RESPONSE OF GAZ MÉTRO LIMITED PARTNERSHIP (GAZ MÉTRO) TO THE IGUA'S REQUEST FOR INFORMATION

Introductory Commentary
Gaz Métro notes that, concurrently with the filing of the responses to this request for information, Gaz Métro is also filing Exhibit Gaz Métro-7, Document 4, which describes a new approach to the evaluation of profitability. The content of this new exhibit provides additional information to be taken into consideration by the intervenor in its analysis of Gaz Métro's responses.

Gaz Métro - Application regarding the generic matter relating to the allocation of costs and Gaz Métro's rate structure

1. <u>The Application</u>

References:

(i) R-3970-2016-B-0002, page 3
(ii) B-0176, page 3

Preamble:

(i) *"[TRANSLATION] Ultimately, Gaz Métro proposes, in Exhibit Gaz Métro-3, Document 4, a methodology for the acceptance of extension projects with profitability potential, and asks the Régie to approve said methodology."*

(ii) *The following excerpt is taken from the distributor's application in this matter:*

[TRANSLATION]

III. <u>Methodology for Evaluating the Profitability of System Extension Projects (Exhibit Gaz Métro-7, Document 1)</u>

21. <u>Following decisions D-2016-090 and D-2016-169, Gaz Métro adduces its evidence with respect to the methodology for evaluating the profitability of system extension projects and respectfully asks the Régie to:</u>

a) <u>acknowledge the follow-up required under decisions D-2016-090 and D-2016-169 with respect to system extension projections for a 5-year and a 10-year term, and with respect to the preparation of a benchmarking report on the existing approaches in other provinces regarding acceptability criteria for system extension projects; and</u>

b) <u>acknowledge the methodology for evaluating the profitability of system extension projects,</u>

<u>as appears from Exhibit Gaz Métro-7, Document 1;</u>

Question:

1.1 At the time of the 2017 rate case, Gaz Métro asked the Régie to approve a methodology for the purposes of accepting extension projects with profitability potential (ref (i)). In this matter, Gaz Métro respectfully asks the Régie to take note of the methodology for evaluating the profitability of the projects (ref (ii)). Please confirm or correct the understanding of the IGUA to the effect that the Distributor is not asking for the approval of a change to the current methodology. If confirming the aforementioned understanding, please explain why the proposed change to the methodology no longer requires the approval of the Régie but simply that it take note thereof.

Response:

Gaz Métro confirms that, as appears from its application (B-0176), it respectfully asks the Régie to "take note of" the methodology for evaluating the profitability of system extension projects. Gaz Métro believes that the opportunity to apply, or refrain from applying, such a methodology is a business decision to be addressed internally by its managers, in the course of carrying out its business. Therefore, Gaz Métro respectfully submits that the Régie's approval with respect to the methodology is not required. This position is moreover consistent with the one presented by Gaz Métro in R-3998-2017. Therefore, as indicated in the introductory note of Exhibit B-0178, Gaz Métro-7, Document 1, the review of the application in this matter is a response to the monitoring required by the Régie in decisions D-2016-090 and D-2016-169. Moreover, the term "take note of" is frequently used by Gaz Métro in the conclusions of its applications when it follows through with monitoring required by the Régie.

Moreover, as noted in the response to question 1.13 of the Régie's request for information no. 9 (Gaz Métro-9, Document 1), the latter may, in the context of reviewing rate applications, rule on the utility and prudent nature of investments that will have been carried out by Gaz Métro in applying this methodology.

2. <u>Extension Projects Targeted by the Proposed Methodology</u>

References:

(i) B-0178, page 8

Preamble:

(i) "[TRANSLATION] *Based on the findings of the* a posteriori *profitability analysis, Gaz Métro established the acceptable minimum threshold at 2% of the IRR for extension projects associated with an investment level of less than $1.5 million."*

Questions:

2.1. Please confirm that the new proposed methodology for accepting projects will only target projects below $1.5 million with profitability potential. If so, please confirm why and how the profitability criteria applied to the evaluation of projects exceeding $1.5 million should differ from those applied to projects valued at $1.5 million or less. Please elaborate.

Response:

Gaz-Métro confirms that the methodology, as presented in January 2017 in Exhibit B-0178, Gaz-Métro-7, Document 1, applies to extension projects of less than $1.5 million with profitability potential. For those extension projects where investments exceed $1.5 million, the files will be presented to the Régie in accordance with section 73, clause (1) of the first paragraph of the *Act respecting the Régie de l'énergie* and handled on a case-by-case basis.

3. Establishment of the Acceptable Minimum Threshold

Reference:

(i) B-0178, page 7

(ii) B-0178, page 8

(iii) B-0178, page 8

Preamble:

(i) The following excerpt, taken from the evidence, presents the data used for the calculation of the reduction that Gaz Métro proposes to apply to the IRR of projects with profitability potential.

Table 1

Analysis Results

Fiscal year of the development plan	IRR increase (*a priori* IRR vs *a posteriori* IRR)
2009 Plan	5.08%
2010 Plan	5.52%[1]
2011 Plan	2.85%
Average	4.48%[2]

1 Excluding a mining extension project the profitability of which increases the overall IRR by 11.37%.
2 Excluding a mining extension project from the 2010 Plan, the profitability of which increases the IRR by 6.43%.

Based on the findings in Table 1, Gaz Métro notes that the profitability of the extension projects analysed increased by an average of 4.48%.

(ii) "[TRANSLATION] *Based on the findings of the* a posteriori *profitability analysis, Gaz Métro established the acceptable minimum threshold at 2% of the IRR for extension projects associated with an investment level of less than $1.5 million. The analysis reveals an average IRR increase of 4.48%, which should continue to grow over time."*

(iii) "[TRANSLATION] *Gaz Métro intends to continue analyzing completed* *extension projects in order to assess whether the acceptable minimum threshold is still appropriate."*

Questions:

3.1. Please produce the IRR increase (*a priori* IRR versus *a posteriori* IRR) for 2005, 2006, 2007 and 2008, and calculate the average increase over the entire period (ref (i)). Please produce the data for each of the projects considered as well as for the entire portfolio of projects. Please also include projects exceeding $1.5 million.

Response:

The data required to link densification sales to their original extension project did not exist in Gaz Métro's systems prior to 2009. Gaz Métro can therefore only provide the data requested for development plans after 2008.

However, Gaz Métro refers to question 9.3a of the Régie's request for information no. 9 (Gaz Métro-9, Document 1) which will be answered on August 10, 2017 and presents the IRR increase for the entire portfolio of projects valued at under $1.5 million from 2009 to 2013.

3.2. Please calculate the *a posteriori* rate impact of extension projects from 2005 to 2011. Please produce the data for each of the projects considered as well as for the entire portfolio of projects. Please also include projects exceeding $1.5 million.

Response:

As mentioned in question 3.1, the data required to link densification sales to their original extension project did not exist in Gaz Métro's systems prior to 2009.

For each development plan year, Gaz Métro evaluates the aggregate *a posteriori* profitability of all extension projects for both residential and business markets (valued at under or over $1.5 million). Gaz Métro does not conduct individual *a posteriori* analyses for projects valued at less than $1.5 million, as profitability is monitored globally for the residential market as well as for the business market. Therefore, Gaz Métro establishes a profitability objective at the beginning of the year for each of these two markets, and ensures that they are maintained throughout the year. In addition, as there are many projects valued at under $1.5 million (235 extension projects for the business market in connection with the 2009 to 2011 development plans), such an assessment would take a significant amount of time.

However, Gaz Métro measures the *a posteriori* profitability of extension projects exceeding $1.5 million on a project-by-project basis. Such project monitoring is carried out in the context of the annual report filed with the Régie.

In the following table, Gaz Métro provides, for each business market development plan from 2009 to 2011, the current value of the impact on *a posteriori* rates (40 years) for all projects valued at under or over $1.5 million.

Development Plan	Current value of impact on rates (40 years) Projects valued at under or over $1.5 million
2009	($8,745,519)
2010	($10,728,375)
2011	($12,726,214)
Total	**($32,200,108)**

3.3. What hypothesis can Gaz Métro use to conclude that the average IRR increase of 4.48% should continue to increase over time (ref (ii))? Please elaborate.

Response:

The average IRR increase for development plans from 2009 to 2011 should continue to rise over time, as new densification sales, which are usually very profitable, will continue to be added to the extension projects provided for in these development plans. It should be noted that, with respect to the 2% AMT, a mark-up of less than 4.48% is necessary to achieve the PCC.

4. Alternative Solutions

Reference:

(i) EB-2016-0004, Decision with reasons, page 3

Preamble

(i) *"At the OEB's invitation, parties proposed a variety of measures that could lead to expanded gas service. These included surcharges for new customers, financial contributions from municipalities, subsidies provided by existing customers, funding from other levels of government, and competition in the form of new entrants to the gas distribution business."*

Question:

4.1. Has Gaz Métro considered solutions other than the proposed change to the methodology? For example, has Gaz Métro considered rate solutions such as applying a rate surcharge for clients in localities benefiting from a new system of service lines? Please elaborate.

Response:

Gaz Métro is currently assessing various alternatives in order to promote a development that is beneficial to all of its clients. These alternatives are mainly rate-oriented and will be further examined in Phase 4 of R-3867-2013, which addresses the review of distribution rate structures. Gaz Métro notes that the rate modifications that will be analyzed in Phase 4 of this matter would complement, and not replace, the methodology presented in Exhibit Gaz Métro-7, Document 3.

5. Benchmarking project profitability evaluation practices

Reference:

(i) B-0178, page 13
(ii) British Columbia Utilities Commission, Order no. G-152-07, page 34

Preamble:

(i) "[TRANSLATION] *In British Columbia, Fortis BC is authorized to use a portfolio approach in which projects presenting an IRR below the PCC may be accepted. Fortis BC uses an economic test for its extensions known as the "Main Extension test (MX test)". The economic test generates a profitability index ("PI"). For individual projects, the profitability index must be greater than or equal to 0.8, which corresponds to an IRR of approximately 3.70%. Moreover, the portfolio of projects must achieve a profitability index greater than or equal to 1.1, which corresponds to an IRR of approximately 6.02%.*"

(ii) *"The targeted aggregate PI of 1.1 is more conservative than requiring a PI of 1.0 and will therefore be able to accommodate unanticipated variances in either costs or consumption that may occur.*

The Companies propose to evaluate the aggregated PI of each utility on an annual basis using a random sample of main extension projects from that year (Terasen Argument, para. 13), and ii) the Companies seek approval to reduce the threshold PI for individual main extension projects to proceed without a customer contribution from the current required level of 1.0 to 0.8."

Questions:

5.1. As reported in the evidence presented by Gaz Métro, British Columbia and Ontario use an approach whereby the profitability index for individual projects can be lower than 1, as long as the profitability index is greater than or equal to 1.1 for the entire portfolio. Would Gaz Métro be willing to apply a similar approach allowing for an IRR lower than the PCC for individual projects requiring an IRR slightly higher than the PCC for the entire portfolio of extension projects? Please elaborate.

Response:

As mentioned in the introductory commentary, Gaz Métro notes that it has filed a new approach for evaluating profitability, which is presented in Exhibit Gaz Métro-7, Document 4.

6. Internal Governance Process

Reference:

(i) B-0178, page 9

Preamble:

(ii) "[TRANSLATION] *In order to maximize the positive impacts that potentially profitable extension projects can have on customers, Gaz Métro has implemented a governance process that frames each step leading to the completion of these extension projects, from the evaluation of overall growth potential to the densification of extension projects."*

Questions:

6.1. Please describe how the proposed governance process differs from the current process in the course of an extension project's evaluation and monitoring.

Responses:

Please see the response to question 13.1 of the Régie's request for information no. 9 (Gaz Métro-9, Document 1).

6.2. Does Gaz Métro intend to produce an annual report to present the *a posteriori* IRRs of the various projects and monitor the evolution of their profitability over time to ensure that the applied minimum threshold is sufficient to allow for the eventual achievement of the PCC? Please describe the type of reporting that the Distributor will produce for the various project categories (valued at under $1.5 million versus $1.5 million and up) and, in particular, specify which indicators other than the *a posteriori* IRR would be considered in the assessment of the earnings generated by the expansion projects.

Response:

First, for projects of $1.5 million and up, Gaz Métro will abide by the Régie's decisions in keeping with the evaluation of the applications for authorization, the case dealing with the appropriate monitoring method for these specific cases.

Second, for projects valued at under $1.5 million, Gaz Métro notes that it has filed a new profitability evaluation approach, which is presented in Exhibit Gaz Métro-7, Document 4.