

**Réponses du Transporteur
à la demande de renseignements numéro 3
de la Fédération canadienne de l'entreprise
indépendante
(la « FCEI »)**

**DEMANDE DU TRANSPORTEUR DE MODIFICATION DES TARIFS ET
CONDITIONS DES SERVICES DE TRANSPORT POUR LES ANNÉES 2021 ET
2022**

DOSSIER R-4167-2021 volet 2

EFFICIENCE

Question 1 :

Références:

- (i) B-0159, p. 6.
- (ii) R-3981-2016, B-0022, p. 3.
- (iii) [R-3981-2016, B-0021](#), p. 3.
- (iv) R-4167-2021, B-0039, p. 62, tableau A6.8-1.
- (v) B-0159, Annexe B, pp. 2 et 3.
- (vi) B-0159, p. 23.

Préambule :

- (i) « The facts are in the forecasts themselves—disaggregated and specific to projects, not subjective and/or generalized.

[...]

Those charges are not proper, but simply the result of after-the-fact comparisons of the cumulative differences between forecasts and actual capital addition costs in an existing incentive regime. Such comparisons, made for the purpose of implying forecast bias (as FCEI and AQCIE-CIFQ do), do not make regulating HQT more effective, efficient, or streamlined. Such comparisons merely invite unproductive rate controversies by disconnecting capital cost additions from any reasonable, fact-based, *ex ante* expectations of the cost of the project-by-project forecasts that make up the forecast test year.

Such differences, between project forecasts and actuals, reflect how the incentive inherent to such a forecast test year plan is supposed to work. The value of the Régie's longstanding test year regime lies in pushing HQT to beat its forecasts—providing long-term benefits to its customers as capital projects enter the rate base. Persistently beating forecasts is the goal of the regime—not an indication of a problem requiring a change of course or another regulatory remedy. Again, there is nothing wrong with fairly questioning the reasonableness of those forecasts on a forward-looking factual basis. But it is improper to question their reasonableness merely if HQT beats its forecasts in the construction of new capital projects. » (Nous soulignons)

La référence (ii) présente la base de tarification moyenne prévue de 19 862 212 k\$ pour 2017. Elle indique également des mises en exploitation prévues de 1 984 736 k\$ en 2017.

La référence (iii) présente la base de tarification réelle au 30 avril 2016 de 18 886 589 k\$. Elle indique également des mises en exploitation prévues de 1 458 920 k\$ en 2016 dont environ 1 400 M\$ surviennent après le 30 avril 2016. Par conséquent, les mises en service prévues entre avril 2016 et décembre 2017 sont d'environ 3 500 M\$.

La référence (iv) indique un écart de 399,3 M\$ entre la prévision de la base de tarification moyenne de 2017 et le réel.

(vi)

« Deferral and variance accounts are not intended to be used for costs that are routine, nor those that are expected and easy to forecast. » (Nous soulignons)

Questions :

1.1 Veuillez déposer la traduction anglaise de la preuve de la FCEI consultée par le Dr Makhholm pour la préparation de son rapport.

Réponse :

1 **Voir l'annexe 1.**

1.2 Relativement à la référence (i), veuillez confirmer que le Dr Makhholm considère que les écarts historiques entre la base de tarification prévue et la base de tarification réelle de HQT sont pour l'essentiel le fruit de la productivité de HQT. Sinon, veuillez indiquer les autres causes possibles et commenter l'ampleur historique de leur contribution aux écarts de prévisions sur la base de tarification.

Réponse :

2 **Dr. Makhholm does not know the source of the differences between planned and**
3 **actual expenditures, but is confident that for each project the differences are a**
4 **close-focus function of the management of each specific project.**

1.3 Veuillez indiquer si le Dr Makhholm a analysé les données factuelles sur les causes des écarts de prévision historique de la base de tarification de HQT sur une base de projet spécifique.

Réponse :

5 **Dr. Makhholm has not analyzed that project-by-project factual data.**

1.3.1 Si oui, veuillez indiquer la période analysée et identifier les documents consultés. Si des documents non accessibles sur le site de la Régie ont été consultés, veuillez en déposer une copie.

Réponse :

1 **Non applicable.**

1.4 Relativement aux références (ii) à (iv), veuillez indiquer s'il vous apparaît réaliste qu'HQT ait pu réaliser, en 2017, un niveau de productivité suffisant pour d'engendrer une réduction de 399,3 M\$ de la base de tarification moyenne par rapport à la prévision initiale considérant des mises en service prévues d'environ 3 500 M\$ entre mai 2016 et décembre 2017.

Réponse :

2 **Dr. Makholm refers to Régie request 1.2. He has no basis for forming a factual**
3 **opinion on the specific expenditures that formed the 2014-2018 differences**
4 **for HQT.**

1.4.1 Veuillez indiquer quel serait le niveau de productivité requis pour obtenir une telle réduction.

Réponse :

5 **Please see response to FCEI 1.4.**

1.5 Relativement à la référence (v), veuillez refaire le tableau 3 en supposant une mise en service de 100 M\$ égale à la prévision, mais qui survient en novembre de l'an 1 plutôt qu'en septembre. Veuillez refaire les tableaux 4 et 5 sur la base de cette hypothèse et indiquer si le Dr Makholm considère que les écarts observés au tableau 5 sont assimilables à de l'efficience.

Réponse :

- 1 **Please see the attached in Appendix 2 for the different computations.**
- 2 **With respect to whether Dr. Makhholm “considers the deviations [...] to be**
3 **equivalent to efficiency,” he refers to his answer to Régie 1.2, 1.2.1, and 1.6.2,**
4 **which dealt with how to assess examples of positive balances resulting from**
5 **commissioning delays.**

1.6 Relativement à la référence (vi), veuillez indiquer si le Dr Makhholm considère qu’il a été facile pour HQT de bien prévoir sa base de tarification au cours des 10 dernières années.

Réponse :

- 6 **Dr. Makhholm used the term “easily” to be a synonym for “readily” in a relative**
7 **sense—not intending to indicate that any forecast is easy, per se. He could**
8 **better have said “expected and/or easy to forecast.” In both cases, the**
9 **alternative are significant costs beyond the provider’s control.**

POUVOIR INCITATIF**Question 2 :****Références:**

- (i) B-0159, p. 16.

Préambule :

- (i) « 2. “Small Incentives”

A consistent error for both FCEI and PEG is their focus on the supposed “small incentive” properties associated with the one-year cost-of-service computations—instead of the factual targets that update each year with a new set of capital addition forecasts. But as all regulatory analysts should agree (as prominent economists, like Kahn, have themselves usefully stated), the incentive operates at the margin—which persists when the future rate trajectory associated with capital additions is set in advance.

A one-year duration of forecasts does not diminish the marginal incentive. What the one-year durations do is provide a limit on the size of the cumulative award given the yearly cost-of-service updates for capital additions. Such limits are useful for an orderly rate regime that cannot deviate too far from what is reasonable, either for HQT

or its customers. PEG considers such an incentive mechanism “weak,” but PEG has no basis for that opinion—the incentive, based in regulatory lag, is both visible and persistent over the years. The one-year rolling duration of forecasts simply limits the cumulative savings for HQT. » (Nous soulignons)

Questions :

- 2.1 Veuillez clarifier la distinction que fait le Dr Makhholm entre l’incitatif marginal (« marginal incentive ») et la récompense cumulative (« cumulative award »). Veuillez indiquer si cette distinction se retrouve dans la littérature économique et déposer les passages des références qui supportent cette distinction.

Réponse :

- 1 **Please see Dr. Makhholm’s answer to AQCIE-CIFQ, 4.1.**

- 2.2 Veuillez confirmer que l’entreprise réglementée sera davantage motivée à poser une action qui amène une réduction de coût de 100\$ si elle peut bénéficier de cette réduction pendant 5 ans (pour une récompense cumulative de 500\$) que si elle ne peut en bénéficier qu’une seule année (pour une récompense cumulative de 100\$). Sinon, veuillez expliquer votre réponse.

Réponse :

- 2 **The question posits “a step” that will yield the marginal gain alternatively (a)**
3 **\$500 (comprising five \$100/year payments); or (b) \$100 (comprising a single**
4 **\$100 payment). For these two, (a) provides the great payoff at the margin, and**
5 **the “regulated company” would be more motivated to take it over (b).**

- 2.3 Veuillez confirmer que la réglementation en coût de service annuel induit un incitatif à générer des écarts entre les prévisions de l’année témoin et le réel.

Réponse :

- 6 **Dr. Makhholm, in response to Régie 1.1 described the underlying incentive for**
7 **HQT to retain a useful incentive plan. That is, it has an incentive to forecast**
8 **accurately both to contribute to revenue-generating capital facilities and to**
9 **support a useful incentive program generally.**

- 2.3.1 Veuillez confirmer que l’efficience est une manière parmi d’autres de générer de tels écarts.

Réponse :

1 **Confirmed, regarding the incentives that form the basis for question FCEI 2.3.**

2.3.2 Veuillez confirmer que des écarts de prévisions peuvent également être obtenus en présentant une prévision plus élevée ou en ne réalisant pas l'ensemble des activités prévues au dossier tarifaire.

Réponse :

2 **Not confirmed, regarding the incentives that form the basis for question 2.3—to**
3 **the extent that the question implies that HQT has an incentive to provide**
4 **inaccurate forecasts. See Dr. Makhholm's responses to Régie 1.1 and 1.2.1.**

PRUDENCE**Question 3 :****Références:**

(i) B-0159, p. 18.

Préambule :

(i) « My point in referencing this history of Canadian and US regulation is twofold. First, it supports use of factual evidence and the avoidance of impermissible hindsight-based prudence evaluations. Second, it removes from practical consideration for the Régie practices of regulators (such as in the UK or Australia) that rest on quite different regulatory and accounting foundations. » (Nous soulignons)

Questions :

3.1 Veuillez indiquer si la compréhension du Dr Makhholm est que la FCEI remet en question dans ce dossier la prudence des investissements de HQT. Le cas échéant, veuillez indiquer les passages de la preuve de la FCEI qui suggèrent une telle position.

Réponse :

1 **No, Dr. Makholm is questioning not prudence, per se, (which is different**
2 **consideration) but the hindsight-based evaluation of deviations between**
3 **forecast and actual capital project expenses.**

3.2 Veuillez confirmer que la question des écarts de base de tarification observés au rapport
 annuel est distincte et indépendante de la question de la prudence des investissements.
 Sinon, veuillez expliquer votre raisonnement.

Réponse :

4 **Please see response to FCEI 3.1.**

Annexe 1

Réponse à la question 1.1

BRIEF BY THE CFIB

HYDRO-QUÉBEC TRANSÉNERGIE 2021–2022 RATE APPLICATION

Submitted as part of

**Régie de l'énergie
Rate application
R-4167-2021
(Part 2)**

**By
Antoine Gosselin**

**For
Canadian Federation of Independent Business**

Montréal, November 4, 2021

1. DVA for capital expenditures

In Decision D-2020-041, the Régie asked the Transmission Provider to submit evidence concerning the impact of creating a DVA for items related to the return on the rate base and amortization in its next rate application.

That request stems from the discovery of recurring substantial variances between authorized and real rate base values, resulting in an overestimation of the authorized return and depreciation and amortization expenses. The Régie writes:

“[390] Like the stakeholders, the Régie observes major variances between the authorized and real rate base values in recent years, related to the commissioning forecasts. It further notes that these variances are generally favorable to the Transmission Provider.” *[Translation]*

“[...]

“[394] In regard to the forecast variance due to monthly commissioning breakdown, the Régie reiterates the concern expressed in decisions D-2018-021 and D- 2019-047:” *[Translation]*

“[564] The Régie considers that the reliability of forecasts regarding property, plant and equipment commissioning is a recurring issue. It believes that this issue does not stem solely from the total commissioning amount for a given year, but also from the time of year at which the commissionings occur. 251.” *[Translation]*

“[389] The Régie notes the Transmission Provider’s efforts to improve its forecasts regarding total annual commissionings. However, the impact on the rate base of the forecast variances caused by the delay between the real commissioning dates and those included in the Transmission Provider’s forecasts remains a concern. These discrepancies tend to increase forecast revenue requirements by overestimating amortization and depreciation costs and the return on the rate base. The Régie considered these impacts in its review of the depreciation and amortization expenses.”

“[...]

“[396] The Régie notes that, for every year from 2014 to 2018, the real average of the 13 balances is less than the authorized average. Moreover, it notes that despite a \$170-million reduction in the rate base that it determined for test year 2018, the variance observed between the authorized and real values is \$261.4 million. *[Translation]*

“[397] The Régie remains concerned by the forecast variance associated with the monthly commissioning breakdown due to its tendency to increase projected revenue requirements. *[Translation]*”

“[398] In light of the foregoing, the Régie estimates the amount of the rate base overestimation to be \$150 million. Consequently, for the purpose of determining the revenue requirements and rates, it is reducing the Transmission Provider’s rate base for test year 2020 by \$150 million.” *[Translation]*

“[...]”

“[401] The Régie notes that, despite the measures taken by the Transmission Provider to correct the situation, the overestimation of the average of the 13 rate base balances remains significant. This situation led to an overestimation of the return on the rate base and depreciation and amortization expenses. *[Translation]*”

“[402] The Régie notes that the rate base has been overestimated for many years despite the Transmission Provider’s efforts to improve forecast accuracy. In these circumstances, it believes that it may be advisable to create a DVA for items related to the return on the rate base and amortization. The DVA could protect both the Transmission Provider and its customers from these accuracy problems and reduce the regulatory burden for cost items still calculated using the cost-of-service method. The Régie believes that it is appropriate and useful to examine this possibility at the time of the next rate application. *[Translation]*”

“[403] Therefore, it asks the Transmission Provider to submit evidence concerning the impact of creating a DVA for items related to the return on the rate base and amortization in its next rate application.” *[Translation]*

The Transmission Provider refers to the following points in response to this request:

- Does the need identified by the Régie still exist?
- How would the DVA affect the PBR?
 - Greater difficulty managing budget variances
 - ESM
 - Exit clause
 - Efforts to enhance efficiency
- Have the requirements for creating a DVA been met?

Does the need identified by the Régie still exist?

First, the Transmission Provider questions the very need for a DVA for capital expenditures, citing the improvements made through successive rate applications to improve forecast accuracy and presents the real 2019 and 2020 variances.¹

While it is true that the Transmission Provider has presented the steps taken to improve forecast accuracy over the years, those measures did not allow for the reversal of the forecast variances up to 2018. In 2019, unlike previous years, the average rate base was higher than expected by some \$172 million.² However, that variance, which was unfavorable to the Transmission Provider, can be mainly attributed to the calculation of the Distributor's contribution, which was \$192 million less than anticipated because of commissioning postponements.³ The rate base associated with real commissionings of in service property, plant and equipment was similar to the forecast, at about \$27 million.⁴ As a result, there was no significant forecast variance in 2019.

In 2020, a rate base forecast variance was again identified for in service real property, plant and equipment items, which were \$332.8 million less than forecast.⁵ Like the Transmission Provider, the CFIB holds the view that the data's probative value is low because of the health crisis. Nevertheless, it notes that the Transmission Provider did not establish any causal link with the health crisis for \$79 million of the variance and that, for another \$192-million portion, it identifies the health crisis as the leading but not sole cause.⁶

According to the CFIB, the fact that the real results for 2019 are more or less in line with projections is encouraging. However, it believes that a single annual result is insufficient grounds to conclude that a permanent and sustainable solution has been found for recurring forecast variances. For this reason, it believes that it would be premature to take for granted that the average rate base problems have been resolved. Consequently, the need identified by the Régie still exists. However, the situation could be reassessed if the results for the coming years show a lasting improvement in forecast accuracy.

How would the DVA affect the PBR?

The Transmission Provider also maintains that it would be impossible to establish a DVA without reviewing other PBR characteristics, including the ESM.⁷

¹ B-0039, pp. 33 and 34

² R-9000-2019, B-0005, p. 18, line 19

³ Idem, line 13

⁴ Idem, line 1

⁵ R-9000-2020, B-0015, p. 18, line 1

⁶ Idem and R-9000-2020, B-0021, p. 7

⁷ B-0039, p. 30

According to the CFIB, the presence of an EMS can avoid excessive return variances when a performance-based system or even cost-of-service regulation is in place. It was in this latter situation that the Régie laid the foundations for the current ESM in response to recurring and substantial surplus earnings. However, the presence of an ESM does not mean that clearly biased forecasts are acceptable. Accepting that state of affairs would be incompatible with setting fair and reasonable rates, even though the ESM can reduce the impact of rate base overestimations. In Decision D-2014-034, the Régie stated that it expected the Distributor and Transmission Provider to try to establish the best possible forecasts, even with an ESM in place.

“[364] The Régie wishes to point out that the ESM’s primary objective is to establish a method for sharing surplus earnings. In addition, it considers it essential for applicants to make the best possible forecasts. The Régie believes that the applicants’ efforts to enhance efficiency should focus primarily on including measures in rate applications so that customers can benefit as quickly as possible. However, the Régie does not wish to discourage applicant initiatives in the course of the year that could lead to efficiency gains.” *[Translation]*

For that reason, the Régie approved the ESM based on an expectation of median forecasts. The forecast variances observed over the last 10 years are not compatible with this expectation. A DVA would help reestablish the premises on which the ESM’s approval was based.

Impact of a DVA on the ability to manage budget variances

The Transmission Provider further notes that the Régie had considered the possibility that the Transmission Provider could use various management levers to meet its financial objectives and limit the risk of negative variances. It suggests that it would not be able to limit the risk of negative returns with a DVA removing 75% of the revenue requirements applicable to the ESM.⁸

Like the Transmission Provider, the CFIB believes that imposing a DVA would reduce the Transmission Provider’s flexibility to manage cost overruns. However, that flexibility would likely not be eliminated completely. Moreover, although the Régie presumed that the Transmission Provider disposed of various management levers of use in maintaining a balanced budget⁹, the latter has never, to the CFIB’s knowledge, confirmed that it has engaged in any such practices in regard to the commissioning schedule.

⁸ B-0039, p. 31

⁹ D-2014-034, paragraph 363

The Transmission Provider maintains that introducing a DVA would make it more likely that the PBR exit clause is triggered.¹⁰ The CFIB does not share this view. The PBR exit clause is triggered when the earnings surplus or shortfall reaches 125 base points following application of the ESM.¹¹ That works out to over \$80 million. Because the expenses included in the formula amount to approximately a billion dollars, an overrun of roughly 8% of that amount would be required for the exit clause to be triggered. Since a significant share of the expenses is made up of wages that are relatively predictable, the CFIB considers that this eventuality is very unlikely and probably less likely to occur than without a DVA.

Impact of a DVA on efforts to enhance efficiency

The Transmission Provider believes that adding a DVA could impede efforts to enhance efficiency because the efficiency gains would be entirely returned to customers, without any incentive whatsoever for the Transmission Provider. The CFIB shares this view, but wishes to point out that using an annual cost-of-service approach alone produces little incentive for improving efficiency, a major reason for introducing the PBR. This lack of incentive is a modest drawback, in the CFIB's view.

Have the requirements for creating a DVA been met?

Based on a paragraph in Decision D-2007-008, the Transmission Provider cites two requirements that it attributes to the Régie for justifying the creation of a DVA:

- 1) Presence of a problematic situation subject to uncertainties that are beyond its control or that of its customers
- 2) These uncertainties must have a significant impact

It bases those two requirements on the following paragraph:

“The Régie acknowledges that reservations for short-term point-to-point service depend on numerous uncertainties, including market conditions and water availability. The Distributor's surplus electricity liquidation activities are also subject to significant uncertainties that are beyond the control of the Transmission Provider and its customers and may have a significant impact on short-term point-to-point revenue.”¹² *[Translation]*

¹⁰ B-0039, p. 31

¹¹ D-2019-060, paragraph 485

¹² D-2007-008, p. 63

First, we must point out that, in this paragraph, the Régie does not provide an exhaustive definition of the requirements for creating a DVA. Although it concludes that these two requirements are sufficient for creating a DVA, it excludes the creation of DVAs for other reasons.

That said, the CFIB is of the opinion that the forecast variances mostly meet these requirements. First, their impact is undoubtedly significant. Second, they are clearly—at least in part—beyond the Transmission Provider’s control. The mere fact that the Transmission Provider has guaranteed the accuracy of its forecasts repeatedly to the Régie for the last 10 years but has not managed to make good on those guarantees shows that to be the case. Moreover, the Transmission Provider itself cites that uncertainty in its responses to many of the CFIB’s questions.

“1.1 In regard to reference (i), please state whether the Transmission Provider shares the CFIB’s understanding that the Régie’s concern stems from variances in the rate base rather than variances in commissionings (ii).” *[Translation]*

“Response: The Régie is concerned by the variances associated with monthly commissioning breakdowns, which lead to variances in the rate base. In the past, specific, separate events have occurred during certain projects, leading to commissioning variances. These were chance events and totally unpredictable.”¹³ *[Translation – Underline added]*

“1.3 In light of past experience, please indicate whether the Transmission Provider anticipates a favorable variance in the average rate base forecast for 2022 or considers instead that this is a median forecast. The CFIB uses the term “median forecast” to refer to a forecast for which a favorable variance is no more likely than an unfavorable variance. Please indicate too whether the same applies to 2021.” *[Translation]*

“Response: The Transmission Provider must at all times ensure and maintain system reliability. For that reason, it carries out a large number of projects every year with multiple constraints, the main ones being the following: tight schedules, especially when equipment has to be removed from service since these operations generally have to be carried out in off-peak periods; supply availability in a timely manner; and deadlines set by contractors. Its goal is to maintain the expected level of quality and the safety and security of the project site, equipment and system. The Transmission Provider makes considerable efforts at all times to carry out the planned projects in circumstances where situations beyond its control may occur.”¹⁴ *[Translation – Underline added]*

¹³ B-0059, p. 4

¹⁴ B-0059, p. 3

A study of the reasons given by the Transmission Provider to justify the forecast variances in these annual reports also shows its lack of control over several situations.

Although it is self-evident that the Transmission Provider controls the execution of work, experience shows that it does not always have control over what work is carried out and when. According to the CFIB, this situation is not unlike major outages and unforeseen events that affect the Distributor's off-grid systems, for which the DVAs were established.

In Decision D-2014-034, the Régie wrote:

“[365] The Régie must strike a balance between actions that can provide efficiency gains while taking pains not to increase applicants' income as a result of forecasting errors.” *[Translation]*

Considering both the limited efficiency incentives provided by cost-of-service regulation and the significant, recurring financial impact of forecast variances, **the CFIB concludes that it would be economically justified to establish a DVA on capital expenditures.**

Moreover, the context of uncertainty surrounding the Transmission Provider's ability to follow through on its planned commissioning activities further supports the establishment of a DVA. The CFIB points to the lack of significant forecast errors in 2019, among other evidence. It being uncertain whether this result can be interpreted as a coincidence or a lasting success on the part of the Transmission Provider in controlling the pace of commissioning, establishing a DVA could avoid unduly penalizing customers or the Transmission Provider, depending on the Régie's decision regarding capital expenditure levels.

Annexe 2

Réponse à la question 1.5

(Document déposé en format électronique)