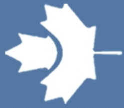

MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA HYDRO

GENERAL RATE APPLICATION

2014/15 AND 2015/16

Before Board Panel:

Regis Gosselin	- Board Chairperson
Marilyn Kapitany	- Board Member
Richard Bel	- Board Member
Hugh Grant	- Board Member

HELD AT:

Public Utilities Board

400, 330 Portage Avenue

Winnipeg, Manitoba

June 15, 2015

Pages 3763 to 4135

"When You Talk - We Listen!"

1 MS. HELGA VAN IDERSTINE: Thank you.
2 THE CHAIRPERSON: Thank you very much.
3 I appreciate the hard work that you've done. Thank you
4 -- we do.
5 MR. DARREN RAINKIE: Good morning, Mr.
6 Chairman, members of the Board, Intervenors, and ladies
7 and gentlemen. And a special welcome to Ms. Lee on her
8 first time here in Manitoba Hydro rate proceeding.
9 I appreciate the opportunity to speak
10 this morning to this undertaking because, as usual, we
11 filed a schwack of paper with you on Monday morning,
12 and I don't -- I know this was an important question
13 and you took some time delineate it out to us.
14 So I wanted to make sure that you had a
15 chance to -- to understand it because it's not a simple
16 answer, as usual.
17 So just by way of -- and we have the
18 document up on the screen, and I'm going to try to be
19 careful in terms of moving to certain pages so that I
20 can show you how we approach the end response to this
21 question. So if I lose you along the way, please just
22 stop me and I'll -- I'll backtrack as appropriate.
23 So just a general background, and I
24 think you -- you've heard us say this before, but at
25 Manitoba Hydro, we follow a cost -- what we refer to as

1 a cost-of-service rate-setting approach in proposing
2 rates.
3 So in that approach, proposing rates is
4 not based strictly on the level of cost, but rather on
5 implementing gradual rate increases to cover costs and
6 achieve our financial targets over time.
7 So under this approach, we propose rates
8 to cover all of the various costs to providing service,
9 including financing costs, as well as an annual
10 contribution which we call net income to re --
11 financial reserves, which is of course called retained
12 earnings on our financial statement. The purpose of
13 those financial reserves are to promote rate stability
14 for customers.
15 So while -- under this methodology or
16 approach, it's not possible to give you a precise
17 delineation of the contribution of each factor to the
18 3.95 percent rate increases that are requested.
19 We certainly can use different rate
20 scenarios, if you like, or alternate rate scenarios
21 with respect to our financial proj -- projections to
22 respond directionally to the question and give you a
23 pretty good answer.
24 So if we could move to -- Diana, to page
25 4 of 21 of the -- Jerry I'll just -- it's not going to

1 be as quite as slick a -- oh, Kurt, it's -- Kurt and
2 Diana. Okay. It's not going to be quite as slick as
3 if we had the PDF in front of us. But maybe we can
4 just pull it up a little bit so we can get all the
5 figures in. Okay. Oh. You lost it there for a
6 second.
7 So with the 3.95 percent rate increases,
8 if you look at the 2016, 2017, and 2018 columns and you
9 go down to net -- the net income line, with the
10 inclusion of the 3.95 percent rate increases, you can
11 see that we're projecting a contribution to reserves
12 through net income of $115 million in 2016, $59 million
13 in 2017, and $64 million in 2018, respectively. If you
14 add those up, that's a total of $230 million -- $38
15 million over that three (3) year period.
16 Now, that contribution to reserves is
17 rel -- relatively modest considering that Manitoba
18 Hydro's asset base is approaching -- on the electric
19 side of the business is approaching $17 billion and our
20 retained earnings are -- currently are at $2.7 billion.
21 It certainly isn't anything like a 9 or 10 percent rate
22 of return that you might see from an investor-owned --
23 owned company.
24 And if you -- and if you look at the
25 very bottom right-hand under 2024 column, under the

1 financial ratios, you see the equity ratio is projected
2 to fall to 10 percent by 2024 from the current level of
3 around 22 percent, even with the 3.95 percent rate
4 increases.
5 And if you add up the losses that -- if
6 you look at the columns between 2019 and 2024 and you
7 add up the losses that are of 90 million, 160 million,
8 178 million, 206 million, 187 million, and 124 million,
9 those are losses of $901 million in the last six (6)
10 years of -- of this particular ten (10) year part of
11 the forecast.
12 And if we go to page 6 of 21 for one (1)
13 second.
14
15 (BRIEF PAUSE)
16
17 MR. DARREN RAINKIE: If you look under
18 the 2024 column and you pan down to the retained
19 earnings line, you'll see that we project with those
20 losses that we'll move from our current level of
21 retained earnings of $2.7 billion down to $2 billion by
22 2024. And this includes the effects of the 3.95 per --
23 percent rate increases.
24 So the proposed and indicative of 3.95
25 percent rate increases are not -- are not building a

1 war chest for us for future investment in assets, but
2 rather, they're just there to manage the rate of
3 decline in our financial strength. So we're not
4 asking, under the 3.95 percents, for something extra in
5 the first few years. We're simply trying to manage the
6 rate of decline in our financial health. The 3.95
7 percent does not allow us to pre-fund future investment
8 requirements.
9 But in the spirit of the -- the
10 undertaking, what we wanted to do was present a couple
11 alternate -- alternate rate scenarios just to amp --
12 amplify the -- the situation, I suppose, and also to
13 give you some options to consider.
14 So if we -- if we -- and we can move to
15 page 10 of the attachment. So what I've just
16 summarized is what's inherent in our actual IFF13 with
17 the 3.95 percent rate increases. But if we took an
18 approach of allocating the 3.95 percent rate increases
19 between current operations and between an amount to go
20 into a capital deferral account similar to the Bipole
21 III deferral account that was approved in Orders 43/'13
22 and 4 -- 49/'14, it won't particularly change or
23 improve the financial projections. What it will do is
24 just reshape them slightly. And I'll -- and I'll go
25 through that now.

1 So you can see -- so this alternative is
2 for the next three (3) years, 2016, 2017, and 2018, 3
3 percent of the 3.95 percent rate increase going to our
4 current revenues and then .95 percent of the rate
5 increase being added to the -- to the reserve account
6 that was established in Order 43/'13. And you can see
7 that the net income for the next three (3) years is
8 projected at 103 million, 34 million, and 24 million,
9 for a total of 161 million over that three (3) year
10 period.
11 And you can see if we were to take that
12 approach with the 3.95 percent rate increases, that our
13 net income is becoming particularly thin. It would be
14 quite easy if we had below average water flows or other
15 negative financial circumstances for Manitoba Hydro to
16 slip into a loss position in those years.
17 And I should note that in 2016, of
18 course, with the rate increase being implemented later
19 than April 1st, we're already assuming an August 1st
20 implementation date would be down about $17 million
21 from the figures that are included in this -- in this
22 particular exhibit.
23 So if we follow along between 2019 and
24 2024 on the net income line, we see losses of 101
25 million, 85 million, 148 million, 175 million, 186

1 million, and 124 million. So that's a total -- total
2 losses of $819 million during that last six (6) years
3 of this ten (10) year period.
4 If you look at the 20 -- 2024 column,
5 and you pan down to the equity line, you see that we
6 still decline to a -- a projection -- projected equity
7 ratio of 10 percent by 2024. And if we then move to
8 page 12 of the exhibit for one (1) second...
9
10 (BRIEF PAUSE)
11
12 MR. DARREN RAINKIE: And we move down
13 under the 2024 column, the retained earnings line, you
14 see that retained earnings still decrease to two (2)
15 thous -- to $2 billion by 2024, so allocating the rate
16 increase of 3.95 percent to current operations and --
17 and the capital reserve account by the end of the ten
18 (10) years will essentially get you back to the -- to
19 the same place.
20 It doesn't improve your financial
21 projections over the long term, of course, it just
22 reshapes it. It takes a bit of the -- the net income
23 off the front end -- shaves it off the front end and --
24 and amortizes it into net income in the back six (6)
25 years of this forecast. And if you think about that

1 mathematically, it -- it makes sense. It's not a
2 perverse result at all.
3 So as I said, we believe that the 3.95
4 percents are the -- are the minimum that are required
5 for future earnings requirements. And so this scenario
6 simply just shapes that a little differently, but
7 doesn't -- doesn't change the -- the picture.
8 So what we then endeavoured to do is
9 say, Okay, well, what if we want -- what if the
10 objective was to set aside some funds for future
11 investment requirements in the next few years? And if
12 that's the case, then consideration could be given to
13 approving higher rate increases in the next three (3)
14 years, and then allocating those higher rate increases
15 to a capital deferral account.
16 So we -- if we turn to page 16 of the
17 exhibit for one (1) second, this is what we've coined
18 rate alternative number two (2). We see 5 percent rate
19 increases in the next three (3) years versus the 3.95
20 percents, with the differential of 1.05 percent being
21 added to the capital deferral account in those -- in
22 those three (3) -- three (3) years.
23 And if you look under the 2016 to 2017
24 and 2018 columns in net income, you'll see a slight
25 improvement of 117 million, 65 million, and 74 million.

1 If you look at the -- the, losses, then in the back six
2 (6) years, they are reduced to 42 million, 15 million,
3 71 million, 92 million, 100 million, and 28 million.
4 So that's a -- that's a total of 348 million versus the
5 $900 million that we saw when we just looked at our
6 Manitoba Hydro IFF13 projection.
7 So -- so under this scenario, if you
8 look under the 2024 column and you pan down to the
9 equity ratio line, you see that those additional rate
10 increases would assist in somewhat tempering the
11 reduction in the equity ratio. We would get down to 12
12 percent versus 10 percent, but you can see how sticky
13 this projection is to -- to rate changes, just because
14 of the large intensive capital investment in the next
15 number of years.
16 And if we move to page 18 of the exhibit
17 for one (1) second, and we look at the retained
18 earnings line and we move over to the far column, the -
19 - the 2024 column, you'll see -- you see that under
20 this scenario, retained earnings are not that different
21 to what we currently have. They're a little lower, but
22 they're in the $2.6 billion range. So certainly those
23 higher rate increases would assist us in at least
24 maintaining our financial reserves, not significantly
25 improving them. You have to remember the size of the

1 asset base of the Company is doubling over this period.
2 But at least it would allow us to maintain our
3 financial reserves, not -- not deplete them.
4 And in doing that, of course, it would
5 reduce the risk of rate shock to customers if some
6 adverse event, like a significant drought, were to
7 affect us during that period of time.
8 I wanted to just note one (1) other
9 factor in this last scenario. If we could go back to
10 page 16? This will be my last switch, for a moment --
11 or maybe -- sorry, I'm not sure I can promise that, but
12 one (1) of my last switches.
13 You'll -- you'll see that those 5
14 percent rate increases in the next three (3) years, if
15 we move down to the capital coverage line for 2016,
16 2017, and 2018, would assist in making -- approving the
17 capital coverage ratio to at least one (1) or higher so
18 we would be able to generate enough cashflow to cover
19 off our sustaining capital expenditures that we have
20 forecast in the next three (3) years.
21 So in terms of the question, What is the
22 core earnings requirement of the rate increases? Well,
23 at -- at the very least, I think the 3.95 percent is --
24 is the -- is the minimum requirement. Of course, the 5
25 percent requirements would -- 5 percent rate increases

1 would assist us in -- in at least covering our capital
2 -- sustaining capital expenditures from cashflow, which
3 is a desirable thing to occur.
4 The other line item that I would note on
5 this scenario, which is the 5 -- 5 percent rate
6 increases in the next three (3) years, is -- is if we
7 look at the finance expense line and we move all the
8 way over to the 2024 column, you see that finance
9 expense under this scenario would be forecast at one
10 billion, three hundred and nineteen million dollars
11 ($1,319,000,000).
12 I don't think we need to go back to the
13 original scenario. I'll just read you the figure. But
14 if you look at our current projections with the 3.95
15 percent rate increases, that same figure would be one
16 billion, three hundred and forty-nine million dollars
17 ($1,349,000,000), so the higher rate increases would
18 improve finance expense each and every year by up to
19 $40 million, you -- as you can see in this scenario.
20 And -- and that finance expense is
21 really the truth serum of our forecast. We can play
22 around with accounting policies and all the different
23 things we've talked about this hearing, but eventually,
24 after we get through the period of capital build and we
25 no longer are capitalizing, you know, hundreds or

1 millions of dollars of finance expense to plant but
2 that finance expense now moves into our income
3 statement once those assets are in service, thi -- this
4 is the line item to be wary about. It -- it is the
5 true reflection of our finance expense.
6 It's not being -- not being, once we get
7 -- once we get past that extensive level of capital
8 investment, it is reflecting what's happening, it's
9 reflecting -- or more reflective of our cash
10 requirements to meet finance expense. So this is
11 something we need to manage carefully.
12 You can see that finance expense after
13 the big build, the -- the battle of the bulge, as Mr.
14 Hacault would say, increases two (2) or threefold in
15 this -- in this forecast. And higher rate increases at
16 the front end would certainly help us to -- to try to
17 mitigate that increase.
18 So I -- I think that was all that I had
19 to -- to say. It's probably more than you expected
20 this morning, but -- and I know there are other
21 witnesses lining up behind me to -- to speak to their
22 evidence, but that's a very quick moving through --
23 through the scenarios, sir.
24 And I certainly would be more than
25 prepared to answer any questions or clarify anything in

1 these three (3) scenarios that we have in this -- in
2 this undertaking.
3
4 (BRIEF PAUSE)
5
6 THE CHAIRPERSON: I'm trying to do some
7 quick calculations here. But by increasing rates by
8 point -- 1.05 percent over the next three (3) years
9 yields savings of in the order of 550 million?
10 MR. DARREN RAINKIE: Yes. The
11 difference between the losses under our current
12 scenario and the 5 percent, yes, they're fairly --
13 fairly staggering.
14 THE CHAIRPERSON: I haven't done the
15 calculations of the amount of, you know, the 1 percent
16 -- the 1.05 percent increase in rates, what that will
17 cost ratepayers. But I -- you know, the first thing
18 that jumps up at me is 550 million is -- it's a fairly
19 significant amount of savings.
20 MR. DARREN RAINKIE: Well, sir, what --
21 what you see demonstrated here is the power of early
22 rate increases. I mean, it's just the time value of
23 money.
24 I mean, it's just -- you know, it's the
25 -- as your parents probably told you, invest early.

1 Invest a little bit early versus waiting to the -- to
2 the end of your life to build a retirement fund, and it
3 will come much easier.
4 And that's -- our forecast is -- is just
5 like that. If we -- if we kick things down the road,
6 it very quickly can spiral out of control. I don't
7 think it has to. I think we can accomplish all the
8 investments that we have to make on behalf of
9 customers.
10 I think we just need to ask customers to
11 invest a little bit more up front, and -- and we can
12 maintain that reliable, safe power system that they've
13 enjoyed for decades.
14 But if we try to find ways of kicking it
15 down the road, we are -- we are risking that finance
16 expense line to, you know, increase. And as I said,
17 it's a bit of the truth serum in this -- in this whole
18 equation.
19 THE CHAIRPERSON: Now, I'm trying to
20 assess the -- the impact of the deferral account.
21 Could you address that directly? If -- if -- you know,
22 looking back at what was done by this Board a few years
23 ago, we directed Manitoba Hydro to put a portion of the
24 rate increase into a deferral account.
25 Could you -- could you describe the --

1 the significance of that to you, to Manitoba Hydro?
2 MR. DARREN RAINKIE: Sure. if we can
3 just move through the pages a little bit more, I can do
4 that. So if we -- if we move back to page -- page 6 of
5 the document for one (1) second, if you look at the
6 line that says Bipole III Reserve Account, that's where
7 we have apportioned both the current amount that the
8 Board has approved to go into the deferral account,
9 plus any other amounts in this second and third
10 scenario, sir.
11 So right now, with the amounts that had
12 been approved by the Board in Orders 43/'13 and I think
13 it is 49/'14, you can see that that reserve account is
14 projected to build up to about $162 million by 2019.
15 And what we've assumed in -- in this
16 scenario is that we would build that amount up to July
17 of 2019 when Bipole III goes in service, and then we
18 would amortize that amount fairly quickly over three
19 (3) years. So -- so that's why you see the $162
20 million figure amortizing down to one oh eight fifty-
21 four (10,854) and -- zero.
22 The Board certainly, I would
23 acknowledge, hasn't approved yet an amortization period
24 for that amount because it's in the future.
25 But we assumed a fairly quick