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Changes to Hydro -Québec Transmission & Distribution Ratemaking

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1. Introduction

In June 2026, Hydro-Québec in its capacity as provider of power transmitter and to distributor ("T&D") services in Québec ("HQTD" or "the Company") submitted an application to amend the ratemaking systems under which it currently provides these services. The proposed amendments include replacement of the earnings-sharing mechanisms called *méchanismes des écarts des rendement* ("*MTÉR*") that the *Régie* previously approved for these services with alternative mechanisms that the Company calls *méchanismes de traitement des surplus ou des manques* ("*MTSM*"). HQTD also proposes to eliminate the performance incentive mechanisms that have been a component of the *MTÉRs*. The Company's proposal is supported by evidence prepared by the Brattle Group.

Pacific Economics Group Research LLC ("PEG") is a leading North American consultant on alternatives to traditional utility ratemaking such as multiyear rate plans and other forms of *réglementation incitative*. The *Association Québécoise des Consommateurs Industriels d'Électricité* ("AQCIE") and the *Conseil de l'Industrie Forestière du Québec* ("CIFQ") have asked PEG to prepare evidence for this proceeding on these Company proposals.

In this document, we first provide pertinent background information on the evolution of Québec ratemaking. We next discuss controversial aspects of the HQTD and Brattle evidence. We then provide a proposal for research and testimony in this proceeding and discuss project cost.

2. Background

Québec Regulation

The *Loi de la Régie de l'énergie* ("*LRÉ*") for several years strongly encouraged *réglementation incitative* for T&D services of Hydro-Québec. Section 48.1 stated the objectives of *réglementation incitative* to be

- ongoing improvement in performance and service quality;
- cost reduction that benefits both consumers and the utility; and
- streamlining the process by which the *Régie* fixes or modifies utility rates.

A particular approach to *réglementation incitative* was not prescribed.

After a lengthy process, the *Régie* approved separate *méchanismes de réglementation incitative* ("*MRI*") for the Company's T&D services. Each *MRI* was a multiyear rate plan that included a *formule paramétrique* that escalated the revenue requirement corresponding to certain cost components and an *MTÉR* that asymmetrically shared surplus earnings but not earnings deficits and was linked to HQ's performance as measured using service quality metrics. The term of each plan was four years.

In 2019 Bill 34 revised the *LRÉ* and the Hydro Québec Act to detail a specific multiyear rate plan for the Company's distribution services that tied rate escalation to the growth in a Consumer Price Index. The *MTÉR* and various CER did not operate during this multiyear rate plan. In 2025, Bill 69 revised Section 48 of the *LRÉ* to prescribe another approach to regulating the Company's transmitter and distributor services.

The revised *LRÉ* is nonetheless still supportive of *réglementation incitative* for HQTD.

- Revised Section 48 of the *LRÉ* calls for a different and more incentivizing ratemaking treatment for HQTD than for gas distributors, specifically multiyear rate plans with three-year terms in which revenue requirement escalation is based on multiyear cost forecasts. Multiyear rate plans with terms of three years or more are widely considered to be a form of *réglementation incitative*. Plans with revenue requirements informed by cost forecasts are used in several other jurisdictions that include Georgia, Minnesota, New York, Great Britain, and New Zealand.
- Section 49 affords the Régie discretion in determining the revenue requirement for HQTD that is necessary and prudent.
- 49 (4) of the *LRÉ* calls for the Régie to "favor measures or incentives to improve the performance of [gas and electric utilities] and the satisfaction of client's needs".
- 49 (9) requires the Régie to "consider service quality".
- 49 (12) says that "The Régie may also use any other method or take account any other element it considers appropriate in particular to facilitate the carrying out of the energy transition or economic development."

3. Controversial Features of the HQTD Evidence

The HQTD and Brattle evidence have several controversial features.

- Brattle recommends and the Company proposes earnings sharing mechanisms that are roughly symmetrical even though Brattle's survey of relevant precedents shows that these are uncommon.
- Brattle suggests (p. 13) that the *LRÉ* calls for a « cost of service » framework for HQTD where efficiency gains are not prioritized.
- Brattle suggests that Section 52.3 of the *LRÉ* prescribes a symmetrical earnings sharing mechanism.
- Brattle's explanation of why a symmetrical MTÉR is needed is unconvincing.
- Service quality incentive mechanisms would be deleted.

- Brattle maintains (p. 20) that the proposed new ratemaking system would generate a "strong financial incentive" to manage cost.
- Brattle states (p. 27) that the MTSM "provides a financial incentive for the utility to find efficiencies."
- Brattle's survey ignores key issues including the following
    - Multiyear rate plans that don't have MTÉR's.
    - Precedents for service quality incentive mechanisms in U.S. multiyear rate plans.

4. Proposed PEG Evidence

Based on this analysis, PEG proposes to provide on behalf of AQCIE and CIFQ polished written testimony on the following topics:

- Why performance incentives are still relevant in HQTD ratemaking
- Impact of the proposed MTSM on HQTD's cost containment incentives
- Is there a plausible rationale for a symmetrical MTÉR?
- Does the *LRÉ* mandate a symmetrical MTÉR?
- Alternative means of reducing HQTD risk that are appropriate in the context of the energy transition.
- Precedents for multiyear rate plans without MTÉRs
- Need for service quality incentives
- Precedents for service quality incentives in US multiyear rate plans

Preparation of this evidence would require review of recent developments in Québec ratemaking and energy policies. PEG would then draft *demandes des renseignements* ("DDRs") to HQTD and review their responses. Analyses and surveys would ne conducted. After filing our report, PEG would respond to DDRs of other parties and provide oral testimony. A trip to Montréal is assumed. We would also assist AQCIE and CIFQ with cross examination of other parties in the proceeding and final arguments.

5. Proposed Cost of Services

In estimating the cost for the proposed work we have used the *Guide de paiement des frais 2020 révisé Tarifs des honoraires au 1er décembre 2025*. These rates are much lower in U.S. dollars due to USD/CAD exchange rate and are well below those that PEG charges to most clients

6. PEG Credentials

Company Overview

Pacific Economics Group Research LLC ("PEG") is a consulting firm in the field of energy utility economics. Our offices are located on Capitol Square in Madison, WI. The University of Wisconsin-Madison ("UW") has trained most of our staff. Work for a mix of regulators, utilities, trade associations,

government agencies, and consumer and environmental groups has given us a reputation for "middle of the road" views on utility policy, objective empirical research, and dedication to good regulation. Our practice is multinational and has to date involved projects in twelve countries. We periodically write articles on our work in respected professional journals.

Dr. Mark Newton Lowry is the President of PEG. He has been the principal investigator for most of our projects and provides most of our expert witness testimony. Vice President David Hovde manages our empirical team. Rebecca Kavan is our econometrician and helps with other empirical tasks. Matt Makos plays a prominent role in our research on the design of MRP provisions. Gretchen Waschbusch is our office manager. The Company also has several Senior Advisors who are not employees. Our offices are only a mile from the UW campus and this helps us to hire capable interns who are usually talented undergraduate economics students.

Relevant Experience

PEG personnel have decades of expertise in the areas that are pertinent to this project. Since the early 1990s, we have been leading North American practitioners and thought leaders on alternatives to traditional energy utility regulation that are collectively called "Altreg". Multiyear rate plans and other forms of *reglementacion incitative* are company specialities. We popularized the term "multiyear rate plan" and many others that are widely used in ratemaking today. We were expert witnesses for utilities in early proceedings in California, Maine, Massachusetts, and British Columbia that approved multiyear rate plans.

PEG also helped to spearhead the adoption and evolution of multiyear rate plans in Canada. We have been the principal multiyear rate plan advisor to the Ontario Energy Board for more than a decade and have helped the Board become a world-class multiyear rate plan practitioner. We have also played a large role in Alberta's *reglementation incitative* as consultants to the Consumers Coalition of Alberta.

In addition to the statistical research that supports the design of rate and revenue cap indexes, PEG personnel have worked on many other multiyear rate plan design issues that include earnings sharing mechanisms (another term that we popularized), revenue decoupling, off-ramps, efficiency carryover mechanisms, capital revenue supplements, and targeted performance incentive mechanisms. Clients of our multiyear rate plan design services have included Duke Energy, Green Mountain Power, Hawaiian Electric, Hydro One Networks, Lawrence Berkeley National Laboratory, several Massachusetts energy distributors, Northern States Power - MN, Public Service of Colorado, Public Service of New Mexico, Puget Sound Energy, San Diego Gas and Electric, and Southern California Gas. We have been involved in several generic proceedings and collaboratives on many multiyear rate plans and other forms of Altreg over the years.

PEG has published several papers and articles on the rationale for and design of multiyear rate plans. The recent surge in the popularity of multiyear rate plans in the US has been encouraged by influential white papers on the design of such plans that we wrote for Lawrence Berkeley National Laboratory ("Berkeley Lab"). Berkeley Lab has also funded numerous presentations on multiyear rate plans and other forms of *reglementation incitative* that we have made to public interest entities. We routinely

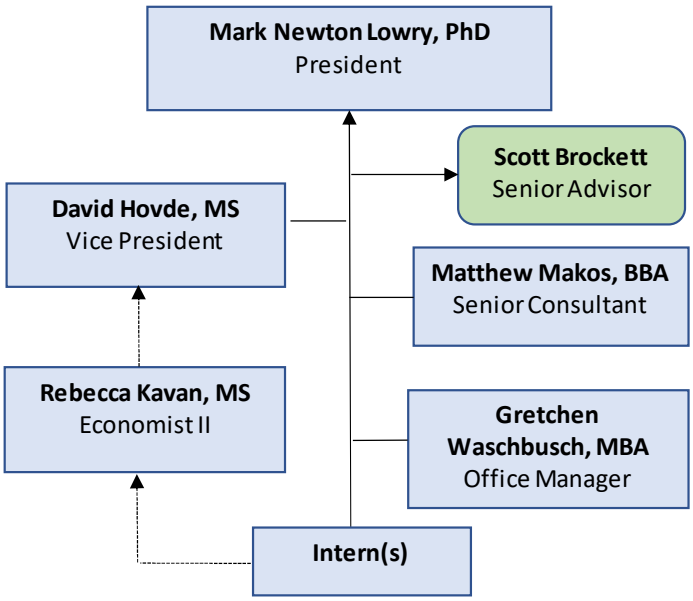
prepare presentations and seminars on *reglementation incitative* for entities that include NARUC, Michigan State University's Institute of Public Utilities, Washington University in St. Louis, University of Wisconsin, and York University's Law School.

PEG's Incentive Power model, developed with funding from diverse clients, has been used to consider the cost efficiency impact of various multiyear rate plan provisions, such as longer plan terms and earnings sharing mechanisms.

PEG has also undertaken several authoritative surveys of multiyear rate plans and other alternatives to traditional ratemaking for the Edison Electric Institute. PBR to foster a cost-effective transition to low-carbon energy has been a recent focus of our research.

PEG Team

Organizational Chart of the Proposed PEG Team



Mark Newton Lowry, President and owner of PEG, has more than thirty years of experience in the fields of energy and regulatory economics. We propose that he serve as project manager and expert witnesses. Research and testimony on Altreg statistical benchmarking and productivity trend studies have been his chief professional focus for more than thirty years. He has testified dozens of times on these topics.

Before joining PEG, Dr. Lowry was Vice President of Regulatory Strategy at Christensen Associates here in Madison. Prior to that he was an assistant professor teaching energy economics at the Pennsylvania State University. He was a visiting professor at the École des Hautes Etudes Commerciales in Montréal and can assist clients in French and Spanish as well as his native English.

Dr. Lowry has spoken many times on *reglementation incitative* and utility performance measurement, chairing several conferences, and published numerous articles and white papers

on these subjects. He attended Princeton University and holds a Ph.D. in applied economics from the University of Wisconsin – Madison ("UW"). A northeast Ohio native, he now lives in Shorewood Hills, Wisconsin near Madison.

Scott Brockett has been a Senior Advisor to PEG for several years. He is an experienced economist with extensive background in energy policy and economic regulation of gas and electric utilities. At PEG, Scott has worked chiefly on the design of multiyear rate plans. A performance incentive mechanism he designed for peak load pricing was recently approved by the state of Washington's utility regulator. Scott can play a major adjutant and client contact role and can participate in workshops and testimony. Prior to joining PEG, Scott was an Assistant Vice President at Public Service of Colorado and held several other jobs in the utility ratemaking field. He holds an MA in Economics from Miami University in Ohio and a BA in English and Economics from Otterbein College. A southwest Ohio native, Scott now lives near Denver, Colorado.

Matt Makos is a Senior Consultant at PEG. His specialty is multiyear rate plan design work and the monitoring of Altreg precedents. He played a leading role in our Altreg surveys for the Edison Electric Institute. Matt is also active in our empirical work and the preparation of our reports, testimony, and data requests. He holds an undergraduate degree in business from UW. A Wisconsin native, Matt now lives in Stoughton, WI, near Madison.