D E C I S I O N

Québec **RÉGIE DE L'ÉNERGIE**

D-2013-106	**R-3809-2012 Phase 2**	**July 15, 2013**

PRESENT:

Marc Turgeon
Françoise Gagnon

Commissioners

Société en commandite Gaz Métro
Plaintiff

And

The intervenors whose names are listed below

Decision

Application for the approval of the supply plan and amendments to Gaz Métro Limited Partnership's **Conditions of Natural Gas Service and Tariff** ***effective October 1, 2012***

10. OVERPAYMENT OR REVENUE SHORTFALL SHARING METHOD

[361] Gaz Métro is asking the Régie to approve the overpayment or revenue shortfall sharing method of the distributor proposed for tariff year 2013. It is proposing a symmetrical method that will share both the overpayments and revenue shortfalls of distribution based on the following formula:

- first 50 basis points: Gaz Métro;
- between 50 and 150 basis points: Gaz Métro and clientele 50-50;
- above 150 basis points: clientele.

[362] The measure would compare the revenues actually generated with all of the service cost of distribution and apply the regulatory principles in force, including the deferred cost accounts.

[363] The remittances would be carried out over a period of one year as soon as the actual data are available, which means that the sharing for 2013 would first be accounted for in a separate deferred costs account before being included in the 2015 tariffs (T +2).

[364] Gaz Métro is not proposing that any service quality indicia be met before its share of the overpayments is remitted, although it does believe it is reasonable that some be required.

[365] Gaz Métro believes that a 100 basis point impact on performance is significant. This impact is estimated at approximately $10 million, and will prompt the distributor to make the best possible decisions over the course of the year that will be in both its own interest and that of its clientele. Gaz Métro believes that this is in keeping with the orientation of decision D-2012-076,[1] in which the Régie mentions that the distributor has a duty to manage its business over the course of the year to the best of its knowledge and that it is important that it be responsible for all decisions it makes as well as for the consequences thereof.

[366] According to the distributor, the first basis points depend on ongoing operations and boost the incentive. It believes that the possibility of a 100 basis point shortfall increases its short-term regulatory risk, which hinges on the symmetry and lack of tools to mitigate the risk of loss. It believes that the proposed sharing rule offers an incentive similar to that of the previous incentive mechanism. Its proposal has three features: it has symmetry, presents a strong incentive and offers a safety net. It attempts to strike a balance between a strong incentive and a safety net. It has not conducted any study of equivalents.

[367] Gaz Métro maintains that it has submitted the best possible forecasts. If believes that the service cost examination process used in the tariff case is the appropriate tool that will

[1] Record R-3693-2009, p. 21, paragraph 75.

allow the clientele and the Régie to make sure of that. It argues that the recorded variances were generated by the sales volumes and service costs. It has no control over a large client that ceases consuming. It will postpone projects as needed, but believes that these delays do not constitute productivity gains.

[368] The distributor notes, however, that 2013 is unfolding in a very particular context, since the year is already underway. The risks of an inaccurate forecast are not as great since the loads of the first six months are "[TRANSLATION] *in-line with budgetary forecasts*".[2]

[369] Gaz Métro maintains that it has little or no room to maneuver in response to a decision that would significantly reduce the revenue requirement. According to it, the asymmetry of information was a more present reality in 1995 than it is today. It believes it would be unfair to assume all risks associated with the revenue shortfalls and to order a sharing of overpayments.

[370] According to the IGUA, regulating based on service costs is less risky than a true incentive mechanism, namely a revenue cap or price cap and not a hybrid that gives Gaz Métro the best of both worlds. When it comes to service costs, the distributor has much more room to maneuver and a great deal of control, both in terms of forecasting costs as well as actual loads. In the 1990s, period during which the distributor was regulated based on service costs, there was a 50-50 surplus yield sharing mechanism, but Gaz Métro was alone in assuming all revenue shortfalls.

[371] According to the CFIB, few regulatory frameworks offer less efficiency incentives than service costs. The distributor can capitalize, delay work, submit more conservative forecasts to control costs. That actual loads turn out to be less than the budgeted loads does not mean that there has been a gain in efficiency.

[372] The CFIB believes that the goal of the sharing method should be to give a portion to Gaz Métro to prevent it from avoiding all risks and incurring any expense whatsoever without due consideration. Gaz Métro should also be prevented from receiving undue benefits that were not in large part generated by efficiency. It believes that the levels lead to interannual arbitration.

[373] The GRAME notes that, in addition to good management, no efficiency-improving measure is included in the goals to be reached. It believes that the risk of failure must remain, as it is the guarantee of sound management.

[374] According to OC, the risk mitigation tool available to Gaz Métro in the previous mechanism, namely submitting a conservative budget, is also available for the year underway. An asymmetrical measure favouring clients would seek to achieve symmetry in risk sharing, given that Gaz Métro has the possibility of preparing conservative budgets. In the service cost mode, if any sharing does take place, clients should not have to assume the

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[2] Exhibit A-0133, p. 20.

revenue shortfalls. OC knows of no case where revenue shortfalls have been shared under this type of regulation.

[375] According to UC, the suggested formula allows for a variance of no more than 1% in Gaz Métro's distribution revenues, namely a maximum variance of $5.5 million, which implies yields of between 8.1% and 9.7%, a variance of 1.8%, which is an exceptionally high rate of return given the scant possibility of fluctuations.[3]

[376] The intervenor believes that Gaz Métro's proposal does not allow for a symmetrical sharing of risks and benefits between the distributor and its clientele. UC gave a quick overview of the list of Gaz Métro's short-term risks and concluded that they are mitigated. It is of the opinion that Gaz Métro should assume a greater portion of the risks and proposes an incentive to create higher productivity gains. Gaz Métro has variance accounts that limit rate of return fluctuations. Historically, it has not had any problem reaching the authorized rate of return.

[377] UMQ believes that Gaz Métro has great potential for savings. According to its diagnosis, Gaz Métro has developed flexibility over the years. An effort at management, even if relatively restricted, would save Gaz Métro a considerable amount from the very start. The intervenor therefore proposes a mechanism that would reverse the proposed suggestion.

[378] The proposals to share overpayments and revenue shortfalls are summarized in the table below. Some intervenors have also presented alternative proposals. The IGUA supports OC's proposal.

Table 10
Proposals to share overpayments and revenue shortfalls

Basis points	**Gaz Métro**	**CFIB**	**GRAME**	**OC**	**UC**	**UMQ**
150 and +			DCA		50%	
100-150	50%	25%	50%	50%		50%
50-100					75%	
0-50	100%			100%		
(0-50)	100%					
(50-100)			50%			
(100-150)	50%			100%	50%	50%
(150 and -)			DCA			

Gaz Métro portion Clientele portion

[3] Exhibit C-UC-0027, p. 20.

[379] The Régie notes that between 1982 in 1992, Gaz Métro was regulated based on service costs. During that period, overpayments reached an average of $4 million[4] per year, in a context where distribution's revenue requirement was lower than it is today. From 1983 to 1988, an incentive award for overpayments was in force.[5] In 1993, the distribution's revenue requirement stood at $365 million,[6] and Gaz Métro was still regulated based on service costs. The Régie then modified the sharing of overpayments, giving 50% to clients, and 50% to Gaz Métro. Revenue shortfalls were the responsibility of the shareholder. Under this sharing regime, Gaz Métro was required to reach certain performance indicia in order to receive its share.[7]

[380] From 2000 to 2012, Gaz Métro was regulated based on an incentive mechanism. It kept 25% of overpayments and was responsible for 50% of revenue shortfalls. During this period, it experienced overpayments for 11 years but only one revenue shortfall.

[381] Starting in 2013, Gaz Métro was once again subjected to regulation based on service costs. This period was originally expected to last only one year, but it could be concluded from decision D-2013-063[8] that this period might last longer.

[382] The Régie considers that the risk associated with regulation based on service costs is generally less than that associated with regulation by incentive. This context allows the distributor to present conservative budgets. Asymmetrical information must also be taken into account when establishing a sharing mechanism for overpayments and shortfalls.

[383] The Régie notes that the intervenors have submitted a wide variety of sharing mechanisms for overpayments and revenue shortfalls. Some of these promote productivity gains resulting from ongoing operations, while others favour higher but harder to reach productivity gains. At any rate, the Régie notes that there is some confusion between the notion of end-of-year overpayments and the notion of productivity gains. Productivity gains are only one possible source of overpayment.

[384] Historically speaking, when regulation was based on service costs, revenue shortfalls were always assumed by the shareholder. No analogous situation was submitted to justify a proposal for symmetrical sharing.

[385] According to the Régie, the sharing terms and conditions must be examined in a context of transition. While no incentive mechanism was implemented for 2014, the Régie still believes the current period to be one of transition between two incentive mechanisms. In this particular case, it is therefore on the lookout for simple sharing rules for this context of transition.

[4] Record R-3260-93, decision D-93-51, p. 57 and 58.
[5] Record R-3260-93, decision D-93-51, p. 56.
[6] Exhibit A-0074, p. 9.
[7] Record R-3260-93, decision D-93-51, p. 58.
[8] Record R-3693-2009, p. 12.

[386] The Régie believes that sharing overpayments and revenue shortfalls in the context of service costs consists of allocating the variances recorded at year's-end between the amounts forecasted and actual data. Such variances are inevitable when tariffs are determined using projected data. The Régie takes into account the characteristics inherent to this process, namely the asymmetry of information and presentation of conservative forecasts both for loads and sales volumes. In this context, it believes that a sharing mechanism is a simple regulatory tool designed to dispose of variances that are deemed normal in this regulatory context.

[387] While it is possible to achieve efficiency targets in service cost mode, it is not possible to distinguish the variances between the predicted efficiency gains in this context. During transition periods, the Régie therefore concentrates on achieving the best possible forecasts.

[388] **Consequently, the Régie determines that the revenue shortfalls will be assumed by the shareholder. The overpayments will be shared as follows:**

- **first 50 basis points: 50% to Gaz Métro, 50% to clientele;**
- **After the first 50 basis points: 100% to clientele.**

[389] For 2013, the Régie deems it is not appropriate that the attribution of Gaz Métro's portion of the overpayments be subjected to service quality maintenance indicia. It is particularly late in the year now underway for this request to be relevant. Gaz Métro will, however, be required to present such indicia as part of the examination of the 2013 annual report, as was done in 2012.

[390] **For the following years, the Régie asks Gaz Métro to present, in the tariff records, what indicia were used for the previous incentive mechanism. The remittance of overpayments will be subject to the same terms and conditions as those established for the incentive mechanism that ended in 2012.**

[391] As the distributor requested, the remittance will be carried out over the course of one year, as soon as the actual data are available. In the meantime, the balance will be accounted for in a separate deferred cost account.

[392] Moreover, in its decision D-2013-054,[9] the Régie reserved its decision respecting the manner in which it would recover the balances in the deferred cost accounts for overpayments or revenue shortfalls resulting from the transmission and load balancing services.

[393] Gaz Métro justifies spreading the allocation of gains generated by the balancing and transmission incentive over a period of three years due to the fact that the fluctuation of this amount is expected to be high.

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[9] Page 14, paragraph 43.

[394] The Régie considers that remittance of the distribution's overpayment or revenue shortfall will be carried out over a period of one year, and there is no background on balancing and transmission incentives. **As a result, it asks Gaz Métro that the balances of the deferred cost accounts for overpayments or revenue shortfalls generated by the balancing and transmission services be recovered over a period of one year.**