CANADA
PROVINCE DE QUÉBEC
DISTRICT DE MONTRÉAL

No: R- 4167-2021

RÉGIE DE L'ÉNERGIE

Demande du Transporteur de modification des tarifs et conditions des services de transport pour les années 2021 et 2022;

HYDRO-QUÉBEC
Demanderesse

- et -

OPTION CONSOMMATEURS
Intervenante

* Presentation of Option Consommateurs Volet 2

Dr. Roger Higgin

Sustainable Planning Associates Inc.

I. Capital Deferral and Variance Account (DVA/CER)

A. Regulatory Deferral and Variance Accounts;
B. Regulatory Lag;
C. NERA Comments on FCEI and AQCIE-CIFQ Evidence
D. OC Comments on NERA Evidence
E.Conclusions and Recommendation.

A. Regulatory Deferral and Variance Accounts- NERA Criteria:

- the cost is beyond the provider's control and can have a significant impact on revenues.
- criteria established by the Régie and used by HQT are no exception to the rule that is widely employed by North American regulators.
- Limits **expense** deferral accounting to cases where:
  (1) the cost is material and extraordinary in nature, and
  (2) the cost was incremental to what was allowed in rates.
- "deferral and variance accounts are not intended to be used for costs that are routine, nor those that are expected and easy to forecast. Rather, these accounts are used for those costs *that cannot reasonably be expected or may be out of the utilities control* as the above examples (NERA Table 2) show".

B. Regulatory Lag

Dr. Makholm states :

- "The source of the incentive on HQT to be efficient in pursuing needed new capital projects is *regulatory lag;* It permits regulated companies to earn returns against a pre-determined trajectory of rate control—driving those companies' incentives to keep costs down".
- "Regulatory lag is a subject integral to Canadian PBR generally. For example, from 2010 to 2012, the Alberta Utilities Commission (the AUC) held North America's largest generic proceeding on how to re-implement *RPI minus X* regulation for its electric and gas utilities. *The AUC confirmed that its PBR regime was all about regulatory lag*".
- "As NERA emphasized, this concept [of regulatory lag] corresponds to the underlying theory behind PBR plans in Canada and the United States: to permit regulated prices to change to reflect general price changes and industry productivity movements without the need for a base rate case. The effect is to lengthen regulatory lag and better expose regulated utilities to the type of incentives faced by competitive firms".
- Dr. Makholm cites regulatory lag as a major consideration for deferral accounts.
- He cites specifically, the late Dr. Alfred Kahn, Alfred E. Kahn, *Economics of Regulation, Vol. 2* (New York: John Wiley & Sons, 1971), page 48.

NERA Report Section IV

B. Regulatory Lag (continued)

Dr. Makholm also refers to Decision D-2020-041 and the reduction in capital made by the Regie. He concludes that:
"It would have been better, in framing the DVA issue, for the Régie to make a distinction between
(a) a more detailed review of business plans and
(b) after-the-fact comparisons that by themselves simply cannot answer the question of whether forecasts underlying such a PBR plan are reasonable".

NERA Report Page 14

C. NERA Comments on AQCIE-CIFQ Evidence

With regard to the position of AQCIE-CIFQ and FCEI, Dr. Makholm concludes:

- "There should be a reasonable expectation that an incentive regulatory regime based on forecast test years will produce earnings for HQT (which are shared with consumers in an independent ESM-based sharing). The FCEI discussion of "median forecast," mixing forward-looking forecasts and hind-sight-based actual expenditures, is inconsistent with that reasonable expectation".
- "Neither FCEI nor PEG have offered any reasonable evidence, or any recommendation for obtaining evidence, to support their charges of bias, exaggeration, or a basis upon which any future "trimming" could occur. PEG does suggest a closer review of HQT's "business plans." If PEG means a further close-focus engineering review of HQT's capital project forecasts at the time HQT makes them, it could be a useful suggestion. But the rest of PEG's short discussion of the issue—particularly the comment on "trimming," continues to suggest that PEG, like FCEI, mixes *forward-looking* forecasts with *hindsight-based* actual expenditures, which is a type of comparison that undercuts any incentive based in regulatory lag".

D. OC Comments on NERA Evidence

- **OC notes that the issue is limited to whether a DVA (CER) for capital is appropriate, not if DVA's for operating expenses or revenues are appropriate.**
- **OC notes that NERA was not aware of the Capital-In-Service Variation Account (CISVA) of Hydro One Transmission*.**
- **OC notes that NERA did not analyse the historic capital forecasts for HQT in its evidence and declined to provide this analysis as requested in OC DDR's (B-0196, Q.5 and 6).**
- **OC suggests that the NERA evidence on the merits of regulatory lag as an incentive mechanism, is less pertinent to HQT under cost of service than it would be under a PBR scheme (including capital) or it would be under a multi=year capital plan.**
- **HQT capital forecasts for projects <$65 million are reviewed under *cost of service* annually**
- **Regulatory Lag is reduced compared to multi-year rate plans. In addition, the ESM provides a buffer for HQT and ratepayers.**
- **OC also suggests that there is clear evidence that as shown by AQCIE and FCEI,(AQCIE-C-101 Table 1) there have been material deviations in both the capital forecast amounts and the in-service (commissioning) dates for projects <$65 million.**
- **Larger Projects such as Michoua-Saguenay, which OC addressed in Volet 1, also often show large deviations between forecast and actual.**
- **OC accepts that recently, deviations may have been reduced somewhat for projects<$65 m.**
- **OC suggests that both ex-ante and ex-post reviews of capital plans are normal regulatory tools.**
- **OC suggests the fundamental issue to be addressed is: are the rates just and reasonable?**
- **OC suggests materially excessive capital forecasts or incorrect In-service dates, do not result in just and reasonable rates. Ratepayers pay for assets that are not "used or useful".**

*OEB EB-2021-0110 Hydro One Joint Rate Application Exhibit G Tab1 Schedule 1 Section 3.14 Page 19 and Exhibit G Tab 1 Schedule 2 Section 4.3 Page 20 and Attachment 10

E. Conclusions and Recommendation

Options Considered by OC

- **DVA(CER), similar to the Hydro One Transmission Capital In Service Variation Account (CISVA)**
- **An ex-ante markdown of capital for 2023 and 2024. The amount would be calculated based on recent 5 year historical difference between the Company's capital revenue and capital cost, on revenue requirement. for projects under $65 million.**
- **Postpone consideration of a CER until the 2024 HQT cost of service rebasing and review of a Second Generation MRI. Monitor HQT Capital performance in 2022 and 2023.**

Primary Recommendation (per OC Memoire)

- **Defer the Issue of a Capital CER to Rebasing in 2024 and consideration of a second-generation MRI, including Capital. In the interim, monitor HQT Capital forecasts.**

New Primary OC Recommendation

- ***Based on continued Cost Of Service for HQT capital for the next few years, consider a DVA similar to Hydro One Transmission CISVA Account (excluding verified productivity and 2% dead-band).***

- **OC notes that the Next Generation MRI for Hydro One Transmission is being reviewed by the OEB this fall (EB-2021-0110) and there may be changes, including the CISVA DVA.**

II. HQ Compensation Benchmark Study

A. Review of Normandin-Beaudry Expert Study

B. Summary of OC Conclusions

C. Recommendation

A. Normandin-Beaudry Total Compensation Benchmark Study

- In Docket R-4167-2021 Volet 2, Hydro Quebec ("HQ") filed a compensation benchmark study authored by Normandin-Beaudry ("N-B") as exhibit B-0020.(Updated B-0189)
- This study was requested by the Régie de l'énergie ("Régie") in D-2018-067 (HQD)[1] and D-2019-060 (HQT)[2].
- The N-B report benchmarks HQ total compensation to a selected peer group of 44 comparable companies, including 18 other energy companies.
- The selected benchmarked positions were 8 groups of employees, including managers, professionals, technicians and office staff.

1.D-2018-067 Paragraphs 280-285
2 D-2019-060 Paragraph 218

Normandin-Beaudry Total Compensation Benchmark Study(continued)

Value of total compensation

The following equation was used by N-B to determine the value of total compensation for each organization:

Direct Remuneration =

Non-unionized employees
Average base salary
+
Target incentive compensation
Unionized Employees
Average base salary (35 hours)
+
Target Incentive

Indirect Remuneration =

Compensation Pension Plan Value
+
Value of Group Insurance Plans

Total Compensation =

Direct Remuneration
+
Indirect Compensation

OC Comparison of 2016 and 2021 Results (2015 and 2020 Data):

OC Table 1: Difference between HQ's total compensation and the market median

Employee Group	2016 Total Compensation	2021 Total Compensation
Middle management	-2%	3%
Managers	9%	2 %
Professionals	7%	11 %
Specialists*	5%	7 %
Engineers*	3%	10 %
Technologists*	11%	15 %
Trades* (in French)	5%	-1 %
Office*	9%	13 %
Total	**6%**	**7 %**

- **The comparison of results of the 2016 and 2021 studies indicates that directionally, in aggregate terms, HQ has not moved closer towards market median total compensation.**
- **In addition, for all groups of employees except trades, the total compensation benchmark has moved to higher levels of total compensation than the market median.**

B.OC Conclusions

- **The 2016 (2015 data) Normandin-Beaudry study found that HQ total compensation was 6% in aggregate, above their market median benchmark.**
- **In 2021(2020 data), N-B found that HQ total compensation was 7% in aggregate above their market median benchmark.**
- **In addition, 7 of 8 employee groups have moved to higher levels of relative benchmark compensation than in 2015. Trades are the exception to this.**
- **N-B states that an appropriate reasonable range is ± 5% relative to market median.**
- **OC questions if this range is appropriate for each group of employees.**
- **Each group of HQ employees, except management, undertake separate collective bargaining.**
- ***OC believes in principle, that it is not reasonable for HQ ratepayers to pay utility total compensation costs that are significantly above the market median.***
- **In the longer term, HQ, like many other regulated utilities, should target market median total compensation for all employees.**
- **OC has not undertaken any analysis, regarding whether employee and employer pension and benefits contribution ratios are in line with best practices, but suggests these should be reviewed by HQ in moving towards market median total compensation.**
- **When setting an appropriate amount of total compensation for 2022 and 2023, inflationary pressures apply to compensation across all sectors of the compensation market. HQ has not demonstrated that it is subject to unique inflationary pressures.**

C. Recommendation

OC Recommends that:

- **The Régie reduce the HQT and HQD OM&A costs related to total compensation for 2023 and 2024 respectively to 5% above market median, in aggregate.**

- **The Régie should direct HQ to attain a market median total compensation benchmark for all employee groups as soon as possible.**

Thank you for your attention