PERFORMANCE INCENTIVE MECHANISM

Agreed in

Negotiated Settlement Process (NSP)

R-3599-2006

BETWEEN:

Association des consommateurs industriels de gaz (ACIG)

Canadian Federation of Independent Business (CFIB)

Corporation des propriétaires immobiliers du Québec (CORPIQ)

Gaz Métro Limited Partnership (Gaz Métro)

Groupe de recherche appliquée en macroécologie (GRAME)

Option Consommateurs (OC)

Regroupement des organismes environnementaux en énergie (ROÉÉ)

Regroupement national des conseils de l'environnement du Québec (RNCREQ)

Stratégies énergétiques et Association québécoise de lutte contre la pollution (S.É./AQLPA)

Union des consommateurs (UC)

Union des municipalités du Québec (UMQ)
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1 SUMMARY

In Decision D-2006-50 rendered on March 23, 2006, the Régie de l’énergie (the Régie\(^1\)) ordered the publication of a notice to initiate the evaluation of the performance incentive mechanism it had implemented, effective October 1, 2004, in decision D-2004-51.

In Decisions D-2006-77 dated May 12, 2006 and D-2006-114 dated June 29, 2006, the Régie identified the intervenors that could participate in this evaluation. These intervenors and Gaz Métro submitted a report that was approved by the Régie in Decision D-2006-148 dated October 20, 2003, which authorised negotiating meetings. An initial agreement was presented to the Régie on January 12, 2007. The Régie held a hearing on February 28, 2007. On March 30, 2007, it rendered a decision in which it expressed various comments and concerns and asked the Task Force to submit any necessary amendments to the agreement or any considerations it considers useful for enabling the Régie to finalize its review of the file. The Task Force considered those comments and concerns and agreed on certain changes to the agreement submitted on January 12, 2007. This document describes the amended agreement reached by the Task Force.

The performance incentive mechanism is essentially based on the mechanism that has been in effect since October 1, 2000, amended slightly on October 1, 2004, which is a hybrid that now features elements of traditional cost of service ratemaking, price cap-based and revenue-cap-based plans. As it is customary to periodically revise a performance incentive mechanism, the parameters of this mechanism have been adjusted to take account of results since October 1, 2004. The method retained continues to provide for a lighter process within which Gaz Métro will file an application every year with the Régie to set rates. The application will compare the Projected Cost of Service with the result of a Price Cap Formula, which applies an escalation factor equal to inflation net of a predetermined X Factor, to the Price Cap for the preceding year and an adjustment for a portion of the volume variations (hereinafter Reference Formula).

If the Projected Cost of Service is inferior to the result obtained by applying the Reference Formula, Gaz Métro will retain a portion of the difference, through its rates, in the form of an authorized incentive return. If the Projected Cost of Service is greater than the result obtained by applying the Reference Formula, rates will be set based on the Projected Cost of Service. However, Gaz Métro will:

- offset the Excess with subsequent Productivity Gains;\(^2\); or
- eventually reimburse one-half of the Excesses, up to a certain level, if they are not offset by subsequent Productivity Gains.

The performance incentive mechanism will cover distribution, transmission and load balancing.

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\(^1\) Italicized terms are defined in Section 9.

\(^2\) The concept of “productivity gains” used in this document does not necessarily correspond to the classical definition thereof.
The distribution *Reference Formula* will be based on an inflation factor net of an *X Factor*. Certain items will be treated as *Exogenous Factors* or *Exclusions*, namely:

- the impact of the vagaries of the weather on revenues;
- the impact of interest rates on the cost of capital, including income taxes;
- the impact of changes in income and capital tax rates;
- the overall cost of energy efficiency programs;
- a portion of the impact of volumes on revenues.

With respect to transmission and load balancing, only variations in contracted quantities and the prices of transmission and load balancing tools will be reflected in the *Reference Formula*. No escalation or productivity factor will be applied.

*Projected Cost of Service* will be determined in the traditional manner, including the use of the rate of return determined in accordance with a methodology to be subsequently approved by the *Régie* to replace the *Rate of Return Determination Formula* that is in effect until September 30, 2007.

The incentive return will still be conditional upon the attainment of service quality indicators.

To ensure that productivity improvements are achieved over a sufficiently long period, the performance incentive mechanism will apply for a term of five years starting on October 1, 2007. However, it is agreed that the mechanism will be reassessed after the 2009-2010 rate application is filed.
2 CONTEXT

2.1 Process

When the Act respecting la Régie du gaz naturel (now la Régie de l’énergie) was amended, a new provision was included in the new Act:

"49. When setting or modifying rates, the Régie will, in particular:

4° determine measures and incentives for improved distributor performance and increased satisfaction of consumer needs".

In applying these provisions, the Régie, in Decision D-2004-51 of March 3, 2004, renewed the performance incentive mechanism for a period from October 1, 2004 to September 30, 2009. The mechanism, which is still in effect, provided for an overall evaluation of how it was working after the 2006-2006 rate application was filed.

The Régie therefore initiated the evaluation process in Decision D-2006-50 of March 23, 2006. In Decisions D-2006-77 dated May 12, 2006, and D-2006-114 dated June 29, 2006, the Régie recognised the following intervenors for this purpose:

ACIG Association des consommateurs industriels de gaz
CFIB Canadian Federation of Independent Business
CORPIQ Corporation des propriétaires immobiliers du Québec
GRAME Groupe de recherche appliquée en macroécologie
OC Option consommateurs
RNCREQ Regroupement national des conseils régionaux en environnement du Québec
ROÉ Regroupement des organismes environnementaux en énergie
S.É/AQLPA Stratégie énergétique et Association québécoise du lutte contre la pollution atmosphérique
UC Union des consommateurs
UMQ Union des municipalities du Québec

In Decision D-2006-114 of June 29, 2006, the Régie authorized the creation of a Task Force and established guidelines for it. Following the submission of the Task Force's evaluation, the Régie, in Decision D-2006-148 dated October 20, 2006, authorized Phase 2, which involved 15 negotiating meetings.

It is within this framework that the recognised intervenors and Gaz Métro reached initial agreement on a new performance incentive mechanism submitted to the Régie on January 12, 2007. On March 30, 2007, the Régie rendered a decision in which it expressed various comments and concerns and asked the Task Force to submit any necessary amendments to the agreement or
any considerations it considers useful for enabling the Régie to finalize its review of the file. The Task Force considered those comments and concerns and agreed on certain changes to the agreement submitted on January 12, 2007. The Task Force therefore met again and agreed on changes to the January 12, 2007 agreement.

The active participants in the process (NSP Participants) were represented by the following individuals:

Jean Benoit Trahan \hspace{5mm} ACIG
Lucie Gervais \hspace{5mm} CFIB
Louis Renaut Rozéfort \hspace{5mm} CORPIQ
Geneviève Deschamps and Jean-Pierre Noël \hspace{5mm} Gaz Métro
Jean-François Lefebvre \hspace{5mm} GRAME
Cristina Maria Romanelli \hspace{5mm} OC
Martin Poirier \hspace{5mm} ROEÉ
Jean Lacroix until January 12, 2007 and
François Valiquette thereafter \hspace{5mm} RNCREQ
Richard Massicotte \hspace{5mm} S.É./AQLPA
Marc-Antoine Fleury \hspace{5mm} UC
Yves Hennekeens \hspace{5mm} UMQ

In accordance with the guidelines approved in Decisions D-2006-148 and D-2006-114, the Task Force chose Jean-Marc Carpentier as its moderator.

Fifteen meetings were held on the following dates:

- October 24, 25 and 30, 2006
- November 15, 16, 20, 22 and 28, 2006
- December 20 and 21, 2006
- January 3, 4, 8, 10 and 12, 2007.

Following Decision D-2007-33, two half-day meetings were held on April 10 and 19, 2007.

As in 2000 and 2003, the participants adopted a cooperative rather than confrontational approach. The participants reviewed the parameters of the mechanism.

2.2 Goals and Objectives

The goals and objectives that guided the 2000 and 2003 negotiations were followed once again. These goals and objectives are:

Co-operative approach involving an effort to find solutions that would satisfy everyone.

Creation of value, i.e. to provide a long-term incentive to:

- increase revenues;
• optimize operating expenses;
• optimize asset management;
• improve energy efficiency;
• increase efforts to displace more polluting forms of energy.

The creation of value very often requires long-term initiatives. As a result, the performance incentive mechanism should enable Gaz Métro to retain part of its Productivity Gains over a period of several years. NSP Participants agree that Gaz Métro’s productivity improvements will also require increasing its revenues as well as optimizing asset management and operating costs.

In addition, NSP Participants agree that improvement in Gaz Métro’s performance will be the result of sustained efforts to improve customer energy efficiency.

Equitable sharing of potential income and losses, while ensuring service quality and system security are maintained as well as a reduction of the environmental impacts and greater energy efficiency by customers.

In addition, everyone has to be better off than under a traditional cost-based regulatory method.

Flexibility and simplicity, which mean:
• a comprehensive mechanism that provides Gaz Métro with certain latitude;
• implementation of an ongoing consultation process between the intervenors and Gaz Métro to ensure that the performance incentive mechanism is applied correctly; and
• effective monitoring of the performance incentive mechanism.

Effective monitoring by the Régie and the recognised intervenors is considered an essential part of the process.

Sustainability, in particular through the implementation of processes for the continuous sharing of Productivity Gains and renewal of the Agreement before it ends.

In public interest, in particular by incorporating the concept of sustainable development by covering certain social and environmental concerns, such as the protection of low-income individuals and families, a reduction of the net environmental impacts, including those related to greenhouse gas emissions, and improved energy efficiency. The maintenance of service quality standards was also taken into consideration.
3 PERFORMANCE INCENTIVE MECHANISM

As noted following Phase 1 of the renewal process in the *Gaz Métro Performance Incentive Evaluation*, Gaz Métro’s business reality has evolved since the performance incentive mechanism was introduced. Sales volumes are more volatile and per customer volumes are down, primarily because of energy conservation initiatives. Accordingly, the *NSP Participants* agreed to modify the existing performance incentive mechanism in order to adapt it to this new business environment. The changes made to the present performance incentive mechanism will provide *Gaz Métro* with an incentive to do better in spite of the aforementioned factors.

The performance incentive mechanism retained by the Task Force remains a comprehensive one which uses as a reference the predetermined progression of transmission, load balancing and distribution rates. This is referred to as the *Rate Cap*, which, when applied to projected volumes for a given year, produces the *Revenue Cap*\(^1\), which is then compared to that year’s *Required Revenue*, determined by means of the traditional cost of service method.

Although the structure of the performance incentive mechanism is the same for the three *Revenue Cap* components, the transmission and load balancing components evolve differently than the distribution component. Each component has its own *Exogenous Factors and Exclusions*.

It is agreed that the predetermined progression of the transmission and load balancing components of the rate will consist in a freeze of the *Reference Rate*, to which will be applied the adjustments set out in the sections dealing with *Exogenous Factors and Exclusions*.

As for the predetermined progression of the distribution component, the formula provides that the *Reference Rate* will first be adjusted by an escalation formula prior to the adjustments set out in the section dealing with *Exogenous Factors and Exclusions*; this also applies for the transmission and load balancing components.

A new *Exogenous Factor* has been introduced to compensate *Gaz Métro* for 90% of volume variations that are not totally under its control, i.e. changes related to customer energy conservation and energy efficiency initiatives. The portion of the volume changes attributed to factors other than energy conservation and energy efficiency, considered economic factors (energy substitution, economic cycles, etc.), will continue not to be neutralized for *Gaz Métro*. The calculation of this *Exogenous Factor* is defined in the section dealing with *Exogenous Factors*.

A *Global Energy Efficiency Plan (GEEP)* performance incentive replaces the adjustment mechanism for lost revenues (AMLR). A target return is fixed to compensate for the

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\(^1\) The *Revenue Cap* results from applying the *Rate Cap* to projected volumes. It should not be confused with a revenue cap that would be determined under a “revenue cap” regime.
disincentives attributable to the fact the Exogenous Factor for volume variations does not totally neutralize them.

The performance incentive mechanism should, therefore, encourage the reduction of the costs to which it will be applied. These costs account for approximately 35% of the customer bill (the other portion being primarily the price of the supply service). NSP Participants also agree to maintain the additional mechanisms which encourage the undertaking of energy-efficiency programs, which further contribute to reduce the bill of participating customers.

3.1 Rate Setting

3.1.1 Formula

The rate setting formula consists of three steps involving the determination of:

- the Revenue Cap in accordance with a predetermined escalation formula;
- the Required Revenue;
- rates based on a comparison of the Required Revenue with the Revenue Cap.

Revenue Cap

The Revenue Cap for the distribution component will be determined as follows:

\[
REV_{C(D)_{t}} = \left( RC_{C(D)_{t-1}} - \text{GAINS} \right) \times \left( 1 + \text{INFLATION} - X \text{ FACTOR} \right) \times VOL_{\text{PROJECTED}_{t}} \pm \text{EXOGENOUS FACTORS} \pm \text{EXCLUSIONS}
\]

where:

- \( REV_{C(D)_{t}} \) = Distribution Revenue Cap for year t
- \( RC_{C(D)_{t-1}} \) = Distribution Rate Cap for year t-1
- \( \text{INFLATION} \) = Rate of inflation determined in accordance with section 3.1.2
- \( X \text{ FACTOR} \) = X Factor determined in section 3.1.3
- \( VOL_{\text{PROJECTED}_{t}} \) = Projected volumes for year t
- \( \text{EXOGENOUS FACTORS} \) = Exogenous Factors determined in section 3.1.4
- \( \text{EXCLUSIONS} \) = Exclusions determined in section 3.1.5
- \( \text{GAINS} \) = Previous productivity gains determined in section 3.1.6

The Revenue Cap for the transmission and load balancing components will be determined as follows:

\[
REV_{C(T \& LB)_{t}} = \left( TC(T \& LB)_{t-1} \times VOL_{\text{PROJECTED}_{t}} \right) \pm \text{EXOGENOUS FACTORS} \pm \text{EXCLUSIONS}
\]

where:

- \( REV_{C(T \& LB)_{t}} \) = Transmission and load balancing Revenue Cap for year t
- \( TC(T \& LB)_{t-1} \) = Transmission and load balancing Rate Cap for year t-1
- \( VOL_{\text{PROJECTED}_{t}} \) = Projected volumes for year t
- \( \text{EXOGENOUS FACTORS} \) = Exogenous Factors determined in section 3.1.4
- \( \text{EXCLUSIONS} \) = Exclusions determined in section 3.1.5
1 **Required Revenue**

*Required Revenue* will be determined in the same manner as under a traditional cost-based regulatory framework. Accordingly, a budget estimate based on the forward test year will be supplied by *Gaz Métro* in each rate application and will deal with the following items:

- operating expenses;
- amortization of property, plant and equipment;
- amortization of deferral accounts;
- property and other taxes;
- deemed income taxes;
- return on projected rate base (13-month average);
- transmission and load balancing expenses;
- other income.

The return on the rate base will correspond to the average cost of capital for the various components of the capital structure as authorized by the *Régie*.

The cost of each component of the capital structure will be determined as follows:

- Short-term debt: Projected rates
- Long-term debt: Projected rates
- Preferred shares: Rate determined in accordance with Decision D-90-75

2 **Rates Based on Comparison of Required Revenue with Revenue Cap**

*Required Revenue* < *Revenue Cap*

If the *Required Revenue* resulting from the determination of the *Projected Cost of Service* is inferior to the *Revenue Cap*, rates will be set so as to generate the *Revenue Cap* less 50% of the difference between the *Revenue Cap* and the *Required Revenue* ("Productivity Gains") net of the amounts invested in the Energy Efficiency Fund (*EEF*)\(^1\)

\[
\begin{align*}
TD_t &= \frac{REEV_{C(T \& LB)t} + REEV_{C(D)t}}{VOL_{PROJECTED}} - (50\% \times (REEV_{C(T \& LB)t} + REEV_{C(D)t} - REEV_{CSI}) - EEF_t) - ECX_t \\
\end{align*}
\]

where:

\[
\begin{align*}
TD_t &= \text{Transmission, load balancing and distribution rate for year } t \\
\end{align*}
\]

\(^1\) Except for LL customers that do not participate in the EEF
Incentive mechanism agreed by the Task Force in NSP Phase 2 – R-3599-2006

In this way, rates will be set so that customers enjoy an immediate benefit of 50% of the Productivity Gains generated by Gaz Métro, either through lower rates or initiatives undertaken by the EEF to promote energy efficiency. The other 50% of the Productivity Gains will be left in rates so as to increase Gaz Métro’s return, which will have been determined beforehand in accordance with the methodology approved by the Régie, to a maximum incentive return of 375 basis points. Gaz Métro’s share in the Productivity Gains in excess of 375 basis points will be added to the customers' share.

**Required Revenue > Revenue Cap**

If the Required Revenue resulting from the Projected Cost of Service is greater than the Revenue Cap, rates will be set so as to generate the Required Revenue.

\[
TD_t = \frac{REV_{CSI}}{VOL_{PROJECTED_t}}
\]

where:
- \( TD_t \) = Transmission, storage and distribution rate for year t
- \( REV_{CSI} \) = Required Revenue (transmission, load balancing and distribution) for year t based on Projected Cost of Service
- \( VOL_{PROJECTED_t} \) = Projected volumes for year t

Thus, there is no incentive return for Gaz Métro based on the methodology approved by the Régie and Gaz Métro will owe a debt to its customers. The terms and conditions of this debt are described in section 3.2.4.

### 3.1.2 Inflation

NSP Participants agree to use the historical rate of inflation of consumer prices for Quebec (Quebec CPI) for the 12 months ending July 31 of the preceding year. This rate is calculated based on the monthly indices in the Statistics Canada table entitled Consumer Price Index (CPI), Basket, 2001, Monthly Data (index 1992 = 100 unless otherwise indicated, CANSIM: Table 326-0001). It will be determined by comparing the average of the indices for the 12 months ending July 31 with the average for the period ending the preceding July 31.
3.1.3 The X Factor

The X Factor adopted is 0.3%.

The X Factor ensures that the Revenue Cap will generate a fair and reasonable return. If Gaz Métro performs better, gains will be shared with customers. If Gaz Métro does not perform as well, the difference will become a debt owed to customers, which will have to be reimbursed in accordance with the terms and conditions set out in section 3.2.4.

3.1.4 Exogenous Factors

Exogenous Factors are events that are not totally within the control of Gaz Métro, which affect its costs or revenues and of which the inclusion in rates is justified. NSP Participants have agreed that, to trigger a rate adjustment, an Exogenous Factor must meet the following criteria:

- it cannot be totally under the control of Gaz Métro (e.g. decision of a regulatory body, government or accounting guideline…);
- it applies specifically to Gaz Métro’s field of activity rather than to the economy as a whole.

In practice, Exogenous Factors apply essentially to the distribution component. The following items will, namely, be considered Exogenous Factors:

- the impact of the vagaries of weather on revenues;
- the impact of interest rates on the cost of capital (debt, Partners’ equity and income taxes) calculated on the deemed capital structure;
- the impact of changes in income and capital tax rates on the cost of service;
- the impact on revenue of volume changes in excess of a predetermined threshold (e.g. energy conservation measures, energy efficiency, etc.)

There is no minimum threshold for including the monetary impact of an Exogenous Factor in the performance incentive mechanism.

Under the performance incentive mechanism, the treatment of an Exogenous Factor can be summarised, therefore, as the quantification of the marginal impact of the factor. Once quantified, the impact will be used to adjust the Revenue Cap. Because cost of service is defined as the sum of Gaz Métro’s various cost components, it will necessarily include the impact of an Exogenous Factor. As Productivity Gains are defined as the difference between the Revenue Cap
and the Required Revenue, adjustment of the Revenue Cap by the amount of the Exogenous Factor will neutralize the impact of the Exogenous Factor on Productivity Gains.

**Application**

Quantification and incorporation of Exogenous Factors into distribution rates will be undertaken exclusively in the rate application.

The impact of the accounts for levelling out the vagaries of the weather and interest expense will be included in a deferral account which will be remunerated at the weighted cost of capital. Deferral accounts will be included in the rate base and amortized over five years. Any other Exogenous Factor affecting distribution costs during the year will be included in a deferral account to be included in the following year’s cost of service.

The Exogenous Factor which is intended to neutralize the impact of interest rates on pre-tax cost of capital will be determined as follows:

\[
\text{EXOGENOUS} \kappa_t = (P_{t-1} \times \text{REV}_{C(D);t} \times \frac{i_t}{i_{t-1}}) - (P_{t-1} \times \text{REV}_{C(D);t})
\]

where:

- \( \text{EXOGENOUS}_{k_t} \) = Adjustment for impact of interest rates Exogenous Factor on cost of capital for year \( t \)
- \( P_{t-1} \) = Share of pre-tax cost of capital in distribution revenue cap for year \( t-1 \), before Exogenous Factors and Exclusions
- \( \text{REV}_{C(D);t} \) = Distribution Revenue Cap for year \( t \), before Exogenous Factors and Exclusions
- \( i_{t-1} \) = Weighted rate of pre-tax cost of capital for year \( t-1 \)
- \( i_t \) = Weighted rate of pre-tax cost of capital for year \( t \)

The Exogenous Factor dealing with the changes in income and capital tax rates will be established by calculating the difference, on the cost of service, between the income taxes calculated at the new rates in force and the rates for the previous year.

The Exogenous Factor that is intended to neutralize the impact of volume variations that are greater than a predetermined threshold will be applied to SML customer volumes and will cover 90\% of the variation in the average volume (normalised) per Tariff D1, D3 and DM customer, less 0.86\%. This consumption variation applied to the Exogenous Factor will be the total annual variation in normalised consumption for customers served continuously since 1999 and that have not required any sales intervention by Gaz Métro. This group totalled 126,235 customers as at August 1, 2006. Customers’ annual volume variations will be updated as at September 30 each year.

The Exogenous Factor that is intended to neutralize a portion of the impact of the volume variation will be calculated as follows:
\[
EXOGENOUS_{t_1} = -[(\Delta V_{t-2}\% + 0.86\%)*90\%*VSML*Rate_{t-2}]
\]

\(EXOGENOUS_{t_1}\) = Adjustment for the impact of the volume variation Exogenous Factor for year \(t\)
\(\Delta V_{t-2}\%\) = Total normalised consumption variation of the group, as a percentage, for year t-2
\(VSML\) = Total volume consumed by SML customers
\(Rate_{t-2}\) = Rate based on rate brackets used to convert volumes into revenues ($) for year t-2

### 3.1.5 Exclusions

Exclusions are items that affect Gaz Métro’s costs and which, unlike Exogenous Factors, are basically under its control. As is the case with Exogenous Factors, there is justification for including the full impact thereof when setting rates.

Exclusions serve three distinct objectives; namely:

- to avoid creating an incentive to avoid expenses, which would otherwise be considered desirable, e.g. costs related to carrying out the GEEP;
- to adjust rates for Over-earnings and Shortfalls;
- to include actual transmission and load balancing costs in rates. For this purpose, the following will be considered Exclusions:
  - the impact of variations in transmission and load balancing rates (regulated or negotiated) of Gaz Métro’s suppliers;
  - the acquisition (approved by the Régie) of new transmission and load balancing tools;
  - where applicable, the stranded costs resulting from unbundled services recognised by the Régie.

There will be no minimum threshold for incorporating the monetary impact of an Exclusion in the performance incentive mechanism.

As with the treatment of an Exogenous Factor, the treatment of Exclusions can be summarised as the quantification of the marginal impact of the factor on the cost of service. Once quantified, the impact will adjust the Revenue Cap. Of necessity, the required cost of service will include the impact of an Exclusion because it is defined as the sum of the different components of the Gaz Métro’s costs. As with Productivity Gains, which are defined as the difference between the Revenue Cap and the Required Revenue, adjustment of the Revenue Cap for an Exclusion will neutralize its impact on Productivity Gains.

**Distribution**

Exclusions will be incorporated in rates solely in the rate application. With respect to the GEEP, the amount of the Exclusion will correspond to projected costs for carrying out the program as described in section 3.3.1.
An adjustment to reflect the spread between the actual costs and the projections in the rate application (in connection with the GEEP), will be included in a remunerated deferral account, which will, following the approval of the Régie of the amounts that can be included therein, be incorporated into rates in the following year. If necessary, the Régie could be asked for its approval during a year as part of an accelerated review process.

**Transmission and Load Balancing**

Quantification and incorporation of transmission and load balancing Exclusions into rates will be done in the rate application and from time to time during the year if there are any changes affecting prices. In particular, such periodic adjustments are necessary in the context of unbundled rates so that rates always reflect the current prices of transmission and load balancing tools.

**Application in Rate Application**

The rate application will show the progression of the Revenue Cap by applying the formula described in section 3.1.1. With respect to Exclusions, the calculated Revenue Cap will be adjusted for the monetary impact arising from the sum of the following known or projected items at the beginning of the year:

- impact of the variation in the average cost of the portfolio of Gaz Métro’s transmission and load balancing tools. This average cost will reflect changes in the price of the tools (either known or projected) as well as changes in the portfolio of tools, the latter having to have been recognised by the Régie;
- where applicable, stranded costs resulting from unbundled services recognised by the Régie.

**Application in the Course of the Year**

When there are price changes during a year as the result of a decision by a regulatory body, rates will be adjusted automatically. This adjustment will be included in the determination of the Revenue Cap at the beginning of the following year.

**3.1.6 Previous Productivity Gains**

The return of the Previous Productivity Gains in the Revenue Cap will be based on the moving average for the previous five years. The difference between the productivity gain for year t-5 and the moving average for years t-5 to t-1 will be amortized over five years starting in year t.

**3.2 Sharing**

The items to be shared are:
1. Projected *Productivity Gains* or *Excesses*, corresponding to the difference between the *Revenue Cap* and the *Required Revenue* in the annual rate application;

2. Gains or losses realised during the year, after rates have been approved, and recognised in the year-end review (*Over-earnings* or *Shortfall*).

### 3.2.1 Sharing Formula

The agreed sharing of gains will vary depending on whether the sharing occurs at the rate application phase or the year-end review:

<table>
<thead>
<tr>
<th>Phase</th>
<th>Sharing of gains</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>Gaz Métro</em>'s maximum share$^{(1)}$</td>
</tr>
<tr>
<td>Rate application</td>
<td>50%</td>
</tr>
<tr>
<td>Year-end review</td>
<td>25%</td>
</tr>
</tbody>
</table>

$(1)$ Up to a maximum incentive return of 375 basis points annually. Any amount in excess of 375 basis points will be fully returned to customers.

$(2)$ Plus excess over 375 basis points that will be returned in the customers' share.

These percentages were determined with the objective of motivating *Gaz Métro* to submit forecasts which are as realistic as possible. Accordingly, *Gaz Métro* will retain a larger portion of its *Productivity Gains* if these gains are submitted beforehand, at the time of the rate application, rather than achieved during the course of the year and, thus, considered *Over-earnings*. In the rate application, *Gaz Métro* will therefore be motivated to estimate all of the gains it expects to earn in order to receive a larger incentive.

As *Gaz Métro* has to sustain the gains generated throughout the performance incentive mechanism in order to ensure its subsequent gains, the gains projected in the rate application will represent primarily "recurring" gains. As the gains at the end of the year are more related to economic than structural aspects, *Gaz Métro*’s share of the year-end gains has been maintained at 25%. Recurring gains realized during the year that were not forecast in the rate application by *Gaz Métro* will be incorporated in the forecasts in the rate application for the following rate year.

If in a given year, *Productivity Gains* turn out to be lower than forecast, *Gaz Métro* will absorb the difference up to the amount of its share of the *Productivity Gains*, beyond which, any *Shortfall* will be shared by *Gaz Métro* and the customers.

The sharing of losses will also vary depending on whether they are observed at the rate application or year-end review report phase:
Table 3.1: Sharing of losses

<table>
<thead>
<tr>
<th>Phase</th>
<th>Gaz Métro’s share</th>
<th>Customers’ share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate application</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Year-end review</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

The sharing of losses will be 100%/0% in the rate application and 50%/50% in the year end review. Excesses over the anticipated Revenue Cap in the rate application will be fully recovered in rates; they will, however, be subsequently reimbursed, with interest at the weighted cost of capital, by way of subsequent Productivity Gains or Over-earnings, 100% of which will be returned to customers, up to the amount of accumulated Excesses. One-half of amounts not yet reimbursed at the termination of the performance incentive mechanism will be reimbursed to customers at the end of the period. The amount to be reimbursed to customers cannot exceed 0.75% of the total amount of the rate base.

Examples of the sharing formula under different scenarios are shown in Appendix 1.

3.2.2 Sharing of Transmission and Load Balancing Over-earnings and Shortfalls

The transmission and load balancing Over-earnings or Shortfalls addressed below can come from two sources:

1. operating transactions, which involve selling transmission and load balancing tools not required during a year to meet forecast demand in the supply plan approved by the Régie in connection with the rate application;
2. financial transactions, which are transactions involving transmission and load balancing tools that do not have a net impact on the total quantity of the transmission and load balancing tools available on an annual basis (e.g. loans of storage space to maximize the utilisation of storage tools).

The two revenue sources will be separated and treated differently.

Operating Transactions:

Operating transactions will be treated as follows:

- In rate application:
  - The revenue that is likely to be earned from operating transactions will be projected. An average price will be calculated by dividing the projected revenue by the forecast volumes for such transactions;
In year end review report:

- The revenue earned on all such transactions will be compared to the revenue projected in the rate application. A portion of the favourable or unfavourable difference in the total revenue will be calculated separately and shared by Gaz Métro and the customers. That portion will be the difference between the average price earned (actual revenue divided by actual volumes traded) and the average price projected in the rate application, multiplied by the lesser of the forecast or the actual volume;

- That portion of the difference will be shared 25% by Gaz Métro and 75% by the customers, whether or not Gaz Métro attains the base return, the incentive return or Over-earnings;

- The remainder of the difference (total difference less difference shared) will be treated like any other revenue and may therefore enable Gaz Métro to earn its base return, its incentive return or Over-earnings, which will be shared in accordance with the rules herein.

Financial Transactions:

Financial transactions will be treated as follows:

- The revenue that will likely be earned from financial transactions will be projected in the rate application;
- Revenue earned from financial transactions will be calculated apart from operating transactions in the year end review report. The revenue earned from all transactions of this type will be compared to the revenue projected in the rate application;
- If actual revenues are lower than the projected revenues, the difference will be included in a deferral account and fully recovered from customers in the subsequent rate application;
- If actual revenues are higher than the projected revenues, the difference will be shared 25%/75% by Gaz Métro and the customers whether or not Gaz Métro attains the base return, the incentive return or Over-earnings;

3.2.3 Over-earnings or Shortfalls

At the end of the year, Over-earnings will be calculated by comparing the actual return to the authorized rate of return (the rate generated by the methodology retained by the Régie to replace the Rate of Return Formula) to which will be added, if applicable, the incentive return allowed to Gaz Métro in the rate application.
For purposes of simplicity, the reimbursement of potential Over-earnings will be made through rates and will be treated as an Exclusion. In fact, since such reimbursements are not permanent, they cannot be permanently incorporated into rates.

Shortfalls will be calculated by comparing the actual return (as at present) to the return generated by the methodology retained by the Régie to replace the Rate of Return Formula (before any incentive).

In the event a Shortfall is recognised at the end of a year, 50% thereof will be recovered from customers in the following year through rates and treated as an Exclusion.

3.2.4 Reimbursement of Excesses over Cap and Shortfalls

If the Required Revenue submitted by Gaz Métro in a rate application exceeds the Revenue Cap, rates will be adjusted to the level of the Required Revenue, subject to the following:

- Any subsequent Productivity Gains (Required Revenue inferior to Revenue Cap) will first be applied to reduce rates (before any sharing) until all Excesses are offset;
- Any subsequent Over-earnings will first be applied to reduce rates (before any sharing) until the Excesses are offset;
- If the performance incentive mechanism expires, Gaz Métro will reimburse 50% of the accumulated Excesses, up to 0.75% of the rate base, to customers, through rates over a period of three years, with interest at the weighted cost of capital rate.

The share of a Shortfall recovered from customers will be reimbursed to customers, with interest, out of subsequent Productivity Gains or Over-earnings. If the performance incentive mechanism expires, any owed balance will be cancelled.

3.2.5 Service Quality Indicators

Application

As is currently the case, participation by Gaz Métro in the sharing of the incentive return in the rate application and the Over-earnings in the year end review will be conditional on the attainment of an overall percentage level with regards to service quality indicators. The overall result will be equal to the weighted average of the results of each indicator, calculated according to the rules specific to the component in question.

The conditions for participating in the sharing of performance incentive or Over-earnings will be as follows:

- A minimum overall attainment percentage of 85% will be required for Gaz Métro to be entitled to its 85% share of the Productivity Gains and Over-earnings;
- With an overall attainment percentage between 85% and 95%, Gaz Métro will retain a corresponding percentage of the Productivity Gains and Over-earnings;
• With an overall percentage attainment of less than the 85%, Gaz Métro will not be entitled to any performance incentive.

Selected Indicators and Parameters

The safety and service quality indicators are revised as follows:

• Preventive maintenance: the indicator is maintained but the weighting has been reduced from 20% to 10%.\(^1\)

• Customer Satisfaction - Tariffs D₁, D₃ and D₅: the indicator has been limited to Tariff D₁, D₃ and D₅ customers.

• Customer Satisfaction - Tariffs D₄ and D₅: an indicator is added with a weighting of 5%.

• Collection and Service Interruption Procedure: the indicator is the same as at present and its weighting has been increased from 5% to 10%, except that the procedure has been changed and is now as described below:

Gaz Métro’s collection procedure for unpaid bills involves two steps before a collection visit. To collect amounts owed by residential customers, between November 15 and March 15 of the following year, Gaz Métro shall:

Reminder: If a bill remains unpaid after the due date, Gaz Métro will send a written reminder to the billing address.

Final notice: If a bill is still not paid following a reminder, Gaz Métro will send a final written notice to the billing address by a means that enables it to prove such notice was sent. The notice will inform the customer that if the amount is not paid, natural gas service may be interrupted.

Collection Visit: If the bill is not paid in full following the final notice and no arrangement has been made for payment or an arrangement is not respected, Gaz Métro can make a collection visit to the service address in order to collect the amounts owing at the date of that visit.

Before interrupting service, Gaz Métro must contact, by telephone or in person during a collection visit, the residential customer who uses natural gas for space heating to propose a payment arrangement. Furthermore, before interrupting service, Gaz Métro will try to contact, by telephone or in person during a

---

1 The Task Force determined that obtaining and maintaining OHSAS 18001 certification might be a valid alternative to this indicator. Gaz Métro will soon analyze this possibility. If the results of the analyses are positive and the Régie would retain the proposed certification, Gaz Métro would take the initiative and the present service quality indicator might be replaced for a future renewal of the performance incentive mechanism, by obtaining and maintaining OHSAS 18001 certification.
collection visit, the residential customer who uses natural gas for domestic uses other than space heating to propose a payment arrangement.

In addition, before interrupting service of a residential customer who uses natural gas for space heating, Gaz Métro’s employee must verify the file and situation at the customer’s premises with his/her superior before the superior authorizes a service interruption for non-payment. The superior must prepare a report on the matter.

Gaz Métro can interrupt service to a residential customer who uses natural gas for space heating in the following situations:

- The customer and Gaz Métro have not made an arrangement for payment or the customer has not respected an agreed arrangement; and
- The minimum outdoor temperature forecast by Environment Canada for the area and for the next 24 hours is not below 10 degrees Celsius.

- Greenhouse gas emissions: the indicator is redefined as follows:

The greenhouse gas emissions (GGE) indicator aims for an annual reduction of 350 tonnes of CO₂ equivalents of GGE from Gaz Métro’s activities. The reduction is obtained by adopting recurring projects. Gaz Métro can also include reductions from the adoption of employee programs to reduce GGE, in particular emissions related to transportation for getting to work.

The final result takes account of the emission credits that can be obtained by Gaz Métro and reductions made by Gaz Métro that exceed the new indicator of 350 tonnes of CO₂ equivalents (the surpluses). These surpluses could be accumulated and used in subsequent years to achieve the indicator. The credits or surpluses obtained will be added to the amounts of the present commitment to reduce GGE before the percentage attainment of the indicator is calculated. If Gaz Métro obtains emission credits or uses its surpluses to make up the shortfall in the indicator for a particular year, it must multiply the shortfall to be made up by 5 because the reductions are considered to recur for five years. The reductions considered will be the reductions from the project(s) implemented no earlier than 12 months before the start of the rate year and no later than the end of the rate year.

The indicators adopted, the parameters used to measure them and the weight given to them in calculating the average used to determine the overall attainment percentage will therefore be as follows:
<table>
<thead>
<tr>
<th>Indicators</th>
<th>Parameters</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preventive maintenance</td>
<td>Percentage of annual program completed</td>
<td>10%</td>
</tr>
<tr>
<td>Emergency response time</td>
<td>Percentage of calls answered in 35 minutes or less</td>
<td>20%</td>
</tr>
<tr>
<td>Telephone response time</td>
<td>Weighted average of percentages achieved within the objective, based on number of calls received by customer category.</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td><strong>Objectives:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Preferred” Customers: % of calls in 60 seconds or less</td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Business” Customers: % of calls in 120 seconds or less</td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Residential” Customers: % of calls in 180 seconds or less</td>
<td></td>
</tr>
<tr>
<td>Meter reading frequency</td>
<td>Weighted average of percentages achieved within the objective, based on number of readings by category of customer.</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td><strong>Objectives:</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Preferred” Customers: % 12 readings per year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Business Customers”: % 6 readings per year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Residential Heating” Customers: % 6 readings per year</td>
<td></td>
</tr>
<tr>
<td></td>
<td>“Residential Non-heating” Customers: % 1 reading per year</td>
<td></td>
</tr>
<tr>
<td>ISO 14001</td>
<td>For the period covered, obtain and maintain ISO 14001 registration or equivalent thereof</td>
<td>10%</td>
</tr>
<tr>
<td>Greenhouse gas emissions</td>
<td>Percentage achievement of annual greenhouse gas emissions reduction objective</td>
<td>10%</td>
</tr>
<tr>
<td>Customer satisfaction – D₁, D₃ and D₅ customers</td>
<td>Percentage of satisfied D₁, D₃ and D₅ customers based on proportion of respondents to the questionnaire who gave at least 8 out of 10 to the question dealing with customer satisfaction with respect to service received.</td>
<td>15%</td>
</tr>
<tr>
<td>Customer satisfaction – D₄ and D₅ customers</td>
<td>Percentage of satisfied D₄ and D₅ customers based on proportion of respondents to the questionnaire who gave at least 8 out of 10 to the question dealing with customer satisfaction with Gaz Métro.</td>
<td>5%</td>
</tr>
<tr>
<td>Collection and service interruption procedure</td>
<td>Number of service interruptions for failure to pay which contravene service interruption procedure described in this agreement</td>
<td>10%</td>
</tr>
</tbody>
</table>

1 The preventive maintenance program will be the same as the one applied under the current service quality indicators, adjusted to reflect variations in the level of activity:
2 • The number of cathode protection activities will be based on the number of test stations on the system (which should be monitored once a year);
3 • The number of kilometres of pipeline inspected to detect leaks will be based on the number of kilometres in the system, which will be inspected once every two years;

April 19, 2007
Incentive mechanism agreed by the Task Force in NSP Phase 2 – R-3599-2006
Translation – Not approved by Participants
• The number of odour tests will be based on the number of strategic points to be verified once a month, as identified by the Engineering Department (generally at the extremities of the system where there is limited gas flow);

• The number of “pre-distribution and distribution pressure reduction stations” activities will depend on the required inspection frequency in accordance with the importance of the station, which in turn will depend on:
  • its importance in supplying the system;
  • operating pressure;
  • type of equipment;
  • number of customers served.

Attainment

The achieved percentage for each indicator, except for ISO 14001, the collection and service interruption procedure and the greenhouse gas emissions, will be determined as follows:

If the individual result is 50% or less, Gaz Métro will obtain an achievement percentage of 0% for that indicator;

If the individual result is more than 50%, the achievement percentage will follow a straight line producing an individual target of 85%, based on the following formula:

\[ R = (A - 50\%) \times \frac{85\%}{(T - 50\%)} \]

where:
\[ R \] = Resulting percentage for indicator (maximum 100%)
\[ A \] = Percentage achieved for indicator
\[ T \] = Percentage target result for indicator, i.e. 85%, for all indicators except the D4 and D5 customer satisfaction indicator for which it is 75%

The resulting percentage for ISO 14001 will be 0% if Gaz Métro does not have ISO 14001 registration as at September 30 of the current year and 100% if registration is effective at that date.

For the collection and service interruption indicator, each violation of the procedure will reduce the achievement of the indicator by 20%. If there are no violations, the indicator will therefore be 100% achieved. If there is one violation, the indicator will be 80% achieved, etc.

For greenhouse gas emissions, the reductions in emissions will be quantified and validated by Gaz Métro personnel and each year Gaz Métro will submit to the intervenors and the Régie a report on the project(s) whose reductions contribute to the attainment of the indicator. Where applicable, the methodology already submitted will be used (calculation methods taken from Handbook for Estimating Methane Emissions from Canadian Natural Gas Systems published by
Gas Technology Canada in 1998 or a subsequent version, if applicable). In the other cases, recognized methodologies will be used, notably ISO 14064 standard.

The percentage achieved with respect to the greenhouse gas emissions indicator will be calculated as follows:

<table>
<thead>
<tr>
<th>Tonnes of greenhouse gas reductions</th>
<th>Indicator achievement percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 350 tonnes CO₂ equivalents</td>
<td>100%</td>
</tr>
<tr>
<td>0 tonnes CO₂ equivalents</td>
<td>0%</td>
</tr>
</tbody>
</table>

Interim results will be interpolated.

The service quality attainment percentages will be calculated for the period covered by the Productivity Gains or Over-earnings to be shared. Indicators will be calculated once a year and submitted to the Régie at the end of the year with the year-end review. Assessment of the D₁, D₃ and D₅ customer satisfaction survey will be carried out, on a test basis, by an external firm and will be based on the same questions (or equivalent questions if the questions are no longer applicable) submitted to the Régie in the 2000 rate case, to ensure that results are consistent from year to year.

The evaluation of Tariff D₄ and D₅ customer satisfaction will be based on an annual survey that makes it possible to determine the percentage of those customers who give a mark of at least 8/10 to a question dealing with overall satisfaction with Gaz Métro.

The weighted average of the percentages for the various service quality indicators will give the overall achieved percentage that will be applied to the performance incentive to be paid to Gaz Métro. The share of the Productivity Gains allotted to Gaz Métro at the beginning of the year will therefore be conditional upon maintaining service quality indicators over the year in question.

In the event the overall result does not reach the set minimum (85%), Gaz Métro will add to end-of-year Over-earnings the gains incorporated in the rates as a performance incentive at the beginning of the year. The entire Over-earnings will then be returned to customers through rates in the following year.

**Penalties**

In the event Gaz Métro is in a Shortfall situation, it agrees not to neglect customer service quality. To ensure this:

Gaz Métro will have to reimburse customers $200,000 for each of the two safety service quality indicators (emergency call response and preventive maintenance) for which the percentage result attained is not at least 85%; and
$100,000 per service quality indicator for each of the other seven indicators for which the percentage result attained is not at least 85%.

These amounts will be reimbursed entirely out of Gaz Métro’s share of subsequent Productivity Gains or Over-earnings.

3.3 Energy Efficiency

The performance incentive mechanism includes three provisions related to energy efficiency:

- an adjustment mechanism for costs related to the realization of the GEEP;
- a GEEP performance incentive;
- An Energy Efficiency Fund (EEF) financed from interest income earned on its capital, a fixed contribution of $1.5M per year starting with the 2009 rate year and by a portion of the Productivity Gains. The EEF is intended to complement the GEEP.

3.3.1 GEEP Costs

These costs will be excluded from the performance incentive mechanism at both the rate application and the year-end review phases. With respect to the rate application, GEEP-related budget variances between two years will not generate performance gains or losses. The budget (in absolute terms) will therefore be treated as an Exclusion. This will also apply to the year-end review: any variance between the GEEP budget submitted in the rate application and costs actually incurred during a year will be excluded and deferred in accordance with the rules in 3.1.5. Any such variance will not contribute to Over-earnings or Shortfalls unless the Régie refuses, in accordance with 3.1.5, to approve their inclusion in a deferral account.

3.3.2 Global Energy Efficiency Plan Performance Incentive

A GEEP performance incentive formula includes a target reward of $4M. The formula is intended to compensate the disincentives of the fact the Exogenous Factor for volume variations does not completely neutralize them.

The objective fixed for Gaz Métro to receive the full incentive of $4M is 24,000,000 m$^3$ per year (annualized volume of measures implemented in the year), starting with the 2007-2008 rate year. The objective will be cumulative thereafter, such that the cumulative objective will be 48,000,000 m$^3$ in 2008-2009, 72,000,000 m$^3$ in 2009-2010 and so on. The cumulative results achieved at the end of each year by Gaz Métro will therefore be compared to the cumulative objective. If it is achieved or surpassed, Gaz Métro will be entitled to $4M. If the objective is
only partially achieved, Gaz Métro will then be entitled to a prorated portion of the $4M based on actual results and the objective.

If, in a particular year, the Régie reduces the annual GEEP energy efficiency objective proposed by Gaz Métro, the difference will not affect the calculation of the achievement of the objective. The results achieved by Gaz Métro will be measured by excluding the opportunists and the savings realized in connection with the EEF.

The incentive to which Gaz Métro will be entitled will be calculated at the end of the year when the annual year end review report is submitted. The incentive will be included in a deferral account and recovered in rates (and treated as an Exclusion) in the subsequent rate application.

Even if the AMLR is eliminated, the starting Revenue Cap for 2008 will include the AMLR forecast in the 2007 rate application and adjusted for the other agreed items in this agreement.

3.3.3 Energy Efficiency Fund (EEF)

**Mission**

*NSP Participants* agreed to maintain the EEF to carry out, either itself or through a subcontractor, energy efficiency projects which are:

- in addition to those under the GEEP;
- for the benefit of consumers who use or are going to use natural gas;
- in part in the residential market and in part in the commercial, institutional and small industrial markets, in proportions that reasonably approximate the respective contributions of these two markets;
- as much as possible, carried out in partnership so as to maximize the impact of amounts invested in the EEF.

Without excluding any project whatsoever, the EEF will give priority to initiatives which are:

- for the benefit of low-income residential customers or community or social projects (for the portion allotted to the residential sector); or
- innovative (the rationale is to make it possible to experiment with programs which would not otherwise be tried);  

- for building envelopes.

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1 The term "innovative" includes not only technological aspects but also the implementation of new management or financing tools that reduce the monetary barriers for the investor, new marketing concepts, etc.
The members of the EEF management committee and the individuals responsible for the GEEP will ensure the EEF and GEEP programs are consistent with each other for low-income customers and the social and community organization clientele that help them.

The EEF will be managed with a long-term view. As funds may fluctuate from year to year, they will be allocated in such a manner as to maintain regularity in the initiatives and ensure long-term survival.

**Funding**

The EEF will be funded from three sources:

1) EEF interest income earned in the year;
2) an annual fixed contribution of $1.5M in the rate application, starting with the 2009 rate year, until the end of this agreement;
3) a portion of the Productivity Gains earned by Gaz Métro under the performance incentive mechanism. The percentage of those gains allotted to the EEF is 25% of the customers’ share, excluding the share of LL customers.

This new method of funding the EEF will provide more regular cash receipts that will more closely match the funds required each year to offer those programs.

The funds accumulated in the EEF will bear interest at the same rate as the average cost of capital.

There will be a total or partial holiday for the fixed and variable customer contribution to the EEF for a particular year if, when a rate application is prepared, the capital of the EEF is four times greater than the last annual EEF budget approved by the Régie.

When the year end review report is prepared, there will also be a total or partial holiday for the variable contribution if the capital of the EEF is four times greater than the last annual EEF budget approved by the Régie.

The sharing percentages will therefore be as follows:

**In Rate Application:**

If:

\[ EEFBalance < 4 \times EEFBgt \]

where:

- \( EEFBalance \) = Amounts not disbursed by EEF at most recent available date when rate application is filed
- \( EEFBgt \) = Last annual budget of EEF disbursements approved by the Régie
the sharing will be as follows:

\[ EEF_t = (\text{REV}_{C(T&LB)t} + \text{REV}_{C(D)t} - \text{REV}_{CSI}) \times \text{minimum50\%} \times (\text{REV}_{SMLt^{-1}} / \text{REV}_{Tt^{-1}}) \times 25\% + \text{FIXED} \]

where:

- \( EEF_t \) = Amount allocated to Energy Efficiency fund for year \( t \) (\( \geq 0 \))
- \( \text{REV}_{SMLt^{-1}} \) = Distribution revenues for SML customers for year \( t^{-1} \)
- \( \text{REV}_{Tt^{-1}} \) = Distribution revenues for all customers for year \( t^{-1} \)
- \( \text{REV}_{C(T&LB)t} \) = Transmission and load balancing Revenue Cap of year \( t \)
- \( \text{REV}_{C(D)t} \) = Distribution Revenue Cap of year \( t \)
- \( \text{REV}_{CSI} \) = Required Revenue (transmission, load balancing and distribution) of year \( t \) based on cost of service
- \( \text{FIXED} \) = Fixed contribution of $1.5M per year starting in 2009 (0 in 2008).

The sharing will be up to the maximum contribution, i.e. four times the last annual budget approved by the Régie.

If:

\[ EEF_{\text{Balance}} \geq 4 \times EEF_{\text{Bgt}} \], then no amount will be paid into the \( EEF \).

**In Year End Review Report:**

If there are *Over-earnings*

\[ EEF_{\text{Balance}} \times 4 \times EEF_{\text{Bgt}} \]

where:

- \( EEF_{\text{Balance}} \times 4 \times EEF_{\text{Bgt}} \) = Amounts not disbursed by \( EEF \) as at September 30 of year \( t \)
- \( EEF_{\text{Bgt}} \) = Last annual budget of \( EEF \) disbursements approved by the Régie

the sharing will be as follows:

\[ EEF = OE_t \times \text{min.75\%} \times (\text{REV}_{SMLt} / \text{REV}_{Tt}) \times 25\% \]

where:

- \( OE_t \) = *Over-earnings* before income taxes for year \( t \)
- \( \text{REV}_{SMLt} \) = Total revenues (for transmission, load balancing and distribution) of SML customers for year \( t \)
- \( \text{REV}_{Tt} \) = Total revenues (for transmission, load balancing and distribution) for all customers for year \( t \)

---

1 May be greater than 50% if incentive return exceeds 375 basis points.
2 May be greater than 75% of incentive return exceeds 375 basis points.
The sharing will be up to the maximum contribution, i.e. four times the last annual budget approved by the Régie.

If:

$$EEF\text{Balance}, \geq 4 \times EEF\text{Bgt}$$, no amount will be paid into the EEF.

Amounts allotted to the EEF will be paid monthly as follows:

- In the rate application, Productivity Gains are forecast. Part of the customers’ share will be allotted to the EEF. The projected amount will then be divided by projected distribution revenues, which will produce a percentage that will be applied each month to actual distribution revenues in order to determine the amount of each payment.
- At the end of each year, i.e. 30 days following the date of the Régie’s decision on the year-end review, Gaz Métro will pay, if applicable, the share of Over-earnings due to the EEF.

Management

- Management Committee

Gaz Métro will deposit amounts allotted to the EEF in an account it will maintain for this purpose. Management of the EEF will be the responsibility of a management committee and the EEF funds will be administered by Gaz Métro. Amounts deposited in this account will be used to implement an action plan prepared by the management committee and approved beforehand by the Régie. Gaz Métro will undertake to use the funds deposited in this account only in accordance with the decisions of the management committee and the Régie.

The management committee will be composed of nine members appointed by each of the intervenors recognised for this purpose by the Régie. Two additional external members can be appointed by a two-thirds majority of the members. The external candidates will be appointed to bring an expertise or make other relevant contributions to carrying out the mission. To encourage close relations with intervenors in energy efficiency, one position will be reserved for Gaz Métro. Attendance fees are paid to the members. The amount of such fees will be approved by the Régie when the annual EEF action plan is submitted.

Each intervenor recognised by the Régie for this purpose will appoint a member of the management committee for an initial term of three years. If requested by an intervenor, the Régie may consider the relevance of adding new members from among intervenors.
recognised for this purpose\textsuperscript{1}. At the end of a mandate, management committee members will be selected by the intervenor that gave the initial mandate provided such intervenor is still recognised for this purpose by the \textit{Régie} (e.g. at the time of the last rate application).

The management committee must notify the intervenor if the member that it has appointed has missed three consecutive meetings of the committee for no valid reason.

When appointed to the management committee of the \textit{EEF}, a member must sign a confidentiality agreement and comply with the Code of Ethics reproduced in Appendix 4.

To avoid any conflict of interest, a member of the management committee of the \textit{EEF} may not act as a witness before the \textit{Régie} for both the \textit{EEF} and an intervenor in the same case.

The management committee must advise a member if he/she is in breach of the aforementioned responsibilities.

- Functioning

The \textit{EEF} management committee will establish rules of conduct which are consistent with its mission. To do this, it will appoint a chair of the meeting who will ensure that meetings are properly conducted. A quorum for a meeting consists of a simple majority of the members. Each member of the committee will have a single vote. All of the committee's decisions will require a two-thirds majority of the members present.

The management committee will hire and assess the performance of the individual responsible for the overall and day-to-day management of the \textit{EEF}.

The committee will be responsible for:

- preparation of a three-year action plan for the \textit{Régie}, showing how the funds will be used. Projects included in this plan will be clearly unrelated to the \textit{GEEP} so as to avoid any possibility of duplication, in accordance with the mission of the \textit{EEF}. Each year the \textit{Régie} will approve the first year of the three-year action plan;
- preparation of an annual activity report to the \textit{Régie}, including the use of \textit{EEF} funds and generated benefits;
- an overall assessment of the \textit{EEF} with a view to the overall assessment of the performance incentive mechanism after the 2009-2010 rate application is filed. The assessment will be prepared in such a way as to enable the intervenors, and eventually the \textit{Régie}, to decide what adjustments may be required in relation to the \textit{EEF}.

\textsuperscript{1}To avoid Gaz Métro's competitors that are recognised as intervenors being asked to choose the members of the management committee.
3.3.4 Joint GEEP and EEF Programs for Low-income Customers

With a view to increasing efforts made in respect of low-income households while respecting the basic principles of the GEEP, at least 13% of the total annual budget of the GEEP and the EEF allotted to residential customers will be reserved for complete programs adapted to that clientele and developed jointly by the GEEP and the EEF and reserved exclusively for low-income households and the social and community clientele that help those households. If the amount is not totally allotted to those customers during that year, it may then be allotted to other programs during the following year after an analysis of the reasons for this failure has been performed. Gaz Métro will also make additional efforts, in collaboration with local organizations (ACEF, etc.), to target low-income households as best possible.

3.3.5 Monitoring GEEP and EEF Programs

To better monitor the programs for residential and commercial customers as well as low-income households and the social and community clientele that help those households, they will be monitored as follows:
• Introduction of separate monitoring of residential and commercial customers, *GEEP* and *EEF* budgets as well as programs exclusively for low-income households and the social and community clientele that help them;

• Identification of the respective rate contributions of residential and commercial customers to financing the *GEEP* and the *EEF*;

• Evaluation of the differences between the benefits and the contributions;

• If there is a large difference that cannot be remedies by modifying the delivery of the programs, identification of means (and the costs of implementing and applying them) to adjust the contribution level of each clientele based on the benefits they derive from them;

• Implementation of those means if the costs are considered reasonable by the *Régie*, given the increased accuracy they would bring.
4 ASSISTANCE WITH THE DISPLACEMENT OF MORE POLLUTING FORMS OF ENERGY

In order to reward *Gaz Métro* for its efforts to displace more polluting forms of energy (petroleum products, coal, wood, etc.), an annual contribution of $1 million will be paid to a Polluting Energies Displacement Account ("PEDA") that will be used to carry out substitutions of these forms of energy by natural gas.

The contribution will be added to the cost of service and will not be treated as an Exclusion; in this way, it will be recovered from all customers through rates.

The *PEDA* will be used in the same fashion as a “customer contribution” to make conversion projects profitable for all customers. Such conversions projects will take place on the existing system or on system extensions of less than $1.5 million. Amounts allotted to conversion projects will be based on what would be required on average to bring the break-even point to levels similar to those encountered in a normal system expansion plan (for conversions not requiring customer contribution). *Gaz Métro* will evaluate the best use of the contribution in each rate application and will report thereon in its year-end review.

Depending on the assessment of the current situation, the priorities for the use of the amounts paid to the *PEDA* will be:

- the densification of the system by the addition of residential customers. The displaced energy will be primarily no.2 fuel oil;
- the densification of the system by the addition of CII customers on recent system extensions. The displaced energy will be primarily no. 2 fuel oil; and
- mini-extensions of the system. The displaced energy will be primarily no. 2 fuel oil.

In general, the amounts in the *PEDA* will be paid directly to the customer and will be added to the maximum Consumption Rebate Program (CRP) amount that will allow *Gaz Métro* to earn an acceptable profit. In such case, the total paid under the CRP and *PEDA* programs may not be greater than 100% of the eligible expenses.

Customers will be notified that the assistance received comes from the *PEDA* and of the objectives of the account.

Occasionally, *PEDA* amounts will be used to reduce, as external contributions, the investments required to make a project profitable for all existing customers.

If no CRP amount is paid to a customer, the customer will have to agree to a minimum annual obligation equal to 50% of its forecast consumption. In the event of a default by a customer in meetings its minimum annual obligation, the amount recovered equal to the *PEDA* is remitted to the *PEDA*. 
The balance of the PEDA will be remunerated at the average cost of capital. This account could eventually be funded from external sources (i.e. other than by Gaz Métro or its customers).

**Monitoring of PEDA Use**

Projects undertaken with the use of PEDA funds will be monitored each year and included in the annual report. The monitoring will include the following information:

- Number of customers;
- Volume displaced by energy source (in cubic metre equivalents);
- Investments;
- Pipelines and connections;
- CRP;
- PEDA amounts used; and
- Profitability of projects carried out with PEDA funds.
5 EXTRAORDINARY EVENTS

The performance incentive mechanism can be revised for extraordinary events prior to its expiration. The revision will be part of a separate exercise that will follow the rate application in which the extraordinary events are noted.

Revision will be optional, at the request of one of the interested parties, in the following situations:

- After three consecutive years with no earned incentive return;
- Cumulative Excesses or Shortfalls exceeding 1.5% of rate base (currently amounting to approximately $27M);
- After two consecutive years where inflation is greater than 5%.
6 TERM AND RENEWAL

The term of the performance incentive mechanism is five years, i.e. from October 1, 2007 to September 30, 2012.

After the 2009-2010 rate application has been filed, which will be the third such application under the third performance incentive mechanism, an overall evaluation of the performance incentive mechanism will be undertaken. It is hoped this evaluation will be done by a task force similar to the one set up for the current exercise (NSP). The update of the database appended to the Task Force Report in file R-3599-2006 will be filed each year in the year-end review report in anticipation of the Task Force meetings.

The evaluation will include the following:

- Creation of a task force from among the intervenors recognised at that time by the Régie (possibly at the time of the 2009-2010 rate application) and adoption of identical guidelines as those for this Agreement;
- Distribution to the recognised intervenors of an evaluation grid prepared by Gaz Métro (see proposed content below), as well as the update of the database. The quantitative and qualitative results of the rate applications and annual reports filed since the introduction of the performance incentive mechanism will be used as a basis for the preparation of the evaluation grid;
- Review by the task force of the effectiveness of the performance incentive mechanism. The evaluation grid as well as the update of the database will serve as a basis for the review of the performance and will make it possible to determine whether the objectives have been achieved;
- Preparation of an assessment of the performance incentive mechanism by the task force that will include the identification of issues to be reviewed with respect to the performance incentive mechanism, without disclosing individual negotiating positions;
- Estimate of the time and number of meetings required for negotiation;
- Negotiations in the task force, with the objective of reaching agreement, before the end of the third year of the performance incentive mechanism, on a new mechanism and its effective date.

Evaluation Parameters

The evaluation grid prepared by Gaz Métro and given to the intervenors will be used to assess the results in relation to the objectives of the performance incentive mechanism; namely,

- The creation of value, which involves increasing revenues and optimizing operating expenses and asset use, greater efficiency of energy consumption and increased efforts to substitute more polluting forms of energy;
- Equitable sharing of the profits, in particular such that all of the parties perceive a benefit in relation to a traditional cost-based regulatory system;
• Flexibility and simplicity, involving in particular less micro-management by the Régie or intervenors and the introduction of an ongoing consultation process between the intervenors and Gaz Métro to ensure the performance incentive mechanism is working smoothly and monitored effectively;

• The sustainability of the performance incentive mechanism, which means continual sharing; and

• Conformity with the public interest and incorporation of the concept of sustainable development, including the protection of low-income individuals, the reduction of environmental impacts and greenhouse gas emissions as well as greater energy efficiency.

The evaluation grid will include measurable and non-measurable aspects. The following table shows, for the most easily measurable objectives, the data that will be compiled by Gaz Métro to assist in determining whether the objective has been achieved. A qualitative assessment will be prepared for the other objectives.

**Measurable Aspects of Evaluation Grid**

<table>
<thead>
<tr>
<th>CREATION OF VALUE</th>
<th>Optimization of operating expenses</th>
<th>Optimization of asset use</th>
<th>Improvement of efficiency of energy consumption</th>
<th>Increased efforts to substitute more polluting forms of energy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase revenues</td>
<td>• Budgeted operating expenses&lt;br&gt;• Adjusted expenses, if necessary, to reflect effect of costs beyond distributor’s control&lt;br&gt;• Accumulated inflation over the period&lt;br&gt;• Adjusted expenses, if necessary, in constant dollars&lt;br&gt;• Cumulative variation in constant dollars</td>
<td>• New sales: number of customers, volumes, development cost and impact on tariffs&lt;br&gt;• Evolution of relationship between assets, in constant dollars, and volumes and number of customers served</td>
<td>• Assessment of EEF and GEEP&lt;br&gt;• Monitor impacts of energy conservation and efficiency on customers consumption</td>
<td>• Benefits from PEDA</td>
</tr>
</tbody>
</table>

| EQUITABLE SHARING OF PROFITS | Sharing of Productivity Gains per rate application | Increase in tariffs compared to inflation | Calculation of actual X Factor generated over period |
Renewal

In the event of an agreement to renew, a submission will be made to the Régie for approval as was done in the current NSP and in accordance with the same rules, unless the Régie decides otherwise. If a renewal agreement cannot be achieved, the mechanism will terminate at the end of the present five-year period.

Return of Productivity Gains

A method of incorporating Previous Productivity Gains, based on a moving five-year average, is introduced in the mechanism. This method of return over five years will be applicable in the next rate application, i.e. for 2008. The return of Previous Productivity Gains is described in section 3.1.6.

In Section 6 – Term and Renewal of the first performance incentive mechanism, it was agreed that:

"Productivity Gains achieved during the year and used to provide the distributor with an incentive return will be remitted in full to customers after five years."¹

The Additional Productivity Gains determined in the 2001 rate application have therefore been incorporated in the Revenue Cap of the 2006 year and those of the 2002 rate application have been incorporated in the Revenue Cap of the 2007 year.

Appendix 2 shows a simulation of the return of the Productivity Gains in 2008 to 2012 on the distribution Revenue Cap.

7 FUNCTIONING

7.1 Application to 2008 Rates

The Rate Cap arising from the Revenue Cap approved by the Régie for the 2007 fiscal year will be used to determine the Revenue Cap for the 2008 rate application.

The agreed adjustment is calculated by applying this performance incentive mechanism retrospectively over the 2001 to 2007 years (with no smoothing of the productivity gains). The starting Revenue Cap for 2008 will be increased by the lesser of:

- 3.133%;
- the percentage that would result in the average distribution rate increase (including the return of the 2006 Over-earnings) not exceeding 4.2%.

The 3.133% is determined as follows:

\[
\frac{($489,637,000 - $467,007,000) - $8,000,000}{$467,007,000}
\]

where:
- $467,007,000 is the actual Revenue Cap for 2007
- $489,637,000 is what would have been the starting Revenue Cap in 2008 if the agreed mechanism had been applied since 2000
- $8,000,000 represents the productivity gain corresponding to an incentive return of $4,000,000, i.e. the return replaced by the GEEP Performance Incentive.

The adjustment described above will be incorporated in whole or in part in 2008, provided the average distribution rate increase is not greater than 4.2%. Any residual portion of that adjustment not incorporated in 2008 will be incorporated in 2009.

In the next rate application, Gaz Métro will present a method for normalizing volumes to take account of the impact of wind. The variation between the wind that will be retained as “normal” by the Régie and the average actual winds for 2001 to 2006, which served as the basis for establishing the parameters of this performance incentive mechanism, will be treated as an Exogenous Factor.

7.2 Rate Flexibility (adjustments, rebates, etc.)

If Gaz Métro needs to modify existing rate structures, it will be able to do so with the approval of the Régie, providing the new rates generate the same revenues as the former rates applied to the same volumes, excluding new customers for the projected year providing the Régie approves rate changes that would only affect the new customers.
Measures to correct cross-subsidisation could also be proposed each year by the Régie, after being discussed in the Task Force. The Régie will then decide whether it is appropriate to correct cross-subsidisation. It is agreed, however, that if there are Productivity Gains, no cross-subsidisation correction will result in a rate which is higher than the Rate Cap for a given category of customers, except for new customers.

NSP Participants also agree that Gaz Métro may grant rate rebates to certain customers so that they continue to consume natural gas. Such rebates will comply with the parameters of current commercial programs or any new programs approved by the Régie. These rebates will be entirely expensed in the current year; this will encourage Gaz Métro to resort to such rebates only in moderation. Rebates will be treated in the cost allocation study as a reduction in revenue accruing from the customer class which received them.

7.3 Monitoring

The performance incentive mechanism calls for the continuation of the filing of an annual rate application which will include the following information for the forward test year:

- Deliveries and system extension plan;
- Annual gas supply planning and costs;
- Three-year gas supply plan;
- Existing transmission and load balancing contracts;
- Financial derivatives program;
- Components of the Projected Cost of Service, as presented in section 3.1.1;
- Monthly evolution of average rate base and thirteen-month average;
- Additions to rate base;
- Reconciliation of historical cost and accumulated depreciation of property, plant and equipment;
- Calculation of working capital for twelve-month period ending September 30;
- Calculation and components of average cost of capital;
- Rate of return on average common shareholders’ equity in accordance with Rate Setting Formula, or otherwise, if necessary;
- Calculation of components of prospective average cost of capital;
- Credit rating agencies reports;
- Québec CPI for previous twelve months ending July 31;
- Calculation of Revenue Cap, Exogenous Factors and Exclusions;
- Calculation of Excess or Productivity Gains;
- Calculation, if applicable, of reimbursement of Excesses out of Productivity Gains;
- Cumulative balance, if any, of Excesses, penalties and Shortfalls (customers’ share);
The year-end review report will provide the following information:

- List of directors of Gaz Métro inc. as at September 30;
- Non-consolidated financial statements of Gaz Métro Limited Partnership as at September 30;
- Comparison of actual results of regulated activity with budget for the fiscal year ended September 30;
- Income statement of regulated activity for the fiscal year ended September 30;
- Reclassification of income statement for the fiscal year ended September 30;
- Summary of results for service quality indicators for the fiscal year ended September 30;
- Determination of difference of the return on rate base for the fiscal year ended September 30;
- Calculation of income tax adjustment on share issue expenses excluded from rate base for the fiscal year ended September 30;
- Share of Over-earnings or Shortfalls as at September 30;
- Cumulative balance, if applicable, of Excesses, penalties and Shortfalls (customers’ share);
- Comparison of budgeted deliveries and revenues with actual results for the fiscal year ended September 30;
- Comparison of budgeted gas supply costs with actual for the fiscal year ended September 30;
- Provision for deemed income taxes for the fiscal year ended September 30;
- Auditors’ report on deemed income and capital taxes;
- Status of normalization accounts charged to income for the fiscal year ended September 30;
- Evolution of weather normalization account for the fiscal year ended September 30;
• Evolution of financial expense normalization account for the fiscal year ended September 30;
• Monthly rate base for the fiscal year ended September 30;
• Calculation of working capital in accordance with the results of Lead-Lag Study for the fiscal year ended September 30;
• Additions to rate base for the fiscal year ended September 30;
• Comparison of budgeted system expansion plan with actual for the period ending September 30;
• Comparison of forecast and actual rate base averages and opening balances;
• Calculation of average cost of capital for the fiscal year ended September 30;
• Calculation of cost of average bond debt on September 30;
• Required prices and rates during the year;
• Annual financial derivatives products performance report;
• Determination of deferred charges relating to GEEP;
• Calculation of GEEP performance incentive;
• Annual report on energy efficiency programs;
• EEF report;
• GMCNP (Gaz Métro Commercial Financing Program) status report;
• Report on the use of PEDA;
• Update of database reproduced in Appendix to Task Force's report on the assessment of the performance incentive mechanism to the improvement of the performance of Gaz Métro in case R-3599-2006.

If necessary, the Régie will also recognise the funds related to Gaz Métro’s GEEP.

Monitoring of the performance incentive mechanism will also involve the creation of a task force similar to the one created for the present exercise (NSP). Therefore, public notices will be posted each year in connection with the rate application in order to identify intervenors to be included in the task force. Gaz Métro will forward its year-end review to all intervenors recognised in the rate case.

In the third year, the performance assessment mechanism will be assessed by the task force recognised for that purpose. The assessment will be performed in a manner that will enable the 2011 rate application to be prepared using the amended mechanism, if applicable.

### 7.4 Major Corporate Reorganization

It is agreed that in the event of a major corporate reorganization, Gaz Métro will have to provide explanation and show that the benefits thereof are taken into account and shared within the performance incentive mechanism, before the Régie.
8 ADVANTAGES OF PERFORMANCE INCENTIVE MECHANISM

The main advantages of the performance incentive mechanism are:

Role of Régie Maintained

The performance incentive mechanism maintains the role of the Régie while streamlining the regulatory process. For example, Gaz Métro will have to submit a rate application and a year-end review each year, which will enable the Régie to continue to monitor its activities.

Lighter Regulatory Process

With the new performance incentive mechanism, it will always be in the best interest of Gaz Métro to submit the most realistic forecasts possible. This will make it possible to streamline the regulatory process for setting rates in the rate application. The prior review of the rate application by the task force will also help streamline the regulatory process by providing assurance to the Régie that the performance incentive mechanism has been applied correctly.

Volume Volatility

Unlike other less flexible mechanisms, the performance incentive mechanism will ensure that Gaz Métro recovers its Required Revenue in the event of significant fluctuations in deliveries. The performance incentive mechanism will make its possible to adjust rates to reflect a volume loss arising, for example, from deterioration in Gaz Métro’s competitive situation. This is particularly important for Gaz Métro, which, in view of the heavy concentration of its industrial clientele, is more vulnerable than other distributors to fluctuations in the prices of oil or natural gas or simply to downturns in economic activity.

Economic Considerations

The sharing of Productivity Gains over a five-year period will be an incentive for Gaz Métro to undertake long-term action to:

- increase profitable new sales (connect new customers or new applications at existing customers);
- optimize (which does not necessarily mean reduce in absolute terms) operating expenses;
- optimize asset management, therefore reduce as much as possible the unit cost of assets used to serve customers.

This incentive will be all the more important because the performance incentive mechanism includes a guarantee (partial yet still an incentive) that Gaz Métro’s future financial performance will at least be as good as in the past.
Environmental Considerations

While the performance incentive mechanism will provide Gaz Métro with an incentive to increase its deliveries, it also includes items which make it possible to reconcile this objective with respect for the environment:

- An adjustment mechanism for costs and net lost revenues resulting from energy efficiency activities, which leaves Gaz Métro neutral as to the impact of energy efficiency on its costs and revenues;
- A GEEP performance incentive;
- An energy efficiency fund, financed out of the customers’ share of achieved Productivity Gains and Over-earnings, which will make it possible to carry out energy efficiency activities which go beyond the GEEP;
- An assistance with the displacement of more polluting forms of energy account:
- A service quality indicator dealing specifically with the Partnership’s environmental management;
- A greenhouse gas quality indicator.

Social Considerations

The performance incentive mechanism includes items dealing with social concerns:

- The EEF will give priority to low-income residential customers or community or social projects (for the residential portion) or to innovative projects;
- Service quality indicators dealing specifically with system safety and customer satisfaction.

Sustainability and Ease of Renewal

The assurance of continuous sharing of Productivity Gains, regardless of the amount, improves the chances of satisfying all of the parties, by ensuring that no party derives a benefit to the detriment of the others.

Monitoring the costs of the performance incentive mechanism will also help ensure sustainability by reassuring the Régie as to their trend. Monitoring should also make it possible to renew the performance incentive mechanism more easily when it expires.
## 9 DEFINITIONS

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional productivity gain</td>
<td>Positive or negative difference between the Productivity Gains for a year over the Productivity Gains for the preceding year</td>
</tr>
<tr>
<td>Average cost of capital</td>
<td>Rate of return on Gaz Métro's rate base approved by the Régie</td>
</tr>
<tr>
<td>CPI Quebec</td>
<td>Historical inflation rate of consumption prices for Quebec</td>
</tr>
<tr>
<td>EEF Disbursements</td>
<td>All withdrawals of any kind whatsoever from the EEF</td>
</tr>
<tr>
<td>Excess</td>
<td>Excess of rates over what they would have been, based on Reference Formula</td>
</tr>
<tr>
<td>Exclusion</td>
<td>Event mainly under the control of Gaz Métro for which impact on incentive mechanism is neutralized. Explained in greater detail in section 3.1.5</td>
</tr>
<tr>
<td>Exogenous Factor</td>
<td>Event not totally under the control of Gaz Métro for which impact on incentive mechanism is neutralized. Explained in greater detail in section 3.1.4</td>
</tr>
<tr>
<td>X Factor</td>
<td>Factor reflecting historical progression of rates for the distribution activity as compared to inflation</td>
</tr>
<tr>
<td>GEEP</td>
<td>Global Energy Efficiency Fund</td>
</tr>
<tr>
<td>Gaz Métro</td>
<td>Gaz Métro Limited Partnership</td>
</tr>
<tr>
<td>LL Customers</td>
<td>Customers whose contracted volume is 10,000 m³/day (threshold for Tariff D4 or its equivalent) or more or whose rate-positioning volume is 3,200 m³/day (threshold for Tariff D3 or its equivalent) or more</td>
</tr>
<tr>
<td>Loss</td>
<td>Excess or shortfall</td>
</tr>
<tr>
<td>NSP</td>
<td>Negotiated Settlement Process endorsed by the Régie in Decision D-2006-114</td>
</tr>
<tr>
<td>NSP Participants</td>
<td>Active NSP participants listed in section 2.1</td>
</tr>
<tr>
<td>Over-earnings</td>
<td>Excess of actual revenues over actual costs, including authorized rate of return, including incentive</td>
</tr>
<tr>
<td>PEDA</td>
<td>Polluting Energies Displacement Account</td>
</tr>
<tr>
<td>Previous Productivity Gain</td>
<td>Productivity gain realized in a previous year and that will have to be included in the revenue cap in a future year</td>
</tr>
<tr>
<td>Productivity Gains</td>
<td>Positive difference between Revenue Cap and Required Revenue. Concept of “productivity gains” used in this agreement does not necessarily correspond to the classical definition thereof</td>
</tr>
<tr>
<td>Projected Cost of Service</td>
<td>All costs projected by Gaz Métro, including authorized rate of return, excluding any incentive</td>
</tr>
<tr>
<td>Rate Cap</td>
<td>Rate resulting from escalation of previous year’s Rate Cap (or opening rates for first year of incentive mechanism) to take account of inflation, X Factor, Exogenous Factors and Exclusions</td>
</tr>
<tr>
<td>Rate Setting Formula</td>
<td>Rate setting formula in accordance with Decisions D-99-11, D-99-150, D-2003-180 and D-2004-196</td>
</tr>
<tr>
<td>Reference Formula</td>
<td>Formula determining what the Required Revenue would be for projected volumes if it were adjusted for inflation, X Factor, Exogenous Factors and Exclusions</td>
</tr>
<tr>
<td>Reference Rate</td>
<td>2007 rate for the first year of the performance incentive mechanism, and, for subsequent years, Rate Cap of preceding year</td>
</tr>
<tr>
<td>Régie</td>
<td>Régie de l’énergie</td>
</tr>
<tr>
<td>Required Revenue</td>
<td>Revenue required by Gaz Métro to recover the projected cost of service</td>
</tr>
<tr>
<td>Revenue Cap</td>
<td>Revenue that would be generated by applying Rate Cap to projected volumes. Not to be confused with a revenue cap that would be determined under a “revenue cap” mechanism</td>
</tr>
<tr>
<td>Shortfall</td>
<td>Excess of actual costs over actual revenues including authorized rate of return, excluding any incentive</td>
</tr>
<tr>
<td>SML Customer</td>
<td>Small and medium load customer (on Tariff D1, D3 or DM or their equivalents)</td>
</tr>
</tbody>
</table>
The undersigned hereby confirm that this proposed agreement conforms to decisions made during Phase 2 of the NSP.

ACIG

Jean Benoit Trahan

RNCREQ

François Valiquette

CFIB

Lucie Gervais

ROÉÉ

Martin Poirier

CORPIQ

Louis Renault Rozéfort

S.É./AQLPA

Richard Massicotte

GRAME

Jean-François Lefebvre

UC

Marc-Antoine Fleury

OC

Cristina Maria Romanelli

UMQ

Yves Hennekens

Gaz Métro

Geneviève Deschamps

Jean-Pierre Noël

April 19, 2007

***
APPENDIX 1

Scenarios

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<th>8</th>
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<tbody>
<tr>
<td>BEGINNING END</td>
<td>+</td>
<td>0</td>
<td>-</td>
<td>0</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

BEGINNING OF YEAR

Gaz Métro DEBT

GAINS (EXCESSES) 10.00 - -10.00 - 10.00 -10.00 10.00 10.00 -10.00 -10.00 4.00

SHARING IN RATE APPLICATION

CUSTOMERS 5.00 - -10.00 - 5.00 -10.00 5.00 5.00 -10.00 -10.00 4.00

LARGE LOAD 0.75 - -1.50 - 0.75 -1.50 0.75 0.75 -1.50 -1.50 0.60

SMALL AND MEDIUM LOAD 4.25 - -8.50 - 4.25 -8.50 4.25 4.25 -8.50 -8.50 3.40

RATE (INCREASE) REDUCTION 1.69 -1.50 -10.00 -1.50 1.69 -10.00 1.69 1.69 -10.00 -10.00 1.90

ENERGY EFFICIENCY FUND 2.56 1.50 1.50 1.50 2.56 1.50 1.50 1.50 1.50

PARTNERS 5.00 - - - 5.00 - 5.00 5.00 - - -

DEBT DUE TO CUSTOMERS - - 10.00 - - 10.00 - - 10.00 10.00 1.00

END OF YEAR

INCENTIVE ACHIEVED BY PARTNERS 5.00 - - - 5.00 - 2.00 - - - -

OVER-EARNINGS (SHORTFALLS) - 10.00 - -10.00 10.00 -10.00 - -5.00 10.00 20.00 5.00

SHARING OF OVER-EARNINGS (SHORTFALLS)

CUSTOMERS - 7.50 - -5.00 7.50 -5.00 - -2.50 10.00 17.50 4.00

LARGE LOAD - 1.13 - -0.75 1.13 -0.75 - -0.38 1.50 2.63 0.60


RATE (INCREASE) REDUCTION - 4.78 - -4.25 4.78 -4.25 - -2.12 6.38 13.28 2.80

ENERGY EFFICIENCY FUND - 1.59 - - 1.59 - - - 2.13 1.59 0.80

PARTNERS - 2.50 - -5.00 2.50 -5.00 - -2.50 - 2.50 1.00

TOTAL SHARES

CUSTOMERS 5.00 7.50 -10.00 -5.00 12.50 -15.00 5.00 2.50 - 7.50 8.00

LARGE LOAD 0.75 1.13 -1.50 -0.75 1.88 -2.25 0.75 0.37 - 1.13 1.20


RATE (INCREASE) REDUCTION 1.69 3.28 -10.00 -5.75 6.47 -14.25 1.69 -0.43 -3.63 3.28 4.70

ENERGY EFFICIENCY FUND 2.56 3.09 1.50 1.50 4.16 1.50 2.56 2.56 3.63 3.09 2.10

PARTNERS 5.00 2.50 - -5.00 7.50 -5.00 2.00 -2.50 - 2.50 1.00

DEBT DUE TO CUSTOMERS

TO BE OFFSET WITH FUTURE GAINS - - 10.00 5.00 - 15.00 - 2.50 - - -

TO BE 50% REIMBURSED IF NOT OFFSET - - 10.00 - - 10.00 - - - -

+ Beginning of year: productivity gains
  End of year: over-earnings
  0 Beginning of year: no productivity gains or excess
  End of year: no over-earnings or shortfall
  - Beginning of year: excess over CAP
  End of year: shortfall
  - - Beginning of year: N/A
  End of year: no incentive and shortfall
  + + Beginning of year: N/A
  End of year: over-earning > debt due
Description of scenarios

Scenario 1: Gaz Métro shows Productivity Gains in the rate application and achieves exactly its authorised rate of return (including incentive). Productivity Gains of 10.00 are shared 50% by customers and 50% by Gaz Métro. Of the customers’ share of 5.00, 2.44 (0.75 LL customers and 1.69 SML customers) is incorporated into rates for the year and 2.56 (including a fixed contribution of 1.50) goes to fund the EEF.

Scenario 2: Gaz Métro shows no Productivity Gains or Excess in the rate application and achieves Over-earnings. In the rate application, 1.50 is paid to the EEF. Over-earnings of 10.00 are shared 75% by customers and 25% by Gaz Métro. Of the customers’ share of 7.50, 5.91 (1.13 LL customers and 4.78 SML customers) is included in a deferral account and incorporated into rates in the following year. 1.59 is paid into the EEF.

Scenario 3: Gaz Métro shows an Excess in the rate application and achieves no Over-earnings or shortfall. 1.50 is paid into the EEF and the full Excess of 10.00 is incorporated into rates and Gaz Métro has a debt of 10.00 due to the customers, which is to be offset by future gains. If there is no offset, 50% will be reimbursed.

Scenario 4: Gaz Métro shows no Productivity Gains or Excess in the rate application and experiences a Shortfall. In the rate application, 1.50 is paid into the EEF and the Shortfall is shared 50% by customers and 50% by Gaz Métro. The customers’ share of 5.00 is included in a deferral account and incorporated into rates the following year. Gaz Métro then has a debt of 5.00 to be offset by future gains. If the offset has not been made when the mechanism expires, the debt is cancelled.

Scenario 5: Gaz Métro shows Productivity Gains in the rate application and achieves Over-earnings. This scenario is a combination of scenarios 1 and 2.

Scenario 6: Gaz Métro shows an Excess in the rate application and experiences a Shortfall. This scenario is a combination of scenarios 3 and 4.

Scenario 7: Gaz Métro shows Productivity Gains in the rate application and partially achieves its authorised rate of return (including incentive). Productivity Gains of 10.00 are shared 50% by customers and 50% by Gaz Métro. Of the customers’ share of 5.00, 2.44 (0.75 LL customers and 1.69 SML customers) is incorporated into rates in the year and 2.56 (including a fixed contribution of 1.50) is used to fund the EEF. Gaz Métro only achieves an incentive of 2.00 out of a potential 5.00 authorised in the rate application.
Scenario 8: Gaz Métro shows Productivity Gains in the rate application and experiences a Shortfall. Productivity gains of 10.00 are shared 50% by customers and 50% by Gaz Métro. Of the customers’ share of 5.00, 2.44 (0.75 LL customers and 1.69 SML customers) is incorporated into rates in the year and 2.56 (including a fixed contribution of 1.50) is used to fund the EEF. Gaz Métro achieves 0 incentive out of a potential 5.00 authorized in the rate application. The shortfall of 5.00 is shared 50% by customers and 50% by Gaz Métro. The customers’ share of 2.50 is included in a deferral account and incorporated into rates in the following year. Gaz Métro then has a debt of 2.50 to be offset by future gains. If the debt has not been offset when the agreement expires, it is cancelled.

Scenario 9: Gaz Métro shows an Excess in the rate application and achieves Over-earnings equivalent to the Excess. 1.50 is paid into the EEF and the entire Excess of 10.00 is incorporated into rates and Gaz Métro has a debt of 10.00 to customers to be offset by future gains. If the debt has not been offset, 50% is to be reimbursed. In the year end review report, the entire Over-earnings of 10.00 are used to offset the debt in the rate application. The 10.00 is included in a deferral account and incorporated into rates in the following year.

Scenario 10: Gaz Métro shows an Excess in the rate application and achieves Over-earnings that are higher than the Excess. The full excess of 10.00 is incorporated into rates and Gaz Métro has a debt of 10.00 due to customers, to be offset by future gains. If the debt has not been offset, 50% is to be reimbursed. In the year end review report, the Over-earnings of 20.00 are used, first, to offset the debt in the rate application (1.50 – LL customers; 8.50 – SML customers). The balance of 10.00 is shared 75% by customers and 25% by Gaz Métro. Of the customers’ share of 7.50, 4.41 (1.13 LL customers and 3.28 SML customers) is included in a deferred charge account and incorporated into rates for the following year. 3.09 (including a fixed contribution of 1.50) is paid into the EEF.

Scenario 11: Gaz Métro shows Productivity Gains that are partially used to offset a debt accumulated in the rate application and achieves Over-earnings. Productivity Gains of 4.00 are first used to reduce Gaz Métro’s debt with respect to prior excesses. The 4.00, incorporated into rates for the year, is at the full benefit of customers with no sharing with the Fund because excesses are fully absorbed by customers. The fixed contribution of 1.50 is still paid into the EEF. Accordingly, in the rate application, there remains a debt of 1.00. The Over-earnings of 5.00 are then used to wipe out the debt of 1.00 (fully remitted to customers) and the remainder of 4.00 is shared 75% by customers and 25% by Gaz Métro. Of the customers’ share of 4.00, 3.40 (0.60 LL customers and 2.80 SML customers) is included in a deferred charge account and incorporated into rates for the following year. 0.60 is paid into the EEF.

Note: The scenarios assume that LL customers represent 15% of transmission, load balancing and distribution revenues. This will vary depending on actual results. Each scenario stands on its own.
## APPENDIX 2

### Simulation of Return of Productivity Gains

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<th>Line no.</th>
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<td>4</td>
<td>Productivity Gains</td>
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<td>5</td>
<td>Additional Productivity Gains</td>
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<tr>
<td>7</td>
<td>Breakdown in tariffs</td>
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<td>SML customers</td>
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<td>Total</td>
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<td>Annual impact on tariffs (reductions)</td>
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<td>16</td>
<td>Total</td>
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<td>17</td>
<td>Annual impact on tariffs (reductions)</td>
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<td>18</td>
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<tr>
<td>19</td>
<td>LL customers</td>
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### Assumptions for 2008 and subsequent rate years:

- Productivity Gains (000 $): 16,000
- Percentage SML customers: 85.00%
### Simulation of Return of Productivity Gains

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<tr>
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## APPENDIX 3

### Calculation Scenarios of Energy Efficiency Exogenous Factor

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<th>Line no.</th>
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<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
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<td>-1</td>
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<td>0.5</td>
<td>1</td>
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<td>0</td>
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<td>2</td>
<td>%</td>
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<td>1.86</td>
<td>5.86</td>
<td>10.86</td>
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<tr>
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<td>Remaining volume variation</td>
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<td>-0.41</td>
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<td>Exogenous Factor *</td>
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<td>3.73</td>
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<td>-0.77</td>
<td>-1.22</td>
<td>-1.67</td>
<td>-5.27</td>
<td>-9.77</td>
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</tbody>
</table>

* In practice, the Exogenous Factor will have to be converted into lost revenues or gains ($) based on tariff brackets.
APPENDIX 4

**Code of Ethics of Members of Gaz Métro Limited Partnership’s (SCGM) Energy Efficiency Fund (EEF) Management Committee**

**Section 1 – Objective and Application**

This Code of Ethics sets down the standards of ethics and discipline for the members of the management committee of the Energy Efficiency Fund (EEF) of SCGM and specifies the measures applicable to them in order to preserve and reinforce public confidence in the integrity and impartiality of those members as well as to maintain a high level of quality in the services rendered. If there is any doubt, members of the management committee shall act in accordance with the standards of ethics and discipline applicable to them.

**Section 2 – Impartiality**

Members of the management committee shall be impartial in the positions they take and the decisions they make based on the EEF’s mission. They may not act in the interest, if any, of an intervenor that appointed them to the management committee, and shall always keep in mind that the EEF is financed from contributions by the customers of Gaz Métro. In making decisions, members of the management committee shall act prudently and diligently, it being understood they are managing funds entrusted to them by the customers of SCGM.

**Section 3 – Professionalism**

Members of the management committee shall act in a professional manner and familiarize themselves with files so they can make informed decisions. In discharging their responsibilities, they shall provide the appropriate support to the other members of the committee, with mutual respect for the specific competencies of each member.

**Section 4 – Collegiality**

Members of the management committee shall attend and actively participate in its meetings. They shall endeavour to ensure management committee decisions are coherent. They shall comply with all of the rules authorized by the Régie de l’énergie with respect to the functioning of the management committee and the rules adopted or accepted by the management committee itself.

**Section 5 – Representation**

Members of the management committee shall conduct themselves in a loyal dignified reserved manner and get the prior approval of the Chairman of the management committee to officially represent the EEF.
Section 6 – Confidentiality

Members of the management committee shall not use for their own benefit or for the benefit of a third party privileged information obtained in connection with their mandate. When they become a member of the management committee, they shall sign a confidentiality agreement adopted or accepted by the management committee.

Section 7 – Conflict of Interest

Members of the management committee shall avoid placing themselves in any conflict of interest situation. If they believe they are in such a situation, they shall inform the management committee of this fact as soon as possible and abstain from voting on any matter related to that conflict of interest.

Section 8 – Benefits

Members of the management committee shall not accept any compensation, benefit, rebate or commission relating to the exercise of their functions, unless it has been expressly authorised by the Régie de l’énergie, or if its authorisation is not necessary, expressly authorised by the management committee. Similarly, they shall not pay, offer to pay or agree to pay any such compensation, benefit, rebate or commission to a third party with which it has significant direct relations.

Members of the management committee may not accept any gift, token of hospitality or other benefit other than those that have a modest use and value. Any other gift, token of hospitality or benefit received must be returned to the donor. Similarly, they may not combine the property of the EEF with their own property or use such property or information they became aware of in the course of exercising their functions for the benefit of a third party.

Section 9 – Cessation of Functions

When members of the management committee cease to exercise their functions, they shall act in a manner so as not to derive any undue benefit as a result of their former functions with the EEF.

When members of the management committee cease to exercise their functions with the EEF, they shall not disclose confidential information unless permitted to do so by the confidentiality agreement they signed. In addition, they may not give advice to anyone whosoever based on information that is not available to the public concerning the EEF or to a third party with which they had significant direct relations during the year preceding the cessation of their functions.

Section 10 – Whistleblowing

Members shall inform the management committee if they become aware a former member is in violation, in respect of a procedure, negotiation or specific transaction, Section 9 of this Code, or if they become aware a former employee or contract worker of SCGM assigned to the EEF is in violation of a similar obligation under the terms of their contract.