Opening Statement for Manitoba Industrial Power Users Group

In the 2017/18 & 2018/19 Manitoba Hydro General Rate Application

Background on the Manitoba Industrial Power Users Group (MIPUG)

MIPUG was formed in the late 1980s to address matters of unique importance to industrial electricity users in Manitoba. MIPUG has participated as an Intervenor in each of Manitoba Hydro's hearings since that time, including Hydro's Major Capital Projects hearing in 1990 and most recently in the Needs For and Alternatives To (NFAT) Review.

MIPUG members currently include:

- Amsted Rail - Griffin Wheel Company,
- Canadian Kraft Paper Inc.,
- Chemtrade Logistics,
- Enbridge Pipelines Inc.,
- ERCO Worldwide,
- Gerdau Long Steel North America – Manitoba Mill,
- Hylife Ltd.,
- Integra Castings (CTD Group),
- Koch Fertilizer Canada ULC,
- Maple Leaf Foods Inc.,
- TransCanada Keystone Pipeline, and
- Winpak Ltd.,

Four of these companies joined MIPUG in 2017 as a direct outcome of Hydro's proposed 7.90% rate increases. This rate hearing is something that MIPUG members, and industry in general, take very seriously.

The Interests of MIPUG

A written summary of MIPUG's key concerns related to the regulation electricity rates was provided in the pre-filed testimony of Mr. Bowman in **Attachment B**. The main concerns are:

1) Stability and predictability of rates over the long- and short-term;
2) Ongoing transparent regulation of Manitoba Hydro's rates and major capital spending; and
3) Ensuring rates for all customer classes reflect the fair cost to serve the class.

MIPUG members take a long-term view in making capital investment decisions as the long-term cost of power is very important to the operations and growth of industry. MIPUG members depend on reliable electricity service, but they also support prioritized and paced investment that considers rate impacts for all customers.

MIPUG companies are significant contributors to Manitoba's economy, particularly in some of Manitoba's larger communities outside of Winnipeg. As provided in **Attachment B** of Mr. Bowman's pre-filed evidence the group provided approximately 6,200 jobs in 2015, with most located outside of Winnipeg. Many MIPUG companies are the largest employers in their respective communities.

In 2015 MIPUG companies:

i. Contributed almost $2.8 billion to provincial GDP;
ii. Contributed $223 million to local governments, Manitoba and Canada each year; and
iii. Made approximately $6.3 billion in capital investments in Manitoba.

In addition to the need to maintain stable, cost-based rates in Manitoba, MIPUG members have expressed concerns regarding their competitiveness in relation to sister plants and their competitors, located in other jurisdictions in Canada and internationally.

While Manitoba Hydro indicates they offer some of the lowest published electricity rates in North America, MIPUG companies have been clear that this is not the same as being the lowest cost for power. Members are aware of significant rate options that exist in other locations, which result in the members companies having access to lower overall costs for power than they have in Manitoba. MIPUG members who own plants with operational flexibility also indicate that their sister operations in other parts of Canada or the United States can often alter their loads to access low daily or seasonal market prices and avoid or capture the benefits of times of high market prices. Similarly, for those companies who can generate some proportion of their own power, other jurisdictions offer the opportunity to receive economic price incentives on that generation (similar to what Manitoba Hydro offers to wind IPPs, but specifically prohibits with respect to industrial generators). With this flexibility, some members indicate that sister or competitor plants in other jurisdictions are able to achieve a lower overall power cost profile than exists in Manitoba, despite those other jurisdictions having higher published rates.

One of the only programs provided by Manitoba Hydro to help industry manage electricity bills, the Curtailable Rate Program, was capped as a result of the last General Rate Applications.

The members encourage Manitoba Hydro for further options to help manage their costs through such techniques as an optional Time Of Use program for customers that could find benefit or in a demand-response program.

As part of this hearing, MIPUG members will be making a presentation regarding their operations and the importance or electricity rates. If time permits MIPUG will also address some of the pricing and regulation dynamics that its members experience in other jurisdictions.

Rate Making Principles

In Manitoba, under the current legislation, the system in place is regulated ratemaking based on necessary costs.

The PUB makes the final determination regarding what costs are reasonable for recovery from domestic ratepayers, and when those costs will be recovered. It is MIPUG’s view that Manitoba Hydro has the onus of proving that the costs it seeks to recover are prudently incurred, necessary at this time, and fair.

MIPUG Opening Comments on the Current Proceeding

1. The New View - Hydro's Fundamental Changes to Rate Setting – 7.9% Rate Increases Not Supported

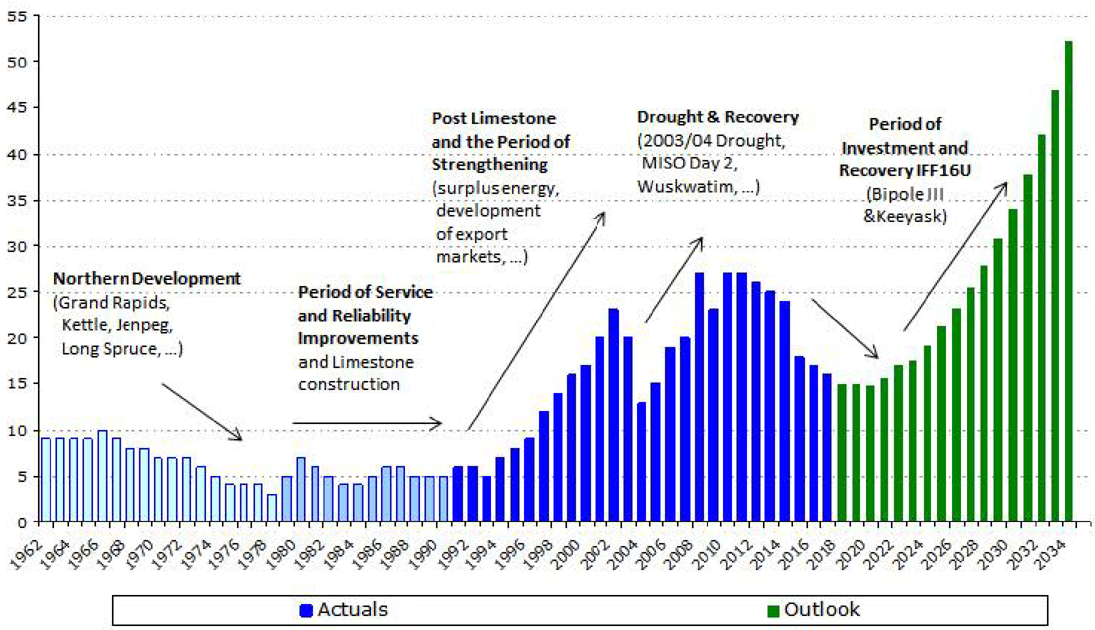
It is MIPUG's view that Manitoba Hydro has not adequately explained to this Board and to Manitobans why its view on rate stability has changed significantly since the NFAT.

i. The evidence on the record does not support a move to 7.9% rate increases. These increases are entirely tied to a new and unsubstantiated view regarding Hydro's financial condition.

ii. Hydro has substantially changed its regulatory approach to rate setting during this period of capital investment – shifting the debt-to-equity target from 20 years to 10 years.

iii. This new target and the financial requirement to achieve 75/25 debt/equity by 2027 is magnitudes higher than any other rate plan in Hydro's regulated history. The rate of achieving the target equity ratio in Hydro's forecast while new assets are brought in service (increasing the required amount to meet the target) is shown in the Figure below.

Manitoba Hydro's Equity Ratio from 1962-2034 Updated for IFF16 Update with Interim[1]



iv. This rate setting approach ignores the approaches used by Hydro during the Needs For and Alternatives To Hearing to manage the impacts of the capital projects over the long-term and consider ratepayer impacts (for example - NFAT Transcript March 21, 2014, page 3380). If these aggressive 10 year targets had been included in the NFAT, Keeyask would not have been approved, it would simply not have been seen as financially beneficial to ratepayers.

v. It is also important to remember that the NFAT "filing" rate scenarios were based on 20 years to achieve 75:25, but Hydro produced a number of "alternative" rate scenarios that took longer to reach 75:25. From this, the PUB recommended (PUB NFAT Final Report, June 20, 2014, pages 28 & 29), and the Minister accepted (PUB-45 from the 2015/16 GRA, page 4), to consider relaxing financial targets further than 20 years to consider ratepayer impacts.

[1] MIPUG/MH 1-2(h-1), page 9 of 14

vi. The proposals adopt a new “view” that runs contrary to all detailed and professional work done on the resources plans over the past decade or more.

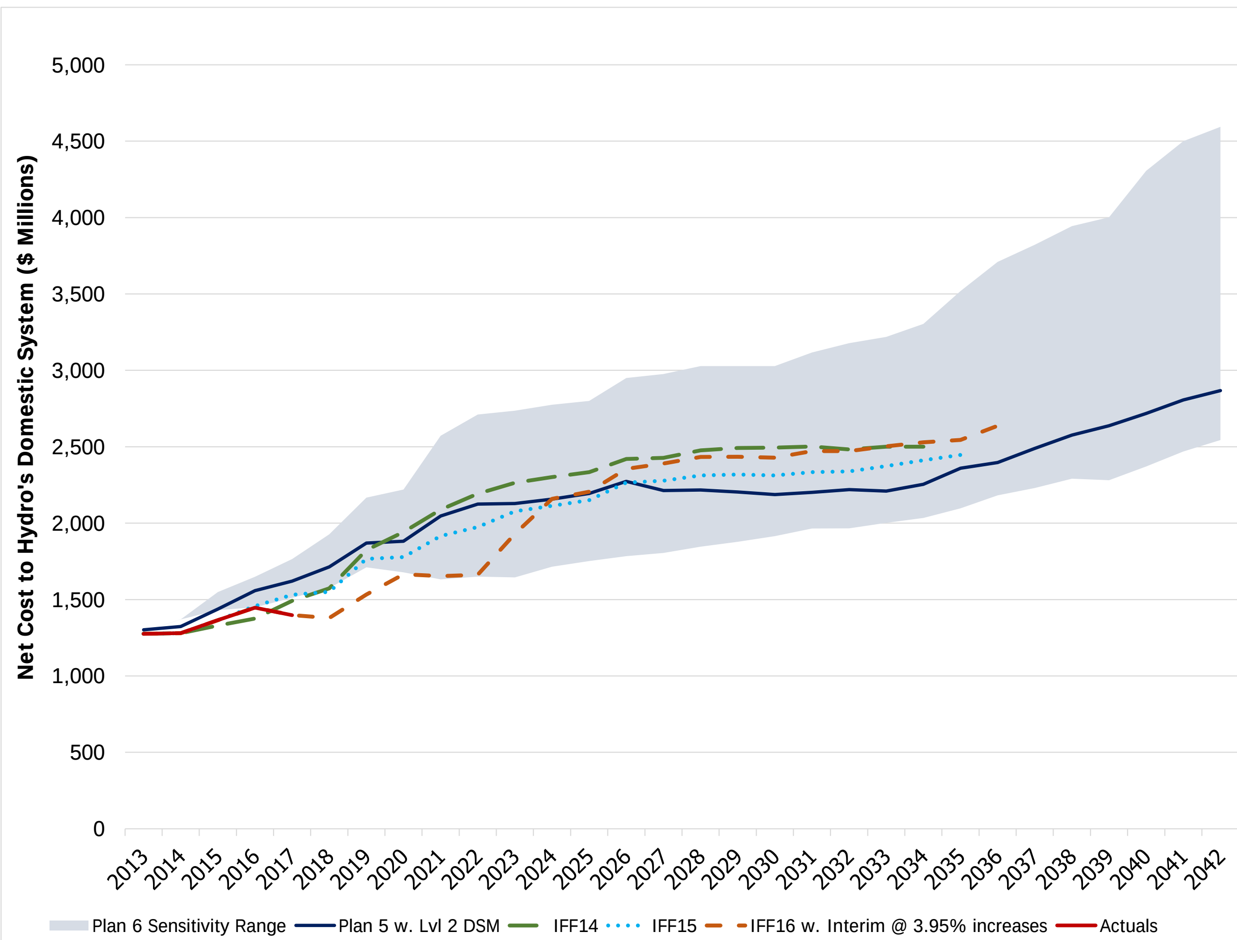
vii. The fundamental change to Hydro’s approach also challenges the entire regulatory scheme in place in Manitoba. This is the reason MIPUG elected to call expertise regarding this longstanding regulatory practice, and the core fundamentals of how rate are to be set and capital projects should be integrated, from Mr. Forrest and Mr. Osler.

viii. The MIPUG intervention will show that the new “view” is not only unprecedented, unprincipled, and out of step with the plans that are unfolding, it is unnecessary to achieve a financially acceptable outcome.

2. The New Facts - Hydro's Application Supports Review of Rate Increases Closer to MH15 Levels

i. Hydro's evidence suggests the utility sees itself in a world of entirely different facts than prevailed at the time of the NFAT. MIPUG will bring evidence that shows that while facts have changed (as they inevitably do) the net effect is very small. For example, see the figure below comparing net costs to ratepayers from the NFAT plans, IFF14, IFF15 and IFF16 with Update for Interim, which is tracking low to average comparatively.

Net Cost of Hydro's Domestic System (before reserves) of NFAT Plan 5/6 versus IFF16, IFF15, and IFF14[2]



[2] MIPUG-15, page B-6

ii. There is room for different opinions on this matter. Much of the hearing will be a substantive consideration of this issue.

iii. However – there is no credible debate that any change in facts (such as they are) is the driver of 7.9%, rate increases four times the rate of inflation.

iv. On the issue of debt:equity ratio, one must recall that the NFAT plans (even without the relaxed financial targets recommended by the PUB) reached a low point of 8% equity during the 20 year forecast. By IFF15, the situation had improved to reach a low point of 10% equity. For that rate request, the Board granted Hydro less of a rate increase than they requested.

v. Now, with 3.95% increases, the equity ratio reaches a low point of 12%. (PUB/MH I-34 Attachment 2). This is indisputably an improvement over NFAT.

vi. Predictably, Hydro's rebuttal evidence changes the focus from the 10 year debt-to-equity target, to a focus on need to minimize the net debt levels.

vii. Note however that net debt peaks at $23.6 billion in MH16 Update with Interim, but $24.6 billion if 3.95% rate increases are used.

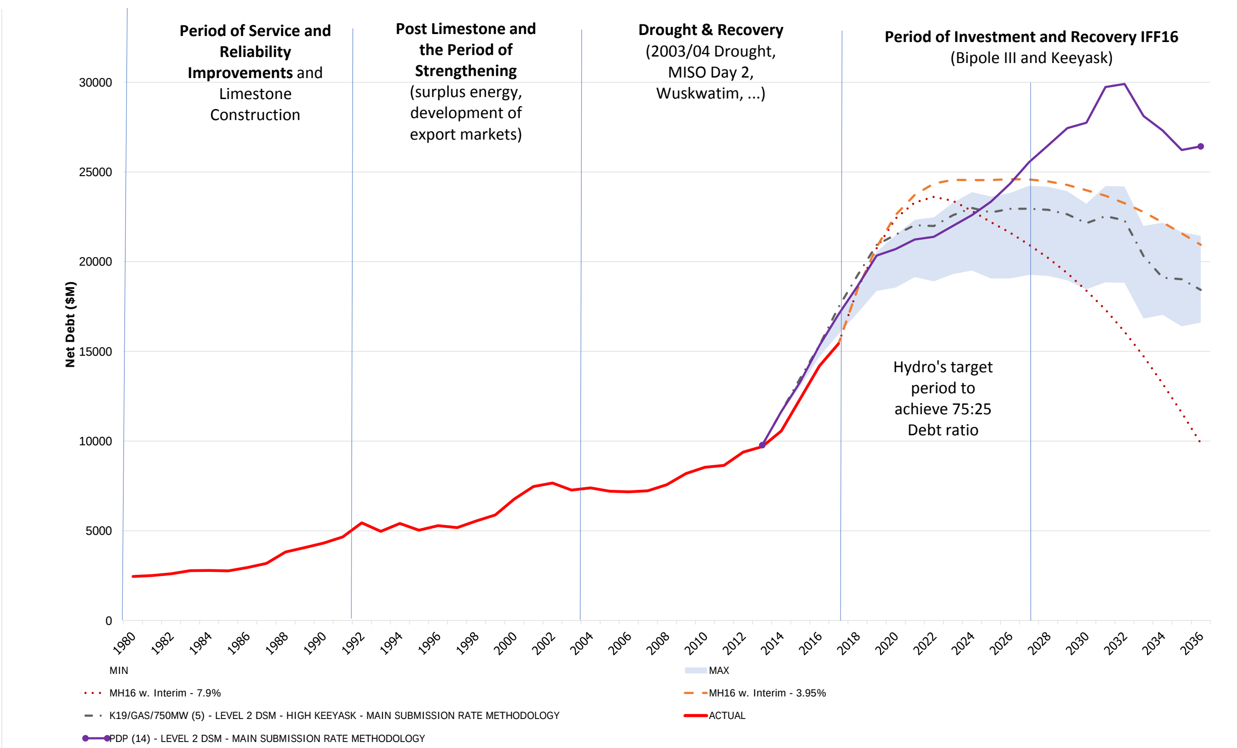
viii. This 'ultimate test' ignores the improved position of retained earnings.

ix. Hydro's plan to reduce net debt (generating a cash surplus in 2023 – 2027 available for debt retirement of $3.1 billion – MH-52, page 12) is inconsistent with regulatory principles for this utility. Paying down the debt, just as 100 year+ assets come in-service, is outside appropriate costs for power generation.

   - Hydro has historically not pursued concurrent major debt repayment initiatives during major capital expansion. Over past 38 years Hydro's Long-Term Debt has effectively never declined on a sustained basis (decreased in only 7 years and these were largely one-year effects matched with increases in adjacent years) (MIPUG/MH I-2g).

- Net debt has doubled a few times over Hydro's history as new assets have been developed, as shown in the Figure below. This is an expected outcome of major capital development.
- Net debt growth during major expansion, as seen in the Figure below, is to be expected. Credit rating agencies understand this (See for example Transcript from the NFAT proceeding Financial Panel, 2014-03-21, page 2269 where then Corporate Treasurer, Mr. Manny Schultz confirms the credit rating agencies have been aware of Hydro's forecast development plans and IFFs since IFF09).

Manitoba Hydro Net Debt under NFAT Scenarios and Updated IFF Scenarios at 3.95% and 7.9%[3]



x. Retained earnings levels have improved compared NFAT short term forecasts. Hydro has dismissed this improvement on 2 grounds:

[3] Supplementary Background Paper A: Manitoba Hydro Debt Levels, prepared by P. Bowman on behalf of MIPUG, October 2017, page A-3.

some has arisen only because of High water flows, and some has arisen only because of Keeyask delays. There is no reason to dismiss these important effects.

xi. High water has been present, and this is fortuitous. It is also a fact, which is now a part of the go-forward baseline. As long as provision is made for the risks of potential future low water (as it is) there is no reason to dismiss the benefits of past water flows.

xii. On delays in Keeyask, whatever the cause, this is also a beneficial and entirely acceptable component of the current financial forecast. Not only is it a fact, delaying Keeyask was also a key strategic alternative considered by Hydro and Boston Consulting to mitigate rate impacts. Delays are not beneficial for project cost, but they can be valid and beneficial aspects of integrating a new project into the financial forecast. The benefits should similarly not be dismissed.

xiii. As a result of all of these conditions, Hydro continues to show much higher retained earnings than has been forecast at NFAT. The actual level at $2.75 billion in 2016/17 (MH16 Update with interim) compared to IFF12 (NFAT Financial Forecast) forecast retained earnings for 2016/17 at only $2.42 billion.

xiv. Similarly, Hydro's focus on net debt ignores the benefits of actual known interest rates that have been locked in. This gives two benefits – first, the interest rates are lower than had been expected at NFAT, and second, there is no longer any uncertainty about what the rates will be. From both a cost and a risk perspective, this is undeniably an improvement.

xv. Although forecast net debt has increased from IFF15 as a result of cost overruns for major capital projects (including Keeyask and Bipole III), the levels do not approach net debt levels Hydro considered acceptable during the NFAT when proposing Keeyask and Conawapa (shown as purple line in above figure).

3. The Pessimism and Adverse Assumptions - Hydro's Financial Forecast Methods Overstate the Need for even 3.95% Rate Increases Today

i. The methods used in Hydro's current financial forecast tend to overstate costs and understate revenues. The more evidence we receive from intervenors and independent experts, the number of ways in which Hydro is shown to have included overly pessimistic forecasts or adverse financial assumptions continues to grow.

ii. Additionally, inherent risks faced by Hydro (including drought risk, interest rate risk, and capital cost increases) have significantly declined or already been absorbed within IFF16.

iii. As a result, even though forecasts using the previous 3.95% rate increases show acceptable financial performance, one does not need 3.95% rate increases to achieve these outcomes. A list of such conditions include the following:

   - Policies regarding administrative overheads and depreciation practices which are not consistent with past PUB decisions (Order 73/15, pages 35 & 36 and 45).
   - DSM spending assumptions that are above the level that can likely be justified to be providing rate benefits (both in terms of reduced sales and in terms of increased costs – compounding the effect). (PUB-MFR-77, Figure 1).
   - Load forecast assumptions which may not fully incorporate expected population growth and which change industrial load forecasts methods to a lower scenario. (DEA-2, page 2)
   - Export revenue assumptions which are demonstrably pessimistic (and include zero revenue from some sources which have a reasonable likelihood of being at minimum better than zero). (Exhibits DEA-1, page 1).

- Further, with increased debt locked in, and reduced export market prices assumed, Hydro's Risk Register continues to show lower and lower potentially adverse conditions:

Risk Register - Key Variable Sensitivity - Impact to Retained Earnings
IFF Comparison[4]

	IFF16 Update w Interim	IFF15	IFF14	IFF13	IFF12
Target Year 7	**2022/23**	**2021/22**	**2020/21**	**2019/20**	**2018/19**
Retained Earnings ($millions)	$4,557	$2,677	2,518	$2,502	$2,376
Low Domestic Load Growth	(133)	13	(24)	(64)	n/a
High Domestic Load Growth	128	19	54	n/a	102
+1% interest rates	(248)	(405)	(423)	(299)	(233)
-1% interest rates	233	390	398	286	136
US$ down $0.10	(16)	(19)	(3)	23	(59)
US$ up $0.10	18	22	3	(23)	57
Low Export Prices	(117)	(315)	(304)	(143)	(160)
High Export Prices	322	397	245	119	159
5 Year Drought (starting in year 3)	(1,175)	(1,857)	(1,711)	(1,583)	(1,553)

iv. Hydro's current financial position, with retained earnings today over double the size of the impacts of the worst 5-year drought on record, right when Keeyask is coming in service, is better than at any past time.

v. Looking particularly at industrials, it is also important note that the customers are paying rates well above their costs as per PCOSS18.

[4] MIPUG-15, page A-15

4. The Impacts - Hydro's Actions Undermine Confidence, and Have Impacts on the Economy

i. In this review, Hydro has produced no evidence regarding impacts on ratepayers and competitiveness, despite building loads being the best way to build revenues. Also Hydro has provided no information on impacts on the economy, despite the primary case being about the need to protect the province's credit rating.

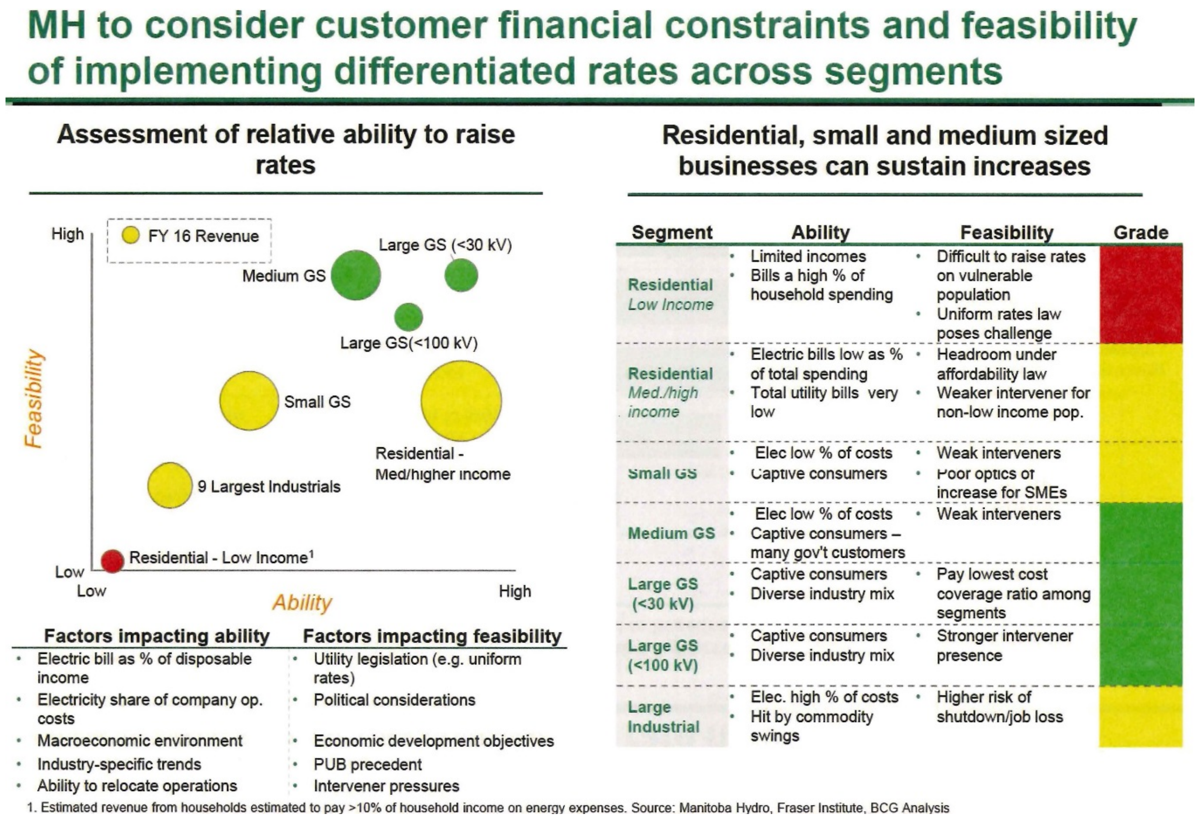
ii. Also, statements by Manitoba Hydro representatives regarding "serious financial troubles"[5] impact the expectations of bond holders and business planning for industry in Manitoba.

iii. Hydro also made clear that the most important criteria for the credit rating is a sound, predictable and consistent regulatory and rate setting process (MIPUG/MH I-8) yet the proposals seek fundamentally to undermine rate setting consistency.

iv. While Hydro's GRA materials provide no information about potential economic impacts, the reports from Boston Consulting Group (MH Exhibit 35), do show vulnerable ratepayer impacts. Large industry and low income customers in particular have higher risk of adverse outcomes from severe rate increases (shutdown/job loss)

[5] For example, as recently as Friday, December 1, 2017 as mentioned in the following news article: https://globalnews.ca/news/3891842/manitoba-hydro-chair-suggests-proposed-carbon-tax-could-offset-rising-rates/

Customer Financial Constraints and Feasibility of Implementing Differentiated Rates Across Segments[6]



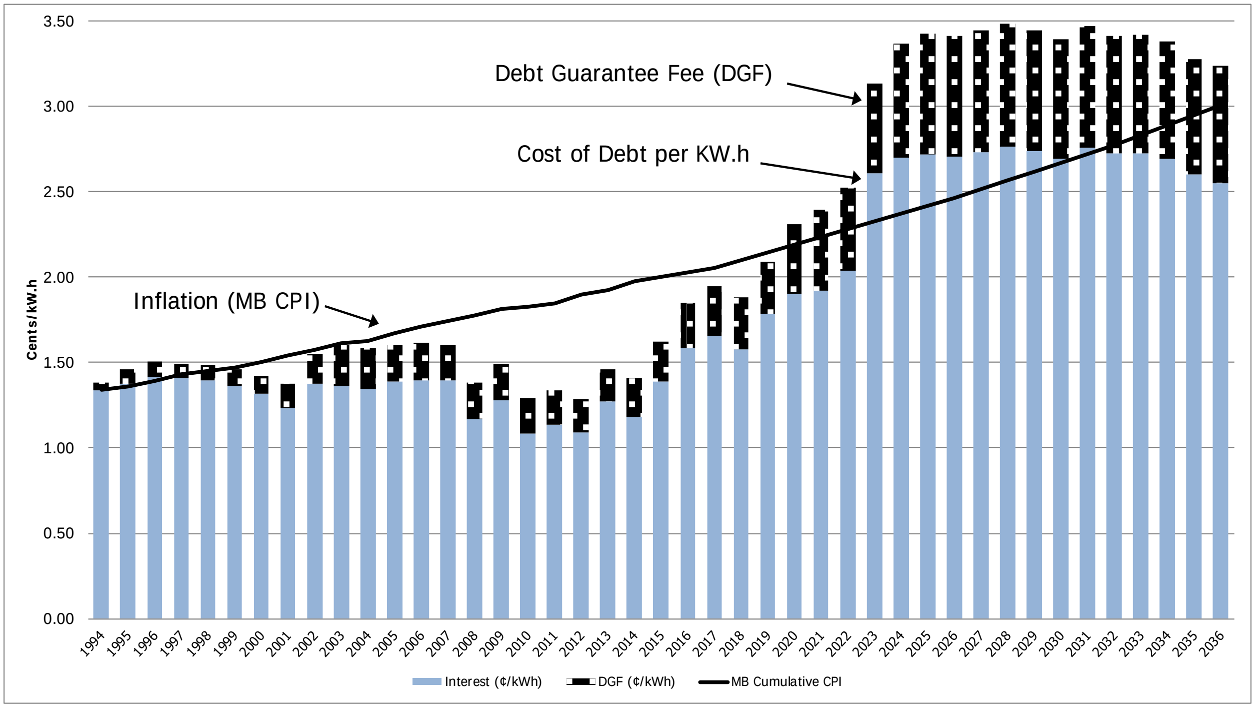
v. Hydro has also indicated a need to protect the province and its credit rating from being adversely affected by Hydro's debt. However, Provincial charges on Hydro have been substantially increased, through increased debt guarantee (especially in relation to costs of borrowing, see the Figure below), and through capital tax on major new Hydro generation and transmission. (See PUB-MIPUG-16 on history).

   o These costs including water rentals, capital tax and debt guarantee fee, also are about to include a fourth charge on Hydro to finance the pending DSM agency, though it will be run as an independent entity.

[6] PUB-MFR-72 Attachment, BCG Presentation from August 25, 2016, pdf page 468 of 615.

- Other governments have relieved cost pressures of large capital projects, including projects in Newfoundland (through construction of Muskrat Falls the original federal loan guarantee in 2012 came with no fee) and BC Hydro (where Site C carrying costs will be solely the cost of debt, and no debt guarantee fee) as discussed in PUB-MIPUG-16.
- While the PUB cannot directly affect changes in this area, there are two important areas where this merits attention:
  - First, no serious case can be made that the province needs protection from Hydro. These claims need to be rejected outright.
  - Second, the PUB can indicate the need for relief from the province, through fees changed to Hydro for at least new incremental revenues the province would otherwise receive.

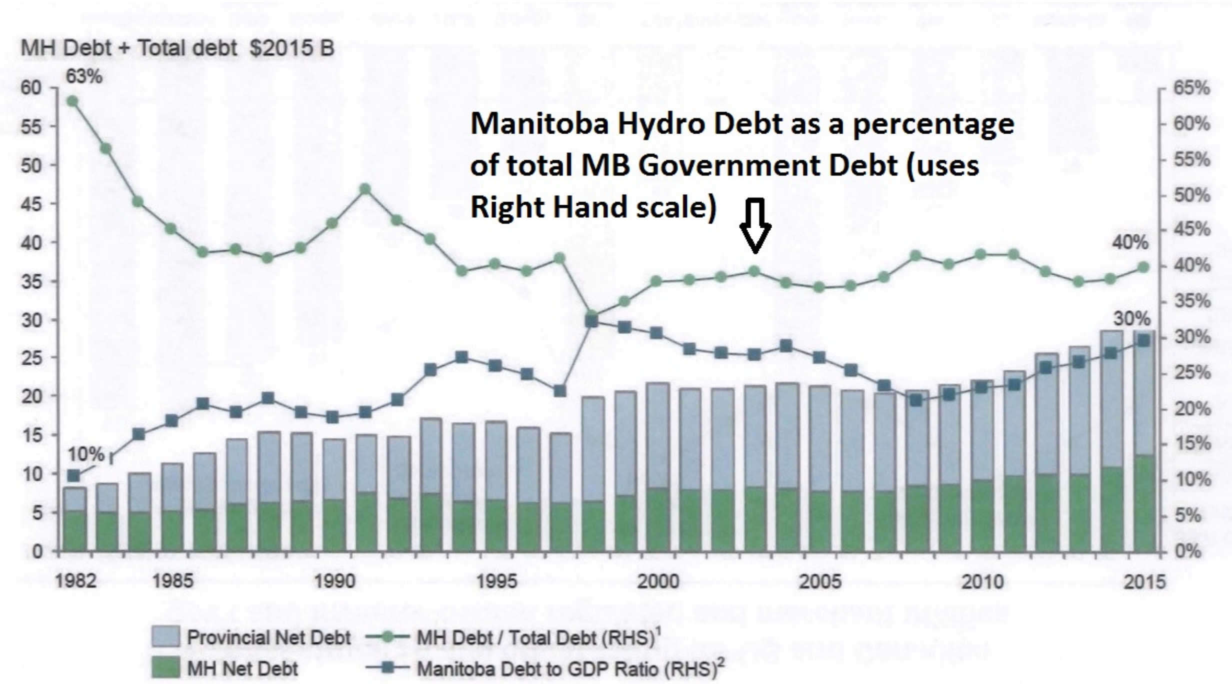
Manitoba Hydro Cost of Debt (Interest Payments & Debt Guarantee Fee) Comparison to MB CPI (cents/kW.h) MH16 w. Interim Update and MH15 Rate Increases – 1994 to 2036[7]



vi. It is also important to note the work of Boston Consulting which showed that as a percentage of the provincial debt, Hydro has not grown, and if anything is well below the percentages that prevailed in previous periods of capital expansion:

[7] MIPUG-15, page A-13

Manitoba Hydro Debt to Manitoba Provincial Debt Comparison ($2015 billion)[8]



[8] PUB-MFR-72 Attachment, page 27 of 615, Manitoba Hydro 2017/18 & 2018/19 GRA.