

2019/20 ELECTRIC RATE APPLICATION**Manitoba Hydro Undertaking #1**

Manitoba Hydro to provide the correspondence with respect to the Technical Conference, including Manitoba Hydro's position.

Response:

Please find as an Attachment to this Undertaking Manitoba Hydro's letter dated August 15, 2018 providing comments on the scope and process of the Technical Conference to review the use of minimum retained earnings as guidance in rate-setting.



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August 15, 2018

Mr. D. Christle
Secretary and Executive Director
Public Utilities Board
400-330 Portage Avenue
Winnipeg, Manitoba
R3C 0C4

Dear Mr. Christle:

RE: MANITOBA HYDRO COMMENTS ON SCOPE AND PROCESS OF TECHNICAL CONFERENCE TO REVIEW USE OF MINIMUM RETAINED EARNINGS AS GUIDANCE IN RATE-SETTING

On May 1, 2018, the Public Utilities Board (“PUB”) issued Order 59/18, its final Order with respect to Manitoba Hydro’s 2017/18 and 2018/19 General Rate Application (“GRA”). Included in that Order was Directive 9, which states:

Manitoba Hydro participate in a technical conference hosted by Board Staff or an external consultant appointed by the Board for the consideration of the establishment of a minimum retained earnings or similar test to provide guidance in the setting of consumer rates for use in rule-based regulation.

On May 30, 2018, Manitoba Hydro filed with the PUB an Application to Review and Vary Directive 9 in Order 59/18 and sought clarification on the objectives and scope for the technical conference. The PUB provided additional insight into their expectation for the technical conference in Order 90/18, issued July 13, 2018, stating that the aim is to “explore the use of rule-based regulation that considers the level of financial reserves required by Manitoba Hydro under various circumstances and meeting other financial metrics in the face of potential risks to the Utility” [emphasis added].

On August 9, 2018, the PUB further clarified its intent by stating that the purpose of the technical conference was to gain a better understanding of the financial reserves required for Manitoba Hydro under various circumstances, including consideration of risk tolerances, what risks should be protected by reserves and the circumstances which would guide the need for more aggressive rate increases to continue full cost recovery for Manitoba Hydro. While Manitoba Hydro believes all Parties, including the Utility, benefit from this additional direction on the PUB’s intent in studying reserve sufficiency to manage risks, Manitoba Hydro notes the PUB appears to have already made preliminary findings prior to the technical conference with respect to Manitoba Hydro’s requirement for financial reserves at pages 64-65 of Order 59/18 wherein the PUB agrees with Intervenor evidence that reserves should not be used to manage two of the three major risks, interest rate and export price risk, which were identified by Manitoba Hydro, alongside drought, as its largest financial risks.

Available in accessible formats upon request

Manitoba Hydro's comments with respect to the technical conference below is based on the expectation that, notwithstanding the PUB's comments in Order 59/18 and in order to have a fulsome discussion on the issue of financial reserves required, risk tolerance and what risks should be protected by reserves, all risks being faced by Manitoba Hydro will be discussed.

Timing of GRA

In its letter of August 9, 2018, the PUB sets out that Manitoba Hydro should not view the technical conference as a condition precedent of making its next GRA noting "Manitoba Hydro is not prevented from filing a GRA based on its financial plan that it views as just and reasonable for the financial health of the Utility".

Manitoba Hydro does not view "rule-based regulation" as anything novel or different from its long-standing practice of developing financial plans in support of rate applications and the PUB's testing of such. At issue is the choice of a particular goal, test or target that informs the objectives of the rate-setting. The pursuit or maintenance of a "minimum level of retained earnings or other similar test" is different not in principle but only outcome from the pursuit or maintenance of a debt-to-equity ratio, the latter of which has been the focus of examination by the PUB since 1995. At issue is whether to look at the sufficiency of equity reserves in absolute dollar terms (minimum retained earnings) or in proportion to the size of the company (debt-to-equity ratio). It should be understood that setting rates to maintain any one metric, such as minimum retained earnings, is inextricably linked to the ability to meet any other chosen financial metric and an examination of the use of a minimum retained earnings or other such test cannot be made in isolation. As such, Manitoba Hydro believes the relationship with other financial metrics needs to be included within the scope of the technical conference, as the PUB has more clearly enunciated in Order 90/18.

The PUB has stated that the evidence at the GRA failed to fully canvas the management of potential risks to the Utility and the level of financial strength (as measured by reserves, maintenance of financial metrics or any other means) necessary to address such risks. On the contrary, Manitoba Hydro placed an extensive amount of evidence on the record at the GRA and Manitoba Hydro submits that exactly such a financial risk management discussion became the principal focus of this last GRA which was envisioned in the scope of the proceedings laid out in the procedural Order 70/17. Manitoba Hydro filed additional evidence including Manitoba Hydro's uncertainty analysis and the 2015 KPMG Financial Targets Review (Appendix 4.1 of the GRA) and 2017 Supplementary Update (Appendix 4.5 of the GRA) which was largely untested by the PUB and Intervenors. Further, the risks faced by Manitoba Hydro was the subject of extensive examination by the PUB and Intervenors at the 2010/11 and 2011/12 GRA proceeding.

Manitoba Hydro acknowledges it is in a position to submit a GRA notwithstanding any clear guidance from the PUB on reserve maintenance or other any other financial metrics that the PUB will consider in rate-setting. Manitoba Hydro's submission is that it is unavailing and inefficient to do so and that all Parties, including the PUB, should obtain the benefit of the further discussion and dialogue on these important matters enabled by the technical conference. This is especially true considering the PUB acknowledged in its letter that the technical conference will also look at the circumstances which would guide the need for more aggressive rate increases to continue full cost recovery for Manitoba Hydro. The alternative is almost certain to be a re-litigation of all the same issues that consumed the most recent GRA with an outcome that will fail to consider any aggressive rate increases as the circumstances guiding the need for rate increases may not yet have been considered

via a technical conference. Manitoba Hydro submits that in order to establish a path forward, the PUB should clearly articulate the short, intermediate and long term financial goalposts it will consider in rate-setting such that future GRA's can more narrowly focus on the implications of unforeseen changes in the Utility's financial condition and business outlook. In consideration of the length and exhaustiveness of this past proceeding, Manitoba Hydro had this as a reasonable expectation of an outcome of the 2017/18 and 2018/19 GRA. Manitoba Hydro hopes the technical conference can be a useful step forward.

Technical Conference

In Order 90/18 at page 35, the PUB invited parties to provide comments on the scope and process for the technical conference. Prior to commenting on the scope and process of a technical conference, Manitoba Hydro believes that as part of the terms of reference, the PUB should also establish and clearly set forth the rules governing participation by parties in the technical conference. It is not clear at this juncture whether the PUB is intending on hiring an independent facilitator or consultant to assist in facilitating the technical conference or what participation the PUB is expecting in terms of Intervenors.

As can be seen with prior reviews before the PUB, processes are very time consuming, costly and budgets are often exceeded above that approved by the PUB. In order to ensure that the technical conference is effective and efficient, Manitoba Hydro suggests that the number of Intervenors participating in the technical conference should be limited to those Intervenors, as identified in the PUB's Procedural Order 70/17 of the 2017/18 & 2018/19 GRA, whose focus was primarily on financial targets, capital markets and debt management. It would be unreasonable, time consuming and costly to allow parties whose focus was not on those issues during the last GRA to now be expected to participate in a technical conference which they would now be required to spend time reviewing and attempting to understand the issues. In addition, based on the evidence presented at the last GRA, Intervenors who were focused primarily on financial targets, capital markets and debt management would be in a position to share a financial advisor for purposes of the technical conference as their positions were aligned.

Manitoba Hydro submits that any budgets established for participation by Intervenors should be limited to only those parties who truly require financial assistance and should be established taking into consideration the extent of the participation required by Intervenors. In addition, if the PUB intends on retaining the services of an independent facilitator or consultant, all parties should be directed to work with the facilitator and/or consultant to focus questions and material filed on those issues specifically identified by the PUB.

The comments outlined above would be in line with the purpose of the technical conference as outlined in the PUB's letter of August 9, 2018 wherein the PUB stated that the purpose was to include gaining a better understanding of the financial reserves required for Manitoba Hydro under various circumstances, including consideration of risk tolerances and risks that should be protected by reserves. It is apparent that the party with the information to provide the understanding requested is Manitoba Hydro and as such, while it would be useful to have some participation by Intervenors, it does not appear that an extensive amount of participation is envisioned.

Manitoba Hydro views the technical conference as building on the evidence filed by Manitoba Hydro during the 2017/18 & 2018/19 GRA and as noted above, Manitoba Hydro placed an extensive

amount of evidence on the record at the last GRA including Manitoba Hydro's uncertainty analysis and the 2015 KPMG Financial Targets Review, and the 2017 Supplementary Update. Manitoba Hydro submits that this would be the foundation for the discussion during the technical conference. Considering the Intervenors who focused on the issues of financial targets, capital markets and debt management have had an opportunity to review the information filed and develop their own views, these documents could be used in the conceptual discussion of issues to occur during the technical conference. Intervenors experts and consultants should be in a position to put forward their position on the information provided by Manitoba Hydro, as well as their views on the issues.

Scope of Technical Conference

Manitoba Hydro believes the following matters should be within the scope of the technical conference:

- Annual contribution to reserves
- Maximum debt
- Cash flow sufficiency
- Interest coverage
- KPMG 2015 Financial Targets Review and 2017 Supplementary Update
- Uncertainty analysis

Manitoba Hydro reserves the right to provide further comments on the scope of issues once the PUB has issued the Terms of Reference to all parties which may be addressed at a process conference in advance of the technical conference.

Process for Technical Conference

A review of a minimum retained earnings or other such test in the context of the overall assessment of Manitoba Hydro's financial health in guiding the setting of rates requires the consideration of a number of highly technical, complex and inter-related concepts. Given the nature of this subject matter, Manitoba Hydro's understanding is that a technical conference is being proposed to replace the traditional discovery processes of filing and responding to written information requests, or the sequential examination and cross examination of witnesses. As the intent of the technical conference would be to promote an open exchange of information through a robust and candid dialogue between the parties, Manitoba Hydro believes that this is best accomplished through direct participation of PUB panel members, PUB advisors and approved Intervenors and their technical advisors/consultants (as identified above). All deliberations that occur throughout the process would be conducted on a "without prejudice" basis.

Manitoba Hydro proposes the technical conference be facilitated by an independent PUB-appointed facilitator possessing related utility and financial experience. Manitoba Hydro further proposes that the facilitator be engaged through an open-tendering process whereby all parties can provide comment on the terms of reference for the facilitator.

Following the receipt of all parties' comments on the technical conference terms of reference by the PUB, Manitoba Hydro recommends that the PUB issue its preliminary terms of reference to all parties which can then be further discussed at a scope and process conference. The scope and

process conference can also discuss the proposed intervention and experts, elaborate on the process to be followed, as well as discuss terms of reference for the PUB-appointed facilitator.

The technical conference would have each party present its positions on metrics for rule-based rate-setting. It is crucial at this portion of the technical conference that Intervenors clearly establish their positions on the subject matter rather than reserve their positions to final written submissions as they have been inclined to do in past proceedings. This would allow all parties to freely discuss and exchange information and views. The PUB advisors and all other parties consultants and experts in attendance would then have the opportunity to fully canvass the subject matter and ask questions of other party's experts on the subject matter within the agreed upon scope of the review process. The discussions in the technical conference would be transcribed.

Instead of written information requests, Manitoba Hydro recommends that additional information that may be required would be identified by the PUB-appointed facilitator in the course of the technical conference and a list of undertakings of Manitoba Hydro and/or other parties would be prepared. The undertakings responses would be distributed to all parties within a given period of time after the conclusion of the technical conference.

The process would then provide Intervenors the opportunity to provide final written submissions to the PUB on the subject matters. Following receipt of those written submissions and as any rule-based rate-setting would impact its future applications, Manitoba Hydro would provide its final written submission to the PUB.

The PUB Panel would then be in a position to assess the evidence and respective positions provided throughout the review process and provide its findings in advance of Manitoba Hydro's next GRA. Once the PUB Panel provides these findings, Manitoba Hydro will be in a position to file its Electric General Rate Application with the PUB, and as part of that review, all parties will have an opportunity, as they deem appropriate, to have legal counsel represent their interests and advocate on their behalf, as part of a traditional regulatory process before the PUB.

Manitoba Hydro appreciates the opportunity to provide its comments on a process feedback and clarification on PUB directives. If you have any questions or comments with respect to this submission, please contact the writer at 204-360-3633 or Liz Carriere at 204-360-3591.

Yours truly,

MANITOBA HYDRO LEGAL SERVICES DIVISION

Per:



ODETTE FERNANDES
Barrister & Solicitor

cc: Bob Peters, Board Counsel