

Manitoba Hydro
Interim Rates August 1, 2017
Reply Submission

July 19, 2017

The Public Utilities Board Act

Application to Manitoba Hydro

[2\(5\)](#) Subject to Part IV of *The Crown Corporations Public Review and Accountability Act* and except for the purposes of conducting a public hearing in respect of an application made to the board under subsection 38(2) or 50(4) of *The Manitoba Hydro Act*, this Act, other than subsection 83(4) and the regulations under that subsection, does not apply to Manitoba Hydro and the board has no jurisdiction or authority over Manitoba Hydro.

The Crown Corporations Governance and Accountability Act

Factors to be considered, hearings

[25\(4\)](#) In reaching a decision pursuant to this Part, The Public Utilities Board may

(a) take into consideration

- (i) the amount required to provide sufficient funds to cover operating, maintenance and administration expenses of the corporation,
- (ii) interest and expenses on debt incurred for the purposes of the corporation by the government,
- (iii) interest on debt incurred by the corporation,
- (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,
- (vi) liabilities of the corporation for pension benefits and other employee benefit programs,
- (vii) any other payments that are required to be made out of the revenue 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

(b) hear submissions from any persons or groups or classes of persons or groups who, in the opinion of the Board, have an interest in the matter.

Consumers Association of Manitoba, Manitoba Society of Seniors and Manitoba Industrial Power Users Group v Manitoba Hydro

The role of the PUB under the Accountability Act is not only to protect consumers from unreasonable charges, but also to ensure the fiscal health of Hydro. It is clear the PUB understood its role in this regard.

*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.*

2005 MBCA 55 at para. 64

The Crown Corporations Governance and Accountability Act

PART 4

PUBLIC UTILITIES BOARD REVIEW OF RATES

Hydro and MPIC rates review

[25\(1\)](#) Despite any other Act or law, rates for services provided by Manitoba Hydro and the Manitoba Public Insurance Corporation shall be reviewed by The Public Utilities Board under *The Public Utilities Board Act* and no change in rates for services shall be made and no new rates for services shall be introduced without the approval of The Public Utilities Board.

Definition: "rates for services"

[25\(2\)](#) For the purposes of this Part, "**rates for services**" means

- (a) in the case of Manitoba Hydro, prices charged by that corporation with respect to the provision of power as defined in *The Manitoba Hydro Act*; and
- (b) in the case of The Manitoba Public Insurance Corporation, rate bases and premiums charged with respect to compulsory driver and vehicle insurance provided by that corporation.

Application of Public Utilities Board Act

[25\(3\)](#) *The Public Utilities Board Act* applies with any necessary changes to a review pursuant to this Part of rates for services.

The Public Utilities Board Act

Interim Order

47(2) The board may, instead of making an order final in the first instance, make an interim order and reserve further directions, either for an adjourned hearing of the matter, or for further application.

PUB Orders

- *All Board Members at the Interim Rate Consideration Hearing find that the Board has the jurisdiction to approve interim rate adjustments for MH (Order 18/10, p.5)*
- *In response to Interveners views as to the ability of the Board to approve an interim rate increase and that approving an across-the-board interim increase could disadvantage certain classes, the Board finds: a) that it has the necessary jurisdiction – urgency is not a required condition: (Order 40/11, pg. 28)*
- *As it has found previously, the Board confirms that it has jurisdiction to approve interim rates for MH... (Order 116/12, pg. 18)*
- *The questions to be determined by this Board are whether it would be just and reasonable to grant interim rates, and whether Manitoba Hydro would suffer a deleterious effect in the absence of an interim rate increase. For the reasons set out below, the Board considers it to be in the public interest to approve an interim rate increase, albeit at a level lower than requested by Manitoba Hydro.... The Board agrees with Manitoba Hydro's rebuttal submission that urgency is not a necessary precondition for an interim rate increase (Order 49/14, pg. 16 & 17)*

The Public Utilities Board Act

Orders involving expense to parties to be after notice and hearing

48 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.

The Crown Corporations Governance and Accountability Act

Compensation or refunds

27 When a new rate for services or an increased rate is allowed pursuant to an interim order and a final order does not allow any changes or allows changes other than those permitted in the interim order, the Public Utilities Board may make any order to compensate for or to refund any excess amounts collected by the Corporation that it considers necessary and appropriate in the circumstances

Coalition's Assertion that Manitoba Hydro's forecasts do not comply with PUB Directives is Unfounded

- Order 59/16 reiterates the accounting directives issued by the PUB in Order 73/15 related to depreciation methodology and capitalization of overheads:

Manitoba Hydro is to continue to use its existing Average Service Life methodology for calculating depreciation rates for rate-setting purposes until the Board is satisfied that a change in methodology is warranted.” (Directive 10, Page 97)

The Board will not accept the higher level of OM&A costs requested in this application but will allow \$36 million of additional costs be expensed for 2015/16 as indicated at the last GRA. (Page 35)

- As discussed in Tab 10, (Section 10.4.4), Manitoba Hydro records its IFRS compliant depreciation using the ELG method in depreciation expense, and the difference between the IFRS ELG method and the CGAAP ASL method is recognized in a regulatory deferral account with a subsequent adjustment recorded in Net Movement on the Statement of Income.
- In effect, Manitoba Hydro is continuing to apply the CGAAP ASL method for determining depreciation expense, consistent with the Directive 10 of Order 73/15.
- Further, the same approach is used to capture the difference between overhead capitalized for financial reporting and what the PUB has set out in Order 73/15 for rate setting purposes where \$20 million was requested to be capitalized rather than expensed.

Coalition asserts that Manitoba Hydro's forecast for 2016/17 does not comply with the PUB Mandated Methodology for IFF15

- MH16 filed with the GRA had initially assumed amortization of the regulatory deferral account for the ELG/ASL difference over a 20 year period beginning in 2017/18.
- Manitoba Hydro's Supplement to Tab 3 - MH16 update removes the amortization of the deferral account from the test years, until 2019/20 to allow for the PUB's review of the recovery of the deferral account as part of the GRA.
- Manitoba Hydro notes that the deferral of amortization results in an increase in net income of only \$22 million over the 10 year period to 2026/27. (Supplement to Tab 3, p. 14)

Coalition states that the PUB Mandated Methodology for IFF15 requires that Manitoba Hydro capture differences in Depreciation Methodology through Other Comprehensive Income

- Coalition has suggested that the difference between the IFRS ELG and CGAAP ASL methodologies should be charged to Other Comprehensive Income (OCI) in order to be compliant with Directive 10 of Order 73/15.
- In the 2016/17 Supplemental Filing, a scenario (Attachment 28) was filed which requested the presentation of the amortization of the regulatory deferral accounts through Other Comprehensive Income.
- Manitoba Hydro notes that this was a scenario, not a finding or Directive of the PUB in either Order 73/15 or 59/16.
- As discussed in Section 10.4.4 and in the response to MIPUG MFR 5, amortization through OCI of the differences between ELG/ASL depreciation methodologies and ineligible overhead captured in the regulatory deferral account is not compliant with the requirements of IFRS 14.
- Manitoba Hydro's approach is consistent with the rate regulated accounting framework of IFRS14 Regulatory Deferral Accounts as well as Directive 10 from Order 73/15.

The MH16 Update reflects a Significant, Material Deterioration to the top-line from MH15

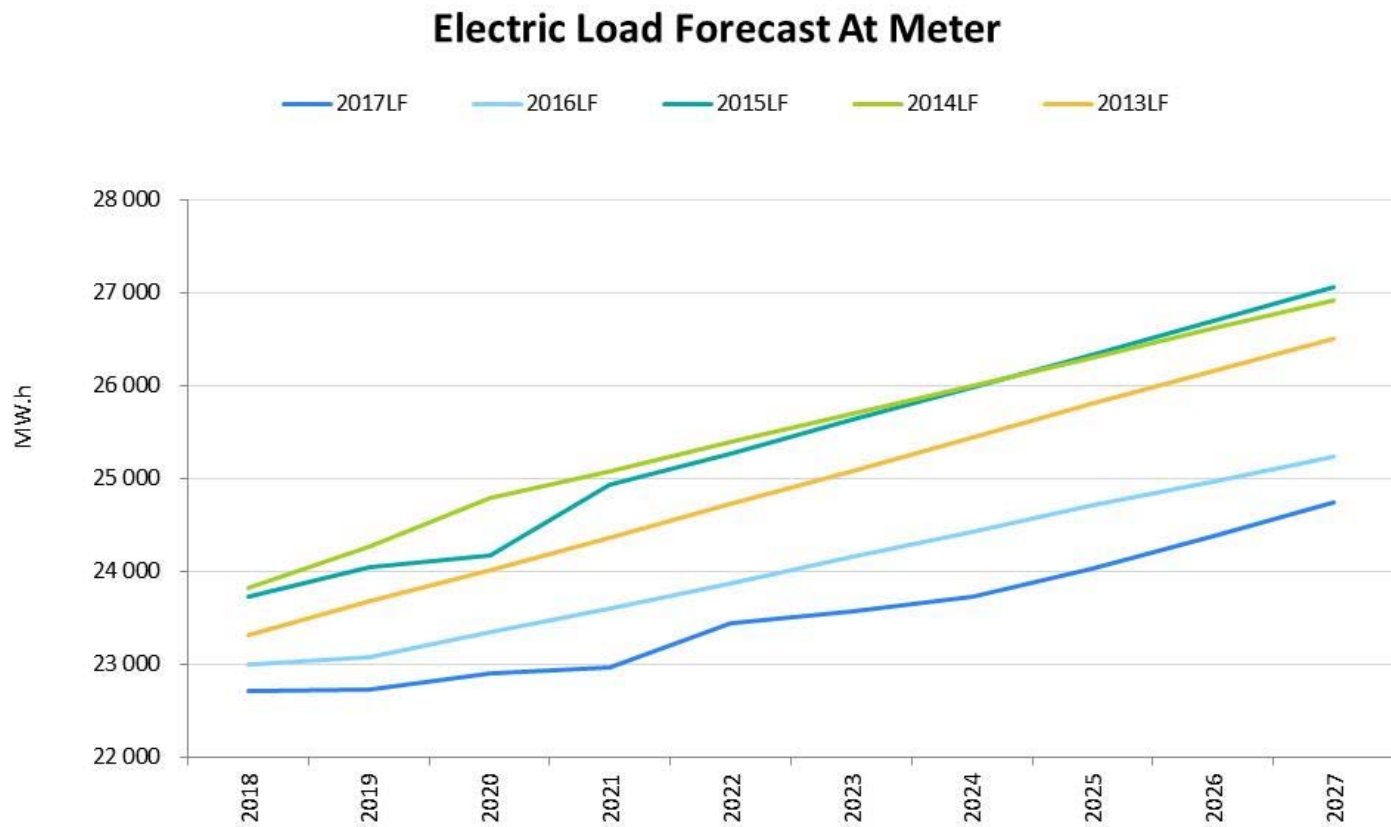
- Domestic revenue is down approximately \$900M at today's rates and domestic growth (net of DSM) is negative in the near term
- Electricity export prices are now down 30% (on-peak) to 35% (off-peak) contributing to an \$880M reduction to net export revenue notwithstanding extraordinary water conditions in the early years of the forecast
- MH is not going to grow its way out of this situation and its financial plan (inclusive of rate increases) must reflect that

The MH16 Update reflects a Significant, Material Deterioration to the top-line from MH15

- Contrary to MIPUG's assertion that the MH16 Update forecast of costs are precisely that of MH15, interest savings are paying for the bulk of revenue erosion - \$500 M from shorter terming and another \$500 M due to lower interest rate forecasts
- MH should not continue to rely solely on interest rates remaining at historical low levels
- To date, a financial crisis for MH, coupled with rate shock for its customers, has been deferred due to two factors outside MH's control, namely:
 - Interest rates declining to levels not experienced in 80 years; and,
 - 2017 will be the 14th consecutive year of above average water flows.

MH16 Forecast Assumptions Not Pessimistic

- **Electricity Load Growth**
 - Successive forecasts have continually proven too robust



MH16 Forecast Assumptions Not Pessimistic

- **Electricity Load Growth**

- Optimism in 2017 load forecast despite market conditions of certain sectors
- DSM targets no longer in MH's control with the creation of Efficiency Manitoba
- PLIL has not been removed
- PUB has expressed concern with Top Consumer growth forecasts in the past
- Manitoba Hydro notes there has been a 5% decrease in Top Consumer load since 2007

PUB Expressed Concerns with Potential Large Industrial Load

Order 73/15

Pg. 78 – There is evidence that Manitoba Hydro consistently over-estimates the Top Consumers load growth. The first year of each load forecast for the past five years over-estimated the Top Consumers load in the greater-than-100 kV sub-class. The Potential Large Industrial Load (“PLIL”) does not recognize the last ten years of near zero load growth in the Top Consumers sector, or that using PLIL in addition to large pipeline load additions overlaps in some years and may be double-counting. The Board sees Manitoba Hydro’s PLIL as an inappropriate upward adjustment that does not reflect the recent Top Consumers load growth history. The Board recommends that Manitoba Hydro take a more rigorous approach to forecasting the Top Consumers load.

Pg. 87 – The Board is concerned that successive Manitoba Hydro export price forecasts have been revised downward and consistently overestimate actual results.

PUB Expressed Concerns with Potential Large Industrial Load

Order 59/16

Pg. 37 – As noted in Order 73/15, the Board continues to have concerns with Manitoba Hydro’s forecasts for Top Consumers load growth. The deferral of additional pipeline load in the Oil and Gas sector by one year demonstrates the variations in industrial load growth. The Potential Large Industrial Load (PLIL) does not recognize the last ten years of near zero load growth in the Top Consumers sector, or that using PLIL in addition to large pipeline load additions overlaps in some years and may be double-counting. The Board continues to question Manitoba Hydro’s PLIL assumptions and the upward adjustment to the load forecast associated with PLIL.

Pg. 39 – The Board continues to be concerned with the decade-long trend of Manitoba Hydro’s forecasting inaccuracies and further revising its export price forecast downward every year

MH16 Forecast Assumptions Not Pessimistic

- **Export Revenue**

- Dependable premium removed to reflect market realities
- Capacity values removed for prudence (no new counterparties with even a signed term sheet) and do not have a material impact before 2025 in any event

MH16 Forecast Assumptions Not Pessimistic

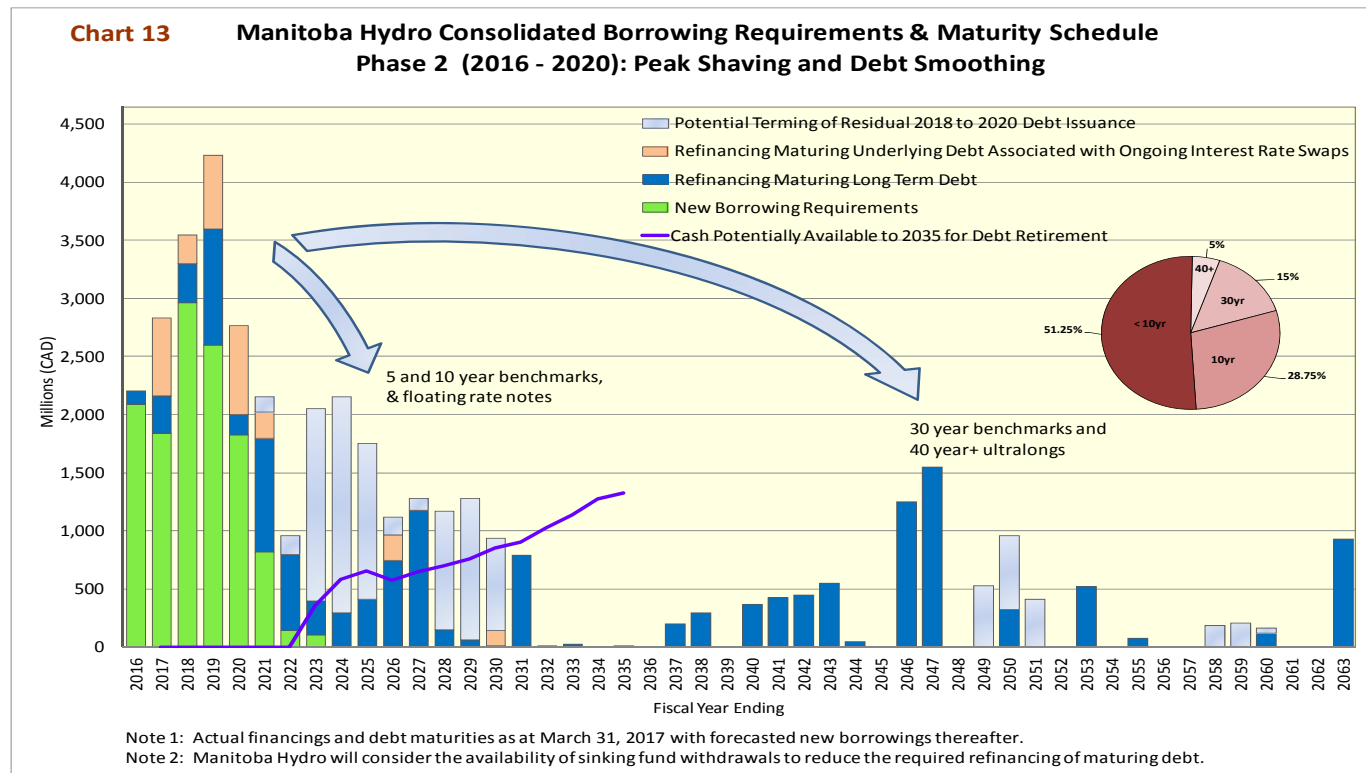
- **Interest Rates for 2017/18**
 - 5 year Government of Canada Fixed Rate
 - March 31, 2017 1.12%
 - IFF16 (2017/18 assumption) 1.27%
 - IFF16 Update (2017/18 assumption) 1.37%
 - July 6, 2017 1.44%

MH Risks are not Diminishing

- Keeyask is a large, complex project and is a long way from being finished
- Over \$12B will be borrowed over the next 5 years including refinancing to complete major investments (assuming 7.90% proposed rate increases)
- Debt must be repaid and we are shortening our average term to maturity increasing our re-financing risk as early as 5 years out (2023)

Debt Risk Does Not Disappear

- Contrary to MIPUG testimony, MH is planning on issuing the majority of new borrowings in terms under 10 years.
- The following chart indicates the potential impact of the new terming strategy which involves issuing 51.25% of the new borrowings with 3-7 year terms to maturity, 28.75% with 10 years, 20% with 30+ years



Source: Appendix 3.5, page 1

CFO Analysis is not a “malleable metric” or a “radical re-imagination”

- CFO analysis is a complementary metric rather than a replacement for the capital coverage ratio
- CFO analysis is far more representative than net income or capital coverage ratio for current reality
- **Reality:** MH is cash negative
 - Carrying cost or interest payments on Bipole debt is real
 - Depreciation of \$396 million ⁽¹⁾ is \$196 million less than Business Operations & MNG&T Sustainment CapEx of \$592 million ⁽²⁾
 - DSM & Other Deferred expenditures must also be funded
- Capital coverage ratio does not incorporate capitalized interest on sustainment / reliability projects (including Bipole 3) as well as other cash expenditures for DSM, MNG&T sustainment and mitigation
- Capital coverage along with debt:equity ratio and interest coverage ratio are **not** PUB approved
 - Order 51/96 states these targets are in MHEB domain

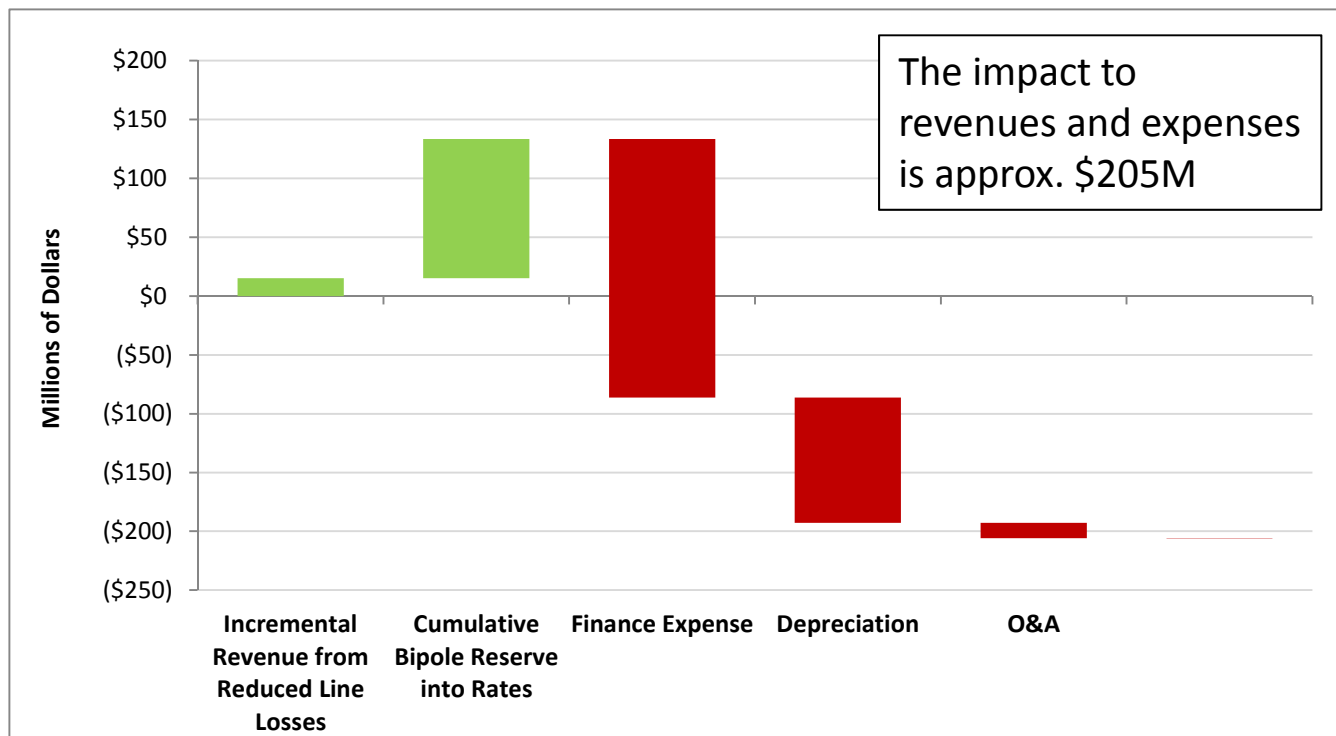
(1) Appendix 3.6

(2) Tab 2, page 16

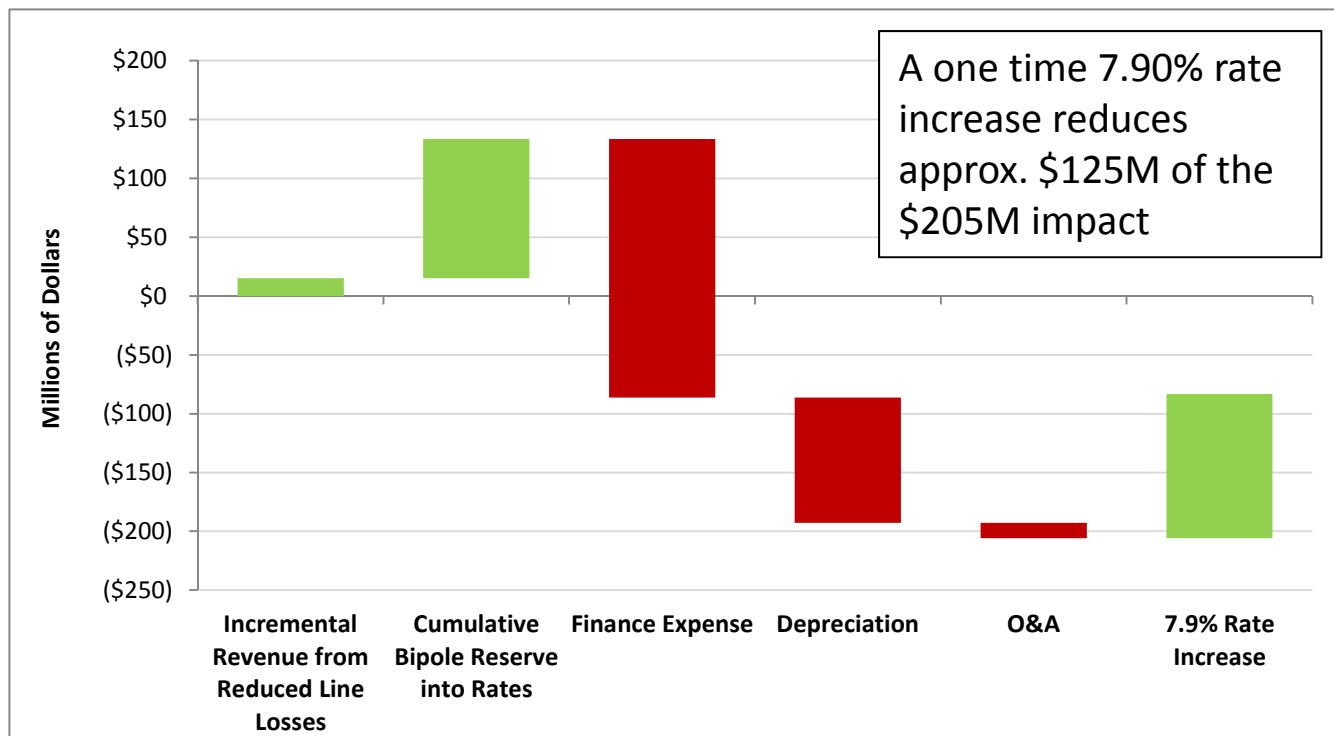
The Material Effect of the Bipole III Reliability Project

- The financial impacts of the Bipole III Reliability project are not only imminent and substantial but also relatively certain in magnitude
- The following graphs demonstrate the financial impacts of the project during the first full year of in-service

Bipole III – First Full Year In-Service



Bipole III – First Full Year In-Service



MIPUG & Coalition want to set Rates Assuming High Water Flows are Perpetual

- Rates should not be set/determined based on current extreme high water conditions
- Above average generation is the only reason MH recorded and projects positive net income

	(Millions of Dollars)			
	Actual 2015/16	MH16 2016/17	MH16 Update	
			2017/18	2018/19
Net Income	37	34	175	297
Revenue Attributable to Above Average Water	(62)	(87)	(91)	(41)
Additional Revenue from Rate Increases	-	-	(88)	(256)
Adjusted Net Income/(Loss)	(25)	(53)	(4)	0

Free Cash Flow before Major Capital Spending or Debt Repayment

- MIPUG states that with a 1.6% rate increase, Manitoba Hydro will be able to make a \$63 M contribution to reserves
- This relies on high storage of water to start the year
- In context of Manitoba Hydro's scale this represents:
 - 0.46% of major projects (Bipole & Keeyask -\$13B)
 - 0.27% of peak debt levels (\$23B)

Regulatory House in Order

- Since the new Board of Directors was appointed to the MHEB in May 2016, MH took the time to pursue all avenues to mitigate rate increases
 - Provincial equity injection
 - Cost cutting measures
 - O&A
 - Debt management strategy

GAC Recommends Manitoba Hydro file a Strategic Plan to Cap & Reduce Energy burdens of LICO 125 Customers

- Manitoba Hydro will introduce its proposed alternative residential rate design which is intended to consider affordability for Electric heat customers as soon as possible in this public hearing process
- Interveners also have the opportunity if they wish to introduce their own rate design proposals at the Intervener evidence stage in this process
- There isn't sufficient time nor resources to develop GAC's requested strategic plan in the course of the current hearing process.

GAC Recommends Manitoba Hydro's Interim Rate Increase be 3.36%

- Manitoba Hydro notes its evidence that a 3.36% Interim Rate increase will require 9.51% rate increases in each of the next 4 year (MH16 Update, Figure 16, page 21)

MKO has Alleged that Nothing Has Been Done to Decrease Costs

- MKO ignores the activities, plans and initiatives being undertaken in a number of First Nation communities as outlined in:
 - 2015/16 Affordable Energy Report filed as in Tab 10, Appendix 10.8
 - June 30, 2017, Manitoba Hydro its 2016/17 Affordable Energy Report

Conclusions

In summary:

- Demonstration of urgency/emergency/special circumstances is not required
- Manitoba Hydro has complied with PUB's accounting directives in Order 73/15
- A comparison of MH15 and MH16 demonstrates a significant deterioration to the outlook for Manitoba Hydro over the next 10 years
 - Domestic revenue down \$900 million
 - Load growth net of DSM is flat
 - Export prices are down lowering export revenues by \$880 million
 - Capital costs of major new projects significantly higher driving increased carrying costs

Conclusions

In summary continued:

- Manitoba Hydro cannot count on growth nor factors outside its control namely, historically low interest rates or above average water flows to recover from the significant deterioration in its financial strength
- The impact to revenues and expenses of Bipole coming on line in one years time is \$205 million annually
- Rates today are materially too low from where they need to be come July 2018 when BiPole III comes into service