Reference: Escalation Recommendation – lines 25 through 27, page 48 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requires more information to understand the reasonableness of the escalation recommendation.

Question:

a) Can Mr. Rainkie and Ms. Derksen provide examples of other Crown owned natural gas or electric utilities that use an escalation rate of 1% (or lower than inflation) for O&A budgeting purposes?

b) In the experience of Mr. Rainkie and Ms. Derksen are regulated utilities typically expected to include a productivity factor or similar assumption when preparing O&A budgets for ratemaking purposes? Please discuss.

c) Do Mr. Rainkie and Ms. Derksen recommend any benchmarking or reporting on O&A activities to confirm cost control and productivity improvements are being realized moving forward? If so, please explain what benchmarks would be appropriate to consider.

Response:

a) The recommendation in Section 6.3 of the Evidence to reduce the escalation for rate-setting purposes to 1%, was not based on research in other jurisdictions, but rather the following factors that are specific to MH/Centra consolidated operations and the public sector in Manitoba:

- The PUB findings from Orders 59/18 and 69/19, that MH continue to find further areas to reduce O&A costs, both in terms of staff reductions and Supply Chain Management in the post Voluntary Departure Program years and that a 1% escalation factor be used for rate-setting purposes;

- The 1% escalation factor was used by MH and Centra to manage growth in its O&A costs in its financial forecasts between 2013 and 2015;

- Consistency with the current provincial governments approach to managing costs in the public sector in Manitoba including provincial wage freeze legislation (Public Services Sustainability Act) and cost saving measures in the Manitoba public sector in general;

- O&A escalation of 2% would offset about 89% of the VDP and supply chain savings allocated to Centra in just two fiscal years and is driving about $9 million or 25% of the projected increase in non-gas revenue requirements in Centra's most recent financial forecast (CGM18); and

- Centra's O&A costs are allocated from MH's consolidated operations and as a result, it is appropriate that the PUB findings in Orders 58/19 and 69/19, apply to natural gas operations as well.

b) In our experience, O&A budgets are set through a combination of top-down and bottom-up budgeting exercises with the top-down component including a stretch-target or productivity factor specified by senior management or the board of directors. It is also our understanding that incentive or performance based regulatory (PBR) approaches often employ a productivity factor in rate-setting.

In addition, it is our view that there is a general expectation of stakeholders that a regulated monopoly would routinely develop productivity initiatives as a matter of course, in order to actively manage its O&A costs, before it considers seeking rate increases from customers.

c) While Section 6.3 of the Evidence did not specifically address O&A benchmarking or reporting, we do recommend that Centra continue to provide information on its cost saving initiatives, overall % increase in O&A costs, cost per customer and comparisons to Manitoba CPI as part of the minimum filing requirements of its GRA's.

In addition, it would be beneficial if Centra were to provide key performance indicators with respect to productivity as part of the minimum filing requirements for future GRA/s. When requested to provide the measures of performance used by Centra that show how productivity has changed over the past five years in information request PUB/Centra I-26 (b), Centra's response was a three-line qualitative response that did not provide the quantitative information requested.

Reference: Section 9 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requests additional information related to the use of a Rate Base Rate of Return rate setting model.

Question:

a) In the view of the Mr. Rainkie and Ms. Derksen, can a ratebase rate of return (RBROR) model for rate setting be implemented without the PUB explicitly approving the inclusion of capital expenditures in ratebase?

b) In the experience of Mr. Rainkie and Ms. Derksen, do Crown utilities regulated using a ratebase/rate of return model ever have capital costs disallowed by their regulator for rate setting purposes? If confirmed, can Mr. Rainkie and Ms. Derksen provide examples of the tests a regulator might use to determine whether certain capital costs should be disallowed?

c) In the view of Mr. Rainkie and Ms. Derksen, what measures could be implemented by the PUB to ensure Centra Gas's capital expenditures are prudent and reasonable and under a Minimum Retained Earnings Test approach to rate setting.

Response:

a) In our view, a RBROR model for rate-setting cannot be successfully used without the PUB explicitly approving the inclusions of capital expenditures into rate base. The purpose behind the formulaic RBROR model is that the utility rates are set by including an overall return on rate base which is determined by multiplying an approved rate base with an approved overall rate of return. Without an approved rate base, this model of rate-setting cannot be appropriately applied.

   Despite Centra's view in the response to PUB/Centra II-41 (d) that "under the current hybrid model established by the PUB, Centra does not request approval of the PUB for specific forecasted additions to rate base in advance of construction", it is our understanding that the PUB has continued to approve net plant additions to rate base or a rate base at each of Centra's subsequent GRA's. For example, please see:

   - Ordering paragraph 16.1 Order 135/05 (2005/06 & 2006/07 GRA),
   - Ordering paragraph 6.1 of Order 99/07 (2007/08 & 2008/09 GRA),

- Ordering paragraph 6.1 of Order 128/09 (2009/10 & 2010/11 GRA); and
- Ordering paragraph #4, Section 2.0.0, Order 89/13 (2013/14 GRA).

b) We have not researched the jurisdiction and practices of regulatory commissions that employ a RBROR method to regulate the rates of crown-owned utilities. As noted in the response to part (a) of this information request, the use of a RBROR method to regulate rates without the ability to disallow capital costs, would appear to defeat the purposes of using this methodology in the first place.

In general, the regulatory tests that a regulator uses to determine if a capital expenditure is approved into rate base (recovered from ratepayers) or alternatively, disallowed, is if the expenditure is used and useful and prudently acquired. It is noted that these regulatory tests are included in Section 61(a) of *The Public Utilities Board Act*, where rate base is a factor in determining just and reasonable rates.

c) Under a Minimum Retained Earnings Test (MRET) approach to rate-setting, the PUB can continue to take a number of measures to ensure that Centra's capital expenditures are prudent and reasonable, including:

- Reviewing the reasonableness of Centra's approach to capital planning and asset management including asset management plans, asset condition assessments and capital investment planning tools and processes;

- Reviewing the overall levels and trends in forecast capital expenditures contained in Centra's CEF by investment category and requesting justification with respect to the changes in capital expenditure levels in each subsequent CEF; and

- Asking questions and testing specific capital expenditure projects or programs where issues are raised by PUB advisors and intervenors, through review of the Centra CEF and capital investment justification documents.

Reference: Section 10.8 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requires additional information on the recommendations with respect to the heating value deferral account.

Question:

a) If the heating value deferral account were eliminated what mechanisms or crosschecks could the PUB put in place to ensure that Centra's forecast heating values are reasonable for rate setting purposes?

Response:

a) In the alternative where the heating value deferral account is eliminated, the effects would impact Net Income on an actual basis. For rate setting purposes, it would appear reasonable that Centra be obligated to file for PUB review its forecasted heating value and supporting rationale as part of a general rate or cost of gas application, and that forecasted value would remain in effect until a subsequent order of the Board.

Reference: Section 6.5 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requires additional information to understand the implications of the recommendation beginning at line 34 of 36.

Question:

a) In the views of Mr. Rainkie and Ms. Derksen, in the event there is no oral hearing of this matter, would it be appropriate for the Board to reduce the escalation factor assumed in developing the property tax forecast?

Response:

a) Our understanding is that Centra has the onus of proof to convince the PUB of the appropriateness of including the new forecast level of property taxes in approved revenue requirements and rates for 2019/20.

In our view, there are sufficient concerns that have been raised with respect to Centra over-forecasting increases in property taxes related to the 2012 and 2016 provincial re-assessments, such that the record of the current proceeding is not clear with respect to the impacts of the 2018 re-assessment on 2019/20 property taxes/revenue requirements. In absence of clear and compelling evidence from Centra in oral or written form, the PUB should make an appropriate adjustment to reduce the escalation related to 2019/20 property taxes (2.8% or $0.350 million) for rate-setting purposes.

Reference: Section 8.4 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requires additional information to understand the implications of the recommended rate review interval.

Question:

a) In Mr. Rainkie and Ms. Derksen's view, would regular GRA reviews help mitigate potential intergenerational equity issues from Centra's rates and riders remaining interim for substantial periods?

Response:

In our view, regular GRA reviews, not exceeding three years, would assist in mitigating potential intergenerational equity issues that arise from changes to the overall level of revenue requirements, shifts in the pattern/nature of underlying costs which are allocated in different proportions to the various customer classes even if the overall revenue requirement is stable, as well as changes in non-primary gas costs and refunds/recoveries of gas cost deferral accounts.

These considerations are outlined in further detail in Section 8.4, pages 73 to 75 of our Evidence

Reference: Section 10.7 Evidence of Darren Rainkie & Kelly Derksen

Preamble to IR:

IGU requires additional information to understand the recommendation related to the zone of reasonableness.

Question:

a) On Page 5 of Order 164/16 the PUB stated:

> "While the results of a COSS appear to be arithmetically exact, a COSS involves considerable judgment."

> Do Mr. Rainkie and Ms. Derksen believe this statement is true for Centra's cost of service study? Please explain why or why not.

Response:

Yes, our view is that a cost of service study involves informed judgment including for Centra's cost of service study. It is understood that the intent of a cost of service study is to evaluate the relative fairness of rates between customer classes. Revenue to Cost Coverage Ratios (RCC) are determined from a cost of service study and indicate the proportion of costs recovered from the revenue arising from each customer class. A Zone of Reasonableness (ZOR) is often employed by utilities to assist in evaluating the RCC ratios considering several factors. First, the results of a cost of service study are approximate (given the judgement involved, data quality, and data limitations), and a ZOR may be employed to recognize the range the uncertainty that's involved in cost allocation. Secondly, other factors including public policy considerations may result in establishing rates that do not equal revenue for a class. Third, there are other ratemaking objectives to be achieved including rate stability. Methodology and cost changes can result in RCCs that vary from year to year. This may include imposing a rate increase for a class in one year and a rate decrease the next year. A ZOR would allow for flexibility to avoid rate instability that might otherwise occur.

Centra moved away from a ZOR in 1997 to unity on account of industrial customer pressure as well as PUB direction, despite the impact on SGS customers. For Centra, in contrast to Manitoba Hydro's electric operations, there is a greater degree accuracy of the results of its COSS. The reason is that a large proportion of the costs incurred to serve natural gas customers is incurred for the cost of commodity, the price of which is established through an external natural gas market. On the electric side of Manitoba Hydro's operations, MH produces the commodity using common plant and more uncertainty exists as to the categorization of costs such as between energy and demand.

Centra also accepted that considerations of fairness and equity were largely accommodated through its cost allocation methodology such that reliance on a ZOR was less necessary. Setting rates based on unity has been in place since 1997 although it is acknowledged that achieving unity is somewhat notional given that it is a point in time calculation and its base of determination is constantly shifting. There have been only a couple of occasions over that 20-year period that rates were not re-based to unity and generally bill mitigation measures have been largely accommodated through a deferral-type of mechanism.

CAC's independent experts view generally that deviating from unity through a ZOR is a reasonable approach for purposes of rate stability. However, in the case before the PUB, it is not advisable for a several reasons as follows:

- First, the SGS class has been overcontributing during the period since Centra's last GRA in 2013/14.
- Second, despite the acknowledged informed judgement in cost allocation that often gives rise to a ZOR, that has not been the methodology in place for Centra who moved away from that kind of methodology in large part because of the past position of industrial customers.
- Third, the RCC for the Special Contract Class is currently approximately 60%. If a temporary ZOR is implemented for purposes of bill mitigation, a ZOR no larger than +/- 3% in light of Centra's operations is reasonable. Even in a very extreme case, in light of Centra's operations, a ZOR of 90% - 110% will be of little practical consequence to address bill mitigation and rate stability given this class' RCC.

For these reasons, it is advisable that there be no further delay in rate relief afforded to the SGS class. Bill mitigation measures such as a deferral mechanism and/or adjustment to the allocation of the heating value deferral is viewed to be fair, reasonable, and more effective.

b) On page 16 of 25 of the Christensen Report (Attachment 11 to the PUB Completeness Review) Centra states with respect to adopting a range of acceptable RCC ratios:

"Centra has previously set rates around a 97:103 range in the early and mid 1990's. While Centra views that it should in most cases strive to align rate levels to costs, it also views that under limited circumstances, deviating from unity may be a reasonable approach to provide rate stability."

i. Were Mr. Rainkie and/or Ms. Derksen involved in preparing, reviewing or approving Centra's response to the Christensen Report?

ii. Do Mr. Rainkie and Ms. Derksen agree that deviating from unity may be a reasonable approach to provide rate stability? Why or why not?

Response:

Part i)

Yes, Ms. Derksen was involved in the preparation of Centra's response to the Christensen Report.

Part ii)

Please refer to the response to IGU/CAC-I 6 (a) above.