

# **Rate Shock and Malleable Metrics: Avoiding an Unreasonable Rush to Judgment**

Submissions of the Consumers' Association of Canada (Manitoba Branch)  
and Winnipeg Harvest (The Consumers Coalition)

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## **Overview - Avoiding a Rush to Judgment**

Manitoba Hydro's application for a 7.9% rate increase in 2017/18 has provoked a sharp reaction from concerned Manitoba consumers, business and industry.

Over 2000 Manitobans<sup>1</sup> have directly contacted the Public Utilities Board (“PUB” or “Board”) to express their views.<sup>2</sup> A record number of parties including food banks, consumer representatives, agricultural producers, First Nation political organizations, environmental representatives as well as business and industry have sought and received Intervener status.<sup>3</sup>

Clearly, Manitobans are gravely concerned about the health of their Crown Corporation, its ability to prudently manage its capital projects and the effects of hydro rate shock on consumers and provincial economic health.

A cursory review of the Hydro filing makes it palpably evident that Hydro's leadership team has struggled to develop an analytically defensible application consistent with good regulatory practice.

Central to the Crown monopoly's claims for a rate increase roughly four times the level of inflation are significant changes in assumptions, methodologies and targets which have not been tested by Interveners or approved by the Public Utilities Board. Hydro's financial forecast and its case for interim and final rates is heavily dependent upon:

- material changes to the methodology for estimating domestic load and export revenues;
- new and aggressive financial target achievement dates;<sup>4</sup>
- a radical re-imagining of cash flow concepts for a regulated public utility;<sup>5</sup>
- proposed new accounting treatments; and
- a change in the approach and methodology for funding sustaining capital.

Ultimately, Hydro's rate shock application relies on a profound philosophical shift in its financial forecast methodology. The members of the Consumer Coalition did not endorse the Keeyask or Bipole III projects but they did expect Manitoba Hydro to live up to its commitment to manage these projects prudently and to manage expected adverse developments in a manner consistent with its express commitment to manage rate

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1 Email from Darren Christle, Secretary and Executive Director of the Public Utilities Board, 13 July 2017. As of 13 July 2017, the number is 2238 consumers.

2 For a colourful outline of one Manitoban's reaction to the proposed rate increases, please see the 2 June 2017 letter of Mr. C. Hugh Arklie to the Public Utilities Board.

3 PUB Procedural Order 70/17.

4 Hydro's argument for a faster return to financial health has not been tested. Issues relating to financial targets, how soon they should be achieved and to what level the equity ratio should be permitted to decline are i) longer term questions and ii) questions that are central to the upcoming full General Rate Application proceeding.

5 Please see the discussion relating to “CFO to Capex” found in the 20 June 2017 Interim Submission of Manitoba Hydro at p 4 as well as Tab 2, p 15-20 of its Application. As discussed both by the Consumers Coalition and the 14 July 2017 Submissions of the Manitoba Industrial Power Users Group, this concept is likely to be highly controversial when subject to rigorous regulatory scrutiny.

pressures reasonably over time.

The Consumers Coalition agree with the Manitoba Industrial Power Users Group (“MIPUG”) that:

The fundamental change between forecasts appears to relate to an attempt by Hydro to impose a new attitude and philosophy into the financial forecasts — one that represents a betrayal of the basic compact of the NFAT concept despite no changes in Hydro’s constating legislation, Corporate objects, regulations, or Ministerial directives.<sup>6</sup>

Hydro has tried to paint the proposed rate shock increases as an analytical *fait accompli*.

But Manitoba consumers beg to differ. They have rejected a rush to judgment especially one driven by the untested claims of Manitoba Hydro. In unprecedented numbers, they are looking to their independent regulator to take an unbiased look at Hydro's application.

Given the evidence-based process of the PUB and its institutional expertise with Hydro-electric operations and regulatory principle, Manitobans are relying on their independent regulator to apply its considered judgment and to separate fact from allegation, ideology and hyperbole.

But that heavy analytic lifting is a matter for a general rate application.

The *bona fides* of Hydro's forecast changes and the testing of the reasonableness and prudence of its actions can only be done in a full public hearing involving discovery, cross examination and competing expert analysis. It can only be done after Manitobans have had their opportunity to hear all competing perspectives and to make their voices heard.

For the purposes of the interim rate application, the issues are much simpler. The Board has expressly narrowed the scope of inquiry to the question of:

what has changed in its Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15.<sup>7</sup>

In offering its submissions on the merits of Hydro's interim rate application, the Consumers Coalition will be guided by:

- its interpretation of the overall public interest with specific reference to sections 47 and 48 of the *Public Utilities Board Act* (“PUB Act”),<sup>8</sup> and,

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6 MIPUG letter, 25 May 2017, at p 5.

7 PUB letter, 9 June, 2017, at p 2.

8 *Public Utilities Board Act*, CCSM c P280: section 47(2) authorizes the PUB to grant interim rather final rates. Section 48 provides that:  
The board shall not make an order involving any outlay, loss, or deprivation to any owner of a public utility, or any person without due notice and full opportunity to all parties concerned, to produce evidence and be heard at a public hearing of the board, except in case of urgency; and in that case, as

- PUB direction relating to:
  - the need to consider whether “unforeseen or emergency situations” exist;<sup>9</sup> and,
  - consideration of the “deleterious effect”,<sup>10</sup> if any, of the absence of a rate increase.

Focusing on the question of whether Hydro is likely to face an “emergency” or “urgent” situation in the absence of a rate increase, the Consumers Coalition will consider both:

- the projected cash flows for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16; and
- the projected net income levels for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16.

Addressing the overall public interest, the Coalition will also consider whether Hydro or its ratepayers will suffer any material “deleterious” effect in the absence of a rate increase. Recognizing past challenges with Hydro's credibility as well as the untested nature of Hydro's evidence, the Coalition's analysis will canvass:

- what has changed in Manitoba Hydro's Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15;
- whether Manitoba Hydro's interim rate submissions have complied with the 9 June 2017 direction of the PUB to apply the Board mandated methodology; and
- the trade-offs between achieving enhanced regulatory efficiency and certainty for consumers by weaning Manitoba Hydro off its unhealthy addiction to interim rate applications versus future rate smoothing through a contribution to the Bipole III deferral fund either in the range of inflation or consistent with Board Order 59/16.<sup>11</sup>

## **Recommended Findings**

The Consumer Coalition recommends that the Manitoba Public Utilities Board make the following determinations:

### **Adequacy of Cash Flow to Fund Current Operations**

- the calculation Manitoba Hydro uses in its submissions regarding its interim rate application to gauge the adequacy of cash flow to cover current operations (the Hydro revision)<sup>12</sup> is not the same as the calculation for financial target purposes

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soon as practicable thereafter, the board shall, on the application of any party affected by the order, re-hear and reconsider the matter and make such order as to the board seems just. [emphasis added].

9 PUB Order 59/16, at p 4 and 12. Reading PUB Order 59/16 with s 47 and s 48 of the *PUB Act*, the Coalition considers the existence of urgency of emergency situations to be a critical consideration.

10 PUB Order 49/14, at p 16.

11 At p 12 of that decision, the Board considered it “to be in the public interest to look beyond the test years and mitigate potential rate shock to consumers that, due to the additional costs imposed by Bipole III in a few years, may be inevitable unless the Board implements a form of rate smoothing.”

12 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4. This untested methodology is also presented in the 5 May 2017 General Rate Application, Tab 2, p 15-20.

that Manitoba Hydro has historically used and is proposing<sup>13</sup> in the current Application to continue to use for measuring the adequacy of cash flow to fund current operations. The Hydro revision is not consistent with the Board mandated methodology for IFF15 as approved by Order 59/16;

- based on the Update IFF16, there is a \$162 million difference between the Manitoba Hydro revision<sup>14</sup> as compared to the calculation for financial target purposes that Manitoba Hydro has historically used and is proposing<sup>15</sup> in the current Application to continue to use for measuring the adequacy of cash flow to fund current operations;
- applying the Board-mandated methodology for IFF15 as approved by Order 59/16, Manitoba Hydro does not face a deficit, or emergency or urgent issue in terms of the adequacy of cash flow to fund current operations;
- based on the Updated IFF16, Manitoba Hydro's capital coverage target for 2017/18 would be met even if there was no interim rate increase approved;

#### Forecast of 2016/17 results

- the Manitoba Hydro forecast for 2016/17 results filed in support of its interim rate application does not comply with the "Board mandated methodology for IFF15";

#### Forecast of 2017/18 results

- the Manitoba Hydro forecast for 2017/18 results filed in support of its interim rate application does not comply with the "Board mandated methodology for IFF15";
- based on the Update IFF16, Manitoba Hydro is looking at \$92 Million in net income in 2017/18 even without a rate increase and \$109 Million in net income based on a 1.6% rate increase even using Manitoba Hydro's treatment (Expensed) of the amortization of the Equal Life Group/Average Service Life (ELG/ASL) difference and capitalized overheads rather than the Board's treatment;

#### Water Flow Forecast

- the water flow forecast underpinning Manitoba Hydro's 2017/18 outlook is the best forecast currently available for the purposes of forecasting 2017/18 financial results;<sup>16</sup>

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13 Appendix 3.1, pp 39-40.

14 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4. This untested methodology also is presented in the 5 May 2017 General Rate Application, Tab 2, p 15 – 20.

15 Appendix 3.1, pp 39-40.

16 Supporting information before another regulatory body confirms extremely high water levels in the Nelson River system. See the 28 March 2017 Alteration Request of Manitoba Hydro to the Environmental Approvals Branch of Manitoba Sustainable Development, Request for Instream Work, p 1 indicating that "the lower Nelson River is currently experiencing unprecedented high inflows for this of year."

### Prima Facie Case for an Interim Rate Increase

- there is no *prima facie* case based on recent actual results or projected 2017/18 results for an interim increase.

### Recommendations

Despite its hyperbole, Hydro does not face an emergency or urgent situation.

Based upon Update IFF16, the expected capital coverage and net income forecasts for 2017/18 demonstrate that there will not be a material deleterious effect in the absence of a rate increase at this time.

The Consumers Coalition recommends that no interim rate increase be granted.

The Consumers Coalition notes that the full General Rate Application process will begin in less than 6 months, following which the PUB will be in a position to make recommendations regarding a rate increase based upon the totality of the evidence presented, and not on untested methodological changes that have not been approved by the Board.

Should the PUB determine, based on the evidence presented by Manitoba Hydro, that it has no choice but to grant some level of interim relief to Manitoba Hydro, the Consumers Coalition would propose an interim rate increase of no higher than the rate of inflation, in the range of 1.6%, be granted. The Consumers Coalition would note that Manitoba consumers who will have to pay higher bills for Manitoba Hydro's services as a result of any interim rate increase granted do not get the benefit of adjustments to their income based on the rate of inflation.

The Consumer Coalition also recommends that:

- Manitoba Hydro be directed to present a proposal to the Public Utilities Board and to Manitoba consumers by no later than May 1, 2018 to bring its regulatory house into order and end its unhealthy addiction to interim rate increases.

### **Introduction**

Manitoba Hydro has applied for an interim rate increase of 7.9% to take effect on 1 August 2017.

On 9 June 2017, the Public Utilities Board issued a letter indicating that it would conduct a process to consider the merits of Manitoba Hydro's interim rate request. In its letter, the Board directed that Hydro's submissions:

be focused on what has changed in its Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology

for IFF15.<sup>17</sup>

## **Overview of General Regulatory Principles**

To frame its submissions, the Consumers Coalition wishes to provide a brief overview of general regulatory principles as they apply to the setting of rates for Manitoba Hydro.

One of the most referenced texts on public utility regulation is James C. Bonbright's 1961 *The Principles of Public Utility Rates*. Bonbright's seminal text highlights the following considerations as they relate to rate-setting<sup>18</sup>:

- Attributes of a sound rate structure should include:
  - Simplicity, understandability, certainty, public acceptability and feasibility of application and interpretation.
- Effectiveness:
  - Recovering total revenue requirements for the utility, including fixed and variable costs.
- Stability:
  - Revenue (and cash flow) stability from year to year for the utility.
  - Stability of rates for ratepayers: minimal unexpected changes that are seriously adverse to existing customers.
- Efficiency:
  - Static efficiency: maximizing use of system and different types of pricing structures.
  - Dynamic efficiency: promoting efficient use of energy and promoting the desired behaviour of customers.
- Appropriately priced:
  - Including internalities, such as costs and benefits within the utility, and externalities, such as promoting renewable energy sources, social programs or economic development.
- Fairness in apportioning cost of service among different consumers, considering:
  - Cost causality
  - No intergenerational subsidies
  - Beneficiary pays
- Avoidance of “undue discrimination”:
  - Equals treated equally and unequals treated unequally.

In Manitoba, the Bonbright principles are reflected in legislation and in Board decisions, which set the rates of utilities as well as Crown monopolies such as Manitoba Hydro.<sup>19</sup>

Under the *Crown Corporations Public Review and Accountability Act*, the Board must

<sup>17</sup> PUB 9 June 2017 letter.

<sup>18</sup> James C Bonbright, *The Principles of Public Utility Rates* (Columbia University Press, 1961); Laurie Reid, “Rate Design”, Presentation at CAMPUT Course on Energy Regulation, 20 June 2017, Kingston, ON.

<sup>19</sup> Manitoba Hydro is expressly excluded from the definition of public utilities under s. 2(5) of the *Public Utilities Board Act*, CCSM c P280.

conduct a review and give its approval before Manitoba Hydro makes any changes to the rates it charges for its services or introduces any new rates for services.<sup>20</sup> Section 39(1) of the *Manitoba Hydro Act* provides that the prices payable for power supplied by the corporation shall be such as to return to it in full necessary costs to the corporation.<sup>21</sup>

The Board's jurisdiction to set just and reasonable rates is established in section 77 of the *Public Utilities Board Act*.<sup>22</sup> The *PUB Act* also provides that “[t]he 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.”<sup>23</sup>

Pursuant to its jurisdiction and the statutory framework in which it operates, the Board has determined that the key elements of its independent review function and rate-setting role include:

- 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.<sup>24</sup>

### **Guidance on the Factors for Determining Interim Rates**

The analytic framework for setting interim rates is less clear.

The Board is authorized under section 47(2) of the *PUB Act* to make an interim order rather than a final order. Section 48 of the *PUB Act* is the source of some controversy in interpretation. It underscores that, except in the case of urgency, there is a right both to produce evidence and to be heard in cases involving orders relating to an outlay, loss or deprivation to any person. Section 48 expressly provides that:

The board shall not make an order involving any outlay, loss, or deprivation to any owner of a public utility, or any person without due notice and full opportunity to all parties concerned, to produce evidence

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<sup>20</sup> *Crown Corporations Public Review and Accountability Act*, CCSM c C336, at ss 25(1)-25(4). Section 25(4) provides guidance on factors to be considered relating to necessary and sufficient funds while allowing for the consideration of “any compelling policy considerations that the board considers relevant to the matter”.

<sup>21</sup> *Manitoba Hydro Act*, CCSM c H 190, at s 39(1).

<sup>22</sup> *Public Utilities Board Act*, CCSM c P280: s 77 The board may, by order in writing after notice to, and hearing of, the parties interested,

(a) fix just and reasonable individual rates, joint rates, tolls, charges, or schedules thereof, as well as commutation, mileage, and other special rates that shall be imposed, observed, and followed thereafter, by any owner of a public utility wherever the board determines that any existing individual rate, joint rate, toll, charge or schedule thereof or commutation, mileage, or other special rate is unjust, unreasonable, insufficient, or unjustly discriminatory or preferential;

<sup>23</sup> *PUB Act*, at s 84(2).

<sup>24</sup> PUB Order 98/14 at p 28, 37; PUB Order 5/12 at p 27.



and be heard at a public hearing of the board, except in case of urgency; and in that case, as soon as practicable thereafter, the board shall, on the application of any party affected by the order, re-hear and reconsider the matter and make such order as to the board seems just. [emphasis added].<sup>25</sup>

In Order 49/14, the Board offered some guidance on its considerations in granting an interim rate increase:

Interim rate orders are intended to relieve Manitoba Hydro from the deleterious effects caused by the length of a regular regulatory proceeding. The questions to be determined by this Board are whether it would be reasonable to grant interim rates, and whether Manitoba Hydro would suffer a deleterious effect in the absence of a rate increase.<sup>26</sup> [emphasis added]

While the Board had previously found that urgency is not required to establish its jurisdiction to grant interim rate relief,<sup>27</sup> the Board has recently expressed concern regarding Manitoba Hydro's continued reliance on interim rate requests. The Board stated in its last interim rate decision that it "is not prepared to consider interim rate applications unless warranted by unforeseen or emergency situations."<sup>28</sup> [emphasis added]

With reference to appropriate criteria, the Consumers Coalition also notes that MIPUG has employed analogous considerations to those articulated by the Board. In particular, MIPUG has suggested that important questions are: "Is the increase required to preserve the financial integrity of the applicant or to avoid financial hardship to the applicant?" and "Can the applicant continue safe utility operations without the interim adjustment?"<sup>29</sup>

## **The Coalition's Analytic Framework for Considering Interim Rate Proposals**

In offering its submissions on the merits of Hydro's interim rate application, the Consumers Coalition will be guided by:

- its interpretation of the overall public interest with specific reference to sections 47 and 48 of the *Public Utilities Board Act*;<sup>30</sup> and,

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<sup>25</sup> *PUB Act*, s 48.

<sup>26</sup> PUB Order 49/14, at p 16.

<sup>27</sup> PUB Order 116/12 at p 18; PUB Order 40/11 at p 28.

<sup>28</sup> PUB Order 59/16 at p 4 and 12.

<sup>29</sup> Please see the 14 July 2017 submissions of the Manitoba Industrial Power Users Group. The Consumers Coalition also agrees with MIPUG in noting that contentious items inconsistent with the PUB approved Methodology flowing from Order 59/16 should be left to tested in a full hearing.

<sup>30</sup> *PUB Act*, s 47(2) authorizes the PUB to grant interim rather final rates. Section 48 provides that: The board shall not make an order involving any outlay, loss, or deprivation to any owner of a public utility, or any person without due notice and full opportunity to all parties concerned, to produce evidence and be heard at a public hearing of the board, except in case of urgency; and in that case, as soon as practicable thereafter, the board shall, on the application of any party affected by the order, re-hear and reconsider the matter and make such order as to the board seems just. [emphasis added].

- PUB direction relating to:
  - the need to consider whether “unforeseen or emergency situations” exist;<sup>31</sup> and,
  - considerations of the “deleterious effect”,<sup>32</sup> if any, of the absence of a rate increase.

Focusing on the question of whether Hydro is likely to face an “emergency” or “urgent” situation in the absence of a rate increase, the Consumers Coalition will consider both:

- the projected cash flows for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16; and
- the projected net income levels for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16.

Addressing the overall public interest, the Coalition will also consider whether Hydro or its ratepayers will suffer any material “deleterious” effect in the absence of a rate increase. Recognizing past challenges with Hydro's credibility as well as the untested nature of Hydro's evidence, the Coalition's analysis will consider:

- what has changed in Hydro's Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15;
- whether Manitoba Hydro's interim rate submissions have complied with the 9 June 2017 direction of the PUB to apply the Board mandated methodology; and
- the trade-offs between achieving enhanced regulatory efficiency and certainty for consumers by weaning Manitoba Hydro off its unhealthy addiction to interim rate applications versus future rate smoothing through a contribution to the Bipole III deferral fund either in the range of inflation or consistent with Board Order 59/16.<sup>33</sup>

### **Contextual Considerations – Significant Adverse Developments were Contemplated by Manitoba Hydro and by the Board**

A review of Manitoba Hydro's General Rate Application and Interim Rate Submissions suggests a disconnect between Hydro's current leadership team and the analysis developed in Board Order 59/16 and flowing from the 2014 Need For and Alternatives To (“NFAT”) Report.

In considering the deleterious effect, if any, of the absence of an interim rate increase, an important consideration for the Board is whether Manitoba Hydro finds itself in emergency adverse circumstances not contemplated by the PUB at the time of *Board Order 59/16* or the 2014 NFAT hearing. Alternatively, is the sum effect of recent changes within the realm of possibilities envisioned by the Board and by Hydro in prior decisions?

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31 PUB Order 59/16, at p 4 and 12. Reading Order 59/16 with s 47 and s 48 of the *PUB Act*, the Coalition considers the existence of urgency of emergency situations to be a critical consideration.

32 PUB Order 49/14, at p 16.

33 At p 12 of that decision, the Board considered it “to be in the public interest to look beyond the test years and mitigate potential rate shock to consumers that, due to the additional costs imposed by Bipole III in a few years, may be inevitable unless the Board implements a form of rate smoothing.”

A careful reading of Orders 59/16 and 73/15 along with the NFAT report makes it clear that Hydro's current circumstances are neither unforeseen or urgent.

Manitoba Hydro is currently “involved in a process of unprecedented capital expansion, approximately doubling its asset base when all of the currently planned projects have been completed.”<sup>34</sup> This capital expansion has a direct impact on rates paid by all consumers of Manitoba Hydro. As stated by the Board in its NFAT report:

Manitoba Hydro’s financial targets determine how rates are set. Targets include a self-imposed 75/25 debt-to-equity ratio. Manitoba Hydro’s financial forecasts are premised on rates being increased sufficiently to allow the debt-to-equity ratio to recover to the target level over a 20-year time period, followed by lesser rate increases thereafter. During the NFAT Review, Manitoba Hydro also provided alternate suggested rate methodologies that would increase rates more gradually, with the result of pushing back the date at which financial targets will fully recover.<sup>35</sup>

While members of the Consumers Coalition did not endorse either Keeyask or Bipole III, they note that the NFAT Report specifically contemplated the risk of adverse developments related to construction costs and revenue projections.

The construction of new generation and associated transmission facilities will add to and prolong these rate increases. Furthermore, construction costs will most likely grow and revenue projections may not be achieved. This gap between rising costs and unrealized revenues will be borne by ratepayers. Given the length of time projected for these rate increases and their magnitude, especially in the early years, the Panel is concerned about intergenerational fairness and the impact on vulnerable residents and communities. Lower income consumers, particularly those in northern and aboriginal communities where energy choices are limited or non-existent, will especially feel this impact. [emphasis added]<sup>36</sup>

The NFAT panel suggested a number of tools to mitigate these adverse developments including:

- using incremental capital taxes and water rental fees from the development of the Keeyask Project to mitigate adverse rate impacts on vulnerable consumers;
- taking internal actions to moderate rate increases; and
- relaxing Hydro's 75/25 debt-to-equity ratio policy to moderate its proposed electricity rate increases.<sup>37</sup>

Board Order 73/15 documents Hydro's admission that financial targets might not be achieved during a period of major investments and that there would be substantial

34 PUB Order 59/16, at p 13.

35 NFAT Report, 20 June 2014, at p 28-29.

36 NFAT Report, 20 June 2014, p 252.

37 NFAT Report, 20 June 2014, p 252.

challenges in the debt/equity ratio:

- In setting its financial targets, Manitoba Hydro stated that it recognized that targets may not be attained during years of major investments in the generation and transmission system.<sup>38</sup>
- Manitoba Hydro's capital structure was forecast to weaken to a debt to equity ratio of 90:10 over the period 2022/23 to 2026/27 due to planned capital spending on major projects.<sup>39</sup>

The fact that Manitoba Hydro was likely to face material increases in capital costs and a significant deterioration in projected revenues is not some divine revelation of special proprietary knowledge to Manitoba Hydro's current leadership team. It was not discovered by the Boston Consulting Group in its multi-million dollar report.

Those very risks and uncertainties led Consumers Coalition members not to endorse Keeyask and Bipole III.

But in the NFAT process, those risks and uncertainties were carefully considered by the PUB in an exercise of its institutional judgment and determined to be reasonable and capable of mitigation

Manitoba Hydro's current financial situation was not unforeseen. It was specifically contemplated in the family of PUB decisions reaching from the NFAT Report to Order 59/16.

### **The Interim Rate Process Should not be Driven by Untested Methodological Changes**

In its 9 June 2017 letter, the Board directed that “Manitoba Hydro's interim rate submission be focused on what has changed in its Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15.”<sup>40</sup>

Unfortunately, Manitoba Hydro's interim rate application is not driven by an analytic response to the 9 June 2017 direction of the Board. Instead, its financial forecast and interim rate submissions are primarily reliant upon untested and significant methodological changes which have not been tested by Interveners or approved by the Board. In particular, Hydro's financial forecast and its case for interim and final rates is heavily dependent upon:

- material changes to the methodology for estimating domestic load and export revenues;
- new and aggressive financial target achievement dates;<sup>41</sup>

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38 PUB Order 73/15, at p 51.

39 PUB Order 73/15, at p 52.

40 Public Utilities Board, 9 June 2017 letter to Manitoba Hydro and Interveners of record.

41 Hydro's argument for a faster return to financial health has not been tested. Issues relating to financial targets, how soon they should be achieved and to what level the equity ratio should be permitted to

- a radical re-imagining of cash flow concepts for a regulated public utility;<sup>42</sup>
- proposed new accounting treatments; and,
- a change in the approach and methodology for funding sustaining capital.

These assumptions are central to the upcoming full General Rate Application proceeding – not questions to be resolved in an interim rate application.

The interim rate determination cannot be driven by yet untested claims flowing from fundamental methodological changes.

This is especially the case given long standing concerns relating to the credibility of Manitoba Hydro forecasts identified both by the Public Utilities Board and by Interveners.<sup>43</sup>

Manitoba Hydro does not have an enviable forecast record. There is no evidentiary basis to conclude that its current leadership is more capable of reliable forecasts than its predecessors.

### **Manitoba Hydro has not Met its Onus**

In considering whether Manitoba Hydro has presented a *prima facie* case for an interim rate increase, the Consumers Coalition has grouped the submissions made by the Crown monopoly<sup>44</sup> into four allegations:

**Allegation 1** - Manitoba Hydro's cash flow from operations is insufficient to fund ongoing business requirements without the proposed rate increases;

**Allegation 2** - Manitoba Hydro's current financial position and outlook has deteriorated from previous forecasts;

**Allegation 3** - Current rates must eventually rise – no interim increase will necessitate higher increases later; and

**Allegation 4** - Previous rate plan no longer tenable.

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decline are ) longer term questions and ii) questions that are central to the upcoming full General Rate Application proceeding.

42 Please see the discussion relating to "CFO to Capex" found in the 20 June 2017 Interim Submission of Manitoba Hydro at p 4 as well as Tab 2, p 15 – 20 of its Application. As discussed both by the Consumers Coalition and the 14 July 2017 Submissions of the Manitoba Industrial Power Users Group, this concept is likely to be highly controversial when subject to rigorous regulatory scrutiny.

43 For comments of the Board, please see Board Order 59/16, p 22 (IFF15 OM&A is likely materially overstated) p 37 (concerns from 73/15 about the load forecast for Top Consumers), p 39 (concerns about Manitoba Hydro's decade long trend in forecasting inaccuracies with respect to export prices). Please also see Board Order 73/15, p 66 (PUB shared concern of Interveners that updated capital costs for major projects not provided on a timely and transparent basis), p 78 (evidence that Hydro consistently over forecasts Top Consumer load), p 87 (concern export price forecasts). Please also see PUB Order 59/16, p 16: "The Consumer Coalition questioned the overall reliability of Manitoba Hydro's financial forecasts given the significant improvement from reduced finance expense."

44 Manitoba Hydro Interim Rate Submission, 20 June 2017.

## Rebutting Allegation 1. Cash flow – A Malleable Metric

Cash flow is a malleable metric in the hands of Manitoba Hydro.

Manitoba Hydro claims that “the most fundamental and compelling reason for Manitoba Hydro’s proposed and indicative rate increases, as contemplated in its current financial forecast, is the need to increase the level of the Corporation’s cash flow”.<sup>45</sup>

Hydro alleges that without the proposed rate increases, Manitoba Hydro’s cash flow from operations is insufficient to fund the capital requirements to maintain normal operation and growth of the system (even excluding major projects such as Keeyask and Bipole III).<sup>46</sup>

There are fundamental problems with Manitoba Hydro’s argument regarding the need for the proposed interim rate increase to meet cash flow requirements.

First, the calculation that Manitoba Hydro uses in its submissions regarding its interim rate application to gauge the adequacy of cash flow to cover current operations<sup>47</sup> is not the same as the calculation for financial target purposes that Manitoba Hydro has historically used and is proposing<sup>48</sup> in the current Application to continue to use for measuring the adequacy of cash flow to fund current operations.

The difference is that the metric used by Manitoba Hydro in its current submissions regarding the interim rate request only excludes the cash requirements for Keeyask, Bipole III and Manitoba-Minnesota Transmission Project & Great Northern Transmission Line (“MMTP&GNTL”) from the calculation. However, the approved financial target for the Corporation excludes all Major New Generation and Transmission Projects.<sup>49</sup>

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45 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4.

46 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4-7. In an attempt to illustrate this point Manitoba Hydro compares the cash flow available from operations with the cash requirements for all capital expenditures except those associated with Keeyask, Bipole III and Manitoba-Minnesota Transmission Project & Great Northern Transmission Line (“MMTP&GNTL”), over the period 2017-2022 and determines the annual cash flow deficiencies assuming annual rates increases of 0%, 3.95% and 7.9%. Manitoba Hydro argues that:

- Under the zero rate increase case there is a persistent deficiency over the 6 year period;
- With 3.95% annual increases the deficiency exists for the first four years; and
- Even with the 7.9% increase, a deficiency exists for the first two years.

47 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4. Please also see the discussion relating to “CFO to Capex” found at Tab 2, p 15-20 of its Application.

48 Appendix 3.1, pp 39-40.

49 The Coalition also notes that the metric used by Manitoba Hydro in its interim rate request submissions calculates: the cash available from operations by subtracting first the Gross Interest (as reported on the Cash Flow Statement (See also the General Rate Application, Tab 2, page 20, Figure 2.16 and footnotes to Figure 2.16), followed by removing Interest Capitalized (except that associated with Keeyask and MMTP&GNTL). It is not immediately clear why the Interest Capitalized was removed as one would expect the Gross Interest reported on the Cash Flow Statement to include all interest paid, including capitalized interest. While there may be a satisfactory explanation, given that the interim rate process did not allow for further discovery, the Consumers Coalition did not have the opportunity to request further information from Manitoba Hydro.

Schedule 1 sets out the difference in terms of the capital spending dollars excluded from the calculation based on both IFF16 (which was filed with the Main Application and referenced in Manitoba Hydro's 20 June 20, 2017 submission) and the updated IFF16 filed on 11 July 11, 2017:

	<b>Schedule 1: Capital Expenditures Included in Capital Coverage Calculation (\$M)</b>						
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	Source
IFF16							
MH Interim Rate Submissions – Revised Metric	664	668	685	669	654	632	Tab 2, Fig. 2.6 PUB MFR 51 – Initial
MH Capital Coverage Ratio	529	526	517	516	511	499	PUB MFR 17 Fig. 4 PUB MFR 51 – Initial
IFF16-Updated							
MH Revised Cash Flow Metric	N/A	688	709	689	674	652	PUB MFR 51 - Updated
MH Capital Coverage Ratio	N/A	526	517	516	511	499	

Note: The 11 July 2017 Update did not include updated values for 2016/17

Second, in calculating the cash flow deficiency for the purposes of its interim rate request submissions, Manitoba Hydro removed<sup>50</sup> the capital spending for Bipole III but not the capitalized interest for Bipole III, as it did in the case of Keeyask and MMTP&GNTL.

The rationale appears to be that, unlike Keeyask and MMTP&GNTL, Bipole III has no expectation of revenue increase or cost efficiencies<sup>51</sup>. However, as set out in the 2016 Resource Planning Assumptions and Analysis Report<sup>52</sup>, Bipole III is expected to reduce line losses, thereby making additional power available for either export or to serve domestic customers.

Finally, Manitoba Hydro's analysis examines the impact of alternative rate increases,<sup>53</sup> assuming these increases apply for the entire period 2017/18-2021/22.

<sup>50</sup> See Footnotes to Figure 2.16.

<sup>51</sup> Tab 2, page 17.

<sup>52</sup> Appendix 7.3, pages 10 and 13-19.

<sup>53</sup> Zero or 3.95% versus 7.9%.

However, the Interim Rate process is only dealing with whether or not there should be an interim rate increase in 2017/18. It will not address Manitoba Hydro's request for a 7.9% rate increase in 2018/19 nor the indicative rate increases of 7.9% per annum set out in IFF16 for subsequent years.

In Order 59/16 the Board indicated<sup>54</sup> that it is “not prepared to consider interim rate applications unless warranted by unforeseen or emergency situations”. Given this context, the more appropriate cash flow outlook to consider would be one that included a lower (or zero) increase in 2017/18 followed by the increases requested/indicated by Manitoba Hydro in the subsequent years.<sup>55</sup>

Schedule 2 compares Manitoba Hydro’s capital coverage ratios, based on Manitoba Hydro’s current and proposed definition for the 2017-2022 period, assuming: i) no rate increase in 2018 followed by 7.9% in each subsequent year; ii) 3.36% rate increase in 2018 followed by 7.9% in each year and iii) 7.9% in each year 2018-2022.

<b>Schedule 2: Capital Coverage Ratio (Based on IFF16)</b>							
Rate Incr.	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	Source
IFF16							
2018 – 0% - After - 7.9%	1.08	1.14	1.22	1.40	1.78	2.22	MH Interim Rate Submission, Attachment 1
2018 – 1.6% After – 7.9%	1.08	1.18	1.28	1.45	1.84	2.30	
2018 - 3.36% After – 7.9%	1.08	1.21	1.33	1.52	1.92	2.38	
2018-7.9% After – 7.9%	1.08	1.31	1.49	1.69	2.11	2.60	Appendix 3.1, page 57
IFF16 - Updated							
2018 – 0% - After - 7.9%	N/A	1.33	1.37	1.35	1.74	2.18	Appendix 3.7
2018 – 1.6% After – 7.9%	N/A	1.36	1.43	1.40	1.81	2.25	

54 PUB Order 59/16, at p 4.

55 It is recognized that Order 59/16 (pages 10-11) also considered the impact on future rates if there was no rate increase in 2016/17. However, this perspective is dealt with in section 3, later in this document.



2018 - 3.36% After – 7.9%	N/A	1.40	1.48	1.47	1.88	2.34	
2018- 7.9% After – 7.9%	N/A	1.49	1.63	1.64	2.07	2.56	Appendix 3.6
Note: The 11 July 2017 Update did not include updated values for 2016/17							

Based on IFF16, even with no interim rate increase in 2017/18, the capital coverage ratio improves in 2017/18 from the previous year's value. This suggests that there is no emergency situation when it comes to cash flow coverage.

It is also clear that rate increases of substantially less than the 7.9% interim value requested by Manitoba Hydro would allow the corporation to meet its minimum capital coverage target of 1.20<sup>56</sup> in 2017/18.

Indeed, based on the Updated IFF16, Manitoba Hydro's capital coverage target would be met even if there was no interim rate increase approved.

In its letter establishing the current process for considering Manitoba Hydro's interim rate request the PUB directed that Manitoba Hydro's interim rate submissions should be focused to what has changed since Order 59/16.<sup>57</sup>

Unfortunately, in its submission, Manitoba Hydro has not addressed how the outlook for the capital coverage ratio in 2017/18 (or beyond) has changed from that anticipated in IFF15. Schedule 3 below provides such a comparison. It includes three outlooks based on IFF15:

- the first outlook is the one submitted by Manitoba Hydro in its Application for Interim Rates Effective 1 April, 2016;
- the second is an outlook that uses the same rate increases but is based on the Board's accounting directives per Order 73/15; and
- the third outlook<sup>58</sup> achieves the target debt/equity ratio on the same date as in IFF15 but does so with average annual increases of 3.36% over the period, based also on the Board's accounting directives per Order 73/15.

It should be noted that the third scenario was the basis for the Board's decision in Order 59/16 to approve an interim rate increase of 3.36% effective 1 August, 2016.

Schedule 3 then compares the results with those from the Updated IFF16. It indicates that, foregoing any increase in 2017/18 still results in a higher capital coverage ratio for

<sup>56</sup> Appendix 3.1, p 40.

<sup>57</sup> PUB letter, 9 June 2017.

<sup>58</sup> It is this outlook that appears to be the genesis for the Board's decision to approve a 3.36% increase effective 1 April, 2016.

that year than forecast in IFF15 in either Manitoba Hydro's original financial forecast or alternative versions of IFF15 based on the Board's accounting Directives.

For all cases in the time period after 2017/18, the capital coverage ratio is higher now under the Updated IFF16-based scenarios than in IFF15. This is the case even for scenarios with constant rate increases designed to achieve the target equity ratio in the same time frame as IFF14 or IFF15.

<b>Schedule 3: Capital Coverage Ratio Outlook</b>							
<b>Rate Incr.</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>	<b>Source</b>
<b>Capital Coverage Ratio (IFF15- Based on Manitoba Hydro's Accounting)</b>							
3.95% to 2028/29, After - 2% <sup>1</sup>	0.98	1.21	1.05	1.06	1.13	1.32	IFF15, page 41
<b>Capital Coverage Ratio (IFF15- Based on Board's Accounting Directives)</b>							
3.95% to 2028/29, After - 2% <sup>2</sup>	0.98	1.20	1.05	1.06	1.12	1.32	MH Apr. 2016 Interim Appl, Att. 28
3.36% to 2033/34 <sup>3</sup>	0.97	1.17	1.00	0.99	1.01	1.18	MH Apr. 2016 Interim Appl, Att. 46
<b>Capital Coverage Ratio (Updated IFF16- with 3.36% increase August 1, 2016)</b>							
2017/18 – 0% After - 7.9% <sup>4</sup>	N/A	1.33	1.37	1.35	1.74	2.18	Appendix 3.7
2017/18 – 1.6% After – 7.9% <sup>5</sup>	N/A	1.36	1.43	1.40	1.81	2.25	
2017/18 – 3.36% After – 7.9% <sup>6</sup>	N/A	1.40	1.48	1.47	1.88	2.34	
2017/18- 7.9% After – 7.9% <sup>7</sup>	N/A	1.49	1.63	1.64	2.07	2.56	Appendix 3.6
4.05% to 2033/34 <sup>8</sup>	N/A	1.41	1.38	1.23	1.48	1.74	PUB MFR 73 - Updated
4.53% to 2031/32 <sup>9</sup>	N/A	1.42	1.42	1.29	1.55	1.84	

- Notes: 1) Target Equity Ratio of 25% achieved in 2031/32  
2) Target Equity Ratio of 25% achieved in 2030/31 (Note: Results are same if Regulatory Accounts are amortized to OCI (per Board approach) or treated as an expense (per MH))  
3) Target Equity Ratio of 25% achieved in 2033/34 – same date as in IFF14  
4) Target Equity Ratio of 25% achieved in 2034/35  
5) Target Equity Ratio of 25% achieved in 2032/33  
6) Target Equity Ratio of 25% achieved in 2031/32  
7) Target Equity Ratio of 25% achieved in 2027/28  
8) Target Equity Ratio of 25% achieved in 2033/34 – same date as in IFF14  
9) Target Equity Ratio of 25% achieved in 2031/32 – same date as IFF15 per MH

## Rebutting Allegation 2. Financial position and outlook

### **Hydro's 2016/17 Forecast results – Three Fundamental Problems**

While the change in forecast results for 2016/17 is not specifically discussed in Manitoba Hydro's interim rate request submissions, a comparison of results based on IFF15 and IFF16<sup>59</sup> is provided.

In Figure 6, Manitoba Hydro compares the net income forecasts for 2016/17 as presented in IFF14, IFF15 and IFF16 (\$59 M, \$29 M and \$34 M respectively).<sup>60</sup>

Manitoba Hydro then goes on to note that IFF16 was prepared using a different accounting for depreciation and capitalized overhead. In Figure 8, Manitoba Hydro presents adjusted results for 2016/17 for IFF16 using the same accounting approach as was used in IFF14 and IFF15. The adjusted results for 2016/17 now show a net income loss of \$18M - \$19M.<sup>61</sup>

However, there are three fundamental problems with Manitoba Hydro's 2016/17 forecast comparisons.

The first problem is that Manitoba Hydro adjusted the IFF16 results so as to reflect the accounting approach prior to the Board's accounting directives in Order 73/15 that the Company continue to use the ASL methodology for depreciation and to capitalize certain overheads that were previously expensed.<sup>62</sup>

Hydro's approach is contrary to the Board's 9 June 2017 letter regarding the current process for consideration of Manitoba Hydro's interim rate request where the Board specifically directed that Manitoba Hydro's interim rate submissions focus on what has changed since Order 59/16.<sup>63</sup>

As a result, the appropriate approach would have been to restate the IFF14 and IFF15

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59 The Updated IFF16 did not provide updated values for 2016/17.

60 Note: These values are for Manitoba Hydro separate from Non-Controlling Interest.

61 Note: It is not clear why the different rate scenarios for 2017/18 yield different net income results for 2016/17 but with no opportunity for discovery, the question is unanswered.

62 Note: Despite Order 73/15, IFF15 used the ELG methodology for depreciation and expensed the noted overheads. However, the Board's Directives were reflected in IFF16.

63 PUB letter, 9 June 2017.

forecasts using the Board's mandated methodology. There is no information on the record to indicate what the IFF14 forecast result for 2016/17 would be using the Board's methodology per Order 59/16. However, it is also noted that, based on the Board's 9 June 9 2017 letter, the Board views the appropriate comparisons to be made as being those with respect to IFF15. In this regard, Board Order 59/16 indicates that based on IFF15 and the Board's mandated methodology, the forecast net income would be \$72 M if the approved 3.36% increase had been allowed to flow to general revenues.<sup>64</sup>

The second problem is that the 3.36% increase did not flow to general revenues but rather the Board determined that the increased revenues be directed to the Bipole III deferral account – resulting in a forecast net income for 2016/17 of \$20 M<sup>65</sup> based on IFF15 and the Board's decision. The forecast net income for 2016/17 in IFF16 is \$34 M. Based on this comparison, there has been no deterioration in forecast financial results for 2016/17 as shown in IFF16 versus those anticipated by the Board in Order 59/16 based on IFF15 and its approved methodology.

The third problem is that the Board's approved methodology calls for the ELG/ASL difference and the capital overheads to be amortized to Other Comprehensive Income, whereas in IFF16 the amortization was treated as an "expense". Manitoba Hydro's Application for April 2016 Interim Rates, Attachment 46 shows that using Manitoba Hydro's approach in IFF15 would have yielded net income of \$68 M for 2016/17 (versus \$72 M) which translates into \$16M in net income (as opposed to \$20 M) when the rate increase revenues are directed to the Bipole III deferral account, thereby making the IFF16 comparison even more favourable.

Finally, Manitoba Hydro may suggest (and has done so in its discussion of the 2017/18 forecast) that forecast net income levels of \$34 M are too low for a Corporation of its size. This may be true when rate proposals are being considered as part of a normal General Rate Application and the underlying forecasts and policies driving the request can be thoroughly tested.

However, this argument runs counter to the determinations of the Board in Order 59/16 that: i) interim rate increases are only warranted by unforeseen or emergency situations<sup>66</sup> and ii) provided there is an expectation of positive net income for year there is no *prima facie* case for an interim increase that would flow to general revenues<sup>67</sup>.

## **2017/18 Forecast Results**

In its Submission for interim rate increases, Manitoba Hydro claims<sup>68</sup> that comparisons of IFF14, IFF15 and IFF16 forecast results for 2017/18 undertaken by MIPUG and the Coalition did not recognize the change in accounting treatment that took place between IFF15 and IFF16.

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64 PUB Order 59/16, p 10.

65 PUB Order 59/16, p 10,

66 PUB Order 59/16, p 12.

67 PUB Order 59/16, p 11.

68 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 17.

To account for the alleged defect, Manitoba Hydro adjusts the IFF16 forecast results for 2017/18 to reflect the accounting treatment used in IFF14 and IFF15. The results are shown in Figure 8 of the 20 June Submission which reports a net income for 2017/18 of \$61 M based on IFF16 and a 7.9% rate increase, slightly less than the forecast net income for the same year in IFF14 and IFF15. The results also suggest that if there was no interim increase in 2017/18 the net income for the year would be negative.

Manitoba Hydro also alleges<sup>69</sup> that the IFF16 forecast results for 2017/18 assume water flows are based on very favourable water flow conditions and reservoir levels relative to those assumed in IFF14 and IFF15, which were based on average flow conditions.

Hydro asserts that under water flow conditions similar to those used in IFF14 and IFF15, export revenues would be in the order of \$100 M less and that this clearly demonstrates that its financial outlook has deteriorated<sup>70</sup>.

Once again, there are fundamental problems with Manitoba Hydro's comparison of the IFF14, IFF15 and IFF16 forecast results for 2017/18.

Similar to the problems noted regarding the comparisons for 2016/17, Manitoba Hydro has not followed the approach prescribed in the Board's 9 June, 2017 letter.<sup>71</sup>

The following table compares the forecast net income results for F2017/18 based upon the Updated IFF16 versus IFF15-adjusted to incorporate the Board's accounting directives using either the Board's treatment (OIC) or Manitoba Hydro's treatment (Expensed) of the amortization of the ELG/ASL difference and capitalized overheads. For IFF15 the table also includes the results based on the 3.36% average annual increase scenario used by the Board in Order 59/16 and the 3.95% increase initially used by Manitoba Hydro in IFF15.

<b>Figure 4: Comparative 2017/18 Net Income Results</b>		
<b>IFF and 2017/18 Rate Increase Assumptions</b>	<b>2017/18 Forecast Net Income</b>	<b>Source</b>
IFF15 <sup>1</sup> – Board (OIC) Treatment - 3.36% in 2017/18	\$44 M	MH Interim Rate Request for April 2016, Attachment 46
IFF15 <sup>1</sup> - MH (Expensed) Treatment - 3.36% in 2017/18	\$38 M	
IFF15 <sup>2</sup> – Board (OIC) Treatment - 3.95% in 2017/18	\$55 M	MH Interim Rate Request for April 2016, Attachment 28
IFF15 <sup>2</sup> - MH (Expensed) Treatment - 3.95% in 2017/18	\$49 M	

69 Manitoba Hydro Interim Rate Submission, 20 June 2017, pp 17-18.

70 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 18.

71 PUB letter, 9 June 2017.

Updated IFF16 - MH (Expensed) Treatment - 0% in 2017/18	\$92 M	Appendices 36 & 37
Updated IFF16 - MH (Expensed) Treatment - 1.6% in 2017/18	\$109 M	
Updated IFF16 - MH (Expensed) Treatment - 3.36% in 2017/18	\$128 M	
Updated IFF16 - MH (Expensed) Treatment - 7.9% in 2017/18	\$175 M	

Notes: 1) In each case the net income reported for 2017/18 has been reduced by \$52 M to reflect the Board's decision to direct the 2016/17 increase to the Bipole III deferral account.  
2) In each case the net income reported for 2017/18 has been reduced by \$61 M to reflect the Board's decision to direct the 2016/17 increase to the Bipole III deferral account.

Based on the Update IFF16, Manitoba Hydro is looking at \$92 Million in net income in 2017/18 even without a rate increase and \$109 Million in net income based on a 1.6% rate increase even using Manitoba Hydro's treatment (Expensed) of the amortization of the ELG/ASL difference and capitalized overheads rather than the Board's treatment (OIC).<sup>72</sup>

Based on the Board's approved methodology, the forecast net income for 2017/18 is positive even with no interim rate increase which would indicate, based the same principles that the Board used in Order 59/16,<sup>73</sup> that there is no *prima facie* case for an interim increase.

Indeed, in all cases (even where there is no interim rate increase for 2017/18) the projected net income for 2017/18 now exceeds the 2017/18 forecast income in the IFF15 scenarios, including the one which Board Order 59/16 is based (i.e., equal annual rate increases of 3.36% to achieve the target equity ratio). This suggests that the financial outlook for 2017/18 has not deteriorated and, indeed, has improved from that set out in IFF15 based on the Board's approved accounting methodology.

It should also be noted that for IFF16 Manitoba Hydro has changed the amortization period for the regulatory deferral accounts related to ineligible overhead capitalization and the difference between ELF vs. ASL depreciation both of which will increase the amounts amortized in 2017/18.<sup>74</sup> Adjusting for this "methodology" change would make the current forecasts for 2017/18 even more favourable.

Manitoba Hydro's argument that the original IFF16 2017/18 forecast is based on very favourable water flow conditions is inconsistent with the Main Application<sup>75</sup> where it is

<sup>72</sup> See Scenarios in Appendix 3.7.

<sup>73</sup> PUB Order 59/16, p 11.

<sup>74</sup> MIPUG MFR 5.

<sup>75</sup> Tab 7, page 29

stated that for the second year of IFF16 (which is 2017/18) inflow assumptions are based on the full range of historic inflow conditions similar to the approach used in subsequent years of the forecast.

Manitoba Hydro's argument that the favourable forecast for initial reservoir levels in 2017/18 masks a deterioration in its financial outlook is one-sided and self-serving:

- Despite these arguments, Manitoba Hydro has made no claims/case that the forecast reservoir levels underpinning its 2017/18 outlook (which is based on current information regarding reservoir levels and water flow conditions) are not the best forecast available or inappropriate for purposes of forecasting 2017/18 financial results.
- While arguing that the improvement in Manitoba Hydro's financial outlook for 2017/18 should be viewed with caution due to the changed assumptions regarding reservoir levels, Hydro does not offer similar arguments with respect to its revised forecast for exports prices which are substantially lower in IFF16 than in IFF15. Indeed, the revised export price forecast (again based on the best information available) more than offsets the favourable impact of the higher water flows.<sup>76</sup>
- While Manitoba Hydro is now arguing that actual (favourable) water conditions should be ignored or at least downplayed when considering the need for an interim rate increase, it is doubtful that the Company would take such an approach if the forecast called for lower than average water flows or reservoir levels. Indeed, as it did in the 2004/05 & 2005/06 GRA,<sup>77</sup> it is likely that Manitoba Hydro would to rely heavily on the lower water conditions to buttress its case for rate increases.

### Rebutting Allegation 3. Current rates must eventually rise

On many occasions, in its Interim Rate Submission<sup>78</sup>, Manitoba Hydro references the future cost pressures that the corporation will face primarily due to the in-service of Bipole III and Keeyask. It argues that no rate increase in 2017/18 will simply lead to higher increases in later years.<sup>79</sup>

Hydro faults Interveners for allegedly failing to look beyond 2018/19.

That submission is based on an impoverished reading of the Interveners' comments. On pages 6-7 of its 25 May 2017 submissions, Manitoba Industrial Power Users Group acknowledged the need to look beyond the test years and indicated that it was only by taking such a perspective that an interim increase of any level could be justified. Similar points were also made in the Coalition's 26 May 2017 submissions.<sup>80</sup>

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76 Page 18, Figure 9.

77 2004-2005 GRA Application, Tab 1, page 1: "In the 2004/05 and 2005/06 test years, due to the usually severe impacts of the current drought, Manitoba Hydro is no longer able to achieve its projected revenue requirements without requesting rate increases".

78 See Manitoba Hydro 20 June 2017 Submissions, p 2 (lines 6-10 & 27-29); p 8 (lines 13-15); p 10 (lines 27-34); p 11 (lines 20-29) and p 18 (line 23) to p 19 (line 6).

79 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 2 (lines 30-32) and p 10 (lines 20-22).

80 Consumers Coalition 26 May 2017 Submission, p 6 and Appendix B, p 20.

The following table compares the IFF15 financial outlook for returning to the 25% equity target set by the Corporation with financial projections for achieving 25% over similar time frames based on Updated IFF16:

<b>Schedule 5: Comparative Long-Term IFF Results</b>					
	<b>25% Equity Achieved by</b>	<b>Average Rate Increase</b>	<b>Minimum Equity Ratio</b>	<b># Years with Negative Net Income</b>	<b>Source</b>
A) IFF15 – as filed by MH (ELG & no Overhead Capitalization)	2031/32	- 3.95% for 2017-2029 - 2% thereafter	12%	3	Interim Rate Request for April 2016, Attachment 1
B) IFF15 – per BO 59/16 Accounting Treatment <sup>1</sup>	2030/31	- 3.95% for 2017-2029 - 2% thereafter	13%	None	Interim Rate Request for April 2016, Attachment 28
C) IFF15 – per BO 59/16, with MH Accounting Treatment <sup>2</sup>	2030/31	- 3.95% for 2017-2029 - 2% thereafter	13%	None	Interim Rate Request for April 2016, Attachment 28
D) IFF15 – per BO 59/16 Accounting Treatment <sup>1</sup>	2033/34 (same as IFF14)	- 3.36% to 2033/34	12%	3	Interim Rate Request for April 2016, Attachment 46
E) IFF15 – per BO 59/16, with MH Accounting Treatment <sup>2</sup>	2033/34 (same as IFF14)	- 3.36% to 2033/34	12%	5	Interim Rate Request for April 2016, Attachment 46
F) Updated IFF16 – with MH Accounting Treatment <sup>1</sup>	2033/34 (same as IFF14)	- 4.05% to 2033/34	13%	4	PUB MFR 73 - Updated
G) Updated IFF16 – with MH Accounting Treatment <sup>1</sup>	2031/32 (same as original IFF15)	- 4.53% to 2031/32	14%	1	PUB MFR 73 - Updated



- Notes: 1) Difference between ELG and ASL Depreciation and Ineligible Overheads amortized to OIC.  
2) Difference between ELG and ASL Depreciation and Ineligible Overheads amortized as an Expense.

Based on IFF15 and the Board' direction to continue to use ASL based depreciation and to capitalize overheads, achieving a 25% equity ratio by 2033/34 would require equal annual rate increases of 3.36% up to that date (See row E above) whereas based on the Updated IFF16, average annual rate increases of 4.05% are now required.

As a result, one could conclude that the long term outlook for Manitoba Hydro has deteriorated between IFF15 and IFF16. However, it should be noted that the IFFs are not totally comparable in term of "methodology". In IFF16 MH has shortened the amortization period for its regulatory deferral accounts related to ineligible overheads and the difference between ELG vs. ASL depreciation. It also ended the deferral as of 2022/23 whereas in IFF15 the deferral period was indefinite.<sup>81</sup>

However, achieving a 25% equity ratio by 2033/34, which is the same date as in IFF14 and the same date as used by the Board in its assessment of IFF15 and the need for an interim rate increase effective 1 April 2016, does not require rate increases anywhere near the 7.9% level requested by Manitoba Hydro.

Rather, achieving a 25% equity ratio by 2033/34 would require 4.05%/annum. Similarly, achieving 25% by 2031/32, the same date as in the original IFF15 prepared by Manitoba Hydro, based on the Updated IFF16 would require an average annual rate increase of 4.53%. Both 4.05% and 4.53% are materially less than the 7.9% requested by Manitoba Hydro.

It is acknowledged that this later comparison is not exactly an "apples to apples" comparison as the date for achieving 25% equity in IFF15 (2031/32) is based on different accounting practices regarding depreciation (ELG as opposed to ASL) and overhead treatment (no capitalization) than IFF16.

However, Manitoba Hydro did not provide, nor did the Board direct the corporation to file, a scenario that would show the average annual rate increases needed to achieve 25% equity by 2030/31. While the average annual rate increase will be greater than 4.53% it will also be materially lower than 7.9%, particularly if the regulatory deferral account amortization is corrected to match that use in Board Order 59/16.

#### *Rebutting Allegation 4. Previous rate plan no longer tenable*

At page 19 of its 20 June 2017 submissions, Manitoba Hydro discusses its past plans for achieving the target equity ratio, which called for doing so over a longer period of time than that set out in IFF16 and which also anticipated a further deterioration in its financial results (e.g. lower equity ratio and years with negative net income) when Bipole III and Keeyask first come into service.

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81 MIPUG MFR 5.

Manitoba Hydro indicates<sup>82</sup> that these “plans” relied on continued domestic load growth and real growth in forecast export prices and that these assumptions are no longer valid – i.e., the outlook has changed since IFF15. The submission also suggests that the change (reduction) in forecast interest rates in IFF16 is something that cannot be relied on.

Manitoba Hydro concludes<sup>83</sup> that its “previous plans were not sufficiently robust to address current circumstances”.

For purposes of considering Manitoba Hydro’s interim rate request, the Board has directed<sup>84</sup> that the focus should be on what has changed since Order 59/16.

As a result in considering Manitoba Hydro’s submissions it is important to separate out:

- What has actually changed in the IFF and the associated financial plan?
- versus
- What has changed in terms of Manitoba Hydro’s view as to the acceptability of the risks associated with the IFF and the associated financial plan?

The first issue is legitimately within the scope set by the Board’s 9 June 2017 letter. The second issue is not and is rather one of the major issues to be explored in the upcoming GRA.

It is clear that the load forecast and export price forecast are both lower in the Updated IFF16 than in IFF15. However, PUB MFR 73 (Updated) demonstrates that with increases far less than 7.9% but somewhat higher<sup>85</sup> than those envisioned by the PUB in Order 59/16, Manitoba Hydro can still be expected to achieve its target 25% equity ratio in 2033/34. Furthermore, as can be seen from Schedule 5 (above), it does so with more favourable long term financial results than in the scenario used by the Board in Order 59/16.<sup>86</sup>

The upshot is that the previous financial plan is still viable even with the lower forecast load growth and export price outlook. The reasons are that the same underlying market/global conditions that underpin the lower load forecast and export price outlook have also reduced forecast interest rates in (at least) the near term. The forecast Operation, Maintenance and Administration cost reductions are also assisting in this regard.

Manitoba Hydro suggests<sup>87</sup> that adopting a financial plan similar to that underpinning IFF15 would be relying on natural phenomena (i.e., high water flows) to achieve the targeted results. However, IFF16 only relies on higher water flows and reservoir levels for

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82 Manitoba Hydro 20 June 2017 Submissions, p 19.

83 Manitoba Hydro 20 June 2017 Submissions, p 22.

84 PUB Letter, 9 June 2017.

85 4.05% versus 3.36%

86 Compare Rows D and G of Schedule 5.

87 Manitoba Hydro Interim Rate Submission, 20 June 2017, p 19, lines 33-35.

the initial years – when they are known to exist. For the balance of the projection period IFF16 is based on the average results of flow conditions for the past 102 years.<sup>88</sup>

With respect to Manitoba Hydro's concern that the low interest rate forecast in IFF16 cannot be relied on, it is noted that the 2017 Economic Outlook<sup>89</sup> used in the Updated IFF16 calls for higher interest rates throughout the period than those in the original IFF16. Indeed, beyond the year 2022/23, the long term<sup>90</sup> Canadian interest rate forecast in the 2017 Economic Outlook is higher than that used in IFF15.<sup>91</sup>

Manitoba Hydro notes that the lower interest expense forecast in IFF16 is predicated on higher rate increases in the short term, which, when combined with a shortening of the weighted average maturity of its debt portfolio, allows for more debt to be retired over the period.

First, it is important to note that this debt management strategy differs significantly from that put forward in the last General Rate Application<sup>92</sup> and is currently untested, representing another key issue for the upcoming General Rate Application. However, even then, the alternative scenarios provided for IFF15 and the Updated IFF16 show that with equal average rate increases of 3.36%<sup>93</sup> and 4.05%<sup>94</sup> respectively, so as to achieve the 25% target equity ratio in 2033/34, the Updated IFF16 scenario still has a lower total finance expense over the period.<sup>95</sup>

Overall, the previous plan is still viable under IFF16 (albeit with higher average annual rate increases) in terms of achieving the target debt equity ratio in the same time frame as anticipated in IFF14 and IFF15 with similar financial results during the ensuing years. What has really changed is Manitoba Hydro's view as to the appropriateness of such a plan. It is this new perspective that is driving the request for a 7.9% interim rate increase.

## **Applying the Coalition's Interim Rate Analysis**

In applying its Interim Analysis framework<sup>96</sup>, the Consumer Coalition found an

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88 Appendix 3.1, page 16.

89 PUB MFR 53 - Updated

90 10 Years+.

91 As provided in the Application for Interim Rates Effective 1 April 2016, Attachment 22.

92 20015/16 & 2016/17 General Rate Application, Tab 3, p 17 and Appendix 3.7 – describes a strategy of increasing weighted average maturity of its debt portfolio in order to “lock-in” low interest rates.

93 Manitoba Hydro Application for Interim Rates for April 2016, Attachment 46.

94 PUB MFR 73-Updated.

95 Total finance expense over 2017/18 through 2033/34 inclusive.

96 Focusing on the question of whether Hydro is likely to face an “emergency” or “urgent” situation in the absence of a rate increase, the Consumer Coalition considers both:

- the projected cash flows for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16; and
- the projected net income levels for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16.

Considering the overall public interest, the Coalition also considers whether Hydro or its ratepayers will suffer any material “deleterious” effect in the absence of a rate increase. Recognizing past challenges with Hydro's credibility as well as the untested nature of Hydro's evidence, the Coalition's analysis considers:

- what has changed in its Integrated Financial Forecast since the Board issued *Order 59/16* based

overwhelming case to reject Hydro's 7.9% interim application as untested and unreasonable.

Accepting a rate shock application based upon unproven and untested methodological changes in an interim process would be inconsistent with the direction of the 9 June 2017 direction of the Board. It would undermine the trust placed in the regulatory process by the unprecedented numbers of ratepayers who have made submissions to the Board. It would enable an interim preemptive strike against active participation by consumers.

In the Coalition's view, granting this interim rate request as proposed by Manitoba Hydro is likely to encourage Manitoba Hydro's unhealthy addiction to interim rates. It may also contribute to Manitoba Hydro ignoring Board directives, as we have already begun to see when it did not file its rate application by December 2016 and when it filed for an interim rate application on 5 May 2017.

After rejecting the Manitoba Hydro Interim Rate proposal, the Consumer Coalition tested three main options:

- 3.36% - 4.05% on the grounds that:
  - no urgency or emergency has been demonstrated; and
  - this range is generally consistent with the most recent PUB Interim Order 59/16.
  
- 1.6% (inflation) given that:
  - no urgency has been demonstrated;
  - inflation is a relatively objective measure of some cost pressures; and
  - based on the Update IFF16, Manitoba Hydro is looking at \$109 Million in net income based on a 1.6% rate increase even using Manitoba Hydro's treatment (Expensed) of the amortization of the ELG/ASL difference and capitalized overheads rather than the Board's treatment;
  
- 0% on the grounds that:
  - no urgency or emergency has been demonstrated;
  - based on the Updated IFF16, Manitoba Hydro's capital coverage target for 2017/18 would be met even if there was no interim rate increase;
  - based on the Update IFF16, Manitoba Hydro is looking at \$92 Million in net income in 2017/18 even without a rate increase approved;
  - Hydro did not comply with past PUB directives to avoid interim rate

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on the Board mandated methodology for IFF15;

- whether Manitoba Hydro's interim rate submissions have complied with the 9 June 2017 direction of the PUB to apply the Board mandated methodology; and
- the trade-offs between achieving enhanced regulatory efficiency and certainty for consumers by weaning Manitoba Hydro off its unhealthy addiction to interim rate applications versus future rate smoothing via a contribution to the Bipole III deferral fund either in the range of inflation or consistent with Board Order 59/16.

- increases and get its regulatory house in order;
- Hydro's submissions lack credibility given their long standing challenges with forecasting and their malleable metric for cash flow, and
- Hydro's forecasts for 2017/18 and not in compliance with the directive found in the PUB Letter of 9 June 2017.

In considering the three options above, the Consumer Coalition relied heavily on:

- Updated IIF16 projections in terms of capital coverage and net income ratios;
- the need to protect consumers by weaning Hydro off its addiction to interim rates; and
- fundamental concerns with the credibility of Manitoba Hydro especially given its malleable metrics for cash flow and its failure to adhere to the direction of the 9 June 2017 direction of the PUB

Based upon its consideration of the three options above and the analysis conducted, the Consumers Coalition recommends that no interim rate increase be granted at this time.

In making this conclusion, the Consumers Coalition notes that despite its hyperbole, Manitoba Hydro does not face an emergency or urgent situation.

Based upon Update IFF16, the expected capital coverage and net income forecasts for 2017/18 do not suggest a material deleterious effect in the absence of a rate increase at this time.

The Consumers Coalition notes that the full General Rate Application process will begin in less than 6 months, following which the PUB will be in a position to make recommendations regarding a rate increase based upon the totality of the evidence presented.

Should the PUB determine based on the evidence presented by Manitoba Hydro and Interveners that it has no choice but to grant some level of interim relief to Manitoba Hydro, the Consumers Coalition would propose an interim rate increase of no higher than the rate of inflation, in the range of 1.6%, be granted.

The Consumers Coalition would note that Manitoba consumers who will have to pay higher bills for Manitoba Hydro's services as a result of any interim rate increase granted do not get the benefit of adjustments to their income based on the rate of inflation.

### **Hydro's Unhealthy Addiction**

Before concluding, the Consumers Coalition wishes to reiterate its recommendation that:

- Manitoba Hydro be directed to present a proposal to the Public Utilities Board and to Manitoba consumers by no later than May 1, 2018 to bring its regulatory house into order and end its unhealthy addiction to interim rate

increases.

Except in exceptional circumstances, interim rate increases work to the detriment of Manitoba consumers and to public confidence in the regulatory process. Interim rates enable Manitoba Hydro to delay rigorous scrutiny under oath. They create budgeting uncertainty for consumers and business.

Interim rate increases enable the imposition of significant rate increases without rigorous “before the fact” regulatory review. They allow for the entrenchment of a regulatory *status quo* that is difficult to overturn.

The Board recognized the challenges associated with interim rate increases when it stated:

The Board shares the Interveners' concerns that interim applications ought not be the 'norm' for Manitoba Hydro. Interim rate applications do not offer the same level of public review as General Rate Applications. Manitoba Hydro's internal planning cycles will need to be adjusted, with prior Board and Intervener consultation, if the Utility requests rate adjustments to coincide with April 1 – the start of Manitoba Hydro's fiscal year.<sup>97</sup>

In Board Order 59/16, Manitoba's Public Utility Board (PUB) sought to put a stop to Manitoba Hydro's unhealthy addiction<sup>98</sup> to interim rate increases. The PUB indicated that:

- The Board is not prepared to consider interim rate applications unless warranted by unforeseen or emergency situations.<sup>99</sup>
- [I]interim rate applications ought not be the ‘norm’ for Manitoba Hydro.<sup>100</sup>
- Manitoba Hydro is to adjust its planning cycles to ensure the required information is available on a timely basis.<sup>101</sup>
- Manitoba Hydro is therefore directed to file on or before December 1, 2016, a General Rate Application to finalize rates for the 2016/17 fiscal year and prospectively set rates for the 2017/18 fiscal year. A December 2016 filing would allow for the adjustment of consumer rates for August 1, 2017.<sup>102</sup>

The Board's express direction to Manitoba Hydro created a legitimate expectation<sup>103</sup>

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97 PUB Order 59/16, p 5.

98 In its February 2016 commentary *Manitoba Hydro and Interim Rates: An Unhealthy Addiction*, the Coalition provided a more extensive criticism of its concerns that Manitoba Hydro's regulatory house was not in order and the detrimental effect of interim rates on consumers.

99 PUB Order 59/16, p 4 and 12.

100PUB Order 59/16, p 13.

101PUB Order 59/16, p 13.

102PUB Order 59/16, p 13.

103*Old St Boniface Residents Association Inc v Winnipeg (City)*, [1990] 3 SCR 1170 at paras 110-111; *Centre hospitalier Mont-Sinaï c Québec (Ministre de la Santé & des Services sociaux)*, 2001 SCC 41 at

among Manitoba consumers and business that:

- Manitoba Hydro would be expected to get its regulatory house in order,
- interim rate increases would be limited to unforeseen or emergency situations, and
- future processes would respect the process guidance set out in Order 59/16.

Following Board Order 59/16, Manitoba Hydro did not file a December 2016 rate application. Rather than provide its independent regulator with an evidence based Integrated Financial Forecast in December 2016, the Chairperson of the Hydro Board undertook a highly public and rhetorical campaign alleging a financial crisis for the Crown monopoly.<sup>104</sup>

The Board will be familiar with the practice in many other Canadian jurisdictions of general rate cases being filed approximately 6 to 12 months before rates are required, depending on the level of complexity of the case, and the number of years of rate increases being requested for approval.

With a well managed regulated entity, this should be a "clockwork" type of process, so ratepayers are not faced with inappropriate rate increases, or the need to "correct" rates with refunds or subsequent increases.

From the perspective of the Consumer Coalition, it is important to put the ratemaking process on a more predictable and sustainable footing.

## **Conclusion**

Manitoba consumers are entitled to reasonably rely on the Board's indication that it was "not prepared to consider interim rate applications unless warranted by unforeseen or emergency situations."<sup>105</sup> Board Order 59-16 sent a clear message to Manitoba Hydro to get its regulatory house in order and to Manitoba consumers that the unhealthy practice of interim rate applications would cease except in truly unforeseen or urgent circumstances.

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paras 22-38. The doctrine of legitimate expectation is part of the duty of fairness and is based on the principle that procedural fairness must take into account the promises or regular practices of delegates and that it will be unfair for them to act inconsistently with representations as to procedure.

<sup>104</sup>For example: on October 18, 2016, the chair of Manitoba Hydro stated "The question everyone asks me is, 'How are we going to get out of this mess?' There's going to be pain, relative to where we are today, suffered by everybody. Clearly, Hydro's operations are going to require a significant restructuring and that will not be pleasant for the people at Hydro" (CBC news: <http://www.cbc.ca/news/canada/manitoba/manitoba-hydro-bipole-transmission-line-1.3811316>); on February 6, 2017, the chair of Manitoba Hydro stated "Even with these reductions, double digit annual rate increases would be required for at least five years in order to re-establish Manitoba Hydro on a proper financial footing," (CBC news: <http://www.cbc.ca/news/canada/manitoba/manitoba-hydro-rate-increase-pallister-business-low-income-1.3969221>); on February 7, 2017 the chair of Manitoba Hydro stated "We want to make people understand, this is a big problem. It's not a small problem. We take that position not only from Manitoba Hydro's perspective, but from the perspective of the government of Manitoba and the people of Manitoba; Hydro is a ticking time bomb" (CBC news: <http://www.cbc.ca/news/canada/manitoba/manitoba-hydro-sandy-riley-rate-increases-1.3970470>).

<sup>105</sup>PUB Order 59/16, at p 4 and 12.

Manitoba Hydro has not discharged its onus and has not presented a *prima facie* case for an interim rate increase. Stepping away from the inflammatory rhetoric used over recent months, it is clear that “unforeseen or emergency situations”<sup>106</sup> have not been demonstrated.

Rather, the pending rate application assumes that issues of profound importance to current and future generations of Hydro ratepayers have already been tested and approved by the Public Utilities Board.

These key issues must be determined in the context of a full General Rate Application proceeding where Manitoba Hydro's evidence can be tested in a public, transparent and accountable proceeding.

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106PUB Order 59/16, at p 4 and 12.