ANSWERS FROM MR. RICHARD BAUDINO, EXPERT FOR THE FCEI WITH RESPECT TO THE REQUEST FOR INFORMATION NO. 2 OF THE RÉGIE DE L'ÉNERGIE (THE "RÉGIE") REGARDING THE GENERIC MATTER BEARING ON THE ALLOCATION OF COSTS AND RATE STRUCTURE OF GAZ MÉTRO

1. References: (i) Exhibit C-ROEÉ-0082, p. 20;
(ii) Exhibit C-ROEÉ-0082, p. 21;
(iii) Exhibit C-ROEÉ-0082, p. 25.

Preamble:

(i) ***"What categories of operating costs result from additions of new loads, as distinct from additions of new customers?***

A:Gaz Métro identifies four categories that it treats as being driven by the number of customers added, but that probably vary more with the added revenue, which I list below, with the line numbers from the B&V Report(B-0145, pp. 9–11):

- *Cost of Bad Debts;*
- *Collection and recovery costs;*
- *Customer retention costs -Major accounts;*
- *Customer retention costs -Major industries.*

A small customer who goes into financial distress or leaves unpaid bills will impose lower costs of bad debt and debt collection than a larger one, for the same number of months of unpaid bills."

(ii) ***"Q: Why do you disagree with B&V on the treatment of Distribution Gas Supply expenses***

A:The costs in this account cover long-term and short-term planning of Gaz Métro purchases of gas for its customers; system control for all gas on the Gaz Métro system; and contractual relationships with Gaz Métro's suppliers, third-party suppliers, and self-supplying customers."

(iii) ***"Q:Has Gaz Métro omitted any costs from this category?***

A:I believe so. Gaz Métro must incur costs prior to the commitment of customers to connection to the new line, for marketing; explaining the connection process, rates, the CRP, and other matters to potential customers; and estimating the costs of service connections so that customers can commit to the connection. Those costs must be included in the evaluation of the decision to proceed with the line extension."

Requests:

1.1 Please comment on the appropriateness of basing the "*Cost of Bad Debts*" and "*Collection and recovery costs*" on the anticipated revenues, as the expert Chernick suggests in reference (i).

Response:

In general, it is the case that a smaller customer would impose less bad debt expenses than a larger one would. However, it is not necessarily the case that bad debt and collection and recovery costs should be based on anticipated revenues for all classes. Instead, a class-by-class study should be performed by the utility to determine the amount of bad debt and collection and recovery costs for which each customer class is responsible. It may not at all be the case that major industries bad debt costs, for example, are correlated with revenues. Please note that Gaz Metro did not include bad debt and collection and recovery costs for the Major Industries class.

1.2 Please comment on the appropriateness of including the costs associated with the "*Distribution Gas Supply expenses*" in the marginal costs of long-term service delivery, as the expert Chernick suggests in reference (ii).

Response:

I agree in principle with Mr. Chernick's proposed inclusion of Distribution Gas Supply expenses, although I have not thoroughly evaluated and verified his calculations. Distribution Gas Supply expenses are a marginal cost that should be included by the Regie in marginal operationing costs.

1.3 Please comment on the appropriateness of including marketing-related costs in the marginal costs of long-term service delivery, as the expert Chernick suggests in reference (iii).

Response:

In my opinion, it is appropriate to include marketing-related costs in the costs of long-term service delivery. It may be the case that these costs have already been incurred and that the addition of one customer, or even a small increment of additional customer demand, would not cause current marketing costs to increase. However, the costs mentioned by Mr. Chernick should be included from the perspective assessing the profitability analyses using marginal costs of long-term service delivery.

2. References: (i) Exhibit C-FCEI-0094, p. 8;
(ii) Exhibit C-FCEI-0094, p. 11 and 12.

Preamble:

(i) *"Regarding customer retention costs, it is not clear at this point as to the elements that constitute these retention costs and whether these costs should be included in the marginal costs of long term delivery service. I sought additional support for these costs in my Information Request No. 8 (e). Gaz Metro responded with references to its response to question 1.1 of the Régie's request for information No. 5 and its response to question 1.4 of Mr. Chernick's information request. However, these referenced responses did not provide the additional details I required. Therefore, I did not include customer retention costs in my recommendation to the Régie."*

(ii) Tables 2 and 3 of the evidence of the CFIB, lines 11 and 12.

Request:

2.1 Please clarify your proposal regarding customer retention costs for the CII and Sale Major Industries markets (references (i) and (ii)).

Response:

I do not agree with including customer retention costs for CII and Major Industries at this time due to the lack of specificity as to the costs that were included by Gaz Metro in its original study. Therefore, I was unable to assess the reasonableness of the level of these costs that were included in the original Gaz Metro study. Both Mr. Chernick and Dr. Marcus have recommended that these costs are marginal operating costs that are incurred as new customers are added. I would be willing to consider including these costs if Gaz Metro furnished greater details about what is included in these costs from their original study.

3. References: (i) Exhibit C-ROEÉ-0082, p. 8 and 9;
(ii) Exhibit B-0196, Schedule 1, p. 1 to 4.

Preamble:

(i) *"Gaz Métro provides a range of estimates, from zero to the average expected cost of the service, for several cost categories (processing CRP applications, customer retention, various meter maintenance costs).* [...]

These ranges add nothing to the analysis of profitability, for two reasons. First, the values presented as the high end are not high-end estimates: they are averages, reflecting high-cost and low cost situations. Gaz Métro is proposing ranges from zero to average, rather than just using the average.

Second, Gaz Métro has not explained how it would use these ranges.

Where Gaz Métro has distinguished the costs of serving different types of customers (as for meter maintenance), those values can be used in the profitability analyses, by multiplying the cost for each type of meter by the number of those meters to be added. It is not clear how Gaz Métro would know, as it is proposing to extend a line, whether the eventual new customers would use the call center, apply for a CRP grant, or require customer retention services in the future."

(ii) Tables describing the methodology used to establish each of the costs presented in the proposal of Gaz Métro's expert.

Request:

3.1 What is your opinion of expert Chernick's position cited in reference (i) regarding the relevance and usefulness of defining ranges for the marginal costs of long-term service delivery, varying between zero and an average value (reference (ii)).

Response:

With respect to the cost categories referred to by Mr. Chernick, I agree with Mr. Chernick that it is appropriate to use the average numbers, rather than a range. It would be reasonable and preferable to use the best estimate of the average cost, or marginal incremental cost, for each activity and to disaggregate these costs where feasible and measurable in the profitability analyses. The one caveat is that I would not include customer retention costs without further explanation and verification, as I mentioned in my previous response to Request 2.1.

4. Reference: (i) Exhibit B-0196, p. 6 and 7.

Preamble:

(i) *"2.1 By comparing the study that Gaz Métro filed in the 2015 rate case in reference (i) with the analysis produced by Black & Veatch in reference (ii), the Régie has noted that the analysis does not include the marginal costs of long-term service delivery for load additions (reference (iii)). Please explain why.*

Response:

Load additions typically do not require new facilities and therefore do not have any marginal O&M. If load additions require new capital to replace existing facilities there is also no incremental O&M and in fact the NPV of future O&M actually decreases. In fact the new facilities have lower current O&M than the replaced facilities because they are largely plastic pipe that requires no cathodic protection. Also, new plastic typically requires little or no maintenance compared to older plant.

Any additional administrative costs would likely be more than offset by the decreased O&M costs, hence the assumption of zero marginal O&M cost."

Request:

5. What is your opinion of the hypothesis retained by Gaz Métro and its expert holding that the marginal costs of long-term service delivery are zero for load additions.

Response:

Gaz Metro's position on this point is not correct when considered from the perspective of a long-run marginal cost study. Over the long run, load additions of sufficient size will indeed result in additional costs being incurred by the utility, including new facilities, capital costs, additional O&M, etc. A full long run marginal cost study should account for all such costs. Although the incremental O&M may be lower than current O&M for new facilities, this lower incremental cost must be quantified and included nonetheless. This is also the case for incremental administrative costs, which are incurred by the Company regardless of whether incremental O&M is lower than current O&M.