

# DECISION

QUÉBEC

RÉGIE DE L'ÉNERGIE

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D-2017-092	R-3867-2013	September 1, 2017
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Phase 3

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**PRESENT:**

Marc Turgeon  
Louise Pelletier  
Commissioners

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**Gaz Métro Limited Partnership**  
Plaintiff

and

**Intervenors whose names appear hereinafter**

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**Final decision pertaining to Phase 3 Subject A, to the requests for payment of the intervenors' costs associated with the examination of this subject, and to the procedural decision on the temporary stay of the proceedings in R-3867-2013**

*Application regarding the generic matter bearing on the allocation of costs and rate structure of Gaz Métro*

### **Intervenors in Phase 3:**

**Industrial Gas Users Association (IGUA);**

**Canadian Federation of Independent Business (Québec Division) (CFIB);**

**Option Consommateurs (OC);**

**Regroupement des organismes environnementaux en énergie (ROEEÉ);**

**Stratégies énergétiques and Association québécoise de lutte contre la pollution atmosphérique (SÉ-AQLPA);**

**Union des consommateurs (UC).**

## 1. INTRODUCTION

[1] On November 15, 2013, Gaz Métro Limited Partnership (Gaz Métro or the Distributor) filed with the Régie de l'énergie (the Régie") an application regarding the generic matter relating to the allocation of costs and its rate structure (the Case).

[2] On January 30, 2014, the Régie rendered its decision D-2014-011,<sup>1</sup> in which it more specifically ruled on the procedural framework of the Case. It split the examination into two phases: Phase 1 pertaining to the cost allocation methods of the distribution service and Phase 2 pertaining to the rate structure, cross-subsidization and rate strategy of the distribution service.

[3] On April 28, 2016, Gaz Métro filed a request pertaining to Phase 2 of the Case.<sup>2</sup> In it, the Distributor proposed that the matter finally be split into four phases, Phase 2 dealing with a review of the supply, transmission and balancing services, as well as the interruptible service, and Phase 3 with fixing the marginal costs of the long-term service delivery (MCLTSDs).

[4] On August 4, 2016, the Régie rendered its decision D-2016-126,<sup>3</sup> in which it allowed part of the Distributor's proposal regarding the procedural aspects of the Case. As regards the proposal for a third phase, the Régie noted the absence of evidence and reserved its decision on the subject as well as on the relevance of handling the matter separately in a phase dedicated to that subject.

[5] On October 5, 2016, Gaz Métro introduced an application concerning the determination of MCLTSDs and proposed that the subject be dealt with in the context of a distinct phase, Phase 3.

[6] On October 24, 2016, the Régie held a preliminary meeting to determine, among other things, the method and timetable for dealing with this new Phase 3 of the Case.

[7] Following the preliminary meeting, the Régie handed down its decision D-2016-169,<sup>4</sup> in which it decided to create a Phase 3 for the Case dealing with the following subjects that were identified, namely:

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<sup>1</sup> Decision D-2014-011.

<sup>2</sup> Exhibit B-0130.

<sup>3</sup> Decision D-2016-126.

<sup>4</sup> Decision D-2016-169.

- A. The method for determining the MCLTSDs;
- B. The methodology for analyzing the profitability of system extension projects.

[8] On December 14, 2016, the Régie rendered its decision D-2016-186<sup>5</sup> in which, among other things, it granted the status of intervenor for Phase 3 to IGUA, CFIB, OC, ROEÉ, SÉ-AQLPA and UC, and set a timetable for examining Subject A.

[9] On February 1, 2017, the Régie rendered its decision D-2017-009<sup>6</sup> in which, among other things, it recognized the status of Messrs. Richard A. Baudino, Paul L. Chernick, William P. Marcus and H. Edwin Overcast as experts.

[10] The hearing for Phase 3 Subject A was held from April 18 to 21, 2017. The Régie took the matter under advisement at the end of the hearing.

[11] Between May 3 and 24, 2017, the intervenors filed their claim for payment of the costs associated with their participation in the examination of Phase 3 Subject A. Gaz Métro did not formulate any comments on those claims.

[12] Commissioner Laurent Pilotto having become unable to act, this decision was made by the two other commissioners, in accordance with section 17 of the *Act respecting the Régie de l'énergie*<sup>7</sup> (the Act).

[13] In this decision, the Régie is ruling on the methodology for determining the MCLTSDs and the claims for payment of the intervenors' costs regarding the examination of Phase 3 Subject A. It is also ruling on the procedural timetable of the Case, taking into consideration that Commissioner Laurent Pilotto was unable to act.

## 2. CONCLUSIONS SOUGHT

[14] The conclusions sought by Gaz Métro regarding the determination of the MCLTSDs are the following:

*“APPROVE the method proposed by Dr. Edwin Overcast for determining the marginal cost of long-term service delivery specific to each project, as described in Exhibit Gas Métro-6, Documents 2;*

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<sup>5</sup> Decision [D-2016-186](#).

<sup>6</sup> Decision [D-2017-009](#).

<sup>7</sup> [CQLR c R-6-01](#).

*AUTHORIZE Gaz Métro, from the moment the decision is rendered, to use this method in the profitability analysis of a customer connection project, an additional load for an existing customer, as well as in the analysis of the overall profitability of the development plan.*<sup>8</sup>

### 3. BACKGROUND

[15] The 2012-2013 development plan, presented by Gaz Métro in the context of its 2013 Rate Case,<sup>9</sup> raised concerns on the part of the Régie regarding certain aspects of the profitability analysis, in particular the MCLTSD used.

[16] In its decision D-2013-106, the Régie asked Gaz Métro to:<sup>10</sup>

*“[27] [...] use a long-term marginal operating cost of \$157 when analyzing the profitability of the residential and CII development plan. This value may be revised in a future rate case when the Distributor submits an evaluation of these costs.”*

[17] In the context of the 2015 Rate Case, Gaz Métro presented its study and proposed establishing, for each of the residential, commercial and industrial markets, those marginal costs that were applied to the profitability analysis (the Initial Proposal).<sup>11</sup> The Distributor stated that, in an effort to reduce the regulatory burden, it did not deem it necessary to retain the services of an expert to conduct this study.

[18] The purpose of this study was to review all marginal operating costs directly associated with a system extension project. These costs, which must be reflected in the evaluation of a project's profitability, are identified using a methodology that internal teams fine-tuned by means of an exhaustive exercise.

[19] Consequently, the Initial Proposal defined the MCLTSDs as being all costs that could be associated with a customer upon being connected to Gaz Métro's system. The study inventories the marginal costs generated by this new customer's connection, as well as the internal costs associated with maintaining these new facilities and the services that are directly supplied to that customer.

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<sup>8</sup> Exhibit B-0142, p. 3 and 4.

<sup>9</sup> R-3809-2012.

<sup>10</sup> R-3809-2012, Exhibit A-0153, p. 15

<sup>11</sup> Exhibit B-0144, Schedule A.

[20] The elements identified in the study are the additional costs of issuing a bill, cashing a payment and, for a telemetry customers, the use of a cellular telephone line.

[21] The internal costs associated with maintaining facilities primarily consist of the salaries and fringe benefits of the employees who perform these tasks, to which can be added the cost of clothing.

[22] The study also identifies maintenance activity costs relating to the meter, connection and service line supplying this connection. It inventories the costs of the services provided by the Distributor's teams when performing the credit check, handling a request for financial assistance or a participation in a consumer rebate consumption program ("RCP"), making telephone calls to customers, reading meters, dealing with bad debts and recovery, retaining customers, and drawing up an agreement.

[23] In that study, Gaz Métro noted discrepancies between the costs associated with service deliveries for the first year and for subsequent years. It noted that some activities occur only in the first year (for example, credit checks), while others are recurrent (meter readings or issuing bills, for example). It also noted that the cost of the same activity can vary from one market to the next (type of meter and inspection, for example).

[24] Moreover, Gaz Métro mentioned that the activities and costs considered in the study should be reviewed periodically in order for the evaluation of project profitability to reflect, over time, the evolution of operations, the scope and nature of costs as well as updates made to the methodology hypotheses.

[25] As CFIB wanted to retain the services of an expert to examine the evidence filed by Gaz Métro, the Régie, in its decision D-2015-048,<sup>12</sup> postponed the study of that subject until this Case so that Gaz Métro could retain the services of an expert and ensure that this subject is examined concurrently with the review of the rate structures.

[26] Gaz Métro therefore retained the services of Dr. Edwin Overcast of Black & Veatch for its study of the marginal costs. Essentially, Dr. Overcast recognized the quality of the Initial Proposal, though he did propose eliminating some of the costs therein.

[27] Gaz Métro confirms that it agrees with the analysis produced by Dr. Overcast<sup>13</sup> and concurs with all of his conclusions. It believes that the expert's recommendations helped refine the understanding of the marginal cost concepts.

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<sup>12</sup> R-3879-2014, Phase 3, Decision D-2015-048.

<sup>13</sup> Exhibit B-0145.

## 4. GENERAL PRINCIPLES

### 4.1 GAZ MÉTRO'S POSITION

[28] Gaz Métro would like to begin by specifying the framework surrounding the request pertaining to Subject A. It states that the methodology used to determine the marginal operating costs serves, among other things, to determine one of the inputs of the profitability analysis used to decide whether or not a system extension project should be carried out.

[29] This profitability analysis takes into consideration various inputs that hinge on two main poles: costs and revenues. These inputs are inventoried in a profitability analysis model that Gaz Métro has been using for many years.<sup>14</sup>

[30] This “costs” pole can be broken down into two segments: capitalizable expenses and non-capitalizable expenses. The latter include what are referred to as “operating costs”, which appear in line 21 of the profitability analysis model.<sup>15</sup> The examination of Phase 3, Subject A bears on the methodology used to determine what amount to enter under the item “operating costs”. In its evidence, the Distributor also uses such terms as “service delivery costs” and “marginal operating costs”.

[31] Gaz Métro points out that, in the past, the Régie and participants in the regulatory process have consistently, recurrently and without any exception whatsoever qualified these “operating costs” as “marginal”. Consequently, in its opinion, there was never any doubt as to the “marginal” quality of the operating costs being examined. It therefore argues that it is up to the Régie, based on the preponderant evidence entered into the record, to determine whether a “short-term” or “long-term” marginal cost should be used to determine what amount should appear in line 21 of the profitability analysis model.<sup>16</sup>

[32] To further the discussion and guide the Régie in its choice, Gaz Métro submits a few definitions for marginal costs regarding the nature of these costs, and concludes by arguing the following:

*“24. In other words, in order for a cost to be included in line 21 of the Table, the Régie must first be convinced that the said cost “results from the last unit produced” [reference omitted], “corresponding to an additional unit”, “supposedly from the last additional unit” or “results from the production of a*

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<sup>14</sup> Exhibit B-0242, p. 15.

<sup>15</sup> Exhibit B-0245, p. 1.

<sup>16</sup> Exhibit B-0244, p. 4.

*single additional unit.*”<sup>17</sup>

[33] Consequently, for the Distributor, the costs identified for the purposes of this exercise must obviously be “marginal” in nature, in other words, had it not been for the addition of this investment project, those costs would not have been incurred. It maintains that all of the marginal operating costs identified in its evidence meet this criterion.

[34] Gaz Métro is of the opinion that such a demonstration is impossible in the case of fixed costs. By its very nature, a fixed cost is not influenced by the “last unit produced” or, in this case, by a system extension project: it remains constant. Gaz Métro points out that a great majority of its operating costs are fixed, i.e. a proportion of 85%. It therefore maintains that most of the \$185 million that it spends annually in operating costs cannot be taken into consideration when determining the MCLTSDs.

[35] Gaz Métro repeats that before filing the Initial Proposal, it adopted an orderly and systematic approach and implemented a rigorous procedure for identifying MCLTSDs. This approach allowed it to identify 19 components linked to one aspect of specific costs to be considered in the marginal operating costs.

[36] It then retained the services of the expert Overcast. He submitted that only the short-term marginal operating costs should be taken into consideration when analyzing profitability in order to accurately reflect the application of economic principles:

*“[...] it’s incorrect to use long-run marginal costs for line extension. There are no efficiency implications for using long-run marginal costs and it’s theoretically an incorrect value to use in line extension policies and as a practical matter, it is, it’s incorrect to use it as well. The proper measure of costs is short-run marginal costs that produces economic efficiency and maximizes social welfare and these conclusions are supported even by the same authors cited by the other expert witnesses as supporting long-run marginal costs.”*<sup>18</sup>

[37] The expert concluded that only short-term marginal costs should be used. To do otherwise would result in an over-estimation of the costs associated with a system extension and would be inefficient from an economic perspective.<sup>19</sup>

[38] The expert Overcast was also of the opinion that the following types of costs must be either excluded or given a value of zero:

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<sup>17</sup> Exhibit B-0244, page 6.

<sup>18</sup> Exhibit A-0110, p. 19 and 20.

<sup>19</sup> Exhibit A-0110, p. 30.



- costs that he qualifies as “social”, such as collection and bad debt costs that either result from a policy prohibiting the interruption of service in winter time, or cannot be associated with a customer at the time that customer is connected to the system;<sup>20</sup>
- costs specific to a consumer that will be recovered therefrom under the user-pay approach;
- costs that will be absorbed by the revenues generated by the extension project;
- costs per level that cannot be attributed to the addition of a single customer and that only appear sporadically after a considerable number of new customers are added (“lumpy costs”);
- fixed costs.

The following excerpts taken from the evidence of the expert Overcast summarize his position:

*“[...] the fixed costs cannot go be included in marginal cost. So unless new capacity is required to provide the O&M service, in which case the fixed cost would increase, those would be marginal at that point but not before that point.”<sup>21</sup>*

*“In any event the cost causation at the margin is likely zero for long periods for modest growth utilities. For new plant O&M the marginal costs are essentially zero initially as new plant does not require more than mandated safety programs such as leak surveys. Those costs are fixed costs for the system and there is no reasonable marginal allocation for a new customer unless there is no existing capacity that can perform the service. This is precisely the economies of scale and lumpiness problem associated with capacity or any other utility service. New customers that cause zero costs provide a benefit to other customers by reducing per unit cost of leak services for all customers. That continues until so many customers have been added that in total additional O&M expense is required. In the meantime existing customers have benefited from lower costs as a result of the addition in the form of lower unit revenue requirements. Practically speaking it is not useful to charge the incremental cost to the new customer as those costs are part of the shared cost of a system. Due to the fixed cost nature of operating a gas distribution system, existing customers will benefit from the addition of new customers by spreading fixed costs over a larger base of throughput. By the time a “step” increase in O&M is needed, there will likely have been numerous customer additions to the system that can absorb the added cost with no impact to existing customers.*

[...]

*“As a general matter, all of this leads to the conclusion that the only current impact of a new customer on O&M is a reduction in per unit O&M for other customers*

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<sup>20</sup> Exhibit A-0110, p. 36 and 37.

<sup>21</sup> Exhibit A-0110, p. 32.

*initially and a small present value of future O&M that the new customer will share with existing customers for their assets before his own assets cause costs. This leads to the conclusion that the most reasonable estimate of marginal O&M costs for new customers is zero for physical plant, positive for service establishment and minimal for direct customer charges. From a toll design perspective, service establishment should be matched by a direct charge while direct customers charges are easily covered by the tolls since average cost is much greater than marginal cost.”<sup>22</sup>*

[40] Besides, according to expert Overcast, the use of an average cost when a marginal cost is not available would be incorrect:

*“Mr. Chernick incorrectly suggested average cost be used for some customer related expenses regardless of marginal cost. And a good example is a call center costs, those are largely fixed and they’re fixed until the capacity of the call center is used up, requiring a lot of, a large increment of customers and, and only then would they be at the margin. And you can also see if you think back to the graph, if marginal cost is less than average cost, it doesn’t matter whether it’s short or long-run, then using average cost over overstates what the marginal cost is and forces customers to pay more to connect than they should.”<sup>23</sup>*

[41] Finally, the Distributor, relying on the position of expert Overcast, is of the opinion that using a marginal cost is only justified if its value over time increases.

*“A. [...] We have shown you that the costs have not risen... there has not been any cost increase, actually... I would have to find the request for information but, if I remember correctly, costs actually dropped seven per cent (7%) over the last ten (10) years. So, no cost increase was observed in association with customer growth. And in the last ten (10) years, we have more customers. That’s why this is not a cost that is associated here. It does not generate a new cost.”<sup>24</sup>*

[42] For all of these considerations, Dr. Overcast concluded that the Initial Proposal would have the effect of overestimating the marginal costs to be taken into consideration in the profitability analysis model. He therefore recommended that changes be made to the Initial Proposal.

*“Essentially B&V concludes that the Gaz Metro exercise of estimating these O&M marginal costs to comply with the regulatory requirements overstates the actual long-run marginal costs and unduly burdens line extension policies to the detriment of all existing customers.”<sup>25</sup>*

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<sup>22</sup> Exhibit A-0145, p. 2 and 3.

<sup>23</sup> Exhibit A-0110, p. 40.

<sup>24</sup> Exhibit A-0110, p. 164.

<sup>25</sup> Exhibit B-0145, p. 3.

[43] Gaz Métro asserts that the evaluation of the marginal costs' accuracy is all the more important seeing as overestimating them could have the effect of preventing the completion of projects that could otherwise be compliant with the objectives sought by the 2030 Energy Policy.<sup>26</sup>

[44] Gaz Métro therefore submits that its proposal, based on the recommendations formulated by Dr. Overcast, allows to support the adequate development of various markets and is in the public interest.

## **4.2 INTERVENORS' POSITION**

### **IGUA**

[45] The intervenor supports the approach proposed by Gaz Métro. That said, it expresses a reserve regarding the link between general costs and operating expenses. IGUA believes it would be expedient to ensure that the costs considered when determining the MCLTSDs are not also factored into the amount of general expenses included in the profitability analysis model when evaluating an extension project.

### **CFIB**

[46] CFIB supports the comments and recommendations of Mr. Baudino, the expert whose services it retained. That expert believes that use of MCLTSDs is coherent with decision D-2013-106, as well as the 40-year horizon that applies to the profitability evaluation model for Gaz Métro's extension projects.

[47] In its opinion, it is more relevant to use long-run marginal costs than short-run marginal costs.

*"In fact, LRMC is a superior measure to SRMC given the lumpiness of capacity additions by utilities and the inability of SRMC to properly reflect those additions."*<sup>27</sup>

[48] Moreover, the expert believes that short-run marginal costs are volatile and unpredictable. He maintains, moreover, that using long-run marginal costs is more coherent with economic theory.

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<sup>26</sup> Exhibit B-244, p. 15.

<sup>27</sup> Exhibit C-FCEI-0094, p. 4.

[49] CFIB considers that a profitability analysis must allow anticipated income to be compared with anticipated costs and, as a result, when it is impossible to obtain an estimate of direct costs, a mathematical estimate of these anticipated costs must be used.<sup>28</sup>

[50] CFIB disagrees with the approach of considering a cost to be zero when it decreases over time. Basing itself on the testimony of the expert Baudino, it instead proposes that marginal costs be included even if they are declining.

*“I would note that even if technological change causes meter-reading costs to decline relative to current meter-reading costs, and it’s likely that they will, those future incremental costs are not zero simply because they are lower than current costs. They are positive value and can be either estimated or known once Gaz Métro develops that technology and implements it more throughout its system.”<sup>29</sup>*

[51] Finally, CFIB recommends that Gaz Métro’s Initial Proposal be used as a starting point.<sup>30</sup>

## OC

[52] OC supports the comments and recommendations of Mr. Marcus, the expert whose services it retained. It emphasizes that there are two fundamental differences between the expert Marcus’s position and that of Dr. Overcast.

[53] Mr. Marcus believes that the long-term marginal operating costs must be used, even if some of them are considerable and not very granular, and even if not all customers will be participating in the activity generating the costs.

[54] As regards the considerable and not very granular nature of some costs (lumpiness), Mr. Marcus concurs with Dr. Overcast when he states that one customer might have little to no impact on a high cost. However, he believes Dr. Overcast drew an erroneous conclusion from this finding when he states that the cost of adding all anticipated customers should also be set at zero.

*“I believe that Dr. Overcast’s analysis suffers from the fallacy of composition – that because one customer might not cause a change in cost, a group of new customers added by Gaz Métro will also not cause a change in cost.”<sup>31</sup>*

[55] The expert Marcus points out that, on average, Gaz Métro adds approximately 2,500 D<sub>1</sub> rate customers each year. The addition of such a large number of customers would

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<sup>28</sup> Exhibit A-0112, p. 73.

<sup>29</sup> Exhibit A-0116, p. 78.

<sup>30</sup> Exhibit C-FCEI-0094, p. 6.

<sup>31</sup> Exhibit C-OC-0023, p. 3.

necessarily increase operating costs. These costs are more granular (less lumpy) than Dr. Overcast implies. For example, Mr. Marcus explains how call centres can adjust their service level in a granular fashion by resorting to part-time employees and overtime to meet the service demand of new customers.

[56] Another fundamental difference between the positions of the experts Overcast and Marcus is how future customer costs are processed. Mr. Marcus maintains that Dr. Overcast mistakenly excludes costs that will be generated in future by all customers that will be replacing, at a new service address, the original occupant of the premises. Mr. Marcus argues that these costs generated by future customers must be estimated and taken into consideration in the profitability analysis, seeing as the objective of that analysis is to establish the profitability of the extension project throughout its lifespan, not only for the period during which the original customer was connected.

[57] Finally, Mr. Marcus believes that Gaz Métro's Initial Proposal (with a few exceptions) is a good starting point for establishing the long-term operating costs, a starting point far better than the approach proposed by Dr. Overcast.

## **ROEÉ**

[58] ROEÉ supports the comments and recommendations of Mr. Chernick, the expert whose services it retained. The intervenor emphasizes the importance of properly evaluating the profitability of system extension projects and warns the Régie against the possible implications of an incorrect analysis.

[59] The expert Chernick points to the confusion that results from the comments of Gaz Métro and the expert Overcast regarding the cost considerations specific to the evaluation of the profitability of extension projects, on the one hand, and the separate exercise of establishing the requisite revenues and rates, on the other.

[60] In the opinion of the expert Chernick, the methodology must take into consideration all of the long-term costs at the time a decision is made, seeing as it irremediably binds Gaz Métro for decades. He maintains that the Régie should not allow short-term marginal costs to be used as a basis for making long-term decisions.

*“And so, we would compare the revenues you expect over your time horizon to all of the expenses that you expect over that same period, a simple process of matching the costs and benefits (...) you can't get the continuing revenues without the*

*continuing expenses.*”<sup>32</sup>

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[61] Mr. Chernick states that excluding certain operating costs, under the pretext that they are not caused by an individual customer, is not an adequate approach. As for the concept of “lumpy costs”, he asserts that projects generate a multitude of costs, some considerable, others less so. These costs add up, requiring the addition of resources, often in portions of units (recourse to casual employees or overtime). The expert emphasizes that these costs must be taken into consideration when evaluating the profitability of projects, and disagrees with Dr. Overcast’s approach, which proposes only taking into consideration those costs associated with the addition of a single customer.

*“Moving onto the next area of difference in terms of the granularity of the analysis. I think it’s fair to say that Gaz Métro has preferred to think in terms of very small additions such as one customer. We had one customer, does that cause us to add a meter reader, does that cause us to add a customer service representative. And to think about very large increments, an entire full time meter reader, an entire service representative, a whole new call centre. And when you look at it that way, an individual residential customer, for example, is not going to cause you to build a whole new call centre. But in general, that’s the wrong way of looking at utility decisions because we’re not adding one customer, we’re adding many customers in this project and in other projects.”*<sup>33</sup>

[62] The expert Chernick is of the opinion that the methodology retained must not confuse a potential cost reduction per customer owing, among other things, to technological changes or efficiency gains, with the fact that the addition of a customer would not generate additional operating costs. He does not concur with Dr. Overcast’s opinion in that regard.

*“Even though the cost of inspecting a meter of pipe may go down over time, and I give an example at the bottom of this page of the cost of gasoline has gone down over the last couple of years and so, you can drive more now and pay less. That does not mean that there’s no cost of driving more. Every kilometer you drive will cost you some gasoline and that’s real money, not as much money as it was a couple of years ago, but it will still cost you something.”*<sup>34</sup>

[63] According to Mr. Chernick, the method must use marginal costs, but in the absence of such values, it is essential to have access to a proxy instead of mistakenly contending that these costs must be considered non-existent for the purposes of the profitability analysis. In such cases, the use of average costs is appropriate.

*“[...] in some cases, you don’t have any estimate from Gaz Métro of marginal cost,*

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<sup>32</sup> Exhibit A-0110, p. 20.

<sup>33</sup> Exhibit A-0110, p. 17.

<sup>34</sup> Exhibit A-0115, p. 26.

*they provided an average cost of some sort and then, later said, 'No, maybe it's zero (0)'. So in those cases I said, 'No, let's use their average'. On, in other places I have talked about an average cost, meaning an average of the incremental cost, with the average of the marginal cost of serving a group of customers.'*<sup>35</sup>

[64] The expert Chernick is of the opinion that the costs described as “social” by Dr. Overcast are actually operating costs. He recommends that they be included in the determination of the MCLTSDs, as they reflect the fact that a portion of new customers serviced by the extension project will not honour their obligations to the Distributor and will thus generate additional collection and bad debt costs. Consequently, the materialization of this risk must be taken into consideration in the profitability analysis of an extension project.

*“I can't believe that Dr. Overcast told us that bad debt and collection expenses are not marginal cost because they are the results of social policies and I've seen that, that concept applied that a cost is, is really not a cost because it's something that's being done for social reasons.*

*[...] I think those are just cost of doing business. I think any business, in trying to figure out what it needs to charge in order to be a going concern has to take into account the fact that not all of its customers will pay their bills and some of them will require some additional effort to pay their bills.*”<sup>36</sup>

[65] The profitability analysis must therefore take into account the fact that completing development projects exposes Gaz Métro to the probability that some collection or bad debt costs will arise. Mr. Chernick is of the opinion that these costs cannot be ignored under the pretext that at the time a decision is made, it is not known which of the new customers will cause them.

[66] Additionally, the expert Chernick is opposed to the idea that some costs do not need to be taken into account as they will be absorbed by future revenues. In that regard, he states:

*“Q. So would you, would you, what's your advice to the Board about this, this concept of, that the revenues, you just said that the revenues...*

*R. Absorb the costs;*

*Q. Absorb the costs, is that an appropriate concept in...*

*R. Well it's not, it's not an appropriate assumption. It may in fact be the result of your analysis, you lay out your expected costs, by which I mean on a, a probabilistic basis, not cost that you expect to happen for every customer or expect*

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<sup>35</sup> Exhibit A-0110, p. 28 and 29.

<sup>36</sup> Exhibit A-0115, p. 17.

*every year but cost that will happen every five (5) years or ten (10) years on the average, you put those in, you look at your revenues, you look at all the costs that you've put together and you ask the question: Have those revenues absorb the cost, if you want to use that term. And that's an outcome of the analysis, it's not something that you can short circuit and just say: We can ignore all kind categories of cost because they might be absorbed, if we actually do the analysis. You do the analysis and reach a conclusion, you don't start with a conclusion before you do the analysis.*"<sup>37</sup>

[67] Finally, ROÉÉ considers that the methodology proposed by Dr. Overcast and maintained by Gaz Métro underestimates the marginal costs used in the profitability analysis of extension projects and demands that it be rejected. It also considers, however, that the Initial Proposal could be a good starting point.<sup>38</sup>

## **SÉ-AQLPA**

[68] SÉ-AQLPA recommends that the marginal costs of a project be determined using not the short-term marginal cost method proposed by Dr. Overcast, but rather all marginal costs allocated to that system extension over a 40-year horizon, namely the long-term marginal costs.<sup>39</sup>

[69] The intervenor emphasizes the quality of the process adopted by Gaz Métro to establish its Initial Proposal, to which the representatives of 14 internal units contributed. It considers that, faced with the results of that work, nothing leads to believe that this information would be less relevant than the information proposed by the expert Overcast.

## **UC**

[70] The UC believes that the method and components of the marginal costs for the purposes of the profitability studies must be fairly and equitably determined in order to avoid underestimating the costs that will be borne by existing customers.

[71] The intervenor points out that in order to be fair to all customers and equitably assess profitability, the costs and revenues for the same period must be taken into consideration. It believes that if the considered profitability takes into account the revenues over a 40-year period, the marginal costs to be taken into consideration must be those that are anticipated and foreseeable (actual, direct and potential) in the course of that same period.<sup>40</sup>

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<sup>37</sup> Exhibit A-0115, p. 32 and 33.

<sup>38</sup> Exhibit A-0116, p. 115.

<sup>39</sup> Exhibit C-SÉ-AQLPA-0039, p. 15.

<sup>40</sup> Exhibit C-UC-0042, p. 4.



[72] The UC argues that the choice Dr. Overcast made, namely to consider only the short-term costs, is erroneous, non-compliant with the Régie's decisions and produces an unfair result by excluding various real and foreseeable costs.

### 4.3 OPINION OF THE RÉGIE

[73] The Régie agrees with the opinion of Gaz Métro and the intervenors regarding the importance of properly assessing the inputs used in the model for analysing the profitability of system extension projects. It believes, in fact, that a marginal cost of the long-term service delivery (MCLTSD), if overestimated, could become an obstacle for system extensions and volume growth, whereas an underestimation of this input would favour the addition of unprofitable new customers, resulting in undue rate hikes for the existing customers.

[74] Taking into account the evidence on record and the major discrepancies noted between the experts' opinions, the Régie feels it is important to properly define the framework for this decision and to review the nature of the inputs used in the model for analysing the profitability of system extensions.

[75] In that regard, it retains the definition proposed by Gaz Métro presented in the context of its arguments, which maintains that the value must be set for one of the inputs in the profitability analysis model allowing to determine whether a system extension project should be carried out or not. This model takes into consideration various inputs associated with an extension project centered around two poles: the costs and revenues generated by the project. An examination of Subject A in this Case will push the Régie to retain the method used to determine Gaz Métro's MCLTSD. The value of this input is entered on line 21 of the profitability analysis model under the heading "operating cost". Currently, the MCLTSD is set at \$157/customer.<sup>41</sup>

[76] The Régie reminds us that the profitability analysis model to which this cost input belongs uses a 40-year horizon<sup>42</sup> that the Régie qualifies as long-term. In that regard, it believes the evaluation of the estimated costs making up the MCLTSD must be carried out using the same horizon as the one used to evaluate the estimated revenues that were taken into consideration in the profitability analysis model.

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<sup>41</sup> Exhibit B-0245, p. 1, line 21.

<sup>42</sup> Exhibit B-0245, p. 1, line 26.

[77] Consequently, the Régie is of the opinion that this decision must rule on the service delivery costs or operating costs, and that the scope and recurrence of these costs must be evaluated over a long-term horizon.

[78] Consequently, the Régie cannot retain the recommendation of Gaz Métro and the expert Overcast that relies on the use of short-term marginal costs. It believes that by associating the marginal costs of service deliveries with a concept of short-term marginal costs, some of the costs incurred after a system extension would not be taken into consideration, thus resulting in an underestimation of the MCLTSDs.

**[79] The Régie concurs with the opinions of the experts Baudino, Chernick and Marcus, and considers that the marginal costs of long-term service delivery must be evaluated over a long-term horizon.**

[80] Moreover, the Régie believes that the principles set forth by the expert Overcast regarding fixed costs and the exclusion of costs by level is incompatible with the concept of MCLTSDs.

[81] Indeed, the Régie believes that long-term costs cannot be estimated by solely considering the costs associated with the last unit produced or the arrival of a single new customer, when a majority of extension projects involve the addition of several customers at once.

[82] The Régie is of the opinion that, over a long-term horizon, the aggregated costs of several projects will cause fluctuations in fixed costs and costs by level, something that must be taken into consideration. As does the expert Chernick, the Régie believes it is possible to estimate the unit value of a fixed cost or cost by level by using a proxy or an average value of a marginal cost.

**[83] For these reasons, the Régie dismisses the recommendations of the expert Overcast regarding the evaluation of marginal costs based solely on the last unit produced, as well as the recommendations dealing with the exclusion of fixed costs and costs by level.**

[84] Moreover, the Régie concurs with the expert Chernick's opinion to the effect that Dr. Overcast created confusion when he introduced the pricing, revenues and user-pays notions in a well-targeted examination bearing on the identification of MCLTSD components, in light of the fact that these are inputs used in the profitability analysis model of Gaz Métro's system extension projects.

[85] Revenues associated with a project are evaluated separately, appear on another line of the profitability analysis model, and are not relevant to the examination of Phase 3, Subject A of the Case.

[86] Consequently, when Dr. Overcast refers to the absorption effect or the user-pay concept, he is introducing notions of revenue and pricing, confounding the inputs of the two poles previously invoked. The Régie believes that this approach creates needless confusion which, if it were to be adopted, could lead to a failure to take certain costs into consideration under the pretext that they will be absorbed by the revenues that the extension projects will generate.

**[87] Consequently, the Régie also dismisses the principles and considerations that rely on the notion of revenues set forth by the expert Overcast.**

**[88] For all of these reasons, the Régie dismisses the recommendations of the expert Overcast and considers that the Initial Proposal filed by Gaz Métro is the best starting point at its disposal to determine the marginal costs of long-term service delivery.**

## 5. METHODOLOGY

[89] To identify and determine the MCLTSDs, Gaz Métro submits a methodology in its Initial Proposal that is based on an exhaustive identification exercise performed by internal teams. Using the results of this exercise, the Distributor proposes:

- MCLTSDs established by market: Residential; Commercial, Institutional and Industrial (“CII”); and Sales Major Industries (“SMI”);
- a distinction between the costs that apply in the first year and in subsequent years;
- a case-by-case application of the costs associated with RCPs and meter maintenance.

### *Segmentation by market and year*

[90] None of the intervenors is questioning the segmentation by market and the distinction made between the first year and subsequent years.

[91] The Régie believes that the methodology used by Gaz Métro and the results presented in the evidence demonstrate the relevance of the proposed approach.

[92] Moreover, the Régie considers that this double segmentation, by market and by year, is a desirable improvement in the determination of MCLTSDs that will increase the quality and accuracy of the evaluations of the profitability of system extension projects.

**[93] For these reasons, the Régie approves of segmenting the marginal costs of long-term service delivery between the Residential, CII and SMI markets, and the distinction made between the costs that apply to the first year and subsequent years, as proposed by Gaz Métro in its Initial Proposal.**

*Application on a case-by-case basis*

[94] Gaz Métro wants to determine the costs associated with RCPs and the inspection of various types of meters on a case-by-case basis, based on each type of extension project. At the time the project is presented and its profitability evaluated (and based on the project's known characteristics), it would use estimates for these two cost categories.<sup>43</sup>

[95] The Distributor proposes using a binary component to determine each of these costs, which would either be considered in their entirety or valued at zero. Consequently, recourse to such a binary approach for these costs will have the effect of establishing the minimum and maximum values of the MCLTSDs per market.

[96] Several intervenors do not support the application of a case-by-case approach for certain costs. CFIB, OC, ROÉÉ, SÉ-AQLPA<sup>44</sup> and UC<sup>45</sup> prefer having MCLTSDs per market without minimum and maximum values. Some intervenors instead recommend using an estimate resulting from an average cost established based on the probability of these types of costs arising. More specifically, the experts retained by CFIB,<sup>46</sup> OC<sup>47</sup> and ROÉÉ<sup>48</sup> recommend using an average cost instead of a cost resulting from the binary approach proposed by Gaz Métro.

[97] The Régie questioned the Distributor as to the accuracy and conservative nature of the estimates regarding eventual costs that might occur (especially for system extensions in the residential and CII markets) as opposed to the application of an average cost. It argues that

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<sup>43</sup> Exhibit A-0112, p. 43.

<sup>44</sup> Exhibit C-SÉ-AQLPA-0036, p. iii.

<sup>45</sup> Exhibit C-UC-0035, p. 11.

<sup>46</sup> Exhibit C-FCEI-0101, p. 4.

<sup>47</sup> Exhibit C-OC-0028, p. 3.

<sup>48</sup> Exhibit C-ROÉÉ-0082, p. 10.

these estimates are more accurate than using a weighted average based on actually observed historical data.<sup>49</sup>

[98] At the hearing, the Régie expressed its concern over the discretionary nature of the hypotheses framed by the Distributor's internal personnel regarding the nature of each project where the case-by-case application of certain costs is concerned.<sup>50</sup>

[99] Furthermore, the Régie notes that the Distributor can rely on its knowledge of the markets in order to determine a weighted average cost that reflects the probability of that cost arising.<sup>51</sup> As a result, it believes that the average RCP cost for the Residential and CII markets is \$20.26 and \$20.40, respectively.

[100] Considering the significant number of new connections the Distributor carries out each year, mainly in the Residential and CII markets, the Régie believes that for the "RCP" and "Meter Inspection" items, an operating cost reflecting the actual weighted average cost is a better estimate than the cost resulting from an application on a case-by-case basis. It is also of the opinion that this approach guarantees a fair treatment of all of these customers and is a simple and direct method that is free of any discretionary judgment.

[101] The Régie further notes that this approach is coherent with the methodology used in the Initial Proposal regarding the other cost items that rely on an estimate based on an average cost.

**[102] For these reasons, the Régie orders the Distributor to use an average cost that is established based on its likelihood of occurring when determining the marginal cost of long-term service delivery that correspond to the "RCP" and "Meter Inspection" cost items.**

[103] Based on the evidence on record,<sup>52</sup> the Régie established Table 1, which lists the average costs that are to be used for these two items.

**TABLE 1**  
**AVERAGE COSTS PER MARKET**  
**PROCESSING OF RCP APPLICATIONS AND METER INSPECTIONS**

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<sup>49</sup> Exhibit A-0112, p. 49.

<sup>50</sup> Exhibit A-0112, p. 45.

<sup>51</sup> Exhibit B-0198, p. 1, Schedule 1 (Q. 1.5).

<sup>52</sup> Exhibit B-0198, p. 1, Schedule 1, (Q. 1.5).

	Residential		CII		SMI	
	Year 1	Year 2 et seq.	Year 1	Year 2 et seq.	Year 1	Year 2 et seq.
<b>Processing of the RCP application</b>	<b>\$20.26</b>	<b>\$0.00</b>	<b>\$20.40</b>	<b>\$0.00</b>	<b>\$0</b>	<b>\$0</b>
<b>Inspection, per type of meter</b>						
Positive displacement meter, with radiometry	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Turbine meter	\$0.02	\$0.02	\$0.13	\$0.13	\$31.68	\$31.68
Fixed-pressure factor positive displacement meter, with radiometry	\$1.10	\$1.10	\$2.90	\$2.90	\$0.00	\$0.00
Rotating meter, with radiometry	\$0.79	\$0.79	\$4.42	\$4.42	\$0.00	\$0.00
Fixed-pressure factor rotary meter, with radiometry	\$0.21	\$0.21	\$3.58	\$3.58	\$0.00	\$0.00
Spin test for turbines (measuring less than 12 inches)	\$0.06	\$0.06	\$0.33	\$0.33	\$19.80	\$19.80
Spin test for turbine (measuring 12 inches and +)	\$0.00	\$0.00	\$0.00	\$0.00	\$178.19	\$178.19
<b>Subtotal of meter inspections</b>	<b>\$2.18</b>	<b>\$2.18</b>	<b>\$11.36</b>	<b>\$11.36</b>	<b>\$229.67</b>	<b>\$229.67</b>
<b>Meter installation inspection</b>						
Inspection of corrective instruments	\$1.70	\$1.70	\$0.37	\$0.37	\$87.11	\$87.11
Inspection of telemetry	\$0.09	\$0.09	\$0.50	\$0.50	\$118.79	\$118.79
<b>Sub-total of metering inspection</b>	<b>\$1.79</b>	<b>\$1.79</b>	<b>\$0.87</b>	<b>\$0.87</b>	<b>\$205.90</b>	<b>\$205.90</b>
<b>Telemetry – Addition of a cellular line</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$9.31</b>	<b>\$9.31</b>
<b>Total meters, metering and telemetry</b>	<b>\$3.97</b>	<b>\$3.97</b>	<b>\$12.23</b>	<b>\$12.23</b>	<b>\$444.88</b>	<b>\$444.88</b>

Source: Exhibit B-0196, Schedule 1, p. 1 to 4; [B-0198](#), 1.5).

## 6. OTHER COST ELEMENTS

### 6.1 BAD DEBTS AND RECOVERY COSTS

[104] In its Initial Proposal, the Distributor determines bad debt marginal costs of \$0.57 and \$7.77, respectively, for the Residential and CII markets. No amount is associated with the Sales Major Industries market. As for the recovery costs, the Distributor determines marginal costs of \$2.43 and \$33.31, respectively, for the Residential and CII markets. No amount is associated with Sales Major Industries market.

[105] In its calculation of bad debt costs, the Distributor uses the amount of write offs per market for fiscal 2013, divided by the number of customers in each market.

[106] For recovery costs, it uses the total costs of the recovery and collection department, which includes the wages and fringe benefits of the collectors, clerks and representatives, to which it adds the relevant lawyers' fees. It then allocates this amount among the markets based on the bad debt costs and divides each of these amounts by the number of customers in each market.<sup>53</sup>

[107] At the hearing, in keeping with the approach favoured by the expert Overcast, Gaz Metro stated its belief that the risk inherent to this type of cost is already taken into consideration in the *Conditions of Service and Tariff* under the heading “Deposit”:

*“It will therefore not be necessary [...] to consider the bad debt costs as some have suggested. If there were a risk, Gaz Métro could avail itself of the Conditions of Service and Tariff and obtain a deposit [...] consider an operating cost also reflecting that risk, as some have implied, but we feel that would be taking those costs into consideration twice”.*<sup>54</sup>

[108] Gaz Métro therefore believes that a new connection should not generate bad debt marginal costs.

[109] ROÉÉ believes that bad debt and recovery costs must be taken into consideration, seeing as they are part of the business practices and some customers can be expected not to meet their obligations.<sup>55</sup> This intervenor maintains that some types of occasional costs, such as those resulting from bad debts, should be included in the operating costs associated with an extension project.

[110] SÉ-AQLPA concurs, and recommends that Gaz Métro consider a bad debt marginal cost for customers of Sales Major Industries, as does Hydro-Québec.<sup>56</sup>

[111] The Régie notes that each year, a certain number of customers do in fact fail to meet their payment obligations and, as a result, generate recovery and collection expenses and, in the worst-case scenarios, generate losses associated with these bad debts.

[112] The Régie concurs with the opinion of experts Baudino, Chernick and Marcus, and believes that these items are part of the Distributor’s service costs that must be taken into consideration when determining the MCLTSDs.

[113] As for the Sales Major Industries market, the Régie retains Gaz Métro’s argument that the representatives dedicated to this market’s customers provide them with what constitutes a one-stop service.<sup>57</sup> Consequently, it believes that the recovery and collection costs associated with the Sales Major Industries market, should any arise, are included in the costs under the item entitled “Cost associated with maintaining the Sales Major

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<sup>54</sup> Exhibit A-0110, p. 64.

<sup>55</sup> Exhibit A-0110, p. 181, 183 and 185.

<sup>56</sup> Exhibit C-SÉ-AQLPA-0039, p.18.

<sup>57</sup> Exhibit A-0110, p. 83.

Industries clientele”. Therefore, the cost of the item “Recovery and Collection” for this market is equal to zero.

[114] The Régie believes that the cost associated with managing bad debts for the Sales Major Industries market is not necessarily zero, and must be taken into account when establishing the MCLTSDs.

[115] In that regard, it notes that the Distributor establishes the amounts per market for this cost item based on the results presented for fiscal year 2013. It also notes that in the cost allocation study bearing on the 2013-2014 rate year filed in the context of Phase 1 of this Case, bad debts are also allocated based on the actual data available. In this study, no amount is allocated to bad debts for the Sales Major Industries clientele ( $D_4$  and  $D_5$  rates). The Régie therefore concludes from this that no bad debt was in fact noted for this market for that year.<sup>58</sup>

[116] Accordingly, the Régie maintains at zero the amount of the cost associated with this item for the Sales Major Industries market, but asks that the Distributor calculate in its next update an amount that is associated with bad debts for Sales Major Industries customers, should any such amount actually be noted for that market.

**[117] For these reasons, the Régie determines that the recovery and bad debt costs must be taken into consideration when determining the marginal costs of long-term service delivery. Consequently, it orders Gaz Métro to include in the marginal costs of long-term service delivery the recovery and bad debt costs, as set forth in the Initial Proposal for the Residential and CII markets.**

**[118] Moreover, it also orders the Distributor to consider the bad debt amounts in the marginal costs of long-term service delivery for the Sales Major Industries market, whenever any such costs are noted.**

## **6.2 PROCUREMENT COSTS**

[119] ROÉÉ proposes that gas supply costs be taken into consideration when determining the MCLTSDs. It is of the opinion that these costs must rise as the number of customers served by a Distributor increases. The expert Chernick feels that system extensions, over the long run, increase the volumes of natural gas delivered just as much as does the number of customers connected to the system. He believes that both the complexity and supply management costs increase accordingly.<sup>59</sup>

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<sup>58</sup> Exhibit B-0040, tab FS-26.

<sup>59</sup> Exhibit C-ROÉÉ-0082. P.21.



[120] Gaz Métro and the expert Overcast believe, for their part, that the natural gas supply costs cannot be considered a marginal cost.<sup>60</sup> They believe that the operating costs of the gas supply and transmission department do not vary based on the quantity of natural gas distributed or the number of customers connected, but instead are influenced by developments in the gas sector and the means used to face them.<sup>61</sup>

[121] The expert Beaudino does not, in theory, challenge the expert Chernick’s suggestion on the subject, but indicates that he is unable to estimate its scope or conduct an accurate estimate.<sup>62</sup> The expert Marcus does not dismiss his colleague’s suggestion, but does express some doubt as to the significance of this marginal cost.<sup>63</sup>

[122] Based on the evidence filed in Phase 1, the Régie notes that the gas supply operating costs are estimated at \$3.5 million. In the context of this phase, these costs were sub-functionalized into three separate items in Table 2.

**TABLE 2**  
**SUPPLY COSTS (IN \$000)**

System control center	1,545
Agreements and administration	1,178
Management	758
<b>Total</b>	<b><u>3,481</u></b>

*Source: Exhibit [A-0052](#), decision D-2016-100, p. 130.*

[123] The item “Agreements and administration” consists mainly of the cost of processing and managing all fixed-price purchase agreements, make-up gas agreements and the gas supply customer agreements with or without transfer of ownership, including customers that provide their own transportation service.

[124] The Régie concurs with the Distributor’s opinion that there is no obvious link allowing to establish a correlation between changing gas supply management and planning

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<sup>60</sup> Exhibit A-0112, p.37.

<sup>61</sup> Exhibits B-0236, question 1.2, and B-0225, questions 4.2 to 4.4.

<sup>62</sup> Exhibit C-FCEI-0101, p. 2.

<sup>63</sup> Exhibit C-OC-0027, p. 2.

costs (under the item “System control center” and “Management”) and new customer connections.

[125] However, the Régie considers that this is not the case for those costs associated with managing the agreements appearing under the item “Agreements and administration”, evaluated at \$1.2 million. Indeed, to the extent that these costs mainly represent the expense of administrating and managing agreements, the Régie feels that these must be taken into consideration when determining the MCLTSDs, as are the costs of managing other agreements. Consequently, any extension project resulting in a certain number of new customers wanting to provide their own supply or transportation, and therefore requiring the management and administration of their agreements for these services, will generate a marginal cost that must be taken into consideration when determining the MCLTSDs.

[126] Using data pertaining to “Agreements and administration” filed in the context of Phase 1 of this Case, the Régie calculated the cost per market that must be included in the MCLTSDs as follows:

- Residential market: \$1.73/customer;
- CCI market: \$28.92/customer;
- Sales Major Industries market: \$90.99/customer.

[127] For details on this calculation, please see Schedule 1 to this Decision.

**[128] For these reasons, the Régie orders the Distributor to include the “supply agreement management costs” component when determining the marginal costs of long-term service delivery. Until the next update of the marginal costs of long-term service delivery, it sets the value of this component per market at the amounts appearing in paragraph 126 above.**

### **6.3 Marketing Costs**

[129] The expert Chernick proposes taking marketing costs into consideration.<sup>64</sup> In his opinion, Gaz Métro must incur marketing costs resulting directly from system extension projects, like the information sent to potential customers contemplated by the projects. The expert maintains that these costs should be included in the extension project profitability evaluation.

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<sup>64</sup> Exhibit C-ROEE-0082, p. 26.

[130] Gaz Métro and the expert Overcast challenge this proposal. They believe that the marketing costs do not qualify as a marginal cost, seeing as they are invariable and bear no relation to the number of extension projects.<sup>65</sup>

[131] The expert Baudino<sup>66</sup> concurs with the expert Chernick as regards the direct marketing costs, and specifies that they should be taken into consideration when determining the MCLTSDs. As for the expert Marcus,<sup>67</sup> he believes that these costs could be included in the general expenses associated with each extension project. None of the experts, however, has quantified these costs.

**[132] The Régie notes that no study has been presented allowing to demonstrate a direct relationship between marketing costs and system extension projects. Consequently, it did not retain Mr. Chernick's proposal in that regard.**

#### **6.4 GENERAL EXPENSES**

[133] IGUA believes it is important to ensure that the costs taken into consideration when establishing the MCLTSDs are not double counted when determining the general costs allotted to each project. The intervenor petitions the Régie to require that a demonstration be made in that regard. It argues that no information available in this Case allows for these results to be validated.

[134] Gaz Métro indicates that its methodology establishing the general costs reflects the differences between the capitalizable and non-capitalizable costs, and is confident that no operating cost is double counted.

[135] On that subject, it specifies that the costs associated with a same cost center cannot be associated with capitalizable and non-capitalizable activities, and are accounted for separately using cost identifiers; these “tools” ensure that capitalizable costs are accounted separately, avoiding any duplication of costs.

[136] The Distributor cites the metering costs center as an example, a department where personnel participate in capitalizable activities (such as the installation of new meters), as well as non-capitalizable activities (such as meter maintenance).

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<sup>65</sup> Exhibit B-0236, p. 3, question 1.3.

<sup>66</sup> Exhibit C-FCEI-0101, p. 2.

<sup>67</sup> Exhibit C-OC-0028, p. 2.

[137] As a result, Gaz Métro submits that it has implemented reliable mechanisms that should allay IGUA's concerns raised on the context of this Phase 3A.

**[138] The Régie is satisfied with the explanations provided by Gaz Métro and believes there is no need to pursue the examination of this question any further.**

## **6.5 MOBILITY FACTOR**

[139] The intervenors OC, ROEÉ and UC maintain that some types of occasional costs, such as those generated by moves (costs of mailing, opening a bill record file and inputting an agreement) should be included in the determination of the MCLTSDs.

[140] More specifically, OC recommends including a mobility factor,<sup>68</sup> which it derives from the 2011 study establishing the moving rate for Gaz Métro's D<sub>1</sub> rate customers at 10%.

[141] When questioned by UC at the hearing about the use of a mobility factor when determining the MCLTSD, the Distributor pointed out that this cost could be anecdotal, related to the data of a single year. It refuted this proposal by arguing that no investment is made in the case of a move. It concedes, however, that each year it must process a certain number of moves.<sup>69</sup> As for the inputting of new agreements, Gas Métro responds that a new agreement is not always inputted when a residential customer moves in.<sup>70</sup>

[142] The Régie is of the opinion that the title holder of an existing connection on the Distributor's system is subject to change in the course of that connection's lifespan. It considers, consequently, that this will also be the case for any system extension project. The rate at which connection holders change will depend on the nature of the building it supplies in natural gas. In the absence of a better estimate, it considers that the Residential and CII markets share the same rate. It believes, however, that such a rate was not taken into consideration for connections in the Sales Major Industries market.

[143] Consequently, the Régie is of the opinion that a moving or mobility factor component must be taken into consideration where system extensions are dedicated to Residential and CII market customers. It believes that a move generates additional customer service costs, such as the mailing a subscription confirmation letter, opening a bill record file, inputting a new agreement and performing a credit check internally. The Régie believes that to the

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<sup>68</sup> Exhibit C-OC-0034, p. 6.

<sup>69</sup> Exhibit A-0112, p. 125.

<sup>70</sup> Exhibit A-0110, p. 26.

costs associated with these activities must be added, for Year 2 and subsequent years, a mobility factor that will be taken into consideration when determining the MCLTSDs.

[144] In the absence of a better estimate, **the Régie retains a mobility factor of 10% applicable, for Year 2 and subsequent years, to the Residential and CII markets when determining the marginal costs of long-term service delivery. This factor will apply to the costs associated with mailing a subscription confirmation letter, opening a bill record file, inputting a new agreement as well as, for the CII market only, performing a credit check internally.**

## 7. MARGINAL COSTS OF LONG-TERM SERVICE DELIVERY FOR SYSTEM EXTENSIONS

[145] Table 3 presents all of the MCLTSDs that the Régie retains for system extensions.

**TABLE 3**  
**MARGINAL COSTS OF LONG-TERM SERVICE DELIVERY**  
**SYSTEM EXTENSION**

Line	Cost item	Residential		CII		Sales Major Industries	
		Year 1	Year 2 and +	Year 1	Year 2 and +	Year 1	Year 2 and +
1	Mailing of subscription confirmation letter	\$0.83	\$0.08	\$0.83	\$0.08	\$0.83	\$0.00
2	Credit check performed internally	\$0.00	\$0.00	\$17.19	\$1.72	\$17.19	\$0.00
3	Input of new agreement	\$36.29	\$3.63	\$52.62	\$5.26	\$36.29	\$0.00
4	Input of new agreement - major accounts	\$0.00	\$0.00	\$56.25	\$0.00	\$0.00	\$0.00
5	Opening of bill record files	\$9.66	\$0.97	\$9.66	\$0.97	\$9.66	\$0.00
6	Mailing of a bill	\$8.36	\$8.36	\$8.36	\$8.36	\$8.36	\$8.36
7	Cashing of a payment	\$0.74	\$0.74	\$1.75	\$1.75	\$1.59	\$1.59
8	Processing a standard customer call	\$12.84	\$12.84	\$12.84	\$12.84	\$0.00	\$0.00
9	Reading of meters	\$6.71	\$6.71	\$6.71	\$6.71	\$6.71	\$6.71
10	Bad debts	\$0.57	\$0.57	\$7.77	\$7.77	\$0.00	\$0.00
11	Collection and recovery	\$2.43	\$2.43	\$33.31	\$33.31	\$0.00	\$0.00
12	Preventive maintenance - connection	\$12.88	\$12.88	\$12.88	\$12.88	\$12.88	\$12.88
13	Corrective maintenance - connection	\$17.99	\$17.99	\$17.99	\$17.99	\$17.99	\$17.99
14	Processing of RCP application	\$20.26	\$0.00	\$20.40	\$0.00	\$0.00	\$0.00
15	Total meters, metering and telemetry <sup>(1)</sup>	\$3.97	\$3.97	\$12.23	\$12.23	\$444.88	\$444.88
16	Customer maintenance - major accounts	\$0.00	\$0.00	\$39.05	\$39.05	\$0.00	\$0.00
17	Customer maintenance - Sales Major Industries	\$0.00	\$0.00	\$0.00	\$0.00	\$1,197.16	\$1,197.16
18	Management of supply agreements	\$1.73	\$1.73	\$28.92	\$28.92	\$90.99	\$90.99
19	<b>Total</b>	<b>\$135.26</b>	<b>\$72.90</b>	<b>\$338.76</b>	<b>\$189.84</b>	<b>\$1,844.53</b>	<b>\$1,780.56</b>
20	Preventive maintenance - service lines	\$0.22/m		\$0.22/m		\$0.22/m	
21	Corrective maintenance - service lines	\$0.37/m		\$0.37/m		\$0.37/m	
	<b>Total</b>	<b>\$0.59/m</b>		<b>\$0.59/m</b>		<b>\$0.59/m</b>	

## 8. MARGINAL COSTS OF LONG-TERM SERVICE DELIVERY FOR ADDITIONAL LOADS

[146] In the Initial Proposal, Gaz Métro identified the following MCLTSD components associated with load additions for an existing customer, depending on the customer's market:<sup>71</sup>

- inputting a new agreement;
- performing a credit check;
- processing an RCP application;
- adding a cellular line, if the addition requires telemetry.

[147] The expert Overcast stated that load additions typically do not require new installations and therefore do not entail marginal operating costs.<sup>72</sup>

[148] According to the experts Beaudino,<sup>73</sup> Chernick<sup>74</sup> and Marcus,<sup>75</sup> some additional operating costs may be related to load additions. They therefore recommend that the Régie take this into consideration when determining the MCLTSDs.

[149] The Régie concurs with the experts' opinion, and believes that a load addition associated with an existing connection generates marginal operating costs but to a lesser degree than a system extension connecting a new customer.

[150] The Régie established the amounts to be taken into consideration based on the cost components considered in the Initial Proposal for load additions and the decision-making elements of this Decision presented in section 7. These amounts, which appear in Table 4, only apply to the first year, with the exception of the cellular line, which applies to all years.

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<sup>71</sup> Exhibit B-0144, p. 7.

<sup>72</sup> Exhibit B-0196, p. 6 and 7.

<sup>73</sup> Exhibit FCEI-0101, p. 5.

<sup>74</sup> Exhibit C-ROEE-0030, p. 20.

<sup>75</sup> Exhibit C-OC-0028, p. 4.

**TABLE 4**  
**MARGINAL COSTS OF LONG-TERM SERVICE DELIVERY**  
**LOAD ADDITIONS**

	<b>Year 1</b>	<b>Year 2 and +</b>
<b>Residential</b>	<b>\$56.55</b>	
- inputting a new agreement	\$36.29	
- processing an RCP application	\$20.26	
<b>CII</b>	<b>\$90.21</b>	
- inputting a new agreement	\$52.62	
- processing an RCP application	\$20.40	
- performing a credit check internally	\$17.19	
<b>Sales Major Industries</b>	<b>\$62.79</b>	<b>\$9.31</b>
- inputting a new agreement	\$36.29	
- performing a credit check internally	\$17.19	
- adding a cellular line for conversion to telemetry	\$9.31	\$9.31

*Sources: Exhibit B-0198, Schedule 1,(Q. 1.5) and Table 3.*

**[151] Consequently, the Régie orders the Distributor to use the marginal costs of long-term service delivery appearing in Table 4 for load additions.**

## 9. STUDY UPDATE

[152] Gaz Métro indicates that it is able to update the applicable costs and parameters of the methodology on an ongoing basis throughout the rate cases.<sup>76</sup>

[153] The expert Chernick also recommends regular updates to validate any evolution in the data used.<sup>77</sup>

[154] The Régie feels it is important that the MCLTSDs be updated regularly so as to reflect any operating cost changes that might arise.

[155] For example, if the actual data presented in the context of an annual report reveal a significant variation in the Residential and CII market weightings for the number of RCP applications, the Régie could consider (on the Distributor's recommendation) changing the

<sup>76</sup> Exhibit A-0112, p. 122.

<sup>77</sup> Exhibit A-0112, p. 13.

value of that parameter or replacing it with an average of the data observed over a three to five year period. Updates thus presented could also capture cost fluctuations resulting, for example, from new technologies implemented or economies of scale detected.

[156] To optimize the accuracy of the MCLTSDs, the Régie believes that periodic updates could be proposed by the Distributor in the files of the annual report. Based on the actual data observed, the Distributor would propose an update for the value of the parameters and unit costs retained in this Decision.

[157] As for changes to the methodology used to determine the MCLTSDs, much as was done in this Case, the Régie believes that the files of the annual report are not the proper venue for dealing with this issue. For example, if the Distributor wants to propose a change to the methodology used for determining the supply contract management costs, it should do so in the context of a rate case or a specific file.

[158] Until such time as the Distributor proposes an update for cost components, the Régie feels it is expedient to allow the Distributor to use the new values for the MCLTSDs appearing in tables 3 and 4 of this Decision as of the date hereof.

## 10. OPEN DEBATE AMONG THE EXPERTS

[159] As ordered in its procedural decision D-2017-009, the experts [sic] of the participants in the matter held an open debate among themselves (known as *hot tubbing*).

*“[41] Consequently, the Régie orders the experts to communicate among themselves in order to identify the topics on which they agree and to debate those on which they do not. These positions must be recorded in a joint report that satisfies the requirements of section 32 of the Regulation and is filed no later than by March 2, 2017 at 12:00 p.m. The Régie mandates Dr. Overcast to coordinate this work and file the joint report. Each of the experts must present his position on the points under dispute in their individual report, the filing of which is required on the same date.”<sup>78</sup>*

[160] The Régie has determined that the final report produced by Dr. Overcast did not include the points under dispute or any joint recommendation. During the hearing, the expert Overcast declared he did not think it necessary to reproduce the points in dispute:

*“R. Given the requirement that the experts file comments related to those points of disagreement, there was no need to include those specifically in this and there was sufficient disagreement over things that, [...] all four of us didn't have the same disagreements, so we just took that opportunity to file their separate reports to*



*reflect those disagreements.*<sup>79</sup>

[161] The intervenors appreciated the measure imposed by the Régie, and while they encouraged the Régie to continue holding these open debates among experts, they invited it to further clarify the framework of the joint report.

[162] The Régie believes that the measure imposed on the experts helped it with the identification of the subjects and issues to be dealt with and examined during the hearing, as well as in its deliberations.

[163] Moreover, the Régie commends the initiative of the expert Marcus, who filed the table summarizing the respective positions of the experts expressed at that meeting.

## 11. INTERVENORS' EXPENSES

### 11.1 LEGISLATION AND APPLICABLE PRINCIPLES

[164] Under section 36 of the Act, the Régie may, among other things, order the Distributor to pay the expenses of any individual whose participation in the proceedings is considered useful by the Régie.

[165] The *Guide de paiement des frais 2012*<sup>80</sup> (the 2012 expense payment guide, or the “Guide”) as well as the *Rules of Procedure of the Régie de l'énergie*<sup>81</sup> provide the framework for cost claims that the Régie may pay or order be paid, without limiting its discretionary power to determine the usefulness of the intervenor's participation in its deliberations and the necessity and reasonableness of the costs incurred.

### 11.2 Cost Claims

[166] The Régie assesses the necessity and reasonableness of the costs claimed by taking into consideration the criteria provided for in section 15 of the Guide. It also takes into consideration the usefulness of the intervenors' participation in light of the criteria provided in section 16 of the Guide. Finally, it considers the intervenors' compliance with

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<sup>79</sup> Exhibit A-0110, p. 105.

<sup>80</sup> Guide de paiement des frais 2012.

<sup>81</sup> CQRL, c. R-6.01, r. 4.1.

the comments it formulated on the requests for intervention in its procedural decision D-2016-186.<sup>82</sup>

[167] The Régie believes that the participation of CFIB, GRAME, OC, ROEÉ and UC proved useful to its proceedings, and the costs claimed by these intervenors are reasonable. It therefore awards all of the costs that they claimed.

[168] As for IGUA and SÉ-AQLPA, the Régie considers that their participation was partially useful to its proceedings. Consequently, it awards each of them the amount of \$20,000, all taxes included.

**TABLE 5**  
**COSTS CLAIMED AND AWARDED**  
**(TAXES INCLUDED)**

<b>Intervenors</b>	<b>Costs claimed (\$)</b>	<b>Costs awarded (\$)</b>
IGUA	24,573.25	20,000.00
CFIB <sup>(1)</sup>	105,324.04	105,324.04
GRAME	790.91	790.91
OC	71,223.73	71,223.73
ROEÉ	88,759.37	88,759.37
SÉ-AQLPA	24,615.67	20,000.00
UC	18,012.94	18,012.94
<b>TOTAL</b>	<b>333,579.93</b>	<b>324,110.99</b>

*Note (1): Amount claimed corrected on June 8, 2017.*

## 12. PROCEDURAL TIMETABLE OF THE CASE

[169] In light of Commissioner Laurent Pilotto's temporary inability to act, the considerable portion of this Case that has already been heard and the Régie's desire not to delay the matter any further, the Régie establishes a new procedural timetable in this section.

[170] The Régie temporarily suspends the Phase 2 examination schedule established in its Decision D-2017-074. However, it maintains the November 18, 2017 deadline for filing the additional evidence of Gaz Métro, as set in its letter dated August 23, 2017.

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<sup>82</sup> Decision D-2016-186.

[171] What is more, the Régie asks Gaz Métro to proceed with the translation of all the evidence it filed in the context of Phase 2, and to file that translation in the court record as soon as possible.

[172] As for the procedural processing of Phase 3, Subject B, the Régie suspends its activities but asks the participants to respect the deadlines set in the procedural timetable established in its letter dated April 26, 2017, taking into consideration all of the evidence available to date. However, the Régie postpones the hearing that was scheduled for October 30 to November 3, 2017 to a subsequent date.

[173] The Régie points out that it will only render a decision on the contestations of the responses in the RFI filed to date by OC and ROÉÉ and any other potential contestations once the full panel will be able to reconvene. It will then fix a new timetable containing an additional step allowing the intervenors and the Distributor to adjust their evidence based on any new evidence that may be adduced, among other reasons, owing to the decision to be rendered on the contestations of the responses in the RFI.

[174] In the meantime, the Régie asks CFIB to pursue its translation of the documents in Phase 3, Subject B.

[175] **For these reasons.**

**The Régie de l'énergie:**

**APPROVES** the method for determining the marginal costs of long-term service delivery established in this decision;

**FIXES** the marginal costs of long-term service delivery as presented in Tables 3 and 4 of this decision;

**ORDERS** Gaz Métro, as of the date of this decision, to use the marginal costs of long-term service delivery appearing in Table 3 in any analysis of the profitability of a system extension project, of a customer connection project, and of the overall profitability of its development plan;

**ORDERS** Gaz Métro, as of the date of this decision, to use the marginal costs of long-term service delivery appearing in Table 4 in any profitability analysis of a project to add a load to an existing customer;

**GRANTS** the intervenors in question the costs indicated in section 11 of this Decision;

**ORDERS** the Distributor to pay the intervenors the costs awarded in this Decision within a period of 30 days;

Temporarily **STAYS** its activities in this Case;

**MAINTAINS** the date for filing Gaz Métro's additional evidence for Phase 2 of the Case, as stipulated in Section 12;

**MAINTAINS** the procedural timetable for Phase 3, Subject B, with the exception that the period scheduled for the hearing will be specified at a later date;

**REQUESTS** that Gaz Métro proceed with the translation of all of its evidence filed in the context of Phase 2 and that CFIB pursue the translation of the documents of Phase 3, Subject B.

Marc Turgeon  
Commissioner

Louise Pelletier  
Commissioner

**Representatives:**

**Industrial Gas Users Association (IGUA) represented by M<sup>tre</sup> Guy Sarault;**

**Canadian Federation of Independent Businesses (Québec Division) (CFIB) represented by M<sup>tre</sup> André Turmel;**

**Option Consommateurs (OC) represented by M<sup>tre</sup> Éric David;**

**Regroupement des organismes environnementaux en énergie (ROÉÉ) represented by M<sup>tres</sup> Franklin S. Gertler and Nicholas Ouellet;**

**Gaz Métro Limited Partnership represented by M<sup>tre</sup> Hugo Sigouin-Plasse;**

**Stratégies énergétiques and Association québécoise de lutte contre la pollution atmosphérique (SÉ-AQLPA) represented by M<sup>tre</sup> Dominique Neuman;**

**Union des consommateurs (UC) represented by M<sup>tre</sup> Hélène Sicard.**

# SCHEDULE

**Schedule (1 page)**

**M. T.** \_\_\_\_\_

**L. Pel** \_\_\_\_\_

**DETERMINATION OF SUPPLY CONTRACT  
MANAGEMENT COSTS**

	Rate	Level	Number of customers	Number of customers with agreements	Number of customers with an agreement over the number of customers per market	Average weighted cost (\$/customer)
	(1)	(2)	(3)	(4)	(5)=(4)/(3)	(6)=\$(94.73 <sup>(1)</sup> )*(5)
<b>Line</b>						
1	D <sub>1</sub>	[0 - 365]	32,448	162		
2	D <sub>1</sub>	[365 - 1,095]	28,220	131		
3	D <sub>1</sub>	[1,095 - 3,650]	76,265	489		
4	D <sub>1</sub>	[3,650 - 10,950]	28,911	2,239		
	<b>Total - Residential</b>		<b>165,844</b>	<b>3,021</b>	<b>1.8%</b>	<b>1.73</b>
5	D <sub>1</sub>	[10,950 - 36,500]	18,465	4,646		
6	D <sub>1</sub>	[36,500 - 109,500]	8,162	2,892		
7	D <sub>1</sub>	[109,500 - 365,000]	1,677	888		
8	D <sub>1</sub>	[365,000 - 1,095,000]	260	173		
9	D <sub>1</sub>	[1,095,000+]	47	39		
10	D <sub>1-RT</sub>		1,266	381		
11	D <sub>303</sub>		89	54		
12	D <sub>304</sub>		93	66		
13	D <sub>305</sub>		60	56		
	<b>Total CII</b>		<b>30,119</b>	<b>9,195</b>	<b>30.5%</b>	<b>28.92</b>
14	D <sub>406</sub>		46	41		
15	D <sub>407</sub>		31	29		
16	D <sub>408</sub>		8	8		
17	D <sub>409</sub>		3	3		
18	D <sub>410</sub>		2	2		
19	D <sub>505</sub>		60	60		
20	D <sub>506</sub>		15	15		
21	D <sub>507</sub>		9	9		
22	D <sub>508</sub>		2	2		
23	D <sub>509</sub>		4	3		
24	D <sub>535</sub>		25	25		
25	D <sub>536</sub>		15	15		
26	D <sub>537</sub>		7	6		
27	D <sub>538</sub>		1	1		
	<b>Total Sales Major Industry</b>		<b>228</b>	<b>219</b>	<b>96.1%</b>	<b>90.99</b>
<b>Total</b>			<b>196,191</b>	<b>12 435</b>		
Note (1):	The cost of \$94.73/customer comes from the total cost in the apply contract management item of \$1.178 million, divided by the 12,435 customers with agreements.					

Sources: Exhibits B-0169, Schedule 4, p. 1, and B-0040, tab FB08.p