DDWEST LLP
BARRISTERS & SOLICITORS
CALGARY - AIRDRIE - REGINA - WINNIPEG

300 - 305 BROADWAY
WINNIPEG, MANITOBA
CANADA R3C 3J7

TELEPHONE (204) 421-8655
FACSIMILE (204) 421-8566
WEBSITE: www.ddwestllp.com

REFERENCE NO:
003991-0131

Brian J. Meronek, Q.C.
DIRECT LINE:
204-925-5355
EMAIL:
bmeronek@ddwestllp.com

PLEASE REPLY TO:
Yolanda Woods
DIRECT LINE:
204-975-2534
EMAIL:
ywoods@ddwestllp.com

Services provided by:
Brian J. Meronek Law Corporation

BRANCH OFFICES:
CALGARY
AIRDRIE
REGINA

July 5, 2019

Via Email

Public Utilities Board
400-330 Por4tage Avenue
Winnipeg, Manitoba R3C 0C4

Attention: Mr. D. Christle, Secretary and Executive Director

Dear Mr. Christle,

Re: Centra Gas Manitoba Inc ("Centra") 2019/20 Hearing Procedure

On behalf of CAC, I am responding to the Public Utilities Board's ("Board") request that the parties offer their views as to the early identification of oral evidence and the estimated length of the hearing. Before the specific issues are discussed, some general comments are apt. The major premise of Centra is that an oral hearing is not necessary. As a matter of public notoriety, Centra has been unregulated for the last several years; six years for non-gas revenues and four years for gas related issues. But for the Board's nudging, cajoling, and finally ordering a GRA, it is very much open to conjecture as to whether we would be having a GRA even now.

CAC's position is emphatic in that an oral hearing must take place. It is gossamer to suggest that all that is required is argument. Nothing could be farther from fact. There is a chasm of difference between a voluminous record and comprehending that record and the complicated issues which uniform the record. It is imperative that the CAC Revenue Requirement, Cost of Service; and Asset Management experts explain their substantial evidence to the Board which, for the most part, is for the first time having the opportunity to address these very technical matters. Moreover, CAC wishes to test some of the positions advanced by Centra and other Intervenors, as more fully explained below:

CAC Position on an Oral Hearing

Some of the more compelling specifics for an oral hearing are:

1. CAC expert witnesses recommend a material downward adjustment to Centra's requested 2019/20 non-gas revenue requirement for 2019/20 of $6 million, which is the equivalent to a further overall rate reduction of approximately 1.9% based on overall revenues of $308 million, including currently projected gas costs;

2. Centra's financial reserves have essentially doubled since the 2013/14 GRA and with appropriate adjustments for IFRS accounting changes, are projected to be approximately $96 million in 2019/20. Despite the significant improvement in Centra's financial reserves, and recent PUB decisions for Manitoba Hydro

(MH) that question the value of the Equity ratio for rate-setting, the utility is projecting the need to further increase reserves and allowed net income to $7 million to maintain around a 30% Equity ratio as well as the requirement to increase other non-gas revenue requirements by $32 million or 24% (projected indicative rate increases in the order of 10%) by 2027/28.
An oral hearing is the most effective and efficient process for all parties to gain a better understanding of future drivers of the projected rate increases, provide recommendations on the approach to determine future financial reserve levels to promote rate stability for customers and the nature of future regulatory reviews to assist the Board in carrying out its rate-setting mandate for Centra and protecting the public interest;

3. Material differences between Centra and CAC with respect to recommendations to the PUB and assessments of compliance with prior PUB directives related to the review of the ICAM for rate-setting purposes, debt management activities, attribution of the $15 million cumulative profit adjustment related to the gas meter exchange labor accounting policy change and disposition of the Furnace Replacement Program $17 million excess funding;

4. The issue of lack of real time progress, proper capital planning and asset management requires fleshing out at an oral hearing

5. Material differences between CAC, IGU and Koch with respect to the appropriateness of Centra's cost allocation proposals for 2019/20;

6. Centra is expected to file rebuttal evidence on August 2, 2019. Absent an oral hearing, there will be no review or testing of this rebuttal evidence with Centra's witness panels and ability for Intervenor expert witnesses to address Centra's rebuttal evidence; and

7. Centra is planning an update of its non-primary gas cost forecast for the 2018/19 gas year and deferral account balance estimates to October 31, 2019 as part of its pre-hearing update on July 24, 2019 and to provide an update of its interest rate forecast as part of its rebuttal evidence. Absent the ability to cross examine Centra's witness panels at an oral hearing, there will be no review or testing of these updated forecasts and the implications for setting rates in for the 2019/20 Test Year.

<u>Recommended Priority Issues to be Examined in the Oral Rate Setting Hearing:</u>
CAC recommends that the following issues (from the list of 24 in-scope issues from Appendix A of Order 24/19), be given priority to be heard at an oral hearing:

Issue #1 – Rate changes requested

a) CAC's expert witnesses have recommended that the Board adjust Centra's requested non-gas revenue requirement for 2019/20 downward by $6 million to reflect recommended reductions to Centra's O&A targets of $5 million (from $61 million to $56 million) and the recommendation to re-establish the Power Station class minimum margin guarantee of approximately $1 million on an annual basis (and include this amount in other income for rate-setting purposes to allow for all customer classes to benefit from the reduced non-gas revenue requirement). These recommendations constitute a material reduction in Centra's requested non-gas revenue requirement and are equivalent to a further overall rate reduction of approximately 1.9% based on current revenues of $308 million, including projected gas costs.

b) In addition, CAC expert witnesses have recommended that the Board should obtain further information on the impacts of the 2018 province wide-reassessment on Centra's 2019/20 property tax forecast before approving this forecast into revenue requirement and rates. The 2019/20 property tax forecast is still at issue as Centra has forecast a 3% increase in property taxes for 2019/20. Centra had previously forecast property tax increases for the 2012 and 2016 re-assessments, but there were actual decreases as a result of these prior re-assessments.

   Basis for Oral Evidence:
   It would benefit all parties understanding of these recommendations if they can be reviewed and tested through testimony and cross examination of Centra and CAC witnesses, to ensure that the appropriate non-gas revenue requirement is established for 2019/20, particularly considering the six year passage of time since the last comprehensive review of non-gas revenue requirements as part of the 2013/14 GRA.

Issue #3 – Financial Targets & Issue #12 – Return on rate base including return on equity

a) Centra has recorded $49 million of actual net income in the six-year period from 2012/13 to 2017/18 and in the most recent forecast, the level of financial reserves projected for 2018/19 has essentially doubled to $80 million or 45% higher than the level forecast at the last GRA for 2018/19 ($55 million). With the recommendation by CAC expert witnesses to include the cumulative profit adjustment related to the capitalization of gas meter exchange labor (see Issue #6 below) as part of Centra's financial reserves for rate-setting purposes, Centra's projected financial reserves would be $96 million for rate-setting purposes in 2019/20, the highest under MH ownership.

b) Previously, it had been MH's policy that it did not require a rate of return on investment from Centra and that rate increases were proposed to maintain a reasonable level of financial reserves to promote rate stability for customers. Centra appears to have adopted a 30% Equity ratio as the basis for its most recent financial forecasts (CGM16 & CGM18) and indicative rate increase projections, although it is unclear why Centra has adopted this change in policy/approach as well as increased emphasis on rate base/rate of return revenue requirement calculations. The result is that Centra is projecting the requirement to increase the $3 million allowed net income to the $7 million level in order to maintain close to a 30% Equity ratio. The increase in net income to $7 million represents about $4 million or 11% of the projected increase in non-gas revenue requirements of $36 million to 2027/28 (see Issue #4 below).

c) CAC's expert witnesses are recommending that the Board direct the consideration of the establishment of a Minimum Retained Earnings Test for a future Centra GRA for rate-setting purposes (consistent with the Board's directives for MH in Orders 59/18 and 69/19), using the principles/analysis/tools that are developed to set MH's rates, adapted to Centra's circumstances as necessary.

Basis for Oral Evidence:

With the increase in Centra's financial reserves since the last gas GRA; the recent rulings by the Board questioning the use of the Equity ratio to set rates for a crown owned utility with a provincial debt guarantee; and, the timeliness of considering if financial reserves are at sufficient levels that could be maintained or need to increase significantly to maintain a 30% Equity ratio (as currently projected by Centra), it is important that these issues be reviewed at an oral hearing and that the Board provide direction for future rate proceedings with respect to Centra's financial reserve requirements for rate-setting purposes. Centra's most recent financial forecast (CGM18) projects the need for general rate increases $10 million or 3.27% for 2020/21 and 2021/22, of which the increased net income is $4 million.

Given the nature of DCGI's evidence as a benchmarking exercise or a reasonability check of an appropriate ROE based on an assumed Equity ratio of 30%, CAC does not expect to have cross examination related to this evidence at the oral hearing.

Issue # 4 – Changes in finances and financial assumptions since Order 85/13

a) Analysis in the CAC expert witness testimony has identified that at the 2013/14 GRA, it was projected that non-gas revenue requirements would increase by $18 million or 12% and that cumulative general rates increases in the order of 4% would be required by 2019/20 but that these rate increases did not materialize as the underlying cost pressures have been offset by accounting changes and lower than expected operating costs and interest rates. However, it is cautioned that that it is unlikely that the offsets to cost/rate pressures will reoccur to the same extent in the next 5 to 10 years. The analysis of Centra's current forecast has identified that non-gas revenue requirements are projected to increase by $36 million or 24% in the next eight years and that cumulative general rate increases in the order of 10% will be required to 2027/28. This forecast compares to approved general rate increases for Centra of around 9% in the last 20 years.

b) CAC's expert witnesses recommend that the Board re-establish regular GRA reviews every three years given these projected rate pressures and that regular regulatory reviews will assist the PUB to monitor Centra's progress on cost control, implementation of capital planning/asset management enhancements and management of Centra's debt portfolio and will assist in ensuring that rate pressures that are built up over time and refunds that are due to customers are dealt with on a timely basis.

Basis for Oral Evidence:

It would be beneficial if these analyses and recommendations are reviewed through oral testimony and cross examination, which would allow all parties to understand the future drivers of the rate pressures and provide recommendations to the Board in final arguments as to future regulatory reviews to assist the Board in carrying out its rate-setting mandate for Centra and protecting the public interest.

Issue # 5 – Finance expense including interest rate forecast and debt management strategy

a) CAC expert witnesses have recommended that the Board should direct Centra to provide additional information on its debt management strategies, policies and metrics in future GRA filings and report back at the next GRA on identified issues of concerning the application of debt policy guidelines. Centra's finance expense is expected to grow significantly in the next 10 years and optimal debt management practices are important to managing these cost pressures on rates. In addition, Centra is expected to update its interest rate forecasts as part of its rebuttal evidence, as previously directed by the Board.

Basis for Oral Evidence:

b) It is important that the issues of the interest rate forecast update and debt management be tested and reviewed at an oral hearing to ensure the appropriateness of the non-gas revenue requirement that is set by the Board and an understanding of the recommendations with respect to debt management, which is an important consideration for cost management and future GRAs.

Issue # 6 – Accounting changes and implementation of IFRS

CAC expert witnesses recommend that the Board direct Centra to include the cumulative profit adjustment ($15 million) related to the capitalization of gas meter exchange labor from 2014/15 to 2018/19, as part of the financial reserves for rate-setting purposes, as gas customers have funded these costs in rates during this period and its was Centra's prior intent to make this change coincident with the transition to IFRS. The 2019/20 GRA is the first opportunity for the Board and interested parties to test and review the rate-setting treatments/impacts of Centra's transition to IFRS and it is important that these issues be determined as part of this GRA.

Basis for Oral Evidence:

The current evidentiary record is not sufficiently clear as to why Centra has not attributed these retained earnings to gas operations given the earlier intent and as such it would be beneficial that this issue be further tested and reviewed at an oral hearing. The acceptance of the CAC witnesses' recommendations by the Board would increase Centra's projected financial reserves for 2019/20 by a material amount of $13 million to $96 million and would increase the projected Equity ratio by 2% to 33%.

Issue # 8 – O&A Expense

a) As was noted above under issue #1, CAC expert witnesses have recommended that the Board adjust Centra's $61 million O&A forecast downward by $5 million to $56 million for rate-setting purposes to reflect (1) a more appropriate allocation of the VDP and supply chain savings to gas operations ($2.7 million adjustment) (2) a 1% escalation assumption (compared to Centra's 2% assumption) for 2018/19 and 2019/20 to reflect the assumption of a productivity factor ($1.2 million adjustment) and (3) to remove the unallocated general contingency for 2019/20 which has no planned expenditures and has not been justified for rate-setting purposes ($1.1 million adjustment). Many of the same concerns were identified at the recent MH 2019/20 Rate Application, with the Board ultimately finding that in Order 69/19 that MH's O&A targets were not acceptable for rate-setting purposes and finding that the 2019/20 O&A target should be reduced by $22 million.

Basis for Oral Evidence:

These rate-setting recommendations are material to both the O&A target (8.2% reduction to O&A) and the overall rate levels (1.6% reduction) for 2019/20. Moreover, escalation in O&A represents approximately 25% of the projected increase in non-gas revenue requirements of $36 million in the current forecast and the recommendations would reduce the O&A trajectory by approximately $11 million to 2027/28 (equivalent to a 3.6% overall rate reduction). For these reasons, it is important that Centra's O&A forecasts be tested and reviewed at an oral hearing, as they have a significant impact not only on the current rate levels but future rate levels as well.

Issue # 9 – Integrated Cost Allocation Methodology (ICAM)

According to information from 2015/16, approximately $86 million or 58% of Centra's non-gas expenses of $148 million, were allocated to Centra using the ICAM. In addition, there has been an outstanding Board directive since Order 99/07, for Centra to conduct an independent review of the ICAM as a result of organizational and operational changes and to ensure that all parties general acceptance of the ICAM. CAC expert witnesses are recommending that (1) the Board should direct Centra to develop an ICAM report on an annual basis that can be used to support the allocation of consolidated operating costs and shared costs between Centra and MH at future gas and electric rate-setting proceedings and (2) the initial ICAM report could be reviewed through a collaborative process to satisfy the PUB directive from Order 99/07.

Basis for Oral Evidence:

As a result of the materiality of the amounts of the requested 2019/20 non-gas revenue requirement that are allocated to Centra through the ICAM and the desirability to develop an efficient and collaborative approach to satisfy the intent of the PUB ICAM directive from Order 99/07, it is recommended that these issues be canvassed at an oral hearing.

Issue # 11 – Capital expenditures and rate base additions and retirements since Order 85/13

The Metsco report addresses several areas of concern including a lack of reliance on objective data or quantitative tools to evaluate it; Centra's mis-application of an analytical framework and a failure to put into place project projection or program cost benefit analyses.

Basis for Oral Evidence:

It is noted that planned capital expenditures are a significant driver of the projected increase to finance expense, depreciation and taxes that represents close to $23 million or 64% of the $36 million increase in non-gas revenue requirements to 2027/28. For these reasons, it is important that Centra's capital planning and asset management initiatives and the potential to expedite progress on these initiatives, be tested and reviewed at an oral hearing, as they have a significant impact not only on the current rate levels but future rate levels as well.

Issue # 13 – Demand Side Management – Continuation of the Furnace Replacement Program and disposition of account balances

CAC expert witnesses are recommending that the Board should give (1) an opportunity for interested parties to provide recommendations (2) further clarification of the jurisdiction and (3) directives or recommendations (to Centra or the Province of Manitoba) with respect to the disposition or alternate use of the $17 million of excess Furnace Replacement Program funding. This program was originally directed by the PUB and the related funding has been collected solely from SGS customers since 2007/08. The excess funding has been outstanding for many years and the Province of Manitoba has recently released a regulation proposing that this excess be transferred to Efficiency Manitoba to offset the cost of gas DSM initiatives.

Basis for Oral Evidence:

Given the materiality of the amount (refund to residential customers estimated between 1.6% and 8.0% over three or one-year rate rider, respectively) and the proposed Efficiency Manitoba regulation, it is appropriate that this issue be further examined in a timely manner at an oral hearing.

Issue # 17 – Cost of Service Study Results and Methodology & Issue 24 – Rate Design

a) Given that it has been 6-years since Centra's last GRA, a number of cost changes have occurred driving significant changes in revenue requirement by class despite an overall decrease in general revenues that results from Centra's GRA, including the large addition of transmission plant investment and the 3-year accumulation in heating value deferral, which is currently in a positive position, that is, owing from customers to Centra. These matters have been further complicated by 1) Centra's position that it is not seeking an overall change in general revenues; 2) significant redactions of Centra's GRA deemed confidential; 3) the rate rollback flowing from Order 79/17 which rolled back non-gas rates to 2010/11 for some customer classes but not for all; 4) a lack of basic cost allocation materials typically filed in past GRAs that (i) provide a robust analysis of the significant cost allocation results, (ii) discuss the issues, (iii) propose alternate approaches to moderate the impacts to some classes, or (iv) address matters for which a previous commitments have been made. These matters have served to call into question the credibility of Centra's cost allocation methodology and ultimately rates charged to customers by some parties eg. Koch contends that Centra's cost allocation methodology is flawed; and, IGU characterizes Centra's treatment of Heating Value Deferral amounts as blatant rate discrimination.

b) CAC's expert witnesses conclude that the cost allocation results are reasonable, consistent with expectations, and based on sound rationale and well accepted cost allocation practice but do acknowledge are significant for some customer classes. CAC expert witnesses advise against making fundamental methodology changes in effort to mitigate the impacts to some customers flowing from the results of the 2019/20 Cost Allocation Study. CAC's expert witnesses also recommend against having the SGS class continue to over contribute to cost and offer the following alternatives to mitigate the impacts to some customer classes:

1) To capture costs related to transmission investment increased allocation for those classes significantly impacted in a deferral to be gradually paid overtime by the participatory classes; and/or
2) To allocate Heating Value Deferral to all classes except the Special Contract class which will reduce their overall bill impact by approximately 30% and benefit in perpetuity.

Basis for Oral Evidence:
Significant divergent perspectives exist between CAC, IGU and Koch with respect to the application of rate change proposals flowing from Centra's GRA. CAC's expert witnesses' perspectives and recommendations are noted above. IGU recommends that any rate change flowing from Centra's GRA be suspended pending a full cost allocation review or a range of revenue to cost ratios rather than unity to mitigate bill impacts by gradually reflecting the cost changes over time. Koch recommends they be allocated direct system costs only which would result in an overall bill decrease.

These alternatives and any others that may be raised must be reviewed in a public forum. Consideration of these alternatives will require some review of current methodology but on a limited basis such that the Board may adjudicate on the current GRA and related rate changes proposed by Centra for November 1, 2019. All parties, except Centra, appear to agree that a full methodology review is necessary to be dealt with in a future generic cost allocation proceeding.

The treatment of rates flowing from the current GRA for November 1, 2019 will have material impacts on the allocation of revenue requirement by class and ultimately customer bills regardless of the alternative approved by the Board. For example, if the Board adopts IGU's proposal to defer the implementation of the rate changes flowing from this GRA, the SGS class will continue to over contribute by approximately $7.3 million (or 7% of its non-gas cost allocation). If this recommendation were adopted by the Board, along with the other proposals of IGU, Koch as well as the potential loss of the excess contributed funds as part of the FRP, the result would impact the SGS class by approximately $25 million (or 25% of allocated non-gas costs) or over $100 per SGS customer. A portion of these impacts would occur in perpetuity until a cost allocation methodology review. Conversely, the Special Contract customer states that it will be adversely impacted by the cost increases Centra proposes flowing from the 2019/20 GRA. These possibilities need to be better understood by all parties and are clearly matters of significant public interest that require oral evidence.

The issue of balancing fee changes proposed by Centra is significantly contentious and potentially impactful not only T-Service customers, but to sales customers (such as SGS). As such, it would be highly beneficial for a transparent oral public review.

Heating value deferral is likely an issue that can be handled through written argument.

Conclusion:

The above stated explanations make it obvious that an oral hearing be conducted. It must be recognized that many of these issues have either not been dealt with before or vetted in the last six years.

The stakeholders are in the unenviable position of having to reconstruct the past, analyze the present, and deal with regulation for the future. This GRA is unlike any other; where for example Manitoba Hydro has had significant regular oversight; so that with each iteration a more streamlined approach can be developed. Centra is at the "starting line". Now is not the time to genuflect at the altar of perceived costs savings in order to sacrifice a thorough examination of Centra's application. With more regular Board oversight, future reviews can become more truncated and focused.

No. of Hearing Days:

CAC estimates: 1½ day for cross-examination
1 days for CAC experts

Argument:
CAC prefers oral argument, provided there are a few days from the end of the oral evidence until submissions are made. Written submissions are more costly and time consuming.

Yours truly,

DD WEST LLP
Per:

Brian J. Meronek, Q.C.
BJM /yw
encl.
c.c. Rachel McMillin, Assistant Associate Secretary
Bob Peters, Board Counsel
Dayna Steinfeld, Board Counsel
Brent Czarnecki
Intervenors of Record