

CANADA

RÉGIE DE L'ÉNERGIE

PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL

GENERIC MATTER RELATING TO THE
ALLOCATION OF COSTS AND RATE
STRUCTURE OF GAZ MÉTRO

R-3867-2013
PHASE 3, Subject B

GAZ MÉTRO

Plaintiff

-and-

STRATÉGIES ÉNERGÉTIQUES (S.É.)

Intervenor

**RESPONSE TO GAZ MÉTRO'S REQUEST FOR INFORMATION NO. 2 RELATING TO THE
SUBMISSION ON THE METHODOLOGY FOR EVALUATING THE PROFITABILITY OF THE SYSTEM
EXTENSION PROJECT OF GAZ MÉTRO**

Jacques Fontaine, Consultant
M^{re} Dominique Neuman, Counsel

Prepared for:
Stratégies Énergétiques (S.É.)

October 10, 2017

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1. REFERENCES:

- (i) [STRATÉGIES ÉNERGÉTIQUES (S.É.), R-3867-2013, Phase 3, Subject B,] Exhibit C-SÉ-0049, SÉ-3, Document 1, page 16
- (ii) [STRATÉGIES ÉNERGÉTIQUES (S.É.), R-3867-2013, Phase 3, Subject B,] Exhibit C-SÉ-0049, SÉ-3, Document 1, page 17
- (iii) [GAZ MÉTRO, R-3867-2013, Phase 3, Subject B,] Exhibit B-0278, Gaz Métro-7, Document 5, pages 31 and 32:

(i) "We disagree with Gaz Métro's proposal [...] (supported by the joint report of the experts Chernick, Feingold and Marcus [...]) holding that the costs taken into consideration when evaluating the profitability of individual extension projects are supposedly different from those taken into consideration in the overall evaluation of the portfolio of such projects (the development plan)."

(ii) "Consequently, according to our proposal, the types of costs taken into consideration in the evaluation would include, among other things, "general corporate expenses", "general contractor expenses" and the "costs of reinforcing the distribution network", which are supposedly all taken into consideration, both in the evaluation of the profitability of individual projects (based on the cost allocation principles) as well as in the evaluation of the entire context in which they take place (the development plan)."

(iii) These costs, which are fixed for a certain range of projects done each year, should be considered only at a portfolio level when the profitability of all the development activities is evaluated.

If these indirect costs are allocated project by project, some projects taken individually could not meet the profitability index criteria. This situation would result in the utility foregoing an opportunity to take advantage of economies of scale and scope - missing an opportunity to decrease rates for its existing customers. Table 5 and Table 6 illustrate this outcome. When \$100 of indirect costs is allocated to each project, Table 5 shows that Projects 3 and 4 are not profitable. However, because those two projects have a direct

margin of \$40 (\$20 + \$20), as indicated in Table 5, the utility foregoes the opportunity to take advantage of the economies of scale and scope to reduce rates for its existing customers from the \$40 of additional margin that would cover other fixed costs. Of course, the \$100 of indirect costs will eventually be allocated to all four projects at the end of the year when a profitability analysis is conducted for the overall portfolio of projects.

GAZ MÉTRO'S REQUEST 1.1 TO STRATÉGIES ÉNERGÉTIQUES (S.É.)

Please confirm whether S.É. is of the opinion (references (i) and (ii)) that the fixed joint costs (general corporate expenses and general contractor expenses) should be allocated to individual projects. If not, please elaborate.

RESPONSE 1.1 OF STRATÉGIES ÉNERGÉTIQUES (S.É.) TO GAZ MÉTRO

We do confirm this. The joint costs are allocated to each project in the annual portfolio of projects submitted to the Régie for authorization (projects valued at less than \$1.5 million that are authorized globally, as well as projects valued at over \$1.5 million that are authorized individually), these joint costs being the general corporate expenses and general contractor expenses. **This allows the profitability of each project to be compared to the overall profitability of the portfolio.**

As indicated in our report, if such costs are not allocated to each project, we risk winding up in an absurd situation where, for instance, each and every project would be profitable while the portfolio in which they find themselves would be unprofitable.

Fully allocating costs to each project helps better manage a situation of the portfolio's unprofitability and helps the Régie exercise its discretion to authorize or refuse certain unprofitable projects. It is pertinent, among other things, to clearly identify the profitability threshold achieved by each individual project by taking all of the costs allocated thereto into consideration. By clearly identifying the joint costs thus allocated, it would be just as easy to re-allocate them based on the hypothesis of certain individual projects being refused.

Contrary to what was presumed by Gaz Métro's consultants, Black & Veatch (reference (iii)), the fact that one project does not reach the profitability threshold does not automatically mean it will be dismissed. Quite the contrary, the Régie reserves its discretion, which it may exercise by taking into consideration the fact, among others, that the joint costs would be re-allocated among the other projects if one of the projects were to be refused.

GAZ MÉTRO'S REQUEST 1.2 TO STRATÉGIES ÉNERGÉTIQUES (S.É.)

Is S.É. of the opinion that when a distributor must analyze an investment project, it should take into consideration the costs that will not vary based on the decision to carry out or not carry out a project, in other words, that the distributor should take into consideration the costs incurred regardless of whether or not the project is carried out?

1.2.1 In the affirmative, please explain why such costs are relevant when deciding whether or not to carry out a project.

RESPONSE 1.2 OF STRATÉGIES ÉNERGÉTIQUES (S.É.) TO GAZ MÉTRO

As indicated in response 1.1, it is relevant to consider all of the costs allocated to each project. See response 1.1, including the last paragraph thereof.

GAZ MÉTRO'S REQUEST 1.3 TO STRATÉGIES ÉNERGÉTIQUES (S.É.)

Please confirm that S.É. privileges a methodology such as the one illustrated in the numerical example in Table 5 of reference (iii), in which the indirect costs are allocated per project. If not, please elaborate.

1.3.1 In the affirmative, please explain why the methodology illustrated in the numerical example in Table 6 of reference (iii), in which the indirect costs are considered in the overall portfolio of projects, would not be as good as the one illustrated in Table 5 of that same reference, considering that all customers benefit from a favorable situation due to economies of scale.

RESPONSE 1.3 OF STRATÉGIES ÉNERGÉTIQUES (S.É.) TO GAZ MÉTRO

Yes, the allocation of costs common to each project corresponds to what is found in Table 5 of reference (iii). The allocation of these costs to each project does not, however, necessarily constitute the same amount from one project to the next; various allocation criteria based on the size of each project could result in an allocation that differs for each project.

The allocation of costs to each project presents the advantages that are described at length in response 1.1. In response 1.1, we also address Gaz Métro's fears.
