

Appendix B

MANITOBA HYDRO'S REQUESTED AUGUST 2017 INTERIM RATE INCREASE

1. BACKGROUND

- On May 5, 2017 Manitoba Hydro filed an Application with the PUB seeking confirmation of the 3.36% rate increase previously approved on an interim basis in Orders 59/16 and 68/16, approval of a 7.9% across-the-board interim rate increase to be effective August 1, 2017 and an additional 7.9% across-the-board rate increase proposed for April 1, 2018.
- The alleged reasons for the Application are¹:
 - Manitoba Hydro's current and projected financial situation, absent the proposed rate increases, represents an untenable risk to both the financial sustainability of the corporation and the overall economic health of the Province of Manitoba.
 - Previous financial plans did not adequately prepare Manitoba Hydro to absorb the significant increase in operating and borrowing costs that result from the completion of major capital projects currently underway while still ensuring the continued financial strength of the corporation.
 - Since the last GRA, the financial outlook of Manitoba Hydro has deteriorated significantly driven by a reduced outlook for domestic load growth, continued delay in the recovery of opportunity export prices and substantially increased carrying costs associated with increased capital costs associated with several major projects.
 - The Bipole III Reliability and Keeyask Generating Station projects are too far advanced to halt or delay: completing the projects has the least negative consequences for domestic ratepayers.
 - Prolonged above average water flows and declining interest rates have helped mitigate some of Manitoba Hydro's financial deterioration but such conditions cannot be assumed to repeat as the Corporation continues through

¹Tab 2 of Manitoba Hydro General Rate Application, pages 2-3.

a period of high vulnerability with debt set to increase a further \$7 billion by 2021.

- Inclusive of cash interest on reliability and sustainability capital projects, Manitoba Hydro has been and, without substantial rate increases, will continue to be significantly cash flow negative on its core operations, which is unsustainable.
- In order to manage the significant risks it faces, Manitoba Hydro must be permitted rate increases that, when coupled with significant cost enhancement measures, allow it a prospective level of income and cash flow that would begin restoring its financial strength while also being capable of enduring drought or material negative deviations from forecast (export prices, interest rates) without requiring emergency relief from ratepayers.
- Establishing the time frame for the achievement of its minimum equity target at 10 years strikes an appropriate balance between what is reasonable for customers and what is necessary to ensure the long-term financial health of Manitoba Hydro.

2. REQUEST FOR INTERIM AUGUST 1, 2017 7.9% INCREASE

- Manitoba Hydro states that “interim orders properly allow regulators flexibility to make awards that are necessary in circumstances where a utility will suffer financial consequences from having to wait for a full public hearing process to conclude”.
- Occasions that could give rise to such financial consequences include:
 - i. Delays on the regulator's part that mean the application cannot/will not be processed in the standard/expected course of time. The principle here being that the utility should not be penalized for delays that are due to actions of the regulator. However, it is noted that this particular circumstance does not apply to MH's current Application.
 - ii. Significant changes in the utility's actual financial position such that immediate financial relief is needed in the near term (i.e., prior to when the rate application process can expect to be concluded).

- iii. Legitimate delays in the filing of a rate application coupled with forecast of financial consequences that are unacceptable should a rate change (increase) not be granted until the completion normal regulatory process. In its cover letter, Manitoba Hydro notes that Order 59/16 (regarding Interim Rate Application for April 2016) directed that it file its next general rate application no later than December 2016. However, Manitoba Hydro notes that a number of unique circumstance have arisen since then that: a) delayed the filing of Application and b) suggest that the Application's review may take more time than experienced in the past. These events include:
- The appointment of new Board of Directors for the Corporation in May 2016 shortly after Order 59/16 was issued.
 - An independent review of the Keeyask and BP III projects.
 - OIC 92/17 which has tasked the PUB with examining Manitoba Hydro's capital expenditures as part of its rate review.
- In the cover letter² to its May 5th Application Manitoba Hydro outlined the rationale for its request for an interim rate increase effective August 1, 2017.
 - The rationale appears to be based on the following:
 - The financial outlook of the Corporation has declined since the last GRA³. Section 3 and 4 (below) examine whether this particular circumstance applies to Manitoba Hydro, either in terms of its 2015/16 actual financial results or the current outlook for 2016/17.
 - Without interim rate relief it will be foregoing a revenue increase in 2017/18, placing considerable negative pressure on income, cash flow and financial metrics⁴. Section 5 (below) looks at the consequences for 2017/18 of no rate increase during that fiscal year.
 - This will lead to even greater rate increases in the next and subsequent years which is neither in the best interest of ratepayers nor is it supportive of the

²May 5th Letter, pages 2-3.

³Tab 2 of Manitoba Hydro General Rate Application, page 3.

⁴May 5th Letter, page 3.

financial health of Manitoba Hydro. Section 6 looks at the longer term implications in terms of both MH's financial health and customers' rates.

A. SHOULD THE INTERIM RATE INCREASE BE CONSIDERED

3. ACTUAL RESULTS FOR 2014/15 AND 2015/16

- MH claims that its financial outlook has deteriorated since the last GRA. The last GRA was based on IFF14 which provided forecasts for the years 2014/15 and beyond. The following sections compare the actual results for 2014/15 and 2015/16 with the financial targets and also with the forecasts used for the last GRA (IFF14) and the Application for August 1, 2106 Interim Rates (IFF15).

3.1 ACTUAL VS. TARGET

- The following graphics provide the overall Corporate history of financial ratios vs. targets.

Figure 4.1 Equity Ratio Actuals

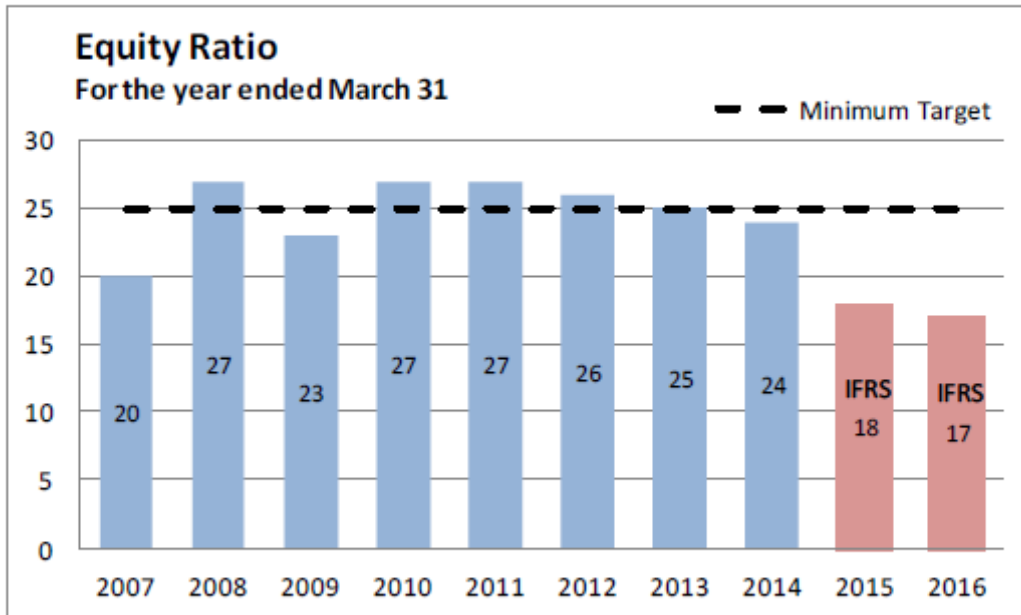


Figure 4.2 Interest Coverage Ratio Actuals

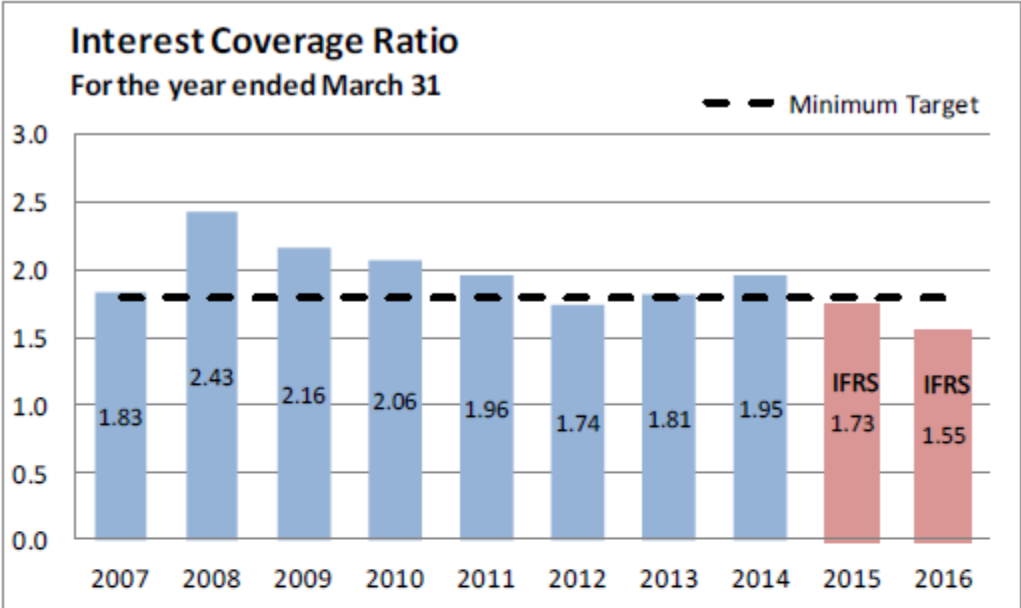
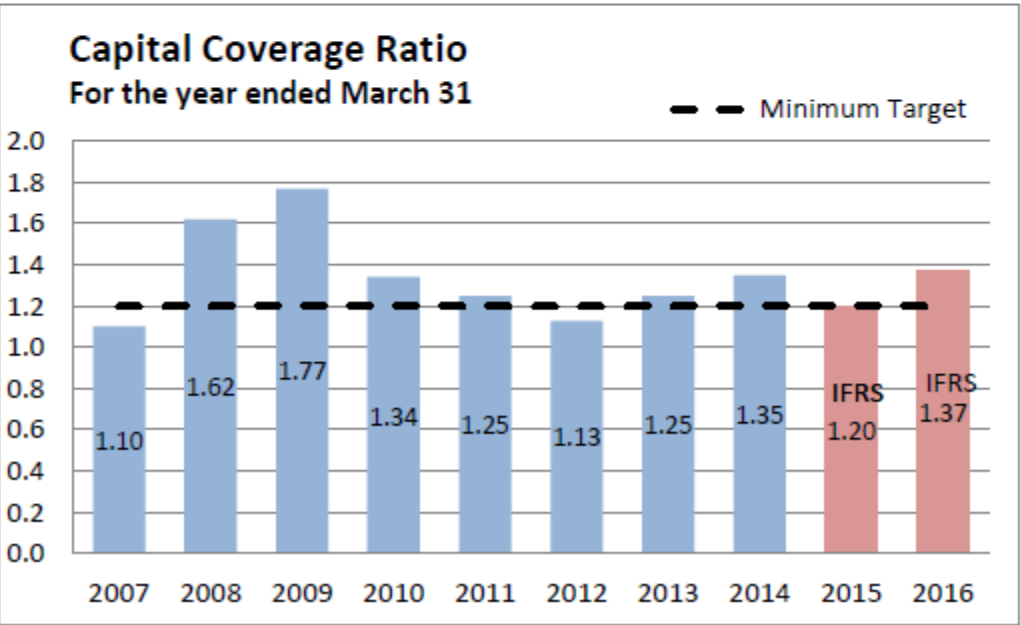


Figure 4.3 Capital Coverage Ratio Actuals



- There has been some decline in the actual interest coverage and more so in the equity ratio since the last GRA. However in both the NFAT and subsequent IFFs, it

was recognized and accepted that the Equity ratio would be below “target” for a number of years.(see Section 7 below). As result, it should be no surprise (and indeed part of the “plan”) that financial results have deteriorated somewhat.

Therefore, it is more critical to examine whether the actual results have varied from expectations as the time of the last GRA. Set out below is a discussion of how the actual results for 2015/16 align with recent (post NFAT) forecasts.

3.2 ACTUAL 2014/15 RESULTS VS. IFF14 (BASIS FOR LAST GRA)

- The following schedule compares the forecast for Manitoba Hydro’s Electric Operations for 2014/15 (the first year of IFF14) with the actual results for that year as provided in MH’s Application⁵ for Interim Rates Effective August 1, 2016. The schedule shows that actual net income is slightly less than forecast after the non-controlling interest impacts have been removed – consistent with the presentation in the IFF. The \$14 M increase in net loss over forecast is the result of the implementation of the Wuskwatim PDA Supplement #2, specifically the revised power purchase agreement between Manitoba Hydro and WPLP⁶. However, MH’s actual financial statements (which include the non-controlling interest impacts) show a higher net income than forecast.
- The actual electric operations equity ratio of 2014/15 is 21% as compared to a ratio of 22% as forecast in IFF14⁷ - exhibiting only a slight decline.

⁵Page 17.

⁶Interim Application, page 18.

⁷Actual – 2016 Interim Application, Attachment 30. Forecast – 2017 &17 GRA, Attachment 11.12.

Figure 11. 2014/15 Actual Financial Results from Electric Operations

MANITOBA HYDRO
STATEMENT OF INCOME
For the Year Ended March 31, 2015
(In Millions of Dollars)

	<u>ACTUAL</u>	<u>FORECAST</u>	<u>FAVOURABLE/ (UNFAVOURABLE) VARIANCE</u>
Revenues			
General consumers	\$1,424	\$1,407	\$18
Extraprovincial	400	409	(9)
Other	18	15	3
	<u>1,843</u>	<u>1,831</u>	<u>12</u>
Expenses			
Operating and administrative	480	486	5
Finance expense	495	495	-
Depreciation and amortization	403	405	1
Water rentals and assessments	125	124	-
Fuel and power purchased	146	134	(12)
Capital and other taxes	100	99	(1)
Other Expenses	2	2	-
Corporate allocations	9	9	-
	<u>1,760</u>	<u>1,754</u>	<u>(5)</u>
Net income before non-controlling interest	83	77	7
Net loss attributable to non-controlling interest	11	25	(14)
Net Income	<u>\$95</u>	<u>\$102</u>	<u>(\$7)</u>

* Please note, Manitoba Hydro's financial results for the 2014/15 year are presented under Canadian Generally Accepted Accounting Principles.

3.3 ACTUAL 2015/16 RESULTS VS. IFF14 and IFF15 (BASIS FOR AUGUST 2016 RATES)

2015/16 Actual vs. IFF14

- IFF14 forecast a net income from electric operations for 2015/16 (after removing the impact of the non-controlling interest loss of \$12 M) of \$115 M. This compares to an actual result of \$37 M. The net income values (per the financial statements are \$104 for IFF14 and \$27 for the actual results). In this comparison the actual results show a deterioration from forecast.

2015/16 Actual vs. IFF15

- The following schedule compares the IFF15 forecast for 2015/16 (which was the basis for the August 2016 Interim Increase) with the actual results for MH's electric operations⁸. In this instance, the actual results show an improvement over the income forecast for 2015/16 at the time of the Interim Rate Application for August 1, 2016.

Figure 6.33 2015/16 Actual Financial Results from Electric Operations

MANITOBA HYDRO			
STATEMENT OF INCOME			
For the year Ended March 31, 2016			
(In millions of Canadian dollars)			
	Actual	Forecast	Favourable / (Unfavourable) Variance
Revenues			
General consumers	\$ 1 399	\$ 1 463	\$ (64)
Extraprovincial	415	395	20
Other	31	29	2
	<u>1 845</u>	<u>1 887</u>	<u>(42)</u>
Expenses			
Finance expense	582	587	5
Operating and administrative	543	542	(1)
Depreciation and amortization	367	367	-
Water rentals and assessments	126	125	(1)
Fuel and power purchased	117	121	4
Capital and other taxes	107	107	-
Other expenses	65	70	5
Finance income	(22)	(21)	1
Corporate allocation	8	8	-
Total expenses	<u>1 893</u>	<u>1 906</u>	<u>13</u>
Net income (loss) before net movement in regulatory balances	<u>(48)</u>	<u>(19)</u>	<u>(29)</u>
Net movement in regulatory balances	<u>75</u>	<u>24</u>	<u>51</u>
Net Income	<u>27</u>	<u>5</u>	<u>22</u>
Net income (loss) attributable to:			
Manitoba Hydro	37	15	22
Non-controlling interests	(10)	(10)	-
	<u>27</u>	<u>5</u>	<u>22</u>

⁸Tab 6, page 46.

3.4 OVERALL – Actual vs. Forecast

Actual vs. Past Forecasts

- The following table compares the actual results for 2015/16 with those forecast in IFF14 and IFF15 for the electric operations.

Results for	IFF14	IFF15	Actual
For 2015/16			
Net Income			
Equity Ratio	19% (Corp.) 18% (Electr.)	16% (Corp.) 15% (Electr.)	17% (Corp.) Electric - ?
Capital Coverage	1.02	0.98	1.37 (Corp.) Electric - ?
Interest Coverage (EBITDA)	?	1.57	1.55 (Corp.) Electric - ?
Sources	2016&17 GRA- App 3.3 & 11.12	2016 Interim Appl.- Attachment 1	GRA, Tab 4, p. 2

- The actual results for 2015/16 are in line with those forecast at the time of the 2016 Interim Rate Approval (IFF15). There is no evidence of any material deterioration.

4 CURRENT OUTLOOK FOR 2016/17 VS. IFF15 and IFF14

- The following table sets out the results for 2016/17 as forecast in IFF14, IFF15 and IFF16.

Financial Forecast For 2016/17	IFF14	IFF15	IFF16
Net Income	\$59 M	\$29 M	\$34 M
Equity Ratio	16%	14%	15%
Capital Coverage	0.94	0.98	1.08
Interest Coverage (EBITDA)	?	1.52	1.50
Sources	16-17 GRA- App 3.3 & 11.12	2016 Interim Appl.- Attachment 1	GRA, Appendix 3.1

- The most recent outlook for 2016/17 is not out of line with that in IFF14 and IFF15 – suggesting there is no real deterioration in expected financial position up to this point time from that anticipated in early proceedings.

5 CURRENT OUTLOOK FOR 2017/18 vs. IFF14 and IFF15

- The following table sets out the results for 2017/18 as forecast in IFF14, IFF15 and IFF16.

Financial Forecast For 2017/18	IFF14	IFF15	IFF16	IFF-16-3.95% Increase	IFF16 – No Increase
Net Income	\$64 M	\$63 M	\$111 M	\$70 M	\$29 M (per Fig. 2.16)
Equity Ratio	15%	14%	15%	14%	~14% (per Fig. 2.22)
Interest Coverage (EBITDA)	?	1.52	1.57	1.53	?
Capital Coverage	1.09	1.21	1.31	1.23	?
Sources:	16-17 GRA- App 3.3 & 11.12	2016 Interim Appl.- Attachment 1	GRA - App. 3.1	GRA – App. 3.4	GRA - Tab 2

- Manitoba Hydro has not provided a detailed forecasts as to what the outlook for 2017/18 would be if there was no rate increase granted during the year. However, the information that has been provided indicates that:
 - Rate increases of less than the requested 7.9% would produce financial results in line with past forecasts
 - Even with no rate increase, net income is expected to be positive and the equity ratio close to previous forecasts.

6 CURRENT OUTLOOK THROUGH TO 2019 - IFF16 VS. IFF15 AND IFF14 (BASIS FOR LAST GRA)

- The following table sets out the cumulative Net Income forecast over 2016/17-2018/19 for each of the three IFFs as well as two modified IFF16s plus the financial ratios as of the end of 2018/19 for each case.

2016/17 - 2018/19 Financial Forecast & Associated Annual Rate Increases	IFF14 (3.95% / annum)	IFF15 (3.95% / annum)	IFF16 (3.36% in 2016/17 then 7.9%/annum)	IFF16–Alt. A 3.36% in 2016/17, 3.95% in Aug/17 and to 2018/19	IFF16-Alt B 3.36% in 2016/17, 0% in 2017/18 and 7.9% after
Cumulative Net Income (excl. Non-Controlling Interest)	\$34 M	\$51 M	\$387 M	\$216 M	?
2018/19 D/E Ratio (Electric Operations)	14%	13%	14%	14%	?
2018/19 Interest Coverage (EBITDA)	?	1.46	1.76	1.63	?
2018/19 Capital Coverage	0.88	1.05	1.49	1.23	?
Source	Last GRA, Appendix 3.3	Tab 3, page 8	Appendix 3.3	Appendix 3.4	

- Manitoba Hydro has not provided detailed results as to what would be the longer term outlook assuming no rate increase for 2017/18 – but rate increases similar to those in IFF16 in the years thereafter. The financial health is likely to deteriorate but

there is no indication as to by how much (i.e. – would it be “considerable” as claimed by MH⁹).

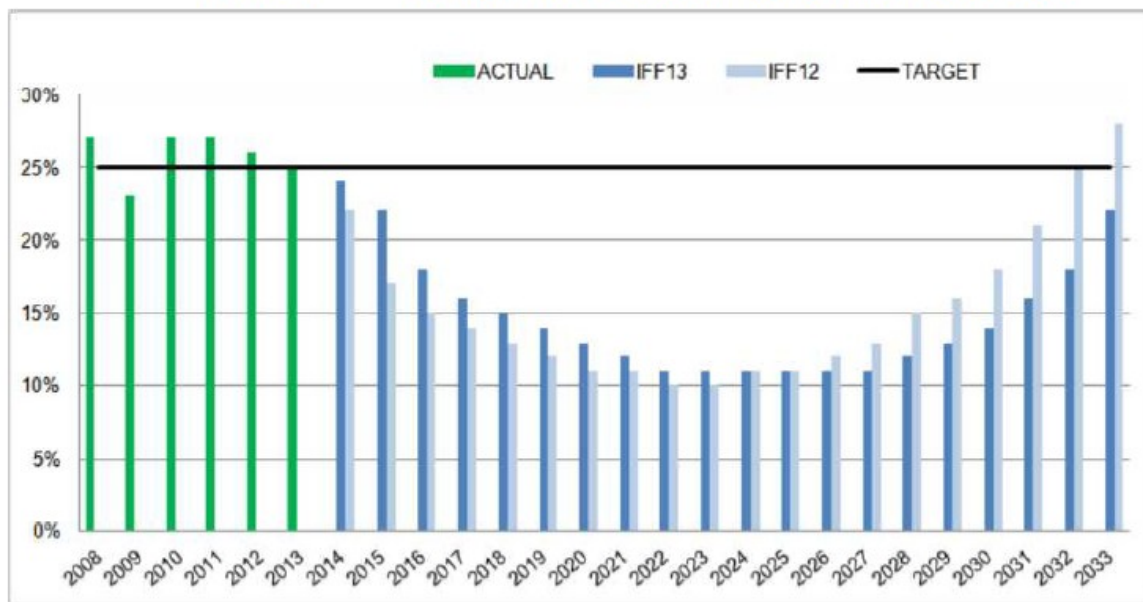
- The information provided (Appendix 3.4) does indicate that lower rate increases (i.e. similar to those in IFF15) would produce financial results similar to those forecast at the time of last GRA (IFF14).

7 WHAT HAS REALLY CHANGED?

7.1 OUTLOOK FROM NFAT - MH'S PREFERRED PLAN

- The following chart from the PUB's NFAT Decision (page 165) sets out the D/E ratio arising from MH's preferred plan.

Figure 19 Manitoba Hydro's Debt-to-Equity Ratio, 2008 to 2033



- At the time of the NFAT MH was promoting a development plan that did not return it to the target 25% equity ratio until sometime in the 2030's and that saw the ratio fall to just above 10%.

7.2 PUB NFAT DECISION AND LAST GRA

- In its NFAT Decision the Board made the following conclusion (page 191):

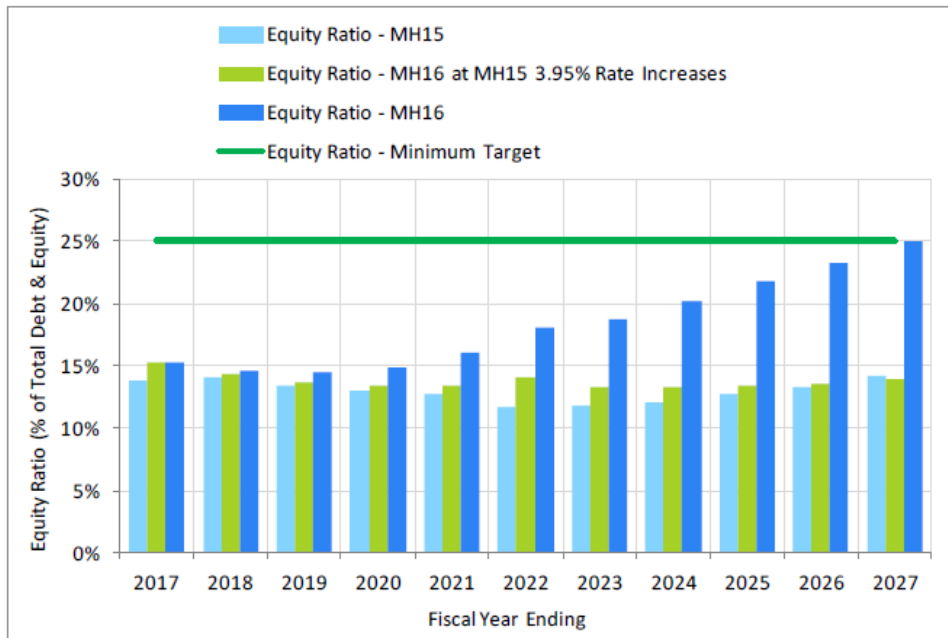
Manitoba Hydro can contribute to the impact of rate increases in two ways. It can relax its 75/25 debt-to-equity ratio policy to moderate its proposed electricity rate increases. Manitoba Hydro should also mitigate rate increases by seeking to reduce its own expenditures through operational savings.

- In its Decision¹⁰ following the last GRA, the PUB noted that MH was not going to fully achieve its financial targets over the next ten years.

7.3 CURRENT LONG TERM OUTLOOK and ACHIEVEMENT OF FINANCIAL TARGETS

- The following table compares the longer term outlook for the D/E ratio based on different IFFs and also using IFF16 – but with the IFF15 rate increases.

Figure 3.1 Comparison of Equity Ratios



- The following Table extends the results out to 2034 and includes the associated rate increase for each IFF. Note – IFF16 modified is based on the same rate increases as in IFF15 (i.e., 3.95% through to 2029).

ELECTRIC OPERATIONS	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
IFF-14																				
Equity Ratio	22%	18%	16%	15%	14%	13%	12%	11%	10%	10%	10%	10%	10%	11%	12%	14%	16%	19%	22%	25%
Ann Rate Incr	n/a	n/a	n/a	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	2.00%	2.00%	2.00%
Cumul Rate Incr	n/a	n/a	n/a	3.95%	8.06%	12.32%	16.76%	21.37%	26.17%	31.15%	36.33%	41.72%	47.31%	53.13%	59.18%	65.47%	72.01%	75.45%	78.95%	82.53%
IFF-15																				
Equity Ratio		15%	14%	14%	13%	13%	13%	12%	12%	12%	13%	13%	14%	16%	17%	20%	22%	25%	28%	31%
Ann Rate Incr		n/a	n/a	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	2%	2%	2%	2%	2%
Cumul Rate Incr		n/a	n/a	3.95%	8.06%	12.32%	16.76%	21.37%	26.17%	31.15%	36.33%	41.72%	47.31%	53.13%	59.18%	62.37%	65.61%	68.93%	72.30%	75.75%
IFF-16																				
Equity Ratio			15%	15%	14%	15%	16%	18%	19%	20%	22%	23%	25%	27%	29%	32%	34%	38%	41%	45%
Ann Rate Incr			n/a	7.9%	7.9%	7.9%	7.9%	7.9%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Cumul Rate Incr			n/a	7.90%	16.42%	25.62%	35.55%	46.25%	49.18%	52.16%	55.21%	58.31%	61.48%	64.71%	68.00%	71.36%	74.79%	78.28%	81.85%	85.49%
IFF-16 (modified)																				
Equity Ratio			15%	14%	14%	13%	13%	14%	13%	13%	13%	14%	14%	15%	16%	17%	18%	20%	22%	25%
Ann Rate Incr			n/a	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	3.95%	2.00%	2.00%	2.00%	2.00%	2.00%
Cumul Rate Incr			n/a	3.95%	8.06%	12.32%	16.76%	21.37%	26.17%	31.15%	36.33%	41.72%	47.31%	53.13%	59.18%	62.37%	65.61%	68.93%	72.30%	75.75%
*Rate Incr per IFF 15																				

- The key take away is that the modified IFF16 returns MH to 25% equity ratio by 2034 – the same timing as in the NFAT proposal and the last GRA (IFF14).
- Indeed comparing IFF14 (last GRA) and IFF16-modified (i.e. 3.95% rate increases) – they both return to 25% equity in the same year, the Equity ratio does not decline in IFF16-modified as much now as it did in IFF14 and the 3.95% increases are not required for as many years as in IFF14. Based on this it is hard to see how MH can claim that the financial position outlook has declined since the last GRA.
- If there was no rate increase in 2017/18, achieving the 25% equity ratio by 2034 would require either higher rate increase in the subsequent year or a longer period of time with 3.95% increase as opposed to 2% increases. It would also lead to lower equity ratios in the short term.
- However, what has really changed since the NFAT and the last rate proceedings is MH’s view as to how low the Equity ratio should be allowed to go and how quickly the 25% equity target should be achieved. On both fronts the current MH view is much more conservative than what was expressed in the NFAT Application by MH or considered by the PUB during either the NFAT proceeding/decision or the last GRA.
- It is now MH’s view that the previous financial plans were inadequate in that the timeframe under which the Corporation reached financial health was unacceptable – leaving the Corporation at too high of a risk for too long. In particular, the view now is that a path back of 25% equity of longer than 10 years is too risky¹¹. MH’s view is now that “establishing a time frame for the achievement of its minimum equity target at 10 years strikes an appropriate balance between what is reasonable for customers and what is necessary in order to ensure the long-term financial health of Manitoba Hydro”¹².
- It is this view that has given rise to the request for 7.9% rate increases for both 2017/18 and 2018/19 and the production of IFF16 which shows “planned” rate increases of 7.9% for the following two years as well.

¹¹Tab 4, page 7.

¹²Tab 2, page 3.

- Manitoba Hydro's rationale for an interim increase is that without one, MH's financial position will deteriorate further and higher (than 7.9%) increases will be needed in the subsequent years to restore the Equity ratio target by 2027¹³ which would not be in the interests of its customers.
- However, while noting that no rate increase will lead to higher rate increases in future years, MH has provided no information as to what such rate increase would be in order to return MH's financial health in 10 years. This is important because while higher rate increase in the future are not in the interest of rate payers neither is perpetuating the habit of (addiction to) interim rate approvals. This is the trade-off the Board must make and it requires more information to do so.

8. OBSERVATIONS

- What is the appropriate target equity ratio, how long should MH delay achieving it and how low should be the equity ratio are key issues for the upcoming GRA. However, they deal more with questions regarding MH's longer term financial performance and are not issues to be resolved as part of a process for determining if an interim increase is required and how much.
- The primary rationale for an interim rate increase should be based on the question of whether there is a financial urgency which would suggest rate increase is needed "now" as opposed to when the GRA is concluded.
- Based on the foregoing, financial results to 2015/16 and current forecasts through 2016/17 do not show a material deterioration in financial ratios from earlier forecasts that would support the need for an "urgent" rate increase.
- Similarly the current outlook for 2017/18 based on even a zero rate increase does not support the need for an urgent rate increase.
- Indeed, Manitoba Hydro's rationale is not really based on immediate financial urgency but rather the fact that higher increases will be needed in the future (in order to restore MH's financial health) if no interim rate increase is granted. Furthermore, the 10 year time frame MH has established for restoring the Corporation's financial

13May 5th Letter, page 3.

health means not only the rate increases originally proposed were significant (i.e., almost 4x the rate of inflation for the next four years) but that such rate increases would need to be even higher or more prolonged if the interim rate increase was not granted.

- The Board may want to also consider the longer term implications of not granting a interim increase but, if it chooses to do so, it must recognize that MH's argument for a faster return to financial health has not been tested. Furthermore, as noted earlier, the issues of what should be MH's financial targets, how soon they should be achieved and to what level should the equity ratio be permitted to decline are: i) longer term questions and ii) questions that are central to the upcoming full GRA proceeding – not questions to be resolve in an interim rate application.
- Also, Manitoba Hydro's rationale flies in direct conflict with the implicit covenant the MH made with the Board and ratepayers during NFAT – namely that the investments could be managed without material rate increases in the short-term by relaxing the Equity ratio requirements for period of time extent into the 2030's. This Application has already seen MH fundamentally changing its estimate as to the capital cost of Keeyask and BP III from that put forward in NFAT – to the detriment of rate payers. The Corporation is now compounding the impacts of this “error” by insisting that financial health be restored over a considerably shorter period of time.

B. PROCESS

- In the event that PUB decides there “may be” an urgent need that requires consideration, it should be considered within the framework of MH’s current financial targets and expectations as established in recent GRAs and the NFAT proceeding. It should not be driven by yet untested claim regarding changed requirements regarding longer term financial performance and, to test such claims at this stage, would expand the scope of interim process to include core issues related to the overall GRA.
- Furthermore, as noted during the preceding discussion, there are currently significant information gaps regarding the deterioration in MH’s financial health and also regarding the implication of no (or a lower) rate increase in 2017/18.
- As a result, process should involve at least one round of IRs (focusing on the current need and, to a lesser degree, the near term implications of no rate increase or a lower than 7.9% increase in 2017/18 in terms of implication for future rate increases) followed by written submissions.