet, la deuxième mise à jour permettrait d'actualiser les paramètres selon une prévision plus récente du Consensus Forecasts, mais les volumes resteraient pratiquement inchangés. De plus, le caractère inerte du coût de la dette tient notamment au fait que seules les portions de la dette à taux variable et des emprunts projetés sont sensibles à une mise à jour des taux. Ainsi, bien que les deux coûts de dette actualisés seraient sans doute très similaires, la réalisation de mises à jour à deux dates différentes requerrait néanmoins un travail supplémentaire afin d'effectuer le calcul de ces prévisions ainsi que les analyses de variations expliquant les écarts par rapport au coût de dette réel.

Les Demandeurs préconisent une approche simple et pratique.

Information Request addressed to Drs. Coyne and Trogonoski (Concentric)

First topic: Credit ratings

1. Reference:

- (i) HQTd-2, Doc-1, pages 16-17
- (ii) <http://www.hydroquebec.com/investor-relations/about-financing/credit-ratings.html>

Preamble

- (i) Concentric Advisors (CA) refer to credit ratings by S&P, Moody's and DBRS. They also refer to a credit opinion by Moody's and a rating report by DBRS.
- (ii) Hydro-Québec presents credit ratings by S&P, Moody's, DBRS and Fitch.

Questions:

- 1.1. Why did you refer to credit ratings by S&P, Moody's and DBRS but not by Fitch?

Réponse :

Concentric obtained its credit ratings from SNL Financial, which provides ratings from Standard and Poor's, Moody's Investors Service, and DBRS. SNL does not provide ratings from Fitch. In our view, it was sufficient to have credit ratings from three major rating agencies.

- 1.2. At footnote 13 of reference (i), you refer to a credit opinion by Moody's dated August 6, 2012. We understand that this is the same report that you mention at page 27 of your report and that you filed in response to the Régie's request 1.1 on August 27.

Réponse :

Yes, the Moody's report referenced in footnote 13 of Concentric's evidence is the same report that was provided to the Régie in response to the Board's Request 1.1 in August 2013.

- 1.2.1. If not, please provide us with a copy of this document.

Réponse :

Not applicable

1.2.2. Has Moody's issued a similar document since then in relation to HQ? If so, please provide us with a copy of this document.

Réponse :

Moody's has not issued a credit report on Hydro-Québec since August 6, 2012.

1.3. At footnote 14 of reference (i), you refer to a rating report by DBRS dated April 12, 2012.

1.3.1. Please provide us with a copy of this document.

Réponse :

Please see Request 1.3, Attachment 1.

1.3.2. Has DBRS issued a similar document since then in relation to HQ? If so, please provide us with a copy of this document.

Réponse :

Yes. DBRS issued a credit report on Hydro-Québec in April 2013. Please see Request 1.3.2, Attachment 1.

1.4. Please provide us with the latest credit opinions, rating reports or similar documents on Hydro-Québec by Fitch.

Réponse :

Please see Request 1.4, Attachment 1 and Attachment 2.

1.5. Please provide us with the latest credit opinions, rating reports or similar documents on Hydro-Québec by S&P.

Réponse :

Please see Request 1.5, Attachment 1.

- 1.6. The excerpts of DBRS's rating report that you quote discuss financial leverage and capital spending for Hydro-Québec at large, not just HQT. Considering the stand-alone principle, please explain how this would be relevant to the determination of HQT and HQD's ROE.

Réponse :

The DBRS report provides an outlook for the financial profile and credit metrics of Hydro-Québec, based on the Company's Strategic Plan 2009-2013. As demonstrated in the following excerpt from the DBRS report, the rating agency discusses the projected capital investments for Hydro-Québec Production, Hydro-Québec TransÉnergie, and Hydro-Québec Distribution.

Based on the Company's Strategic Plan 2009-2013, HQD and HQT are expected to account for approximately \$14.0 billion of the \$25.1 billion in forecasted capital spending. This will result in negative free cash flows and the issuance of additional debt to finance the capital spending requirements. This supports the conclusion that the capital spending requirements of HQD and HQT, under the stand-alone principle which has been adopted by the Régie, will have an impact on investor's return requirements and therefore the cost of capital for HQD and HQT.

Outlook

- Credit metrics could weaken further, due to rising debt levels required to support ongoing growth initiatives outlined in the Company's Strategic Plan 2009-2013.
- Hydro-Québec's Strategic Plan 2009-2013 forecasts \$25.1 billion in investments over the period and provides a good indication of capex over the short-to-medium term, outlining the following divisional expenditures :
- Hydro-Québec Production will invest \$10.4 billion and increase its hydroelectric generating capacity by close to 1,000 MW, mainly as a result of the Eastmain-1-A/Sarcelle/Rupert project.
- Hydro-Québec TransÉnergie will invest \$7.8 billion in various projects aimed at developing the transmission system and ensuring its long-term operability, including the integration of 3,000 MW of new generating capacity.
- Hydro-Québec Distribution will make investments of \$6.2 billion: \$1.6 billion to meet demand growth in Québec, \$2.9 billion to maintain and improve facilities and \$1.7 billion for the Energy Efficiency Plan.

- **Hydro-Québec is expected to continue to issue debt to fund its capital expenditures and dividends, as well as redeem and repay debt, and to manage free cash flow deficits throughout the medium term, while benefitting from historically low interest rates.¹**

2.Reference: HQTD-2, Doc-1, pages 26-28

Preamble

Your American proxy group is composed solely of companies with a credit rating from S&P of at least A-. This threshold is lower than Hydro-Québec's actual credit rating (A+). To support this, you claim that "*absent the government debt guarantee, the credit rating for Hydro-Québec would be several notches lower.*"

Questions:

- 2.1. What is the impact of Hydro-Québec's non-regulated activities (HQP, etc.) on its credit rating? Please quantify in terms of the S&P credit rating system.

Réponse :

Concentric's ROE and risk analysis did not consider the effect of HQP's non-regulated operations on the credit rating for Hydro-Québec. Given the government support for Hydro-Québec's debt, we assume that the non-regulated operations would not have a material effect on the credit rating of Hydro-Québec. There is not sufficient information available to quantify the effect of HQP using the S&P credit rating system.

- 2.2. Please define the terms "operating income" and "revenues" as used on page 28, lines 8 and 9 of your report.

Réponse :

For purposes of this evidence, Concentric has relied on the common definitions of Operating Income and Revenues, which are :

Operating income = Operating revenues - Operating expenses

Revenues = Sales from regulated or non-regulated activities

¹ DBRS Rating Report, Hydro-Québec, April 12, 2012, at 4.

2.3. Please quantify Hydro-Québec's "operating income" and "revenues" for 2011 and indicate where in its 2011 annual report this information is found.

Réponse :

For 2011, HQ reported revenues of \$12,392 million and operating income of \$5,108 million (Canadian dollars).²

2.4. Please quantify the share (in %) of Hydro-Québec's "operating income" and "revenues", respectively, that stem from regulated electric utility service for 2011.

Réponse :

In 2011, regulated electric revenue accounted for 86.9 percent of HQ's total revenue.³ Hydro-Québec's reported financial data do not allow for the calculation of operating income from regulated vs. unregulated activities. Regulated electric activities accounted for approximately 42.7 percent of Hydro-Québec's net income in 2011.⁴

2.5. For each company in your American proxy group and for Hydro-Québec, please indicate the share of company assets that are used for regulated electric utility service, in M\$ and as a percentage of total assets.

Réponse :

See the table below for the U.S. proxy group. For Hydro-Québec, regulated assets were 46.2 percent of total assets in 2011.⁵

² Exhibit 99.1 to Hydro-Québec's annual report on Form 18-K to the U.S. Securities and Exchange Commission for the fiscal year ended December 31, 2011, at 5.

³ Hydro-Québec 2011 Annual Report, at 94.

⁴ Hydro-Québec 2011 Annual Report, at 94.

⁵ Hydro-Québec 2011 Annual Report, at 94.

U.S. Proxy Group Company	Ticker	2011	
		Regulated Assets (\$million)	% of Total
Consolidated Edison	ED	\$37,703	96.1%
NextEra Energy	NEE	\$31,816	55.6%
Northeast Utilities	NU	\$14,957	95.6%
Southern Co.	SO	\$54,622	92.2%
Wisconsin Energy Corp.	WEC	\$13,434	96.9%
Xcel Energy Inc.	XEL	n/a	n/a

Notes:

Data are sourced from company 10-K filings.

Xcel Energy does not report total assets by business segment.

Second topic: Proxy groups

3.Reference: HQTD-2, Doc-1, page 23

Preamble:

Your Canadian Utility Proxy group is comprised of six companies. You explain that “no specific screening criteria were used to derive the proxy group”.

Questions :

- 3.1. Canadian Utilities Limited (CUL) and ATCO are affiliated companies. Both of them are publicly-traded. Why did you choose CUL to be part of your proxy group instead of ATCO?

Réponse :

It would be duplicative to include both Canadian Utilities Limited and ATCO Ltd. in the Canadian proxy group since the latter has a majority ownership (52.7 percent) of the former.⁶ Concentric selected Canadian Utilities Limited for the proxy group because the ATCO regulated utility subsidiaries account for a larger share of the company’s revenue. To illustrate this point, in 2011, the Structures & Logistics business segment accounted for 25 percent of ATCO Ltd.’s total revenue.⁷ In contrast, in 2011, the energy and utilities business segments

⁶ ATCO Ltd., 2011 Annual Information Form, at 4.

⁷ ATCO Ltd., 2011 Annual Information Form, at 6.

accounted for nearly 93 percent of the total revenue reported by Canadian Utilities Limited.⁸

3.2. Besides the six companies in your proxy group and ATCO, are there other publicly-traded regulated Canadian electric or natural gas utility companies?

Réponse :

Yes, AltaGas Ltd., but the company does not have sufficient market-based data to include in our financial analysis, and ATCO Ltd. (discussed in response 3.1), because we have used Canadian Utilities Ltd.

3.2.1. If so, why weren't these companies included in your proxy group?

Réponse :

Please see response to Request 3.2.

4.Reference : HQT-2, Doc-1, pages 24-25

Preamble:

You mention that your US proxy group is a subset of a set of 48 companies that Value Line classifies as Electric Utility Companies. We understand that this subset is comprised of six companies which meet the seven criteria that you mention (credit ratings of at least A- from S&P, etc.).

Questions :

4.1. Please explain the rationale behind each of the seven criteria. When a criterion contains a specific limit or threshold (e.g. credit rating of at least A-, electric/regulated revenue above 60 percent, etc.) please explain why this specific limit or threshold was chosen.

Réponse :

The rationale for each screening criteria to select the U.S. proxy group of electric companies was:

Credit rating : As explained on page 26 of Concentric's evidence, the credit rating screen selects U.S. electric utilities with credit ratings of

⁸ Canadian Utilities Limited, 2011 Annual Information Form, at 5.

A- or higher, thereby taking into consideration the business and financial risk profile of those utility companies. The basis for choosing companies with an A- or higher rating is that absent the government debt guarantee, the credit rating for Hydro-Québec would be several notches lower. Moody's has indicated that the Baseline Credit Assessment for HQ would be Baa1 (S&P equivalent BBB+).

Pay dividends : In order to perform a discounted cash flow analysis, it is necessary for the companies in the proxy group to pay dividends. The DCF analysis sets the discount rate as the dividend yield plus the expected growth rate in dividends over a specified time period.

Earnings growth rates from at least two utility industry analysts : In order to perform the DCF analysis, it is necessary to estimate the growth rate in dividends. Under the assumptions of the Constant Growth DCF model, earnings per share, dividends per share, and book value per share are assumed to grow at the same constant rate. In order to estimate this growth rate, Concentric relies on forecasted earnings growth rates from multiple analysts, including those surveyed by Zack's, First Call, and SNL Financial, as well as those reported by Value Line.

60% of revenue from regulated operations : In order to select those companies with business and operating risks associated with providing regulated utility service, Concentric excluded companies that did not derive at least 60% of their revenues from regulated operations from 2009 through 2011. The 60% threshold was selected in order to exclude companies that did not derive the majority of their regulated revenues from regulated electric utility service.

60% of regulated revenue from electric utility operations : In order to select those companies with business and operating risks associated with provided regulated electric utility service, Concentric excluded companies that did not derive at least 60% of their regulated revenue from electric utility operations from 2009 through 2011. The 60% threshold was selected in order to exclude companies that did not derive the majority of their regulated revenues from regulated electric utility service.

Not considered small capitalization company : Although HQD and HQT are not publicly traded companies, and therefore do not have market capitalizations, both entities own substantial regulated utility assets and generate substantial regulated revenues and operating income. For that reason, Concentric determined that it would not be appropriate to include small capitalization companies in the proxy group for HQD and HQT because those smaller companies typically have higher return requirements due to the risks associated with their smaller size.

Not involved in merger or other transformative transaction : Since the dividend yield is calculated based on the average stock price of the proxy group company over a period of 30-, 90-, and 180-days, and because mergers and acquisitions may result in short-term effects on the stock price of the acquiring company or the target company, Concentric excludes those companies which are party to a merger during the evaluation period unless we are able to determine that the stock price has not been materially affected by the merger or acquisition.

- 4.2. Please provide the full list of all 48 companies that Value Line classifies as Electricity Utility Companies and mention, for each of the 48 companies, (i) its latest Beta according to Bloomberg and (ii) which of the seven criteria it meets. For the following criteria, please provide the following information for each of the 48 companies:

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in Request 4.2, Attachment 1.

- 4.2.1. "Have credit ratings of at least A- from S&P": Please indicate actual credit rating from S&P, Fitch and Moody's

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in response to Request 4.2. Concentric only reports ratings from S&P and Moody's because Fitch ratings are not reported by Bloomberg or SNL Financial.

- 4.2.2. "Have earnings growth rates": Please indicate from how many industry analysts.

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in response to Request 4.2. Concentric does not compile information on how many analysts cover a company other than to confirm that the number is at least two.

4.2.3. “Derived at least 60 percent of their revenue from regulated operations”: please indicate the actual percentage of revenue derived from each of (i) electricity distribution and (ii) electricity transmission.

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in response to Request 4.2. Company financial reports generally do not provide sufficient information to differentiate between revenue derived from electricity distribution and transmission.

4.2.4. “Derived at least 60 percent of their regulated revenue from electric utility operations”: please indicate the actual percentage of regulated revenue derived from each of (i) electricity distribution and (ii) electricity transmission.

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in response to Request 4.2. Company financial reports generally do not provide sufficient information to differentiate between revenue derived from electricity distribution and transmission.

4.2.5. “Are not considered a small capitalization company”: please indicate the capitalization (in M\$).

Réponse :

The data corresponding to the screening criteria employed to select the U.S. proxy group are provided for all 48 Value Line electric utility companies in response to Request 4.2.

4.3. For the credit rating criterion, why did you choose S&P instead of another agency such as Fitch or Moody’s?

Réponse :

The credit rating screen was based on Standard and Poor’s ratings because that agency provides the most complete rating coverage of the companies in the utility sector in Canada and the U.S. Moody’s does not provide full coverage of publicly-traded utility companies. As indicated in response to Request 1.1 from AQCIE/CIFQ, SNL Financial does not provide ratings from Fitch.

4.4. Who determines whether a company is considered “small capitalization” for the purposes of your analysis? What are the applicable criteria?

Réponse :

Concentric screened the potential U.S. electric utility proxy group to exclude any companies with a market capitalization less than \$2 billion. MGE Energy Inc. was the only company that passed the other screening criteria but was not included in the U.S. proxy group because it failed to meet the market capitalization screen.

5.Reference: HQTD-2, Doc-1, Exhibit JMC-3, Schedule 2

Preamble:

You indicate an S&P credit rating for the operating companies of the publicly-traded proxy groups.

Questions:

5.1. Does S&P actually provide a credit rating for individual operating companies, or are these credit ratings those of the parent holding company?

Réponse :

If debt is issued at the operating company level, then S&P does provide a credit rating for the operating company in addition to an issuer rating for the parent holding company. The ratings provided in Exhibit JMC-3, Schedule 2, are for the operating company, unless otherwise noted.

5.2. Please provide the latest S&P, Fitch, Moody’s and DBRS credit ratings (if applicable) for the companies of the third proxy group, i.e. government-owned electric utilities in Canada.

Réponse :

Please see Request 5.2, Attachment 1.

Third topic: Risk analysis

6. Reference: HQT D-2, Doc-1, section VII-A (Business risk analysis) and Appendix A

Preamble:

At page 43, you define business risk as “changes in revenues and costs that may result in variability in cash flows and earnings and the ability of the utility to recover its costs including the faire return on, and or, its capital in a timely manner.”

In the following pages, as well as in Appendix A, you compare HQD and HQT’s risk levels to those of the proxy group members for the purposes of a ROE benchmarking exercise. You examine eight specific risk factors. However, in some cases, you focus on the protection measure instead of focusing on the actual risk, whether the underlying risk or the residual risk, once the protection measure is taken into account.

For example, at pages A-6 and A-7, you do not examine the variability in cash flows and earnings stemming from Volume/Demand risk; instead, you examine what types of protection or mitigation measures are in place.

Questions:

- 6.1. How does an analysis of protection measures allow you to draw conclusions as to the level of risk when you do not also examine the actual risk level (whether underlying risk or residual risk)?

Réponse :

Concentric’s approach in designing the risk analysis, and the approach we believe investors take when analyzing regulated utilities, is to identify the primary business risks that affect the variability of earnings and cash flows for the regulated utility and to determine whether the company has risk protection that allows it to recover costs in a timely manner so that it has a reasonable opportunity to earn its allowed ROE. The company-specific risks might be somewhat different for each individual operating company due to factors such as the characteristics of its service territory and the composition of its customer base. Concentric’s risk analysis is designed to accommodate those company specific differences, while still allowing for an identification of the risks faced by regulated utilities generally, and an evaluation of whether the regulatory authority has taken steps to mitigate those risks.

6.2. Are we led to believe that the underlying risk is the same for all entities?

Réponse :

No. As discussed in the response to Request 6.1 above, Concentric’s risk analysis is designed to be flexible because we recognize that business and operational risks are company specific. The important question for investors is to identify the risk profile of each regulated utility and to determine if the company has adequate protection against those risks so that its cash flows and earnings will be stable and predictable and so that it will have a reasonable opportunity to earn its allowed return.

7.Reference: HQTd-2, Doc-1, p. 49, lines 6-7

Preamble:

“Specifically, HQD faces more competitive risk due to its higher concentration of industrial customers, which suggest that HQD is more susceptible to risks associated with economic bypass and demand destruction, as well as more vulnerable to weak economic conditions.”

Question:

7.1. How do you define the terms “economic bypass” and “demand destruction”?

Réponse :

For purposes of this evidence, “economic bypass” refers to a customer who determines that it is in their economic interest to procure their electricity needs from another source, such as self-generation, or move operations to another service area. The term “demand destruction” as used in Concentric’s evidence in this proceeding refers to a reduction in demand for electricity due to weak economic conditions, energy efficiency and demand side management programs, or customer-specific decisions to close business operations.

8.Reference: HQTd-2, Doc-1, p. A-1

Preamble:

Operating companies that (i) accounted for less than 10 percent of the total distribution customers of the parent company (ii) provided service within the same jurisdiction as a larger entity or (iii) provided regulated natural gas distribution service were excluded.

Questions:

8.1. Please provide a list of the companies that were excluded.

Réponse :

The following U.S. operating companies were not included in Concentric's risk analysis:

Parent Company	Operating Company	State
Consolidated Edison	Consolidated Edison of New York – Natural Gas	New York
	Consolidated Edison of New York – Steam	New York
	Orange and Rockland Utilities – Electric	New York
	Rockland Electric – Electric and Natural Gas	New Jersey
NextEra Energy	LoneStar Transmission	Texas
Northeast Utilities	Yankee Gas Services – Natural Gas	Connecticut
	NSTAR Gas – Natural Gas	Massachusetts
Southern Co.	None	
Wisconsin Energy Co.	Wisconsin Electric Power – Natural Gas	Wisconsin
	Wisconsin Gas – Natural Gas	Wisconsin
Xcel Energy Inc.	Public Service Company of Colorado – Natural Gas	Colorado
	Public Service Company of Colorado – Steam	Colorado
	Northern States Power – Natural Gas	Minnesota
	Northern States Power – Electric and Natural Gas	North Dakota
	Southwestern Public Service – Electric	New Mexico
	Northern States Power – Electric	South Dakota
	Northern States Power – Natural Gas	Wisconsin

8.2. What is the rationale behind each of these three exclusion criteria?

Réponse :

As discussed on page A-1 of Concentric's evidence, the risk analysis excluded operating companies that (a) account for less than 10 percent of the total distribution customers of the parent company ; (b) provide service within the same jurisdiction as a larger entity ; (c) provide gas distribution service. The rationale for each criterion is explained below:

- a) 10% of distribution customers : Concentric's risk analysis was designed to evaluate those operating companies which were the primary drivers of the electric utility proxy company's investment profile and share price. Operating companies with less than 10% of total distribution customers do not have a material effect on the investment profile of the parent company.
- b) Service in same jurisdiction : Concentric's risk analysis was designed to evaluate the regulatory environment in different U.S. and Canadian jurisdictions. For that reason, we did not repeat the risk analysis for different operating companies that provide service within the same jurisdiction unless there was something unique about the way in which a particular company was regulated that would provide a different perspective on that jurisdiction's overall regulatory scheme.
- c) Gas distribution service : Concentric's risk analysis for U.S. operating companies was designed to evaluate the regulatory environment for electric utility companies. The objective was to identify the ways in which U.S. utility regulators have mitigated the business and financial risks of electric utility companies. In Concentric's view, electric distribution companies have different business and operating risks than gas distribution companies, which makes it more appropriate to compare the risks of HQD and HQT to those of electric utility operating companies. For the Canadian proxy group, Concentric included gas distribution companies in the risk analysis in order to provide the Régie with as much information about Canadian utility companies as possible. However, we continue to believe that it is more reasonable to analyze and assess the risks for companies that investors perceive as electric utility companies.

8.2.1. Why did you establish the threshold at 10 percent of the total distribution customers?

Réponse :

Please see response to Request 8.2.

8.2.2. How would the list of excluded companies change if you established the threshold at 10% of total energy sales instead of number of customers?

Réponse :

Concentric did not consider total energy sales in developing our risk analysis. However, the electric utility operating companies shown in the response to Request 8.1 that were excluded from the risk analysis are very small in comparison to the total company operations regardless of whether the threshold is based on percentage of distribution customers or percentage of total energy sales.

8.2.3. Please explain why you exclude natural gas distribution companies from this group and not from the Canadian proxy group?

Réponse :

Gas distribution companies were excluded from the list of operating companies for the U.S. proxy group in an effort to keep this a pure play electric utility group and because there are a sufficient number of companies to analyze the regulatory environment in various U.S. jurisdictions. For the Canadian proxy group, Concentric included operating companies that provide gas distribution service because the list of comparison companies would have been very short if those gas distributors were excluded.

8.3. How do you define the term “jurisdiction” in this context? Does it correspond to a political division (state, county, etc.), a company’s territory, etc.?

Réponse :

As used in this context, the term “jurisdiction” refers to the regulatory jurisdiction which is responsible for overseeing the regulated operations of the operating utility. It includes state commissions in the U.S. and provincial boards and commissions in Canada.

9. Reference: HQTD-2, Doc-1, exhibit JMC-4, schedules 1 to 7

Preamble:

These schedules provide information on certain risk parameters determined by HQTD experts. For each parameter, an average is calculated using the number of customers to determine the weight of each company in the average.

Questions:

9.1. Please provide an Excel (.xls or similar) version of these schedules.

Réponse :

Please see Request 9.1, Attachment 1.

9.2. In this Excel version, please add another column to these tables indicating total energy sales (in kWh) and total assets (in M\$) for each operating company.

Réponse :

Please see the worksheet titled “Energy Sales and Assets” in Request 9.1, Attachment 1.

10. Reference: HQTD-2, Doc-1, page A-2 and exhibit JMC-4, schedule 1

Preamble:

This schedule distinguishes companies with (i) regulated generation (ii) limited regulated generation and (iii) no regulated generation.

Questions:

10.1. At page A-2, you mention that “11 percent of those companies own limited generation, such as renewable resources like solar, wind and biomass”.

10.1.1. What exactly are the criteria that you used to distinguish between “regulated generation” and “limited regulated generation”?

Réponse :

If the company owns generation and it is reported in rate base, we classify this as regulated generation. Limited regulated generation is determined when the company has less than 15% of its energy requirements satisfied by owned resources. These companies typically own small amounts of renewable generation or fossil resources for system reliability. As shown in Request 10.1,

Attachment 1, two operating companies in the U.S. proxy group are listed as owning limited regulated generation. While neither Consolidated Edison of New York nor Western Massachusetts Electric Company is considered a vertically-integrated utility, both companies do own limited amounts of regulated generation. The same applies to Newfoundland Power which owns a limited amount of regulated generation. We note that FortisBC Electric generates 51% of its total energy requirement, and this should be corrected to “Yes” for “Regulated Generation” in Exhibit JMC-4, Schedule 1, and on page A-2. This would change the calculation of “Percent that own Regulated Generation” in the Canadian proxy group from 12.92% to 17.19%, which narrows the gap slightly between the U.S. and Canadian proxy companies on that factor. This does not otherwise impact our risk analysis or conclusions.

10.1.2. Under which category would HQD fall with its “very limited diesel generation”?

Réponse :

As shown on Exhibit JMC-4, Schedule 1, due to its minimal amount of generation, HQD is classified as not owning regulated generation. For our analytical purposes, we do not distinguish between companies with limited or no generation.

10.2. For each company, please indicate the share that regulated generation occupies in relation to the total yearly energy needs (for sales to customers, losses, etc.) of this company.

Réponse :

These data are attached in response to Request 9.1.

11. Reference: HQTd-2, Doc-1, page A-4, lines 8-13

Preamble:

“Similarly, all of the operating utilities in the U.S. electric utility proxy group have fuel cost recovery mechanisms that allow them to pass through fuel and purchased power costs to customers, where applicable. As such, the operating companies in the Canadian and U.S. proxy groups are not at risk for differences between the projected and actual cost of fuel with the exception of [Wisconsin and Nova Scotia Power]...”

Questions:

11.1. For each company in the Canadian and U.S. proxy groups, please describe the “cost recovery mechanisms” in place, if applicable.

Réponse :

Please see Request 11.1, Attachment 1.

11.2. Please confirm that each of these “cost recovery mechanisms” allow the operating company in question to recuperate any variance between projected fuel and power costs on which rates are based and actual costs and that therefore these costs cannot lead to overearnings or under-earnings by the company (i.e. no impact on real ROE). If not, please explain.

Réponse :

As discussed on page A-4 of Concentric’s evidence, the operating companies in the Canadian and U.S. proxy groups have fuel cost recovery mechanisms that allow them to pass through fuel and purchased power costs to customers, where applicable. As such, the operating companies are not at risk for differences between projected and actual fuel and purchased power, and should not impact earned ROE, with the exception of those electric utilities in Wisconsin, which are exposed to risk for two percent of fuel costs, and Nova Scotia Power, which has cost recovery risk for ten percent of its fuel and purchased power costs.

11.3. Please describe what costs are recovered by companies that have regulated generation.

Réponse :

Fuel costs for companies that own regulated generation typically include some or all of the following components: the cost of fuel for generating plants owned or leased by the company; the cost of purchased power; emission allowances; less any net gains from sales in the wholesale market; and less any gains or losses from an approved hedging program.

12. Reference: HQTD-2, Doc-1, page A-4, line 15

Preamble:

“While HQD has more protection with respect to the price stability of its electricity supply, the Canadian and U.S. proxy group companies have protection with regard to recovery of fuel or purchased power costs.”

Questions:

12.1. Doesn't HQD also have protection with regard to recovery of fuel and purchased power costs?

Réponse :

Yes. Please see Concentric's evidence at pages A3-A5.

12.1.1.If so, what is the purpose of this statement?

Réponse :

While the vast majority of operating companies in the Canadian and U.S. proxy groups have no risk associated with fuel and purchased power costs, HQD also has stability in the price of its electricity supply. Credit rating agencies such as S&P and DBRS have commented on the low cost hydro-electric supply for HQD, 97 percent of which is provided at a fixed price set by the government. This is a favorable risk factor from an investment perspective because it supports continued demand for electricity in Québec.

13. Reference: HQTD-2, Doc-1, page A-5, line 14

Preamble:

“Since HQD has little risk associated with variations in fuel or purchased power cost...”

Question:

13.1. Please describe HQD's risk associated with variations in fuel or purchased power cost.

Réponse :

As discussed on page 45 of Concentric's evidence, HQD obtains approximately 97 percent of its energy supply from the Heritage Pool and has no risks with respect to changes in the price of that supply. HQD purchases the remaining three percent of its energy supply under long-term contracts and does not have an automatic adjustment mechanism for purchased power costs. Rather, those costs are recovered through the annual rate case filing, and any difference between actual and forecasted purchased power costs is deferred and recovered through a cost variance account. As also discussed on page 45, the distribution companies in the U.S. and Canadian proxy groups have fuel adjustment clauses that allow them to pass through the fuel costs to customers. As such, those companies are generally not at risk for differences between the projected and actual cost of fuel, with limited exceptions in Wisconsin and Nova Scotia.

14. Reference: HQTD-2, Doc-1, page A-6/A-7 and JMC-4, Schedule 3**Preamble:**

You mention that 62% of the operating companies in the Canadian proxy group have RDMs or LRAMs, and 11% have weather normalization adjustment clauses or variance accounts. This leads you to conclude that HQD has *"somewhat less protection against changes in volume/demand than the operating companies in the Canadian proxy group"*.

You mention at JMC-4, schedule 3 that 9,25% of the Canadian operating companies have RDM's and 52,66%, LRAM's. In other words, about only 20% of the Canadian operating companies (using your terminology) have RDM's or weather normalization instruments, yet this leads you to conclude that *"HQD has somewhat less protection against changes in volume/demand risk than the operating companies in the Canadian proxy group"*.

Questions:

14.1. What are "weather normalization adjustment clauses" and how do they relate to "weather-related variance accounts"?

Réponse :

As explained on page A-6 of Concentric's evidence, several regulators in Canada have mitigated volume/demand risk attributable to weather variations by approving variance accounts to allow the utility to recover the difference between forecasted and actual demand. HQD has a weather-related variance account, as does Newfoundland Power and Gaz Métro. In the U.S., regulators have mitigated volume/demand risk attributable to weather through either weather normalization

adjustment clauses, which also allow the utility to recover the difference in revenues between forecasted and actual demand, or through revenue decoupling mechanisms, which allow the utility to recovery differences in forecasted and actual revenues due to weather, economic conditions, energy efficiency programs, etc. In this context, weather normalization adjustment clauses and weather-related variance accounts provide equivalent protection against changes in volume/demand.

14.1.1. Please specify how and to what extent they protect the operating company.

Réponse :

Weather normalization adjustment clauses and weather variance accounts mitigate the risk that actual demand will be higher or lower than forecasted demand due to variations in weather conditions. As a result of these mechanisms, the regulated utility is able to earn its revenue requirement regardless of deviations in weather that affect volume/demand. These mechanisms help to stabilize the earnings and cash flows of the regulated utility; however, there is still short term variation in revenues and cash flows until the variance account or adjustment clause is trued up at the end of the period. Concentric's risk analysis examines whether each operating company in the Canadian and U.S. proxy groups has protection against weather-related risks that affect demand/volume.

14.2. How do LRAM's compare with weather-related variance accounts in terms of risk protection?

Réponse :

Lost Revenue Adjustment Mechanisms allow the utility to recover revenue that is lost due to changes in demand/volume attributable to conservation and energy efficiency programs, whereas weather-related variance accounts allow the utility to recover revenue when the actual demand/volume is lower than projected due to hotter or colder than forecasted weather.

14.2.1. Should we understand that in your view, Canadian operating companies with an LRAM but no RDM or weather variance account would have, all else being equal, somewhat more protection against changes in volume/demand risk than HQD?

Réponse :

No. As discussed in the response to Request 14.2, while LRAMs and weather variance accounts both help to mitigate volume/demand risk, LRAMs mitigate risk when demand is reduced due to conservation and energy efficiency programs, while weather variance accounts reduce risk when demand varies due to abnormal weather conditions. Full revenue decoupling mechanisms provide the broadest protection against volumetric risk because RDMs break the link between fixed cost recovery and volumetric sales regardless of the cause that volume is lower than forecasted.

14.3. Generally, how did you compare the volume/demand risk of the different operating companies (including HQD) that face different risks (the weather risk may not be the same everywhere) and have different mechanisms (LRAM's etc.)?

Réponse :

As the question suggests, different operating companies in the Canadian and U.S. proxy groups have different volume/demand risks and different mechanisms to mitigate those risks. Concentric's risk analysis is designed to be flexible in that regard. From the perspective of investors, the important question is: if the utility has volume/demand risk (regardless of the source of that risk), has the regulatory authority taken steps to help the utility mitigate that risk so that the effect on earnings and cash flows will be minimized? Concentric's risk analysis identifies the most common mechanisms that utility regulators have used to mitigate volumetric risk and indicates whether each operating company has that risk protection.

15. Reference: : HQTD-2, Doc-1, pages 41-42 and A-7 to A-9

Preamble:

At pages A-7 to A-9, you discuss HQT's risk and compare it to that of other transmission providers. However, the purpose of your risk analysis, as mentioned at pages 41-42, is to "examine whether it is reasonable and appropriate to use Canadian and U.S. Proxy groups to establish the allowed ROE for HQD and HQT", and whether any adjustments should be made.

Questions:

15.1. Why are you not comparing HQT to the proxy groups in terms of volume/demand risk as you are doing for HQD?

Réponse :

See pages A-7 through A-9 of Concentric’s evidence for a comparison of HQT’s volume/demand risk as compared to other proxy group companies in Canada and the U.S.

15.2. Using the same methodology as for HQD (i.e. JMC-4, schedule 3), how does HQT compare with the proxy groups?

Réponse :

Transmission companies in both Canada and the U.S. have a high degree of volume protection, without the distinguishing features of distribution companies where more variability exists. Concentric did provide a higher level overview of transmission risks factors: see pages A-7 through A-9 of Concentric’s evidence for a comparison of HQT’s volume/demand risk as compared to other proxy group companies in Canada and the U.S.

15.3. Why do you say “HQT is not exposed to risks associated with changes in demand” at page A-7, line 17, and then begin the next paragraph by saying that “Other transmission companies in the Canadian proxy group also have little risk with respect to fluctuations in demand”?

Réponse :

The referenced section on page A-7 of Concentric’s evidence describes how HQT recovers its transmission revenue requirement, and explains that there is no risk associated with changes in demand. The following paragraph on page A-8 compares HQT’s volume risk to that of ATCO Electric Transmission and Hydro One Networks, and concludes that ATCO is not dependent on the price or volume of electricity transmission through its system, and that Hydro One Networks has slightly more risk due to its transmission operations than HQT because of possible differences between actual load or consumption and projected levels.

16. Reference: HQTD-2, Doc-1, page A-10, line 2

Preamble: *“Capital spending is a two-edged sword for utilities. On the one hand, capital spending support dividend growth and share price appreciation; on the other, it can increase the need for external financing and place pressure on cash flows and credit metrics without ongoing accommodation in rates for system expansion.”*

Question:

16.1. Please elaborate on this. Please explain exactly in what ways capital spending is a risk factor.

Réponse :

See page A-10 of Concentric's evidence for a discussion of why capital spending is a risk factor that is considered important by debt and equity investors. In particular, capital spending can increase the need for external financing and place pressure on cash flows and credit metrics without ongoing accommodation in rates for system expansion. As explained on page A-11 of Concentric's evidence, investors may be concerned that multiple capital projects will place pressure on the company's cash flows and credit metrics during construction, that any project delays will further postpone cost recovery, and that some portion of costs in excess of any pre-approved amount may be deemed imprudent by the regulator.

16.2. Assuming that a regulator approves 100% of capital spending before it is spent by the utility, how could capital spending affect the utility's business risk, or, as you define it, "*variability in cash flows and earnings and the ability of the utility to recover its costs including the faire return on, and or, its capital in a timely manner*"

Réponse :

Even if the regulator pre-approves 100% of the capital project, capital spending could affect the utility's business risk in several ways. First, if the utility is not allowed to earn a cash return on CWIP, then its cash flows and credit metrics could be impacted during construction and this may place downward pressure on the company's credit rating. Second, if the project takes longer than anticipated, the utility cannot start to earn a return on the capital project until it is placed into service. Third, if the project costs more than originally approved due to increases in labor or material costs, there is the possibility that the regulator will determine that some portion of these additional costs was not prudent. Fourth, certain capital projects are necessary in order to repair or replace aging infrastructure, or comply with environmental regulations, energy efficiency requirements, or renewable portfolio standards. Under those circumstances, the capital spending likely will not result in additional revenues for the utility. Absent cost tracking mechanisms or rate riders to recover the cost associated with these investments, the utility has substantial risk of not recovering its investment through rates.

17. Reference: HQTd-2, Doc-1, pages A-11-A-12

Preamble:

“Q. Why do equity investors and credit rating agencies prefer utilities that are allowed to earn a cash return on CWIP rather than AFUDC?”

Investors may be concerned that (1) multiple capital projects will place pressure on the company’s cash flows and credit metrics during construction, (2) any project delays will further postpone cost recovery and (3) some portion of costs in excess of any pre-approved amounts may be deemed imprudent.

(...)

Therefore, from an investment and cash flow perspective, the opportunity to earn a cash return on CWIP is favorable, especially for large capital projects that are not expected to be completed for several years because it (1) provides more immediate cost recovery, (2) reduces pressure on cash flows and credit profiles during construction, and (3) reduces concerns about rate shock.”

Questions:

17.1. How do pressure on the company’s cash flows and credit metrics, postponement of cost recovery and concerns about rate shock constitute business risks or affect business risks?

Réponse :

As discussed on page 43 of Concentric’s evidence, we have defined business risk as representing changes in revenues and costs that may result in variability in cash flows and earnings and the ability of the utility to recover its costs including the fair return on, and of, its capital in a timely manner. As noted on page A-10 of Concentric’s evidence, capital cost recovery has been identified by credit rating agencies as a significant business and regulatory risk. Specifically, pressure on cash flows and credit metrics during a large construction project could result in downward pressure on the utility’s credit rating. Likewise, investors are concerned about the timeliness of cost recovery for a major capital project, as well as the potential for disallowances once the project is completed and placed in service. Lastly, investors are concerned about rate shock if the entire balance of the new capital project is added to rate base once the project is placed in service rather than gradually as different phases of the project are completed over a multi-year period. Each of these factors is directly related to business risk because each affects the variability in cash flows and the ability of the utility to recover its costs, including a fair return on and of capital, in a timely manner.

17.2. Assuming that, for a given project due to be in service on April 1st of a given year, HQD or HQT is granted pre-approval in time for this project to be included in that year's rate base, but this project is not put into service until December 1st of the same year, how would this delay postpone cost recovery?

Réponse :

As discussed on page A-11 of Concentric's ROE and risk evidence, the Régie annually approves the capital budget for smaller projects on a dollar amount basis and approves individual projects with an estimated cost in excess of \$25 million for HQT and \$10 million for HQD. Projects within that approved capital budget are included in HQT's and HQD's forecasted test year and added to rate base for cost recovery once they are expected to be commissioned into service that year. Under the scenario described in the question, there would be no delay in cost recovery once the project is added to rate base. However, many major capital projects for utilities such as HQD and HQT take several years to complete. In that case, the utility must invest significant amounts of capital during construction without recovering any of costs or earning a return on that investment until the plant is commissioned into service and added to rate base.

18. Reference: HQTD-2, Doc-1, Page A-14, line 3

Preamble:

"Based on Concentric's research and analysis, our view is that HQD and HQT generally have comparable risk mitigation for capital cost recovery as the Canadian proxy group because regulated utilities in Canada file rate cases on a more frequent basis, meaning that utility companies are able to include capital investments in rate base once they are placed into service and start earning a return on those investments without significant regulatory lag. In addition, HQD and HQT receive pre-approval of capital expenditures (including specific approval for major projects), whereas many of the Canadian utilities do not. With respect to the operating companies in the U.S. electric utility proxy group, Concentric concludes that even though those U.S. companies generally do not file rate cases as frequently as those in Canada, they have similar or better risk protection on this factor as HQD or HQT through either approval of CWIP in rate base while the plant is under construction, or implementation of cost tracking mechanisms that provide accelerated recovery of capital costs for replacing aging infrastructure."

Questions:

18.1. When you say "regulated utilities in Canada file rate cases on a more frequent basis", do you include HQD and HQT in this group of regulated utilities in Canada, and who are you comparing this group to?

Réponse :

HQD and HQT have typically filed rate case applications every year since 2004 and 2002, respectively. However, HQD and HQT have not requested a review of the allowed ROE or deemed equity ratio since the original decisions were issued by the Régie. Consequently, both companies have been subject to the automatic adjustment formula adopted by the Régie, which is based on changes in the long-term Canada bond yield. As interest rates have fallen over the past decade, the allowed ROE for HQD and HQT has also decreased, even though other factors suggest that the equity returns required by investors in comparable companies have not decreased to the extent indicated by the automatic adjustment formula. Specifically, there is an inverse relationship between interest rates and the equity risk premium, meaning that as interest rates decrease (increase), the equity risk premium increases (decreases).

- 18.2. Considering that HQD and HQT can have their projects pre-approved, which is a factor on which Moody's "places a high degree of emphasis" according to the quote on page A-10, and considering that 32% of the operating companies in the US may not request such pre-approval, how do you come to the conclusion that US Companies have similar or better risk protection on capital spending as HQD or HQT?

Réponse :

As discussed in the response to request 16.2 above, pre-approval of construction costs does not mitigate all business risks associated with capital spending. Investors also have concerns regarding (1) the timeliness of cost recovery for capital projects, (2) the potential for disallowances if the project exceeds the original amount approved by the regulator, and (3) capital projects to repair or replace aging infrastructure in order to maintain system reliability or that are required to comply with some environmental regulation or commission requirement, but which do not result in additional revenue for the utility.

In order to evaluate whether the operating companies in the Canadian and U.S. proxy groups have protections against those kinds of risks, Concentric's risk analysis also considered additional factors, including : (1) whether the utility is allowed to place CWIP in rate base and earn a cash return on CWIP during construction; and (2) whether the regulator has approved cost tracking mechanisms or rate riders that allow the utility to recover costs associated with specific projects over a defined time period. Based on that analysis, Concentric determined that, on balance, the operating companies in the U.S. proxy group have comparable risk protection as HQD and HQT because regulators have allowed the utility to earn a cash return on CWIP, or to

implement cost tracking mechanisms that provides accelerated recovery of capital costs for projects to replace aging infrastructure or comply with environmental regulations.

18.2.1. How do you compare different protection measures (e.g. pre-approval vs. CWIP in rate base)?

Réponse :

Concentric's risk analysis focuses on the different protection measures for capital cost recovery risk and whether those risks are mitigated. This type of risk analysis is largely a qualitative exercise from the perspective of investors. Important considerations for investors include : (1) whether the utility has certainty related to the amount that will be recovered for the capital project (which is provided through pre-approval of that amount by the regulatory authority) ; (2) whether the utility is allowed to place a portion of the capital project into rate base as different phases are completed, but before the project is placed into service (which is provided through CWIP in rate base) ; (3) whether the utility is allowed to recover costs in a timely manner for capital projects to replace aging infrastructure or comply with environmental requirements (which is provided through a cost tracking mechanism to recover costs over a defined period through a special charge on ratepayer bills); and (4) whether there is the possibility of prudence review and cost disallowance after the project is placed into service.

18.2.2. How does your "yes/no" analysis provide an accurate measure of business risk, i.e. an accurate measure (in \$ or %) of "*variability in cash flows and earnings and the ability of the utility to recover its costs including the faire return on, and or, its capital in a timely manner*"?

Réponse :

Concentric's risk analysis takes into account the primary risk factors that are considered by utility investors. As explained in the previous responses, utility regulators use different methods to mitigate capital cost recovery risk. Some of those methods tend to reduce uncertainty regarding the amount that will be recovered, while other methods ensure timely recovery of capital costs, while still other methods mitigate the risks associated with variability in cash flows and earnings during a major construction project. From the perspective of utility investors, the design of Concentric's risk analysis answers the most important question: Does the utility have regulatory protections in place for capital construction projects that reduce variability in cash flows and earnings and ensure that the utility will recover its costs in a timely manner, without substantial risk of disallowance at the end of the project?

19. Reference: HQT-D-2, Doc-1, p. A-14-A-17**Preamble:**

On other risk factors, you generally draw a conclusion as to whether HQT and HQD face more, less or as much risk as the operating companies of the proxy group. On this particular risk factor, you seem to conclude that HQT and HQD face less risk than both proxy groups since:

- (i) You mention that “[i]n general, as observed by DBRS, any change from cost-of-service regulation is considered an increase in risk for the utility”;
- (ii) Both HQD and HQT operate under traditional cost-of-service regulation; and
- (iii) According to your analysis, only 24% of the Canadian group and 42% of the American group operate under cost-of-service. We understand from your response 10.1 to the Régie’s request for complementary evidence that these numbers may have changed since then but are still well below 100%.

However, you do not explicitly mention this conclusion.

Questions:

19.1. Is this correct?

Réponse :

Yes. The information with respect to whether certain operating companies in the Canadian and U.S. proxy groups have earnings sharing mechanisms has changed since the time Exhibit JMC-4, Schedule 6, was prepared. As indicated in the response to the Régie’s Request 10.1, as a result of the merger of Northeast Utilities and NSTAR, Connecticut Light and Power and NSTAR Electric are operating under multi-year rate agreements that do not include an earnings sharing mechanism. Concentric has updated Exhibit JMC-4, Schedule 6 to reflect these changes. Based on that update, 46 percent of the operating companies (based on number of customers) in the U.S. proxy group currently have earnings sharing mechanisms. There has been no change to the percentage of U.S. operating companies under cost-of-service regulation vis-à-vis those under incentive regulation.

With respect to the operating companies in the Canadian proxy group, as discussed on page A-16 of Concentric’s evidence, the incentive regulation plans for both Gaz Métro and Enbridge Gas Distribution expired in late 2012. Both companies, however, have filed new incentive regulation plans with their respective regulators. Although Gaz Métro is operating under cost-of-service regulation in 2013,

it continues to have an earnings sharing mechanism, and investors expect that it will again be subject to incentive regulation in the future once its new plan is approved. Likewise, investors expect that Enbridge Gas Distribution will operate under an incentive regulation plan in the future once its new plan is approved by the Ontario Energy Board. For that reason, Concentric has not changed Exhibit JMC-4, Schedule 6 for the operating companies in the Canadian proxy group.

19.2. If so, why did you not provide a specific and explicit conclusion as you did for other risk factors?

Réponse :

See response to Request 19.3 below.

19.3. What is the impact of this conclusion on your general conclusion regarding HQT and HQD's risk as compared to that of the proxy groups? On HQT and HQD's ROE?

Réponse :

Updating Exhibit JMC-4, Schedule 6 as discussed in response to Request 19.1 has no impact on the general conclusions on page A-17 with respect to the effect of implementing earnings sharing mechanism or an incentive regulation plan for HQD and HQT. As stated on page A-17, any change in business risk of HQD and HQT relative to the Canadian and U.S proxy groups would depend on the design and parameters of the specific earnings sharing plan that is implemented.

20. Reference: HQT-2, Doc-1, page A-17-20 and Exhibit JMC-4, schedule 6

Preamble:

Regulatory lag

At pages A-19 to A-20, you mention that *“With respect to interim rates, HQD has somewhat more risk than the operating companies in the Canadian proxy group, and more risk than the operating companies in the U.S. electric utility proxy group, the vast of which have the ability to request interim rates”*.

At Exhibit JMC-4, schedule 6, you indicate that the rate case lag, which you define as *“the time between when a rate case is filed and when the decision is issued”* as 10 months for HQT.

Questions:

20.1. Does HQD experience regulatory lag? Please explain.

Réponse :

Please see pages A19-A20 of Concentric's evidence. HQD has limited regulatory lag as measured by its forecasted test year and its rate case lag of approximately eight months. HQD does not have the ability to implement interim rates. Compared to the companies in the Canadian and U.S. proxy groups, HQD has similar or comparable risk protection in terms of regulatory lag.

20.2. Since 2004, has the Régie ever rendered a final decision establishing HQD's rates later than the date upon which these rates are set to come into effect, i.e. April 1st?

Réponse :

No.

20.3. What is the purpose of interim rates when rates are reset every year at a given date, with the rate case beginning well in advance of this date?

Réponse :

As explained on page A-18 of Concentric's evidence, interim rates allow a utility to increase rates to recover higher test year costs while a rate case is pending, subject generally to refund once final rates are adopted. Interim rates, therefore, provide the utility the opportunity to begin recovering higher costs through rates while the application is being reviewed. Absent interim rates, a utility is not able to recover its actual cost of service until the rate decision is issued and new rates are implemented, which can result in regulatory lag.

20.4. How did you derive the 10-month duration for HQT rate cases?

Réponse :

The information on Exhibit JMC-4, Schedule 6 regarding rate case lag is based on the most recent rate case application. In the case of HQT, this is the application in D-2012-059.

20.4.1. Is this based on historical duration of rate cases? If so, which cases were considered?

Réponse :

The rate case lag for HQT on Exhibit JMC-4, Schedule 6, should be corrected to show that the HQT rate case decision D-2011-039 was issued approximately eight months after the application was filed. Concentric notes that the 2012 rate case decision D-2012-059 was issued on May 24, 2012, or approximately 10 months after the application was filed by HQT.

21. Reference: HQTD-2, Doc-1, Pages A-20 to A-22

Preamble:

Cost recovery mechanisms

Questions:

21.1. Please explain in greater detail how the following mechanisms function, and indicate, for each, if they shield the utility from over or under-earnings (for the specific cost or risk that they cover) or otherwise *ensure that it will recover its costs including the faire return on, and or, its capital.*

Variance accounts
Rate riders
Surcharges
Cost tracking mechanism

For each type of cost recovery mechanism, please provide an example of such a cost recovery mechanism using HQT and HQD, or, failing that, from one of the utilities in the proxy groups (with reference to relevant regulatory documents).

Réponse :

Each of these cost recovery mechanisms is described briefly on pages A-20 through A-22 of Concentric's ROE and risk evidence.

Variance accounts

Variance accounts are designed to reduce the volatility of earnings and cash flows due to fluctuations in actual costs and/or revenues compared to projected costs and/or revenues. For example, both HQT and HQD have a pension cost variance account that allows them to recover the difference between realized pension costs and those approved by the Régie. This variance in pension costs is recovered by HQD in customer rates in the following two years after the true-up is completed.

Rate riders

Rate riders are temporary adjustments to customer bills that raise or lower rates for a limited time by a specified amount.

For example, HQT has a rate rider for variance between forecasted (for rate purposes) and actual revenues for point to point transmission services. The variance amount of a particular year adjusts customer bills in the following two years after a true-up is completed.

In addition, Florida Power and Light has a Demand Side Management Adjustment Rider whereby Customers served under one of the above rate schedules (the applicable rate schedule) before the installation of applicable DSM measures will qualify as continuing to meet the demand requirement for their applicable rate schedule when their electrical demand falls below the stated demand requirement as a direct result of the installation of one or more applicable DSM measures. If a customer's actual electrical demand is below the customer's adjusted minimum demand requirement of the applicable rate schedule for twelve (12) consecutive months, the customer will be dropped to the next lower demand requirement rate schedule until the customer's actual demand meets or exceeds the adjusted minimum demand level of the applicable rate schedule. Curtailable customers and customers under the CDR must still be capable of providing the minimum level of curtailment or interruption specified in their rate schedules and curtailment/CDR agreement, based on their actual measured demand. Additionally, the customer shall be required to complete a DSM Adjustment Rider Declaration Form for service under this schedule.

Cost tracking mechanism

A cost tracking mechanism is an adjustment clause that allows a utility's rates to fluctuate in response to changes in costs or conditions, such as a capital project for environmental compliance. For example, Georgia Power has an Environmental Cost Recovery Clause that allows for the recovery of costs associated with certain environmental investment and expenses. Costs are classified and allocated to the rate classes using an allocation method consistent with the cost of service methodology approved in the Company's last rate case. The costs are recovered through a monthly charge on customer bills until the full amount of the investment has been recovered.

21.2. For each type of cost recovery mechanism mentioned at table 13, please indicate (i) what risk is covered and (ii) any material differences (if any) between the specific mechanisms of the different operating companies (including HQT and HQD where applicable), notably whether the different mechanisms shield the utility from over or under-earnings (for the specific cost or risk that they cover) or otherwise *ensure that it will recover its costs including the faire return on, and or, its capital.*

Réponse :

Table 13 identifies five categories of costs that are important from an investors' perspective because they tend to fluctuate significantly from year, are material in nature, and are beyond the control of utility management. The basic question from an investors' perspective is: does the utility have risk associated with this cost, and if so, does the utility have a cost recovery mechanism that helps to reduce or mitigate that risk. The risks considered in Table 13 include: 1) pension expenses; 2) bad debt expenses; 3) storm costs; 4) interest rate changes; and 5) energy efficiency and DSM programs.

As explained in previous responses, Concentric's risk analysis was not designed to evaluate the differences between specific cost recovery mechanisms because utility regulators in various jurisdictions have responded to the same types of risks with different solutions. While the individual cost recovery mechanisms may be different, however, they tend to achieve the same overall purpose, which is to mitigate the effect of that particular risk on the regulated utility, so that the company can recover its costs in a timely manner and enhance the stability and predictability of earnings and cash flows.

22. References: HQTD-2, Doc-1, Pages A-22 and A-23

Preamble:

"HQD faces more competitive risk due to its high concentration of industrial customers in Québec, which makes HQD more vulnerable to longer-term risk associated with an economic downturn that could cause those industrial customers to reduce their demand for electricity (...)"

Questions:

22.1. Please indicate in what way a potentially lower demand from industrial customers in the future represents a long-term business risk for HQD

Réponse :

HQD's revenue requirement is recovered through distribution rates that are based on forecasted demand for the test year. If customer demand is lower than expected, HQD will not recover its revenue requirement, all else being equal. As shown on Exhibit JMC-3, Schedule 2, HQD is more dependent on sales to industrial customers than the vast majority of other operating companies in the U.S. and Canadian proxy groups. HQD has significant distribution assets in place to serve the needs of industrial customers at a specific location. If an industrial customer reduces its demand for electricity, whether due to economic conditions or for some other reason, such as closing its facility or moving to a different location, it will be difficult for HQD to recover the cost of its distribution assets. Further, if one large industrial customer were to shut down operations or file bankruptcy, this would have a significant effect on the financial performance of HQD during a particular year.

22.1.1. Would this bring variability *in cash flows and earnings*? If so, please explain how this would be detrimental to HQD.

Réponse :

Demand for electricity is more sensitive to economic conditions for industrial customers than for residential or commercial customers. For example, in its July 2010 rating report, Fitch commented: "The recent economic recession has negatively affected HQ's industrial sales, as the utility serves many energy-intensive users, such as aluminum producers. Electricity sales to industrial customers have decreased approximately 10,000 GWh during 2008 and 2009, and given the current demand and economic climate, will likely take some time before they return to the pre-2008 usage levels."⁹

This sensitivity to economic conditions causes more variability in earnings and cash flows for HQD because actual demand for electricity from industrial customers will fluctuate from forecasted levels. During recessionary periods, HQD's revenues and demand from industrial customers will be lower than projected, meaning that HQD will most likely not recover its full cost of service from this customer class. This is detrimental to HQD because it will place downward pressure on the company's cash flows and credit metrics.

⁹ FitchRatings, Hydro-Québec, Full Rating Report, July 12, 2010, at 2.

22.1.2. Would this be detrimental to HQD's *ability to recover its costs including the faire return on, and or, its capital in a timely manner*? Please explain.

Réponse :

Yes. A reduction in demand from industrial customers would make it more difficult for HQD to recover its costs, including a fair return on invested capital. HQD would need to spread its fixed costs over lower demand/volume and possibly a smaller customer base. Further, if one large industrial customer were to shut down operations or file bankruptcy, this would have a significant effect on the financial performance of HQD during a particular year.

22.2. Assuming that HQD derives a lower share of revenues from industrial in 2013 than it did at the time of its first rate case, when its ROE was set for the first time by the Régie, does this mean that this specific risk has since then been reduced? Please explain.

Réponse :

No. As discussed on page 15 of Concentric's evidence, HQD derived approximately 31 percent of its revenue from industrial customers in 2011. As shown on Exhibit JMC-3, Schedule 1, HQD's percentage of sales to industrial customers is higher than any operating company within the Canadian or U.S. proxy group with the exception of ATCO Distribution. From the perspective of investors, the important question is not whether HQD's percentage of sales to industrial customers has increased or decreased since 2003. Rather, the important consideration for investors is how HQD's percentage of sales to industrial customer compares to other companies in the proxy group. On that basis, HQD has a higher percentage of sales to industrial customers than other distribution companies in the U.S. or Canadian proxy groups. Therefore, Concentric concludes that investors would perceive HQD as more risky than the proxy group companies on that factor.

23. Reference: HQTD-3, Doc-1, Pages 27-28

Preamble:

At tables 13.1 and 13.2, the Régie provides a detailed account of HQD's and HQT's over or under earnings for the period 2007-2012 which HQ has indicated is correct. We find that since 2009, overearnings have been significant, at 97.6 M\$ for HQT and 122.4M\$ for HQD per year, on average.

Considering their respective rate bases in 2012 - roughly 17G\$ for HQT and 10G\$ for HQD - and the deemed equity in place (which you recommend maintaining) at 30% for HQT and 35% for HQD, these average over-earnings translate into an ROE “premium” of 1.9 percentage points for HQT and 3.5 percentage points for HQD.

Questions:

23.1. Did you take this into consideration in your risk analysis? Please explain.

Réponse :

Yes. Concentric considered the history of over-earnings by HQD and HQT in our risk analysis. In addition, we considered whether the operating companies in the U.S. proxy group were also able to earn their allowed ROE over the period from 2000-2011, and confirmed that the U.S. proxy group companies were also generally able to earn their allowed return. We also considered the effect of implementing an earnings sharing mechanism on the risk profile of HQD and HQT relative to the Canadian and U.S. proxy groups. Please see page A-17 and pages B-5 and B-6 of Concentric’s evidence for that discussion.

23.2. Would you agree that a regulated utility that systematically has over-earnings of this magnitude has very limited short-term risk? Please explain.

Réponse :

No, Concentric does not agree with this proposition. The fact that a utility has over-earned in the past does not necessarily predict whether the utility will continue to over-earn in the future. For example, an unanticipated trend in lower interest costs may lead to a period of over-earning, but may reverse and lead to under-earning in the future. As such, one must look at the company’s exposure and regulatory mechanisms that protect against business risk to draw meaningful conclusions about short-term business risk.