

Proposal for Additional Consultation and Evidence on the MRI of Hydro-Québec Distribution

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On 27 July 2018 Hydro-Québec Distribution (“HQD”) filed a *demande tarifaire* that contained recommendations and some evidence concerning the service quality provisions and *clause de sortie* for HQD’s new *mécanisme de réglementation incitative* (“MRI”). HQD also proposed a meeting in late September to discuss service quality metrics, and presented some details of its plan for the study of productivité multifactorielle (“PMF”) which the Company is required to prepare during the years of the MRI.

I present in this document a proposal for Pacific Economics Group Research LLC (“PEG”) to provide consultation to AQCIE, CIFQ, and other Québec consumer groups on a response to the HQD evidence and appropriate new testimony. I begin with a brief background discussion and then turn to HQD’s proposal, a brief preliminary critique of same, and an offer of services.

Background

In D-2017-043, the Régie in its Phase I decision determined the broad outlines of a new MRI for HQD. It approved a multiyear rate plan featuring a revenue cap index and a *mécanisme de traitement des écarts de rendement* (“MTER”). Performance in the following five areas

- customer satisfaction
- reliability
- power supply
- customer service
- public and employee safety

would be measured using a limited number of familiar metrics like those already used in HQD’s *dossiers tarifaires*. Performance would be measured by comparing company values for these metrics to targets. Performance results would be used to adjust the MTER.

The Régie also approved a *clause de sortie* “permettant une révision ou un interruption du MRI” under certain circumstances. The Régie later ruled that the MTER, apart from a possible performance adjustment, would otherwise resemble that approved in D-2014-034. In this mechanism, earnings shortfalls are not shared, but earnings surpluses are subject to a banded sharing mechanism. Details of the *clause de sortie* and the performance metrics and incentives for HQD are as yet unresolved.



In D-2018-067 on Phase 3 of HQD's MRI, the Régie approved a specific revenue cap index with a provisional 0.3% X factor. HQD was ordered to undertake a PMF study during the MRI term. The Company was ordered to present "*la méthodologie et l'échéancier*" for the study in its 2019 *dossier tarifaire*.

HQD Proposal

Performance Incentive Mechanism

HQD proposes metrics in each of the five performance areas. The Company proposes to use as targets for each metric the averages of the Company's values for the metrics over the five-year 2013-2017 period.

A summary *indice global du maintien de la qualité du service* ("IMQ") would involve calculations in two stages. Following a statistical normalization of the results for individual metrics, performance would be averaged. Results in the five performance areas would receive equal weight.

Unfavorable IMQ scores would not affect earnings until they reached a value of negative one. Progressively higher values would require Trump to forfeit a higher share of any surplus earnings.

Clause de Sortie

HQD embraces a proposal from its consultant Concentric Energy Advisors that the *clause de sortie* be triggered if the Company's rate of return varies by more than 150 basis points from its target in either direction. In that event, the MRI would be suspended and HQD would return to cost of service regulation.

PMF Study

HQD presented a schedule for the PMF study but did not present the contemplated methodology. A methodology will not be presented until a consultant is retained to do the study.

Preliminary Critique

Performance Incentive Mechanism

Here are some areas of concern with HQD's proposed service quality performance incentive system.

Reliability Metrics

HQD proposes only systemwide reliability metrics. This incentivizes the Company to focus on actions that improve these metrics most cost effectively. Service in some localities may suffer. Many approved MRIs have metrics that guard against this outcome.

Customer Service Metrics

Additional customer service metrics should be considered.



Incentive Mechanism

- The proposed method for normalizing performance results is unusual.
- HQD provides no evidence that the financial penalties it proposes for poor service quality are appropriate. It would be quite a coincidence if the appropriate penalty for a 200 basis point decline in the IMQ was to reduce surplus earnings by 100 basis points.
- The performance areas addressed by the mechanism should not be equally weighted. For example, the weight on reliability should be higher than the weight on the safety metric.
- Another concern about the performance incentive mechanism is its linkage to an MTER that does not share earnings shortfalls. While there some good arguments for not sharing these shortfalls, and this issue has been resolved, linking service quality to this kind of MTER would weaken the Company's incentive to maintain quality in periods of underearning, which can easily occur. Many service quality incentive mechanisms do not link performance results to the MTER.
- The substantial deadband in the linkage mechanism is also controversial.

Clause de Sortie

The proposed clause de sortie is too conservative. HQD might even be tempted to suffer one year of low earnings to evade the MRI. Earnings variances should be substantial for at least two years before the plan is reconsidered. Many MRIs do not have a *clause de sortie*. The relatively short four year term of the plan and the MTER reduce the need for such a clause.

PMF Study

HQD disregarded the Régie's order to present its methodology for the PMF study in its 2019 *Demande*. Reasonable guidelines should be established for this study in advance so that it is not blatantly self-serving. For example, the study should consider alternative methodologies and sample periods and thoroughly discuss their pros and cons. Productivity trends in the use of operation and maintenance and capital inputs should be considered as well as the trend in multifactor productivity. Productivity trends of HQD should be measured as well as the productivity trends of other utilities.

Proposed Plan of Work

Consumer groups should energetically push back on some aspects of HQD's new MRI proposal. The Régie has once again not been presented with an informative and balanced review of pertinent MRI options and precedents. PEG can provide testimony on these issues cost-effectively.

The attached budget itemizes potential services by task. These are priced out at hourly rates well below those that PEG charges most of its U.S. clients and far below those of prominent Boston-area consultants. The weak Canadian dollar materially depresses our returns.

We provide a set of "necessary tasks" and also include budgets for some optional tasks. The necessary tasks include



- Preliminary commentary for Quebec consumer groups and followup discussions
- Prepare and respond to information requests
- Compile and report some pertinent precedents for service quality incentives & clauses de sortie, addressing such issues as their relative weights, special protections for rural and small town customers, and the linkage to MTERs.
- Written and oral testimony.

The optional tasks include the following:

- Develop a better service quality incentive mechanism design.
- Attend the service quality *groupe de travail* in September.

Please note, finally, that I am scheduled to speak at a U.S. conference on September 26. If my participation in the service quality working group is desired, AQCIE should consider requesting that service quality issues be addressed on September 27th and not on September 26th so that I can attend.

