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PEG
Pacific Economics Group Research, LLC

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Dear Guy,

I have read the letter sent to the Regie on March 14th by attorneys for the transmission and distribution divisions of Hydro-Quebec ("HQTD"). This letter objects to certain evidence submitted by AQCIE and other intervenors in Phase 1 of the proceeding on the *"Mécanisme de Réglementation Incitative"* ("MRI"). I strongly believe that the Régie should allow us to be heard before rendering a decision striking important aspects of our evidence from the record. As I will not attend next week's pre-hearing conference in person, I would appreciate your filing the following comments on our behalf:

1. Although I am not an attorney, I note that Article 48.1 of the *Loi sur la Régie de l'Énergie* ("LRE") requires that "La Régie établit un mécanisme de réglementation incitative assurant la réalisation de gains d'efficience par le distributeur d'électricité et le transporteur d'électricité." The distribution division of Hydro Quebec ("HQD"), in common with many distribution utilities in North America, provides diverse regulated services that include power procurement, distribution, metering, customer accounts, and conservation and demand management programs. There is nothing in the law to suggest that any one of these services are exempted from the MRI requirement.

2. Article 52.1 of the law requires the Regie to "consider" the electric power and transmission costs incurred HQD when setting its rates, along with the "revenues required for the operation of the electric power system". This language does not preclude an MRI for power procurement any more than it precludes an MRI for distribution. Article 52.2 simply clarifies the power procurement costs that the Regie must consider.

3. Hydro-Quebec's attorneys take particular exception to my clarification, in a response to question 1.3.1 of FCEI, that HQD's recovery of costs of power and transmission that are allocated to price cap customers might not be guaranteed. My comments in points [1] and [2] above suggests that this ratemaking treatment is not necessarily precluded altogether by the LRÉ. My proposed ratemaking treatment of tracked costs is not an obligatory part of price cap regulation and should not preclude the Regie from considering the price cap option for some or all customers. The choice between price caps and revenue caps is a fundamental issue in this proceeding and it should not be ruled out <u>in advance of evidence</u> just because HQTD objects to a particular cost tracker provision. Possible adjustments to price caps could be proposed in Phase 3 of this case in order to address compatibility issues with the LRÉ. Similarly, there are no grounds for striking evidence discussing the benefits of marketing flexibility.

4. HQ's proposed retractions due to these concerns are overly broad, as they would seem to include important discussions of revenue decoupling in Sections 5.2.2 and 6.2.2, and of the general benefits of marketing flexibility in 4.4.2 and 5.4.3, as well as the entirety of my summary recommendations table (Table 4).

5. HQTD also objects to certain documents we submitted in response to an HQTD data request. The statement in my report to the Regie that multiyear rate plans ("MRPs") "are the most common approach to incentive regulation around the world" is based on my extensive experience in the MRI field over many years. It would not have been feasible or appropriate for us to provide an exact count of the "number of countries researched", and my statement does not require such an account. Therefore, we addressed the substance of HQTD's question by drawing on a variety of relevant sources. The three documents in question shed light on the frequency with which MRPs are used in Europe, since we can make confident statements about plans in North America, Australia, and New Zealand.

- HQTD-PEG 8A-2 (prepared by REF-E, AF-Mercados EMI, and Indra) provides information about MRPs in the European distribution sector. The bulk of the document (starting on pg. 183) consists of country reports, which provide detailed information about the regulatory systems used in each European country to regulate power distributors, including the length of plan terms.

- HQTD-PEG 8A-3 (prepared by the Agency for the Cooperation of Energy Regulators) contains information about MRPs in the European transmission sector. Throughout the document the incentive regulation approaches used to regulate power transmission companies are discussed, and a table is shown on pg. 15 that summarizes the regulatory frameworks (including the regulatory periods) used in different countries.

- HQTD-PEG 8-A.1 (prepared by EY) provides additional details about the use of MRPs in Europe to regulate both power distribution and transmission. The case studies in the Appendix are presented in a clear and succinct way, making them easy to review and compare.

Each of these documents includes discussion of some items that are not relevant to the current proceeding, but this does not change the fact that they contain information that is directly relevant to the questions submitted by HQTD.

6. Peak load management can play an important role in improving the efficiency of Hydro Quebec's transmission and distribution divisions. Load peakedness is a growing concern in New York and other US jurisdictions. A performance incentive mechanism for peak load management is one way to accomplish this. One of the challenges with this approach is calculating the resultant cost savings so that they can be equitably shared. The Brooklyn Queens Demand Management Project is an interesting example of an attempt by a utility to use peak load management to contain capex in a particular part of an urban area where savings are easy to measure. The performance incentive mechanism tied to this project is of a type meriting consideration for HQD.

7. Section 6.2.4 of my testimony considers cost trackers for HQTD. Cost trackers are an important issue in proceedings to design MRIs. These trackers weaken cost containment incentives and raise regulatory cost, undermining the goals of Article 48.1. Trackers for capital cost can nonetheless make it more feasible for HQTD to operate under index-based rate or revenue caps. However, problems with capital cost trackers in other Canadian provinces suggest that they must be designed carefully. This is a central issue in Alberta's current generic proceeding on next-generation MRIs.

Based on these considerations, I believe that all of the sections of my testimony and other evidence which HQTD wants to strike from the record should be kept in the record for this proceeding. I am frankly surprised that, in a proceeding to consider the broad outlines of MRIs for HQTD, the company would seek to summarily suppress, at this early stage, evidence on options as fundamental as price caps, marketing flexibility, revenue decoupling, cost trackers, and performance incentive mechanisms for peak load management.

Sincerely,

Mark Newton Lowry, PhD

President, PEG Research LLC