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 3

First Topic: Risk assessment framework

Reference: Company evidence page 9

Preamble:

The company discusses three main sources of risk: income risk; regulatory risk and financial risk.

Question 1:

1.1 Please provide a table for both HQT and HQD with the annual allowed and earned ROE from 2001-2012 so that actual performance can be viewed in one document.

Réponse:

Voir la réponse à la question 17.1 à la pièce HQTD-3, document 1.

1.2 Please confirm that financial risk is captured in the earned ROE, since the ROE is after the payment of fixed interest charges, ie. reflects the financing of each division. If not please explain why not.

Réponse:

Concentric does not confirm that financial risk is captured in the earned ROE. Concentric believes that financial risk is prospective in nature. In our view, financial risk is best measured by the leverage in the capital structure of the firm because this leverage reflects the degree of protection that equity holders have during both normal business conditions and periods of unforeseen business conditions and financial market duress.

1.3 Please confirm that business risk for a non-regulated firm is normally captured in either earnings before interest and tax (EBIT) or earnings before interest tax and depreciation (EBITDA) since these measures capture earnings before taking into account how a firm is financed, that is, financial risk. If not why not.

Réponse:

Concentric did not consider the business risk of non-regulated firms in preparing its ROE and risk analysis testimony for HQD and HQT.

1.4 Please confirm that regulatory risk also shows up in a utility's ability to earn it's allowed ROE, that is, firms lacking regulatory protection in terms of deferral accounts and frequent rate hearings are less likely to earn their allowed ROE than ones with significant regulatory protection? If not please explain why not.

Réponse :

As discussed on page 58 of Concentric's evidence, the Régie has stated in prior decisions that earned ROEs are an important indicator of whether the operating utility has sufficient regulatory protection against various business risks. While this comparison is useful in evaluating the short-term risk protection of the operating companies in proxy group, it is less helpful in terms of assessing the longer-term risks of those entities, especially with respect to recovery of their investment in rate base.

1.5 Please discuss any significant deviations from the allowed ROE provided in answer to 1.1 above for both HQD and HQ. Please define what HQD and HQT would judge to be a significant under-earning relative to the allowed ROE.

Réponse :

Please refer to response to Request 1.1. HQD and HQT do not have a working definition of significant under-earning relative to the allowed ROE, it is more concerned with earning a ROE that meets the definition of a Fair Return that would meet investor expectations on a stand alone basis for a regulated distribution/transmission company.

1.6 Normally business risk is judged to have both a short run and a long run dimension. Short run is the income risk discussed above, whereas long run risk is the risk of fundamental changes in the supply and /or demand for the product being transported and/or distributed. Is the fact that Hydro Quebec does not mention this risk an acceptance that such risk does not exist or is not material for either HQT or HQD? If not please discuss in detail why such risks have not been discussed.

Réponse:

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

Also, please see response to AQCIE/CIFQ's Request 7.1 in HQTD-5, document 4.2.

1.7 Please provide the average economic life of the assets of both HQT and HQD and copies of the last depreciation studies filed with the Regie. Have there been any material changes in the economic useful life over the last ten years for either HQD or HQT?

Réponse:

La notion de durée de vie économique n'est pas une donnée calculée par les Demandeurs, lesquels utilisent la notion de durée d'utilité à des fins comptables.

Les Demandeurs ne peuvent toutefois pas fournir la durée d'utilité moyenne de l'ensemble de leurs actifs respectifs, la durée d'utilité des catégories d'actifs pouvant varier à chaque année, dépendamment des actifs mis en service et des révisions des durées d'utilité effectuées. De plus, une durée d'utilité moyenne globale ne serait pas représentative et pertinente, compte tenu de l'importance du nombre de catégories d'actifs et compte tenu du fait que les durées d'utilité peuvent être significativement différentes.

Aucune étude de révision de durée d'utilité n'a été déposée à la Régie.

L'impact des révisions des durées d'utilité du Distributeur est présenté à la pièce « Conventions, méthodes et pratiques comptables » de chacun des dossiers tarifaires et celui du Transporteur, à la pièce « Évolution de la base de tarification » de chacun de ses dossiers tarifaires.

Second Topic: Business Risk

Reference: Company evidence pages 10-13

Preamble:

The company discusses in a general way the risks faced by HQD and HQT.
Question 2:

2.1 Would HQD and HQT agree that ultimately the risk for both utilities is derived from the demand and supply of the underlying product being transported and distributed? If not, why not.

Réponse:

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

Concentric would not agree with this proposition. Supply and demand for the underlying product are only one aspect of a utility's risk profile. Both divisions must maintain reliable systems capable of delivering energy and ancillary services under a wide variety of load conditions, meeting provincial energy policy goals, meeting service quality objectives, hiring and training a professional work force, financing, building and maintaining complex systems over a diverse geography.

2.2 Please provide any studies that either HQD or HQT have relied on that estimate the sensitivity of the demand for electricity to income and its own price.

Réponse:

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

2.3 Please provide the income and revenue breakdown for HQD in terms of industrial, commercial and residential for each year since 2001 and whether HQD regards any changes as being material.

Réponse :

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

2.4 Please provide a cost comparison for the types of users in 2.3 above and the fuel source that HQD regards as most competitive, for example, fuel oil, natural gas etc.

Réponse :

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

2.5 Please provide the data in 2.4 for 2001 and 2007 and discuss whether in the judgment of HQD there has been a material change in the competitive potion of electricity in Quebec.

Réponse :

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

2.6 Please provide a cost comparison of electricity with natural gas (or any more competitive fuel) for residential customers in BC (Fortis Energy BC (FEI)), Alberta (Atco Gas) and Ontario (Enbridge Gas Distribution (EGDI)) and discuss whether electricity in Quebec has a greater or lesser competitive advantage over alternative fuels.

Réponse :

Voir la réponse à la question 5.1 de l'AQCIE/CIFQ à la pièce HQTD-5, document 4.1.

2.7 Please confirm that the Regie allows Gaz Metropolitain a higher total equity ratio (common plus deemed preferred shares) at 46% than the OEB allows EGDI and Union Gas (36%), the AUC allows Atco gas (39% or the BOUC allowed FEI (38.50%).

Réponse:

The Régie allows Gaz Métro a 38.5% common equity ratio, in comparison to EGDI's allowed 36%, Union Gas' allowed 36%, ATCO Gas' 39%, FEI's 38.5%, and Fortis BC Vancouver's 40% and Fortis BC Whistler's 40%.

Selon la connaissance générale qu'ont les Demandeurs des taux de capitalisation de ces entreprises, il semble que les taux rapportés soient exacts.

2.8 Please confirm that the higher risk profile of Gaz Metropolitain relative to other large gas distributors in Canada can alternatively be viewed as the lower risk profile of HQD. If not please explain why not?

Réponse:

The higher risk profile of Gaz Métro relative to HQD is evident through the deemed equity ratio, which is 38.5% common equity for Gaz Métro and 35.0% common equity for HQD. In addition, Gaz Métro is deemed by the Régie to have 7.5% preferred equity in its capital structure for regulatory purposes. Although the Régie has accounted for the difference in risk between Gaz Métro and HQD through a higher deemed equity ratio for Gaz Métro, the allowed ROE for Gaz Métro is 8.90% compared to 6.19% for HQD. In Concentric's view, and as discussed in our evidence, the difference in business risk between Gaz Métro and HQD has not changed so much between 2004 and 2013 as to justify an ROE differential of more than 270 basis points between Gaz Métro and HQD.

Third Topic: Fair ROE

Reference: Company evidence pages 15-16

Preamble:

Hydro-Quebec defines the stand alone principle as treating the utility "as if it were seeking to attract capital on the financial markets independently from the rest of the enterprise to which t belongs."

Question 3

3.1 Please provide a justification for this definition of the stand-alone principle.

Réponse:

The referenced statement from Hydro-Québec's evidence is consistent with the Régie's prior decisions in which it has indicated that the ROE for HQD and HQT should be set on a "stand-alone basis, as if the entities were independently seeking to attract capital in the financial markets. (See Concentric's ROE and risk analysis evidence at page 20.)

Further, the stand-alone principle is a widely practiced tenet of North American utility regulators in both Canada and the U.S. For example, the Ontario Energy Board is quite clear in its interpretation of the stand-alone principle, stating :

"The Board concludes that if OPG is operated at arm's length, then it should be examined in the same way as Hydro One, another energy utility owned by the Province. In other words, Provincial ownership will not be a factor to be considered by the Board in establishing capital structure."

and

"The stand alone principle leads us to conclude that OPG's financial risks as not lower as a result of Provincial ownership..."[1]

Likewise, in his textbook, New Regulatory Finance, Dr. Roger Morin explains the stand-alone principle as follows : "A utility operating company, segment, division, or line of business must be treated as a separate stand-alone entity, distinct from its parent company, because it is the cost of capital for the division that we are attempting to measure and not the cost of capital for the parent company's consolidated activities. Financial theory clearly establishes that the true cost of capital depends on the use to which the capital is put.s[2]

3.2 Please confirm that in economic terms the stand alone principle simply means that the consumer pays minimum average cost determined without the impact of subsidies or excessive (uneconomic) costs imposed by its owners. That is, regulation is designed to mimic the act of perfect competition and remove the impact of market power

Réponse :

Mr. Coyne does not confirm the above statement regarding the stand-alone principle, although he does agree that regulation is intended to replicate competitive markets by preventing the regulated entity from earning monopoly profits. As stated in the response to Request 3.1, the stand-alone principle, as used in the context of determining the cost of capital for regulated firms, refers to the widely practiced regulatory principle of establishing the rate of return for a utility as if it were a stand-alone entity seeking to attract capital in financial markets based on its operational and financial risk profile, and not that of its shareholder or parent company.

3.3 Please confirm that Hydro-Quebec's owner is the Province of Quebec and indirectly the people of Quebec and indicate all major policy actions by the province that have directly or indirectly instructed Hydro Quebec to take uneconomic actions in the public interest.

1 Ontario Energy Board, Decision with Reasons, EB-2007-0905, November 3, 2008, at page 142.

2 New Regulatory Finance, 2006 Public Utilities Report, Inc., Dr. Roger A. Morin, at 216.

Réponse :

Voir la réponse à la question 1.1 de UC à la pièce HQD-5, document 10.

3.4 Please indicate the charge the Province of Quebec levies on Hydro Quebec in return for the provincial guarantee of its debt. Would Hydro Quebec judge this to be a violation or confirmation of the stand-alone principle?

Réponse :

Les frais de garantie sont de 50 points de base, appliqués à la dette garantie par la Province de Québec au 31 décembre de l'année précédente, conformément à la *Loi sur les frais de garantie relatifs aux emprunts des organismes gouvernementaux.*

Les sommes chargées à la clientèle en 2012 pour couvrir les frais de garantie ont été de 31,1 M$ pour le Distributeur et de 57,3 M$ pour le Transporteur.

Les Demandeurs s'en remettent à l'avis de leurs experts concernant le principe du stand-alone.

Concentric would not judge the Provincial guarantee as either confirmation or a violation of the stand alone principle. The stand alone principle focuses on the return investors would expect if the entity was standing alone for purposes of raising capital, thus reflecting the market cost of capital without subsidy.

3.5 Further to 3.3 above please indicate the current debt cost to Hydro Quebec as the cost of the Provincial guarantee charge plus the current Province of Quebec yield spread over the 30 year long Canada bond yield (Cansim V39056), relative to the current thirty year utility yield spread using the Bloomberg utility yield (C29530Y) and the 30 year Government of Canada bond series (Cansim V39056). Please provide these two spreads for each month since June 1, 2013.

Réponse :

Please see Request 3.5, Attachment 1.

3.6 3Further to 3.4 please provide the same utility spread for the following major utilities since June 1: Enbridge Gas Distribution (EGDI), Canadian Utilities, Fortis Energy Inc (FEI), Union Gas and Gaz Metropolitain.

Réponse:

Please see Request 3.5, Attachment 1.

Fourth Topic: Capital structure Differences

Reference: Company evidence page 16

Preamble:

Hydro-Quebec indicates that a 30% common equity ratio for HQT and 35% for HQD are appropriate based on their risk differences. Question 4

4.1 Please confirm that Hydro Quebec is asking for the same ROE for both HQD and HQT of 9.20% and it judges the differential common equity ratios to totally adjust for the risk differences.

Réponse:

Les Demandeurs confirment qu'ils demandent un taux de rendement des capitaux propres de 9,2 % et que la différenciation de leurs risques respectifs est prise en compte par l'utilisation de structures du capital différentes suivant la recommandation de leurs experts.

4.2 Please confirm that Hydro Quebec no longer judges HQD to warrant a 0.12% higher ROE than HQT (page 14 of company testimony).

Réponse:

Voir la réponse à la question 4.1.

4.3 Since the risk compensation for HQD relative to HQT is reduced (no ROE premium but same higher common equity ratio) please indicate all factors that lead to this decline in relative risk assessment for HQD relative to HQT.

Réponse:

Voir la réponse à la question 4.1.

Fifth Topic: Earnings Sharing mechanism

Reference: Company evidence page 17

Preamble:

Hydro-Quebec seeks a 1.0% dead-band for HQD and 0.50% for HQT.
Question 5

5.1 Please confirm that Hydro Quebec is not seeking performance based regulation for either HQT or HQD?

Response:

The Petitioners propose adding a mechanism for handling performance variances as part of the current regulatory framework, which would allow the objectives of section 48.1 of the *Act respecting the Régie de l'énergie* to be met.

5.2 Please provide the average excess of the actual versus the allowed ROE for both HQD and HQT from the answer to 1.1 above.

Response:

See the answer to question 1.1.

5.3 Please indicate the average $ amount that HQD and HQT would have "kept" had its requested earnings sharing mechanism been in effect since 2001.

Response:

See the answer to question 17.2 of Exhibit HQDT-3, document 1.

5.4 Please confirm that the bulk of the excess earnings are due to under-spending of expenses as indicated in the Regie's additional request #13, Tables 13.1 and 13.2 rather than to efficiency gains.

Response

As mentioned in the response to question 13.2 in Exhibit HQTD-3, document 1 (B-0020), the variances result in all cases from the variances between the projections and the actual costs recorded for a given year. However, some of these variances result from unanticipated efficiency gains that are difficult, and in some cases even impossible, to distinguish from projection variances.

5.5 Please indicate what controls Hydro Quebec is putting in place to prevent the persistent under-spending of requested expenses in the future should the Regie approve the requested dead-bands.

Response

See the answer to question 5.4, the answer to question 31.3 of the Régie in Exhibit HQTD-5, document 1 and the response to question 10.3 in Exhibit HQTD-3, document 1.