An Imprudent Imbalance: Rate Shock, Bias and Inter-generational Inequity in the Hydro Rate Application

Presented by the Public Interest Law Centre on behalf of Winnipeg Harvest and CAC Manitoba

December 4, 2017

The Consumers Coalition Members

Winnipeg Harvest

- Since 1984, a non-profit, community based organization committed to providing food to people who struggle to feed themselves and their families.
- Shares food with more than 50 Manitoba communities through the Manitoba Association of Food Banks
- Works in partnerships with more than 400 agencies to provide emergency food assistance to almost 62,000 people a month including approximately 27,000 children.
- Seeks to maximize public awareness of hunger while working towards long-term solutions to hunger and poverty.
- Advocated for affordable access to financial services, transit, telecommunications, energy efficiency programming and heating and lighting.

WINNIPEG HARVEST INC.

Fighting Hunger and Feeding Hope

The Consumers Coalition Members (cont.)

CAC Manitoba

- Since 1947, volunteer, non-profit, independent organization working to inform and empower consumers and to represent the consumer interest in Manitoba.
- Over the past 25 years, rate regulation matters relating to Manitoba Hydro, Centra Gas, MPI, MTS, payday lending and the maximum cost of cashing government cheques.
- Every Hydro GRA, Cost of Services and Diesel Proceeding, 2014 NFAT (Manitoba PUB) and the Wuskwatim NFAT (joint panel).
- Environmental proceedings relating to Bipole III, Keeyask, LWR (CEC) and MMTP.

Statutory Context

Manitoba Hydro Act

- s. 2: [purpose]
- s. 39(1)(a): The prices payable for power supplied by the corporation shall be such as to return to it in full the cost to the corporation, of supplying the power, including
  - (a) the necessary operating expenses of the corporation [...]
- s. 40(1): [reserves]

Statutory Context (cont.)

The Crown Corporations Governance and Accountability Act

- s. 25(1): [PUB approval for changes to rates for service]
- s. 25(4) (a) in reaching a decision, the PUB may take into consideration: [...]
  - (iv) reserves for replacement, renewal and obsolescence of works of the corporation,
  - (v) any other reserves that are necessary for the maintenance, operation, and replacement of works of the corporation, [...]
  - (viii) any compelling policy considerations that the board considers relevant to the matter, and
  - (ix) any other factors that the Board considers relevant to the matter; and

Statutory Context (cont.)

Public Utilities Board Act

- s. 77 (a): [fix just and reasonable rates]
- s. 84(2): The burden of proof to show that any such increases, changes, or alterations are just and reasonable is upon the owner seeking to make the increases, changes, or alterations.

Regulatory Approach

- Ensuring that forecasts are reasonably reliable;
- Ensuring that actual and projected costs incurred are necessary and prudent;
- Assessing the reasonable revenue needs of an applicant in the context of its overall general health
- Determining an appropriate allocation of costs between classes; and
- Setting just and reasonable rates in accordance with statutory objectives.

(Board Order 5/12 issued January 17, 2012 relative to Manitoba Hydro, see also Board Order 98/14 relative to Manitoba Public Insurance)

The word “necessary” matters

“any other reserves that are necessary”

CCGAA, 25(4)(a)(v)

Manitoba Hydro has the onus of proving necessity

Is Manitoba Hydro listening?

Over 2,300 consumers have written to the PUB regarding the rate increases proposed by Manitoba Hydro

Voices of consumers

- My wife and I are senior citizens and live in rural Manitoba so have no choice but MB Hydro for heat. An increase of $25-30 per month will either take food from our table or clothes from our back. Our pensions go up by 1-1.5% and costs go up by 3 to 8%. Where is the extra money going to come from? [...] 7.9 % twice in a year is just too much. [emphasis added]
  - Consumer #255, May 16, 2017
- As a new home owner, I can hardly make ends meet with bills as it is. I use as much energy efficient options as possible. To raise this by more that 14% in less than a year is absolutely absurd. Please consider the families that will be negatively affected by this change. If it must proceed, please just increase the amount minimally by a few percents each year. The cost of taxes are rising, the costs of everything is on the rise. How can one sustain itself in this economy. Like I am sure everyone is, I am greatly against this change. In my prayers it will not go ahead as planned. [emphasis added]
  - Consumer #1273, May 24, 2017

Voices of consumers (cont.)

- [...] I am on a fixed income on electric heat in rural Manitoba. How the heck do I afford to pay these proposed hikes over years...and it likely won't stop there? The answer is I can't. I can stop eating a meal or two a day I suppose, but we have no way to pay these increases [...] We, the citizens did NOT create this mess and should NOT have to shoulder the burden. [emphasis added]
  - Consumer #251, May 16, 2017
- I hope PUB does not approve the massive rate increases proposed by Manitoba Hydro over the next five years. It will drive Manitobans away and increase heavy industries operating costs that are major Hydro consumers to threaten their moves out of the province or closure. [...] [emphasis added]
  - Consumer #4, May 5, 2017
- [...] I understand that a large expense is going to have to be incurred to renew and update our present system. Maybe it's time to think about more alternate energy supply - ie solar/wind! [...]
  - Consumer #238, May 16, 2017

Where is the balance?

The Manitoba Court of Appeal has said:

> “The PUB has two concerns when dealing with a rate application; the interests of the utility's ratepayers, and the financial health of the utility. Together, and in the broadest interpretation, these interests represent the general public interest.” (*Consumers' Association of Canada (Manitoba) Inc v Manitoba Hydro Electric Board*, 2005 MBCA 55, at para 65)

Forecasting

Core Forecasting Issues

For rate setting purposes, can we reasonably rely on the Corporation's forecasts relating to:

- the export markets
- capital projects
- interest rates and the cost of debt
- Manitoba's population and economic growth
- domestic load
- water flows

On a current or forward looking basis, does Manitoba Hydro need to demonstrate an effort to address the implications of climate change on its water flow forecasts? What would be an appropriate mechanism for doing so?

Implications of findings of Bias and "So Wrong for So Long" on Corporation's Credibility

What implications for finding of credibility can be drawn from Hydro's history of being "so wrong for so long" on forecast issues such as export revenues and capital expenditures?

What are the implication's of Daymark's finding of current bias with regard to Hydro's assessment of the export revenue forecast?

Implications of Rate Shock level rate increases

Is there a risk that successive years of rate shock level increases will dampen demand more than expected in the price elasticity estimates of Manitoba Hydro thereby undermining another aspect of the proposed rate application?

Can we rely on the Corporation's current estimates of capital costs?

Are Manitoba Hydro's current estimates of capital costs for Keeyask, Bipole III and other new capital projects reasonably reliable for rate setting purposes?

For rate setting purposes should we be relying on Hydro's amended selection of contingencies at the P75 and P80 level for large capital projects or would it be more appropriate to rely on contingencies at the P50 level?

Is the 20 Year IFF Analytically Coherent?

What is the purpose of imposing rate shock to avoid rate shock?

In terms of evidence and analysis, is the 20 year IFF presented by Manitoba Hydro coherent or does the rapid "about face" in 2025/26 raise fundamental questions about the 75/25 in 2027 approach? (Tab 2, Pages 24-25; COALITION/MH I-71a-c; COALITION/MH II-6a-b; PUB/MH II-21b)

What are the implications of an analytically incoherent 20 year IFF for rate setting?

Prudent and Necessary Expenditures

Sustaining Capital: Where is Manitoba Hydro on the Road to Competency?

Has Manitoba Hydro rebutted or attempted to rebut the findings of METSCO, UMS and the observations of BCG that its sustaining capital expenditures on generation, transmission and distribution are not efficiently optimized?

What are the implications for the revenue requirement of the conclusions that sustaining capital expenditures are not optimized? Does this mean that we can spend less or that we must spend better?

Sustaining Capital: Where is Manitoba Hydro on the Road to Competency?

Without the Corporate Asset Management framework, what is guiding Manitoba Hydro's decision-making process and what are the implications?

Do Manitoba Hydro's costs estimates reflect the discipline that PUB and ratepayers should expect from a mature utility like Manitoba Hydro?

Given the lengthy delay in adopting modern processes, should the PUB establish a range of potential incentive mechanisms to ensure that the applicant progresses along its path of continuous improvement in asset management capabilities, while exercising increasing cost discipline?

Management of Large Capital Projects

Can Manitoba Hydro demonstrate that its management of large capital projects in terms of costs and risks has been prudent and reasonable?

How can the cost of large capital projects best be allocated to ratepayers over time to reflect inter-generational equity and Manitoba Hydro's status as a non-share capital corporation to be operated at cost?

Given the significant cost and schedule revisions that have occurred regarding Bipole III and Keeyask, has Manitoba Hydro implemented measures to ensure that further project changes and revisions will not occur for Bipole III and Keeyask and similar future projects?

Poor Performance Against Benchmarks as Alleged by BCG

Does Manitoba Hydro contest its poor performance against benchmarks as alleged by BCG in 2016?

To the degree the BCG analysis is reliable, what current opportunities for better value through better management does this represent?

900 Equivalent Full-Time (EFT) Positions Lay-offs

What are the implications, if any, of the corporate restructuring on important priorities such as the development of competent sustainable capital processes?

What are the implications of the 900 EFT lay-off on the corporation's financial results in the short and medium term?

Delayed Response to Savings Opportunities

Were there unreasonable delays in pursuing sustainable capital good management practice dating back to at least 2008? If so, what are the implications for rate setting?

Were there unreasonable delays in pursuing Rural Office Consolidation opportunities dating back to 2006? If so, what are the implications for rate setting?

Reliance on Interim Rates

What is the cost to ratepayers of the Corporation's failure to present timely rate applications and its reliance on interim rate applications?

Are there regulatory approaches that might create incentives for a more a timely approach to general rate applications?

External Consultants Retained by Manitoba Hydro

What conclusions regarding the validity of the export market forecasts and the expenditure on the forecasts can we draw from Hydro's failure to seek input assumptions for the purposes of better understanding the comparability of its forecasts?

Given the 4.5 million dollar expenditure on Boston Consulting Group (BCG) did Manitoba Hydro receive something other than power point slides? (Coalition/MH I-112a-b)

Did Manitoba Hydro prepare a critical analysis of the BCG report?

Overall Health of the Corporation

Balance

Did Manitoba Hydro's analysis in support of 75/25 in 2027 effectively ignore the opportunity costs for Manitoba consumers including residential customers, governments, businesses and industry?

At a time of capital intensive investments in long lived assets, does the 75/25 in 2027 plan place an undue burden on today's ratepayers and violate the principles of inter-generational equity?

Tools

In its single minded pursuit of 75/25 in 2027 has Manitoba Hydro neglected to consider other tools that might give confidence to the financial markets while better protecting the interests of ratepayers and the Crown monopoly?

Recognizing the value of financial markets confidence in Manitoba Hydro and the approaches of other non share capital firms operating at cost such as the Tennessee Valley Authority and Bonneville Power Authority what tools other than 75/25 in 2027 might the regulator consider?

Targets

Recognizing the need for balance between the health of the corporation and the protection of ratepayers, what are appropriate financial targets for a non-share capital corporation operating at cost?

In terms of financial targets, did Manitoba Hydro err by failing to explore the practices of more analogous non-share capital corporation operating at cost?

Does the term equity when employed in the context of Manitoba Hydro have the same meaning and resonance for financial markets as it does in the context of share holder owned for profit corporations?

Targets (cont.)

Given the realities of financial markets and recognizing the practices of more analogous non-share capital corporation operating at cost did Manitoba Hydro err in making the Debt:Equity the primary financial target to be taken into account when setting rates for the future?

Recognizing that capital structure appears to be a secondary issue for the capital markets, is reaching a D/E target of 75/25 in 2027 the only way to ensure affordable access to capital or are there more reasonable approaches that:

- better addresses the primary concern of financial markets relating to risk of default?
- better balance the interests of ratepayers and Hydro?
- provide greater clarity to ratepayers, regulators and financial markets?
- are more consistent with the realities of a capital intensive utility benefiting from a monopoly and a government debt guarantee?

Targets (cont.)

If the capital markets are focused on other financial metrics, then why not make those metrics central to rates, instead of the Debt to Equity Ratio?

Assuming we employ rate setting metrics that are better suited than the Debt/Equity ratio to instill confidence in financial markets is it appropriate to consider over what time period and at what confidence level we should set rates to achieve those targets (ie Bonneville Power Authority – 95% confidence level for rate setting purposes)?

Is the selection of the year 2027 for 75/25 analytically capricious? Would some sort of rolling-forward objective be more reasonable?

Reserves

For what risks is it appropriate to employ reserves for the purposes of rate smoothing (ie water flow) and for what risks would it be unreasonable (ie interest rates)?

Separating Rhetoric from Reality - Can Hydro Justify a Marked Departure from Past Practice and the NFAT Promise?

Has Manitoba Hydro demonstrated that its forecast results over the short, medium and long term are outside the range of outcomes anticipated in the NFAT? Is there an evidentiary basis for a marked departure from modern past practice and the NFAT Promise?

Recognizing both long standing credibility challenges and current finding of bias with regard to export revenue forecast, can Hydro's forecasts be relied upon in the short, medium and long term?

Separating Rhetoric from Reality - Can Hydro Justify a Marked Departure from Past Practice and the NFAT Promise? (cont.)

What happens if the remedy for a change in attitude by the Manitoba Hydro-Electric Board (risk tolerance) is not supported by the evidence and long established regulatory principles?

What happens if Manitoba Hydro cannot demonstrate necessity?

Deferral Accounts

Do deferral accounts have a reasonable role to play in balancing rate setting objectives?

Key Public Interest Considerations Relating to Just and Reasonable Rates

Should we reject Boston Consulting Group's suggestion that the captive status of residential and small business customers should leave them open to disproportionately higher rate increases?

What are the implications of successive years of 7.9% rate increases on captive residential customers including those on low or fixed incomes, living on budgets, reliant on electric heat or living in colder and remote communities?

How many additional Manitoba families run the risk of falling into energy poverty due to successive years of 7.9% rate increases?

Key Public Interest Considerations Relating to Just and Reasonable Rates (cont.)

Does the single minded objective of 75/25 by 2027 risk materially damaging economic growth and job creation opportunities in Manitoba?

Rate Design, Cost of Service and Energy Poverty

Given results of the PCOSS process as well as the relationship between class rates and the estimated marginal cost of power is it appropriate that any rate increase imposed should be equal across all classes?

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Recognizing the vulnerability of particular residential populations to successive rate shock level increases how, if at all, should tools such as low income energy efficiency, bill assistance and rate design be employed? What is the appropriate role of the regulator as compared to government under the statutory scheme?

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To the extent that rates and rate structure depart from principles of cost of service who should financially support these choices (ie all ratepayers or the particular class)?

Rate Design, Cost of Service and Energy Poverty (cont.)

Has sufficient consumer research been undertaken regarding alternative rate design options, including the acceptability of rate designs focused just on low income electric heat customers vis-à-vis all electric heat customers and the willingness of Manitoba Hydro's customer base to support such initiatives?

If public policy and public acceptance exist for an alternative rate design, who should be responsible for any lost revenue: the other customers in the Residential class or customers in all classes?

Rate Design, Cost of Service and Energy Poverty (cont.)

In the event that bill assistance programs are pursued what designs might best achieve the efficiency objective?

In the event that bill assistance programs are pursued how can long standing challenges with program participation and renewal which can lead to a majority of low income persons actually paying more as a result of these programs be addressed?

How can participation in all aspects of affordable energy programming, including rate assistance, energy efficiency and billing management programs for low-income households, be increased?

Must Charter values and the concept of substantive equality be taken into consideration in rate-setting, and specifically relating to bill affordability programs?

Overarching Question

Has Hydro's application wrecked on the shoals of modern rate making principles?

Are there opportunities to make the rate setting process effective and transparent for consumers, the financial markets and Manitoba Hydro?

Our Experts

- highly regarded
- evidence based
- first duty to the PUB

MH Experts

- Boston Consulting Group and KPMG
- not called in this hearing
- What inferences can we draw?

The Consumers Coalition decision-making process in this hearing

- Review written record – not complete (record is not yet complete)
- Stakeholder engagement
- Focus groups
- Attendance at hearing – not complete
- Public townhall meeting – not complete
- Renewed focus group(s) and stakeholder engagement – not complete

Preliminary Findings

- Given that the evidentiary record is not yet complete (e.g. IEC reports, witness testimony, cross-examination, ratepayer panel), the Consumers Coalition cannot identify its final position at this time
- But it is able to provide some preliminary findings

Temporal Period of Analysis

Important to look at the 20 Year Plan as well as the Test Years

Rate Shock to avoid Rate Shock

- Manitoba Hydro's application is unreasonable in the context of modern regulatory principles for a capital intensive, non share Corporation operating at cost
- Manitoba Hydro's application would unreasonably impose rate shock on residential, community, municipal government, business and industrial ratepayers
- The shape of proposed rate increases (sharp increases for the medium term, followed by flattening) does not represent a fair distribution of burden for ratepayers over time
- The shape of proposed rate increases presents particular challenges for low income people, and potentially negative effects at the top of the scale (big industrials) which could lead to loss of investment and jobs in Manitoba

Rate Shock to avoid Rate Shock (cont.)

- Manitoba Hydro's application unreasonably favours the interests of the Corporation and is unjustly biased against today's residential, community, municipal government, business and industrial ratepayers
- Manitoba Hydro's single minded focus on high risk, capital intense mega-projects has distracted the Corporation from:
  - resource planning that is integrated and responsive to market dynamics
  - optimizing the pacing and prioritization of its sustainable capital portfolio in a manner that is consistent with modern practice and with an appropriate balance between reliability and affordability
  - an evidence based consideration of appropriate financial targets for modern markets given the reality of a non share corporation operating at cost
  - the range of tools by which a modern regulator can signal to the capital market its commitment to corporate health

Appearance of Bias / Competence not Demonstrated

- Manitoba Hydro's most recent export market forecasts demonstrate a downward bias that is inconsistent with the realities of the MISO marketplace (Daymark)
- Manitoba Hydro's history of being "so wrong for so long" on its capital expenditure and export revenue forecasts coupled with the appearance of a countervailing bias in its current export market forecasts suggests a need for examination of further mechanisms to develop unbiased forecasting within the Corporation (Prior PUB Orders and NFAT decision)
- There are ample grounds for concern that Manitoba Hydro has not achieved competence in the optimization of its sustainable capital portfolio (METSCO, UMS, BCG)
- Manitoba Hydro has yet to demonstrate that it is reaching reasonable benchmarks for efficiency as compared to other electric "utilities" (BCG)

Unreasonable Pursuit of 75/25 in 2027

Manitoba Hydro has not demonstrated that the target is necessary for the company, and certainly not that they are "good" for ratepayers in any way.

Recognizing that capital structure appears to be a secondary issue for the capital markets, there are more reasonable approaches to ensure affordable access to capital that:

- better addresses the primary concern of financial markets relating to risk of default
- better balance the interests of ratepayers and Hydro?
- provide greater clarity to ratepayers, regulators and financial markets?
- are more consistent with the realities of a capital intensive utility benefiting from a monopoly and a government debt guarantee?

Hydro's single minded pursuit of 75/25 in 2027 is unreasonable.

Given the realities of a capital intensive, non share Corporation operating at cost, a 20 year IFF built around the single minded pursuit of 75/25 in 2027 is analytically incoherent

Cost of Service and Rate Design

Given the results of the cost of service study as well as findings related to the relationship between rates and marginal costs any rate increase should be applied consistently to all classes

Orderly Rate Setting Process

Manitoba Hydro should be directed to file any application for 2019/20 rates by the fall of 2018 in a manner that allows for the orderly setting of rates and which avoids the need for an interim rate hearing

7.9% Rate Application for 2017/18 and 2018/19 should be rejected

The Coalition's alternative rate increase will be presented after a full consideration of the evidence and further consultation with consumers and stakeholders

Conclusion

The NFAT promise has been broken.

Rate shock to avoid rate shock: represents a fundamental change of perspective at Manitoba Hydro that has not been justified as necessary.

To date, Manitoba Hydro has not met its onus of demonstrating that the proposed rate increases will achieve the needed balance between the interests of ratepayers and the financial health of the utility.