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PROVINCE DE QUÉBEC
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RÉGIE DE L'ÉNERGIE

Établissement d'un mécanisme de réglementation incitative assurant la réalisation de gains d'efficacité par le distributeur d'électricité et le transporteur d'électricité;

HYDRO-QUÉBEC

Mise en cause

- ET -

OPTION CONSOMMATEURS

Intervenante

MÉMOIRE D'OPTION CONSOMMATEURS

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I. Introduction

The Régie de l'énergie (the Régie) initiated the current hearing following the introduction of section 48.1 of An Act Respecting the *Régie de l'énergie* which requires the Régie to establish an incentive regulation mechanism (IRM) securing efficiency gains for both the distribution (HQD) and transport (HQT) divisions of Hydro-Québec. Section 48.1 specifies that the mechanism must pursue three objectives:

1. ongoing improvement in performance and service quality;
2. cost reduction that is beneficial to both consumers and the distributor or carrier; and
3. streamlining of the process by which the Régie fixes or modifies the rates the electric power carrier and the electric power distributor charge consumers or a class of consumers.

On March 4th 2015, the experts retained by the Régie, Elenchus Research Associates, published its report on performance based regulation¹.

In its decision D-2015-103, the Régie indicated the IRM hearing will be separated in three phases and also determined the calendar and topics for Phase 1. The topics are: (i) interpretation of section 48.1, (ii) operational characteristics or objectives of an IRM and (iii) the treatment of autonomous networks. The Régie also specifies the goals of Phase 1² :

Cette phase doit permettre d'identifier le type, le nombre et les caractéristiques d'un MRI pour les mises en cause, ainsi que les indicateurs permettant de mesurer l'atteinte de chacune des caractéristiques ou chacun des objectifs opérationnels. Par exemple, si un participant propose un type de MRI faisant appel à un facteur d'indexation, il devra, notamment, préciser s'il préconise un plafonnement des prix ou des revenus. Durant la phase 1, un participant pourrait également suggérer qu'un

¹ *Performance based regulation – A review of design options as background for the review of PBR for Hydro Québec Distribution and Transmission divisions.*

² D-2015-103, p. 7.

mécanisme de report des gains d'efficacité ou un mécanisme de découplage est requis et que des clauses de révision ou de sortie apparaissent nécessaires. Enfin, la Régie considère que la question du partage des écarts de rendement devrait également être traitée de manière conceptuelle.

The Régie also asked the intervenors to provide their interpretation of section 48.1. Finally, the Régie indicated it would decide on the necessity of undertaking a multifactor productivity study after the conclusions of Phase 1 and that the modalities of application of the IRM are to be treated as part of Phase 3³.

On July 21st 2015, Option Consommateurs (OC) filed its participation budget and indicated it would work in collaboration with l'Association Québécoise des Consommateurs Industriels d'Électricité et le Conseil de l'Industrie Forestière du Québec (AQCIE-CIFQ) and retain the services of experts from Pacific Economics Group (PEG)⁴.

On September 8th, OC filed its pleadings regarding the interpretation of section 48.1. The Régie filed a preliminary decision on the interpretation of section 48.1 on October 7th⁵.

On October 26th 2015, PEG and Concentric Energy Advisors (Concentric), the firm retained by HQD and HQT, filed their expert reports and recommendations with the Régie⁶.

In the present Mémoire, OC provides comments on both the PEG and Concentric Energy Advisors reports and presents its own recommendations to the Régie.

³ *Ibid.*, p. 5-6.

⁴ C-0007, p. 3.

⁵ D-2015-169.

⁶ C-AQCIE-CIFQ-0025 and C-HQT-HQD-0023.

II. General IRM characteristics for HQD and HQT

Multiyear rate plans

A Multiyear Rate Plan (MRP) is a fundamental component of an IRM. As expressed in PEG's report, the general idea is to "*compensate a utility for its services for several years with revenue that reflects cost pressures without closely tracking the utility's own cost of service*"⁷. Benefits of MRPs include providing greater incentives to utilities to slow rate base growth or support conservation and load management (CLM) programs⁸. All of the various IRMs surveyed in the Elenchus report were MRPs⁹.

Both PEG and Concentric are recommending the implementation of MRPs as part of first generation IRMs for both Hydro-Quebec divisions¹⁰. OC suggests that an MRP is an essential component needed to achieve the efficiency gains and the streamlining objective of section 48.1 and recommends its adoption for HQD and HQT.

Attrition relief mechanism – Design and components

MRPs typically include an Attrition Relief Mechanism (ARM) as a way to adjust revenues or rates in accordance with cost pressures from year to year. Two options are generally presented as possible ARM candidates depending on whether the mechanism escalates rates (Price Cap) or revenue (Revenue Cap).

A Price Cap provides incentives to grow system use and increase sales since the price of the services the utility is selling is fixed (\$/kWh delivered) but not the quantity. As mentioned in PEG's report, Price Cap is put forward when it is "*important to promote marketing flexibility*"¹¹.

⁷ C-AQCIE-CIFQ-0025, p. 25.

⁸ *Ibid.*, p. 8 and 12.

⁹ A-0003, p. A1.

¹⁰ C-AQCIE-CIFQ-0025, p. 110. C-HQT-HQD-0023, p. 14 and 22.

¹¹ C-AQCIE-CIFQ-0025, p. 13.

A Revenue Cap mechanism provides incentives to reduce average unit costs and are likely to help promote energy efficiency programs¹².

More generally, the Elenchus Report also indicates that *“rate caps are generally used for distribution utilities in order to stabilize costs on a per unit basis since costs tend to increase with number of customers and/or volumetric throughput. Revenue caps are commonly used for transmission utilities since costs tend to be relatively insensitive to year-over-year changes in throughput”*¹³.

The alternative to implementing an ARM is what Elenchus refers to as a *“modified form of COS”*, as exemplified by the Consolidated Edison IRM¹⁴. The Elenchus report indicates that *“while multi-year regimes generally provide less effective incentives for improving productivity than CPI-X regimes, they do provide greater opportunities for a utility to benefit from efficiency improvements than annual cost of service reviews”*¹⁵.

Both experts firms rely on HQT and HQD specificities, mostly relating to the demand and cost profiles of both divisions, to develop their IRM recommendations. A non-extensive summary includes:

- Normal growth trends in the number of customers for HQD compared to North American standards. Sales are more volatile because of weather conditions¹⁶;
- Presence of large industrial customers that are sensitive to HQD's rate and service offers. Sales of large load customers have been trending downward recently¹⁷;

¹² *Ibid.*, p. 14.

¹³ A-0003, p. 2.

¹⁴ A-0003, p. 43.

¹⁵ *Ibid.*,

¹⁶ C-AQCIE-CIFQ-0025, p. 74. C-HQT-HQD-0023, p. 7.

¹⁷ C-AQCIE-CIFQ-0025, p. 74.

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- No “surges” in forecasted HQD’s capex for the coming years¹⁸ ;
- Recent increase in power supply cost due to post patrimonial charges¹⁹ ;
- HQT’s size, being the largest transmission provider in North America²⁰ ;
- HQT’s annual historical capacity growth of 1.1% and peak load growth of 0.7%. Peak load growth is expected be greater in the coming years²¹ ;
- The “stair step” pattern of HQT’s rate base growth²² ;
- Important plant additions for HQT in the years 2018 and 2019, but less afterwards²³ ;

HQD

PEG is recommending a revenue cap ARM for residential and small business customers and a price cap ARM for industrial customers (and potentially electric vehicles). Both mechanisms would also include adjustments for lost revenue due to CDM programs to increase energy efficiency incentives. Arguments in favour of a revenue cap for small customers include (i) less controversy over billing determinants since earnings would become independent of forecasts, (ii) less risk from demand fluctuations and (iii) greater incentives to undertake CDM programs²⁴. The price cap option for industrial customers is justified by the fact that they are “*services that merit encouragement*”²⁵. Both ARMs would apply to operating expenses (opex) and capital expenditures (capex), except certain expenses covered by the Y and Z factors.

Concentric suggests using a revenue cap ARM that would apply to all types of customers. A revenue cap would be a “*logical evolution*” to the current parametric formula, would provide

¹⁸ *Ibid.*, p. 77.

¹⁹ *Ibid.*, p. 79.

²⁰ *Ibid.*, p. 73.

²¹ *Ibid.*, p. 75.

²² *Ibid.*, p. 80.

²³ *Ibid.*

²⁴ *Ibid.*, p. 95-96.

²⁵ *Ibid.*

efficiency incentives and would take into account HQD's specificities²⁶. These include the low share of costs under HQD's control, the smooth trend of capex expenses and "*HQD's ability to manage costs under its control*"²⁷. Similarly to PEG, Concentric is recommending addressing both opex and capex expenses in the ARM. One distinction is the "*specifically tracked items*"²⁸ which Concentric suggests should not be part of the ARM.

As suggested by both expert firms, OC recommends the adoption of a revenue cap for HQD. It would, among other considerations, provide greater incentives to promote CDM programs that are needed, especially to address peak load management. The recent smooth trends of capex and opex as illustrated by Concentric do not require the stability a price cap would offer. Also, incentives to increase system use for small customers are generally less needed because of the low elasticity of electricity consumption. OC recommends both opex and capex expenses be covered by the ARM with exceptions to be included in Y and Z factors as mentioned below.

OC supports PEG's view that a price cap for specific customers could be implemented in markets the Régie would like HQD to promote. If the Régie was to implement such a price cap, OC suggests that it is important that small customers be protected from fluctuations in costs and revenues of larger price cap customers, since an increase in system use is likely to increase cost volatility, due to economic factors and power supply costs. PEG indicates that "*an important further issue is whether "baskets" should be implemented that insulate residential and commercial customers and industrial customers from the revenue impact of fluctuations in each other's revenue*"²⁹. One possibility proposed by PEG could be the use of separate earning sharing mechanisms (ESM), if accepted by the Régie, to distinguish costs and revenues of both classes of customers.

²⁶ C-HQT-HQD-0023, p. 12.

²⁷ *Ibid.*

²⁸ C-HQT-HQD-0023, p. 14.

²⁹ C-AQCIE-CIFQ-0025, p. 96.

HQT

PEG supports a revenue cap for HQT in part because its revenue is “*already insensitive to system use under its OATT*”³⁰. PEG also suggests that a price cap would increase HQT’s operating risks, increase costs for HQD unfairly, necessitate extensive review of the OATT rate and would encourage discounts which are not likely needed³¹. The revenue cap ARM would cover both opex and capex expenses with possible exceptions for special capital projects³² and other cost elements covered in the Y and Z factors.

Concentric supports a multiyear cost of service for HQT which they call a “*building block*” MRI approach. They argue the capital-intensive nature of HQT, where investments can be lumpy and uneven, are generally challenging for IRMs and thus an “*I-X program would be a poor fit*”³³. The “*building block*” approach is in continuation of existing rate setting regime but would accommodate section 48.1 with the addition of the MRP component to the plan.

OC suggests that the “*building block*” approach proposed by Concentric would provide fewer incentives than the PEG approach and is less likely to accommodate the two following objectives of section 48.1.

1. ongoing improvement in performance and service quality;
2. cost reduction that is beneficial to both consumers and the distributor or carrier.

For one, the Elenchus report indicates a “*multi-year regime that does not use escalators along the lines of CPI-X can be challenging to make operational. The longer the term over which costs are being forecast, the more difficult it is to assess the reasonableness of the forecast costs*”. It

³⁰ *Ibid.*

³¹ *Ibid.*, p. 97.

³² C-AQCIE-CIFQ-0025, p. 102.

³³ C-HQT-HQD-0023, p. 17.

also states that it “*involves more on-going cost scrutiny than CPI-X regimes*”³⁴. This also suggests Concentric’s recommendation for HQT is less likely to meet the streamlining objective of section 48.1.

More importantly, OC submits that the *continuous* efficiency improvements embedded in section 48.1 are best achieved under a MRP with an ARM than under a cost of service MRP. A recent decision by the Ontario Energy Board (OEB) is interesting in that regard. Hydro One Networks Inc. (Hydro One) filed its 2015-2019 Distribution rate application suggesting the use of a multiyear cost of service under the custom incentive rate-setting option. The OEB rejected Hydro One’s Distribution proposal for the five following reasons:

1. Inconsistency with outcome-based regulation

The OEB indicated that “*Incentive rate-setting differs from cost of service rate-setting in that it relies less on a utility’s internal cost, output, and service quality to establish rates, and more on benchmarks of cost, output, and service quality that are external to the utility revealing superior performance and encouraging best practice. The decoupling of rates from the utility’s own costs simulates a competitive market environment and is more compatible with an outcomes-based approach to regulation*”³⁵.

2. Lack of externally imposed incentives

The OEB indicated the savings embedded in costs forecasts are not sufficient but come “*from explicit, objectively determined productivity and efficiency adjustments such as stretch factors include mimicking competitive market conditions, sharing anticipated savings with ratepayers “up front”, and facilitating a more outcome-based approach to regulation*”³⁶.

³⁴ A-0003, p. 48.

³⁵ EB-2013-0416/EB-2014-247, p. 14.

³⁶ *Ibid.*, p. 15.

3. Weak benchmarking evidence

The OEB indicated the benchmarking studies provided by Hydro One Distribution lacked “*a top-down perspective of what the appropriate level of costs should be*” and “*measures of Hydro One’s cost performance against other comparable utilities*”³⁷.

4. Limited prospects for continuous improvement

The OEB indicated that Hydro One Distribution plan “*lack of efficiency incentives lessens the probability of achieving continuous improvement*” and that “*while Hydro One characterises its forecasted annual savings as ambitious, the OEB is concerned that the declining trend and relatively small savings do not show Hydro One to be a company with a strong orientation towards continuous improvement*”³⁸.

5. Value to customers

The OEB indicated that “*it is unclear whether Hydro One’s customers would understand the value proposition associated with Hydro One’s plan*”³⁹. The OEB indicated the indicators provided by Hydro One Distribution “*are activity-based such as the number of substations refurbished, rather than outcome-based whereby the number of outages avoided or length of outages reductions as a result of the substation refurbishment would be measured*”.

OC submits that these criticisms can be applied to Concentric’s proposal for HQT. For example, they indicate that the “*building block*” approach is a bottom-up method that would require HQT to “*continue showing evidence of productivity measures employed in its building block forecast of revenue requirements*”⁴⁰. The OEB’s concerns also apply to the recommendations regarding how the parameters of the MRPs would be fixed. As reviewed in the next section, Concentric does not recommend any productivity study for both HQD and HQT.

³⁷ *Ibid.*

³⁸ *Ibid.*, p. 17.

³⁹ *Ibid.*, p. 19.

⁴⁰ C-HQT-HQD-0023, p. 21.

Attrition relief mechanism – Fixing the parameters

PEG strongly supports indexing the parameters of the ARMs for HQD and HQT, with a hybrid approach as a possible fallback for HQT. PEG indicates that an *“all-forecast approach to ARM design has been used in several jurisdictions and been found to have significant problems”* and it involves *“more complexity and controversy”*⁴¹. They suggest that the Régie should undertake extensive benchmarking studies in Phase 2 to inform on the design of the ARM. A hybrid approach for HQT could be a suitable option where *“revenue for O&M expenses would be indexed, while revenue for capital costs would be forecasted”*⁴².

Concentric does not support benchmarking. It recommends *“the Régie rely upon its judgment, with input from the parties, on setting the appropriate productivity factor for HQD”*⁴³. Arguments include: *“lack of history in applying productivity studies for HQD, the prior experience with the parametric formula (with a productivity factor), and evidence that HQD has realized significant efficiency gains over the past few years”*⁴⁴. For HQT, its “building block” proposal does not require productivity studies by definition.

OC supports PEG’s recommendations that extensive statistical studies and benchmarking are needed for both HQD and HQT in Phase 2. Comparability is essential to provide the necessary and sufficient guidance for the continuous efficiency improvements required in section 48.1. The lack of previous productivity studies for HQD is not a valid argument, as suggested by Concentric. Such studies in Phase 2 will be able to inform on how HQD compares to other firms and provide insights for the subsequent MRPs, as well as on whether more research is needed. A benchmarking study would also compare HQD’s recent efficiency gains to other utilities cost realizations. Productivity studies are a desirable start-up cost to inform on current and future

⁴¹ C-AQCIE-CIFQ-0025, p. 97.

⁴² *Ibid.*, p. 101.

⁴³ C-HQT-HQD-0023, p. 25.

⁴⁴ *Ibid.*

IRM designs and are usually required by most regulators in setting the initial parameters of the IRMs.

III. Other IRM features for HQD and HQT

Cost trackers

HQD

PEG recommends that Y and Z factors should be part of HQD's MRP. Under an index-based ARM, PEG suggests no capital tracker is required for HQD. Reasonable candidates for the Y factor are power supply and transmission costs, severe storm expenses, changes in utility accounting standards, expiration of the amortization of deferral accounts and CDM expenses. Overall, PEG suggests Y factors should be limited by the Régie. PEG also recommends the inclusion of Z factors, with high materially thresholds, to address hard to foresee costs⁴⁵.

Concentric considers all recognized deferral accounts should be Y-factored for HQD. OC understands that Concentric recommends the Y factor for HQD would also include specifically tracked items, capex of CDM programs and a return on rate base. Concentric also suggests the Regie would continue to review capital investments as under the current rate setting regime⁴⁶. Finally, they recommend the inclusion of Z factors *"to allow for unanticipated/exogenous events outside of management's control"*⁴⁷.

OC recommends that HQD's IRM should include Y and Z factors. In accordance with PEG's recommendations, OC suggests including capex as part of the ARM for both division with the exception of CDM capex for HQD. The Y factors for HQD should include power supply, transmission and CDM costs. The addition of other Y factors should be evaluated in Phase 3

⁴⁵ C-AQCIE-CIFQ-0025, p. 101-104.

⁴⁶ C-HQT-HQD-0023, p. 13-14.

⁴⁷ *Ibid.*

following guidelines provided by the Régie, similarly to the Alberta Utility Commission (AUC) guidelines mentioned in the Elenchus report⁴⁸.

HQT

PEG recommends most of the capital costs of HQT to be under the ARM. An option would be given to HQT for special investment projects similar to the Incremental Capital Module (ICM) allowed by the OEB for distributors with unusual or lumpy Capex. PEG recommends that requirements on eligibility, evidentiary and incentivization should be met when addressing the treatment of capital trackers. The issues of double counting must also be addressed. With the exception of capital tracker, sensible candidates for HQT are severe storm expenses, changes in utility accounting standards and expiration of the amortization of deferral accounts. Finally, PEG also recommends including a Z factor⁴⁹.

Concentric recommends the continuation of the existing deferral accounting system under its multiyear cost of service proposal⁵⁰.

Following the introduction of a revenue cap ARM for HQT, OC recommends having Y and Z factors for HQT. The staircase pattern of HQT capex indicates that providing an optional treatment for some capital projects is appropriate. OC notes that the ICM implemented by the OEB provides clear guidelines to the Y-factoring of capex. Under the ICM, incremental capital can be included if it meets the eligibility criteria as reproduced below :

- *Materiality : The amounts must exceed the Board-defined materiality threshold and clearly have a significant influence on the operation of the distributor; otherwise they should be dealt with at rebasing.*

⁴⁸ A-0003, p. A28-A29.

⁴⁹ C-AQCIE-CIFQ-0025, p. 101-104.

⁵⁰ C-HQT-HQD-0023, p. 22.

- *Need : Amounts should be directly related to the claimed driver, which must be clearly non-discretionary. The amounts must be clearly outside of the base upon which rates were derived.*
- *Prudence : The amounts to be incurred must be prudent. This means that the distributor's decision to incur the amounts must represent the most cost-effective option (not necessarily least initial cost) for ratepayers.⁵¹*

The OEB also provides a detailed list of ICM filling guidelines.

OC recommends additional Y and Z factors should be evaluated in Phase 3. As for HQD, the Régie should adopt appropriate guidelines for their inclusion.

Performance Metric Systems

IRMs generally include performance metric systems to incentivize areas that could otherwise be neglected by utilities operating under MRP. As Elenchus mention in their Report *“it was quickly recognised that the easiest way for utilities to cut costs and increase profit was to reduce maintenance and defer capital expenditures. The resulting decline in reliability and other service standards was not always consistent with the goal of enhancing productivity. Consequently, a standard feature of the evolution of PBR regimes was the inclusion of quality of service standards »⁵².*

Both PEG and Concentric suggest the use of performance metric systems for both HQD and HQT.

⁵¹ Chapter 3 of the Filing Requirements for Transmission and Distribution Applications, June 22th 2011.

⁵² A-0003, p. 6.

Concentric suggests the use of service quality indicators (SQI) with *“limited number of performance indicators to be linked to earnings”*⁵³. Both HQD's and HQT's existing SQIs could be used and linked to the ESM.

PEG also recommends using some of HQD's and HQT's current metric system, but suggests the inclusion of additional indicators⁵⁴. Some of the them would be subject to financial incentivization, under performance incentive mechanisms (PIMs), as indicated (*) in the list below :

PEG's recommendation for HQD performance metric system :

- **Reliability** : SAIDI*, SAIFI*, Worst performing circuits, MAIFI
- **Customer service** : Telephone response time*, appointments kept*, Timeliness of connections*, customer satisfaction, customer complaints.
- **CDM** : Peak load savings*, Conservation savings, CDM expenses, Customers enrolled in CDM programs.
- **Safety** : Worker safety*, Deaths from electrocution in general population.
- **Cost** : Power supply cost*, O&M, Capital, Productivity indexes, Unit cost metrics, Consumption on inactive meters.
- **Other** : Electric Vehicles, AMI used & useful, Third party cooperation, Transparency in regulation.

PEG's recommendation for HQT performance metric system :

- **Reliability** : Frequency*, Duration*, Frequency detail for point to point customers, Duration detail for point to point customers, Equipment failures.

⁵³ C-HQT-HQD-0023, p. 14 and 22.

⁵⁴ C-AQCIE-CIFQ-0025, p. 107.

- **Customer service** : On time connections*, Miscellaneous*, Customer engagement, Compliance with established standards, Customer satisfaction (Independent point to point customers itemized).
- **Safety** : Worker safety*.
- **Cost** : O&M, Capital, Productivity indexes, Unit cost metrics,
- **Other** : Selected environmental metrics*, Other environmental metrics, Transparency in regulation.

OC recommends the adoption of PEG's performance metric system. OC suggests two proposals for PIMs for HQD need special consideration. They are not included in the Concentric Report.

The first is the *peak load savings* indicator. The motivation for its incentivization is straightforward as it aims to provide "*incentive to reduce peak loads*"⁵⁵. Peak load savings might be difficult to estimate and need meticulous computations, but overall OC thinks it would provide the needed incentives for HQD to address current peak load problem. Incentivization of CDMs was applied to Gaz Métro's MRP⁵⁶.

The other indicator suggested by PEG that needs special consideration is the power supply cost PIM. Although it is difficult to see how it would work in practice as of now, OC thinks the proposition should be explored as of phase 3.

In general, OC recommends that the indicators be *outcome-based* and comprehensible to the public. The Scorecard approach adopted by the OEB might provide useful insights in that regard⁵⁷. Such an approach is more likely to address the complexity mentioned by the Régie in the Gaz Métro IRM :

⁵⁵ C-AQCIE-CIFQ-0025, p. 96.

⁵⁶ D-2007-47, Annexe, p. 28.

⁵⁷ EB-2010-0379 - *Performance Measurement for Electricity Distributors – A scorecard approach*.

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“La Régie reconnaît que, pris distinctement, les indicateurs proposés par le Groupe de travail sont simples et leur impact individuel facile à apprécier. Par contre, lorsqu’il s’agit d’identifier l’impact combiné des différents indicateurs, la situation est toute autre. Enfin, la Régie constate qu’un même comportement peut conduire à une double bonification. Elle considère que cette possibilité est non seulement contraire à l’objectif de simplicité recherché par le Groupe de travail, mais également susceptible de sur-inciter la réalisation de certains objectifs. Cette situation n’est pas souhaitable, puisqu’elle peut induire, chez l’entreprise réglementée, un comportement contraire à l’intérêt public ”⁵⁸

ESM and off ramp provisions.

Both PEG and Concentric recommend including ESMs as part of the IRM for HQD and HQT.

PEG mentions that while it might weaken the efficiency incentives offered by an IRM, ESMs can reduce risk for utilities and guarantee the sharing of benefits with customers. Since it will be first generation IRMs for both divisions, PEG argues that it makes sense to include ESMs and that the efficiency disincentives can be reduced with a deadband⁵⁹.

Concentric considers the parameters of the ESM established previously by the Régie should be revisited, especially since it might have an impact on the achievability of section 48.1 objectives⁶⁰.

In a similar fashion, PEG recommends including off ramp provisions for first generation IRMs and suggests a rule of thumb could be a 300 basis points average deviation of the rate of return

⁵⁸ D-2012-076, p. 13.

⁵⁹ C-AQCIE-CIFQ-0025, p. 104.

⁶⁰ C-HQT-HQD-0023, p. 26.

over three years⁶¹. Although not explained, Concentric also recommends including off ramp provision that would depend on deviations from allowed ROE⁶².

OC agrees with both PEG and Concentric and considers prudent that ESMs and off ramp provisions be part of the first generation IRMs. The exact parameters of the formulae should be discussed in Phase 3.

Marketing flexibility

PEG recommends both HQD and HQT should *“be permitted to gradually redesign tariffs during the term of the plan to achieve any Régie-approved goals”*⁶³. This could include time-sensitive pricing or economic development rates.

Marketing flexibility is mentioned in the Elenchus report as an arising challenge of IRM regulation. One of the challenges is accommodating distributed generation. Elenchus mentions that *“as this issue becomes more pressing, there may be a need for utilities to develop service and pricing strategies that respond to the competitive threat; however, if regulators allow utilities some discretion introduce new services, modify their rate designs and rebalance rates among customer classes and services, they will also have to provide the required oversight to avoid the flexibility resulting in anti-competitive or discriminatory practices”*⁶⁴.

OC suggests that under the new IRM, the rate design proposals by HQT and HQD should be subject to the same amount of scrutiny by the Régie and the intervenors as under the current rate regime. OC shares Elenchus's concerns on the required oversight. If the streamlining objective of section 48.1 is achieved, it might create new opportunities to explore the issue of marketing flexibility to a greater extent.

⁶¹ C-AQCIE-CIFQ-0025, p. 104.

⁶² C-HQT-HQD-0023, p. 14 and 22.

⁶³ C-AQCIE-CIFQ-0025, p. 108.

⁶⁴ A-0003, p. 6.

Plan Termination Provisions

PEG recommends four year terms for the plans of both divisions and mid-term reviews in the third year that could update or extend the plan. A four year term plan would provide greater incentives over current rate regime⁶⁵. Efficiency carryover mechanisms (ECM) are discussed broadly by PEG since they recommend that they should be considered and that appropriate focus should be put on rewarding “*good value to customers in the rates of future MRPs*”⁶⁶.

Concentric recommends two year terms for both HQD and HQT after a rebasing of rates or, similarly, 3 forecast rate years⁶⁷. Concentric suggests ECM “*could be evaluated and incorporated in a subsequent term*” for both HQD and HQT⁶⁸.

OC agrees with PEG’s recommendation of four year terms for both HQD’s and HQT’s plans. It would address both the general efficiency goal of section 48.1 and its third objective which is the streamlining of the regulatory process. OC suggests to the Régie that emphasis should be put on the ECM as it will be one of the main drivers of efficiency gains translation in subsequent IRM. This is essential in meeting the second objective of section 48.1 which relates to the sharing of benefits with customers.

IV. Summary of recommendations

In general, OC finds PEG’s recommendations for HQD’s and HQT’s IRMs are suitable answers to the objectives set in section 48.1. OC retains the right to modify or clarify during the hearing its recommendations to the Régie depending on the answers to be given by both expert firms to the IR’s to be filed on December 1st. OC believes additional information is required regarding the ARM components, Phase 2 studies, the performance metric system, the first year basing of rates and end of term rebasing.

⁶⁵ C-AQCIE-CIFQ-0025, p. 108.

⁶⁶ *Ibid.*

⁶⁷ C-HQT-HQD-0023, p. 14 and 22.

⁶⁸ *Ibid.*

OC recommends to the Régie the adoption of MRPs for both HQD and HQT.

OC recommends to the Régie the adoption of a revenue-cap ARM for HQD that would apply to residential and small business customers. The revenue-cap would cover both opex and capex expenses, excluding Y and Z factors, and include a revenue decoupling mechanism.

OC supports PEG's recommendation for the adoption of a price-cap ARM for HQD that would apply to large load customers, provided residential and small business customers are appropriately protected. The price-cap would cover both opex and capex expenses and include a lost revenue adjustment mechanism.

OC recommends to the Régie, as proposed by PEG, the adoption of a revenue-cap ARM for HQT. The revenue-cap would cover both opex and capex expenses and include a revenue decoupling mechanism.

OC recommends to the Régie the use of benchmarking studies to inform on the parameters of the ARMs for HQD and HQT. OC recommends that extensive statistical studies be conducted in Phase 2.

OC recommends to the Régie the use of Y and Z factors for both divisions. Guidelines should be developed to define the elements to be included.

OC recommends to the Régie the use of outcome-based and comprehensive metrics.

OC recommends some indicators be incentivized, including peak load savings.

OC recommends to the Régie the adoption of ESMs for both divisions.

OC recommends to the Régie that rate designs under an IRM continue to be subject to the Régie's approval.

OC recommends to the Régie four year term IRMs with off ramp provisions for both divisions.

**Établissement d'un mécanisme de réglementation incitative assurant la réalisation de gains
d'efficacité par le distributeur d'électricité et le transporteur d'électricité
Mémoire d'Option consommateurs**

Appendix A – Expert’s recommendations comparison tables

Table 1 – Recommendations for HQD

IRM COMPONENTS	PEG	Concentric
Basic approach	MRP with an ARM	MRP with an ARM
ARM - Design	Revenue-cap for small customers with revenue decoupling. Price-cap for large load customers with a lost revenue adjustment mechanism.	Revenue cap.
ARM – Fixing parameters	Index-based with benchmarking.	Index-based. Inflation is a weighted combination of HQDs labour inflation and Canada’s CPI. No benchmarking, X factor is judgment based.
Included in the ARM	OPEX and CAPEX with exclusions in Y and Z factors.	OPEX and CAPEX with exclusions in Y and Z factors.
Y and Z factors	Y factors would include : Power supply, Transmission costs, CDM, severe storm expenses, changes in accounting standards, expiration of amortization of deferral accounts. Z factors should be included but limited.	Y factors would include the current recognized cost by the Régie. They include : pass-on, transmission costs, weather normalization, fuel cost. Z factors should be to allow for unanticipated/exogeneous events outside of managements control.
Performance incentive mechanism	Metrics for reliability, customer service, CDM, safety, cost and other metrics. Some metrics have financial incentives including peak load savings and power supply cost.	Current service quality indicators with a limited number linked to financial incentives. Financial incentives should be linked with the ESM.
ESM	Yes.	Yes.
Plan termination provisions	Four years with a mid-term review.	Three forecast years.
ECM	To be considered.	To be considered but might be incorporated in a subsequent term of HQD MRI.
Off-ramp	Yes.	Yes as expressed with +/- range from allowed ROE.
Marketing flexibility	Yes.	Not mentioned.

Table 2 – Recommendations for HQT

**Établissement d'un mécanisme de réglementation incitative assurant la réalisation de gains
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Mémoire d'Option consommateurs**

IRM COMPONENTS	PEG	Concentric
Basic approach	MRP (with an ARM)	Multiyear cost of service
ARM - Design	Revenue-cap for small customers with revenue decoupling.	No ARM.
ARM – Fixing parameters	Index-based with benchmarking or hybrid approach for backup.	No ARM. Building block approach with full forecast of revenue requirements. No benchmarking.
Included in the ARM	OPEX and CAPEX	No ARM.
Y and Z factors	Y factors include limited capital cost option if ARM is indexed. Could include severe storm expenses, changes in utility accounting standards, expiration of amortization of deferral accounts. Z factors should be included but limited.	Y factors would include the current recognized cost by the Régie. They include : pension costs, point-to-point services and penalty revenues related to ancillary services. Z factors should be to allow for unanticipated/exogeneous events outside of managements control.
Performance incentive mechanism	Metrics for reliability, customer service, safety, cost and other. Some metrics have financial incentives.	Current service quality indicators with a limited number linked to financial incentives. Financial incentives should be linked with the ESM.
ESM	Yes.	Yes.
Plan termination provisions	Four years with a mid-term review.	Three forecast years.
ECM	To be considered.	To be considered but might be incorporated in a subsequent term of HQD MRI.
Off-ramp	Yes.	Yes as expressed with +/- range from allowed ROE.
Marketing flexibility	Yes.	Not mentioned.