

MIPUG Recommendation

MIPUG recommends to the Board that a rate increase no higher than 1.5% be granted across-the-board for June 1, 2019, solely to smooth the transition to higher rates to address Keeyask in-service (and eventual end of Bipole III deferral amortization). Whether or not the PUB chooses to use a deferral account mechanism to communicate this is at the discretion of the PUB, given the short timeframe before Keeyask in-service, it may not be as effective as the Bipole III deferral account.¹ It is however MIPUG's recommendation that the PUB should clearly distinguish that the rate increase is not based on need by Manitoba Hydro today, but due to the future cost increases associated with Keeyask in-service, potentially as early as October 2020.²

MIPUG also supports having a technical conference as previously contemplated in Board Order 59/18 and the further development of Hydro's uncertainty analysis to determine appropriate reserve levels.

Introduction

Although the detailed reasoning leading to the recommendation is more complex and comprehensive, we submit that 1.5% is appropriate from a very basic approach.

1. In the test 2019/20 year, without a rate increase, Manitoba Hydro is projecting a positive net income of \$64 million (that is already 4+% above costs) which is higher than the \$61 million positive net income (12 year WATM) and the \$28 million positive net income (adjusted for 20 year WATM) rate path illustrated in MH 93;

¹ As discussed by Mr. Bowman in cross-examination on April 25, 2019 with Dr. Williams, transcript pages 591 - 602 and in cross-examination with Mr. Bob Peters at transcript page 691

² As noted by Ms. Bauerlein in direct examination, April 23, 2019, transcript page 82

2. We know the Bipole III revised capital costs result in a recurring annual savings of \$17 million³ which is a bit more than a one-time 1% rate relief (1% is about \$15 million);

3. If we use the 3.5% Hydro rate request as a starting point and subtract this one-time 1% rate relief, we are sitting at 2.5% without any adverse long term impact because of the recurring annual savings of \$17 million.

4. We say it is appropriate to further reduce the 3.5% Manitoba Hydro rate request by an additional 1% leaving an increase of 1.5%. As we will describe in further detail, there are a lot of good news stories which have not yet been fully quantified.⁴ There is an absence of any material or sustained negative developments compared to MH-93. 1.5% is consistent with an inflationary increase. It recognizes that in this truncated hearing Hydro has not provided evidence of all the puts and takes which would normally be in front of this Board to determine whether a more aggressive approach to absorbing the cost of Keeyask needs to be taken. Put it simply, Hydro has not met its onus of proof and candidly admits that the illustrative projections it has put in front of this Board are not updated. We say that the Board requires a higher burden of proof to justify a rate increase exceeding inflation.

5. Although it is not perfectly clear, it appears that in its submission, at page 6 lines 11 to 14, Manitoba Hydro is conceding that, after the adjustment made for

³ PUB/MH I-57

⁴ Summary of longer-term positive directional items MIPUG Exhibit 7, Slides 10 and 11

Bipole III, the net difference of \$326 million in debt “results in lower annual interest costs of \$13 million compared to Exhibit MH-93. Together with the \$17 million Bipole III annual cost savings this amounts to a 2% one-time rate reduction.

Legislative and Regulatory context

As noted in several hearings and in a more in-depth way at the NFAT and 2017/18 & 2018/19 GRA, in this Province, Manitoba Hydro is a vertically integrated monopoly Crown utility. It is a pure cost recovery utility. This allows long-term projects such a major generation projects to be undertaken with a long-term view. It allows Manitobans to reap long-term benefits of inflation protected generation investments with expected lives of over 100 years.

We submit that when setting just and fair rates, it is important to take into consideration intergenerational equity. Existing ratepayers should not be unfairly burdened with carrying a disproportionate amount of absorbing Hydro’s recent major capital projects. All IFF’s directionally show that after the initial absorption years this Crown Utility is expected to generate substantial net income on the current rate path.

It must be remembered that current ratepayers have already been asked to absorb Bipole III into rates and that a significant portion of rate increases in the last 5 years of 11.6%, or more than 2%/yr, were specifically designated for that purpose as follows:⁵

⁵ MIPUG Exhibit 6

Table 1: Past Rate Increases and Proportion Designated to BPIII Deferral – per MIPUG-6

PUB/MH I-11a						
	Amount Deferred	Amortization	Balance	Rate Increase Approved	Rate Increase Designated to BPIII Deferral	Board Order Approving (Interim; Final)
2013/14	19	-	19	3.50%	1.50%	43/13
2014/15	30	-	49	2.75%	0.75%	49/14; 73/15
2015/16	51	-	100	3.95%	2.15%	73/15
2016/17	96	-	196	3.36%	3.36%	59/16; 59/18
2017/18	152	-	348	3.36%	3.36%	80/17; 59/18

Note that in each of 2016/17 and 2017/18, the full rate increase of 3.36% went to absorbing the rate impact of Bipole III. In those 2 years, no additional increase was warranted for other revenue requirements.

Part of the benefits of having a Crown utility is that we can take a patient capital approach. We should be intergenerationally fair and several previous financial forecasts included 5 or more to absorb Keeyask into rates. Keeyask is a 125+ asset. As the decision was made to build Keeyask in advance of domestic need, it is not strictly used and useful for Manitoba consumers. We say that we do not need to be on an expedited path to absorb the rate impact of this inflation protected asset built in advance of domestic need.

By way of example, if we absorbed the 9% expected rate increase impact⁶ of Keeyask in annual increments of 1.5% designated for that purpose, the 9% would be absorbed in about 3 years. There is already about 4% built into current rates (i.e. \$64 million = about 4% in rate increases) The remaining 5% can therefore be We say that in that context, 1.5% is reasonable.

We note that the 9% expected rate increase impact does not consider potential added cost savings on Keeyask capital costs for an earlier in-service date and continued borrowings at levels less than Hydro's forecasts.

⁶ As noted by Mr. Bowman in cross-examination with Mr. Peters, transcript pages 686 – 687, April 25, 2019

MIPUG's position at the last rate hearing was summarized as follows by the PUB at pages 167 and 168 of Order 59/18:

The Manitoba Industrial Power Users Group submits any rate increase for Manitoba Hydro's fiscal year should fall between 3.36% and 3.57%, **based on the evidence on the public record.** However, this Intervener advocates this range should be lowered by the Board because of confidential information related to the understated or pessimistic export revenue forecast and load forecast that were reviewed by the Board.

There is a sound reason for conducting regular reviews based on a proper evidentiary record. Ratepayers are being asked for more funds and greater increases when there are material adverse events. Fairness suggests that when the evidentiary record shows favorable permanent results ratepayer consideration should be given to grant relief, instead of following a predestined rate trajectory based on a less favorable evidentiary record.

Good news hearing

Although there are always puts and takes and issues of timing, we note that it was expected when MH-14⁷ was prepared by Hydro and considered by this Board that negative net income would start showing up in 2018/19 and continue to 2025/26 for a total negative net income of \$977 million dollars. Equity was forecast to drop to 8%. Instead of negative net income, Hydro is on track for a 2018/19 result of \$95 million positive net income. Even without a rate increase, if Manitoba Hydro benefits from average waterflows, its approved budget for 2019/20 without a rate increase is forecasting \$64 million in positive net income. A 1.5% increase in rates would further enhance this revenue by about \$20 million. How can this not be a good news story when MH-14 was projecting 2019/20 as the second year of net negative income?

⁷ See PUB book of documents, PUB Exhibit 14 at p. 17.

As the evidence in the hearing confirmed, there are a lot of positive things which have happened since MH-14 on all key metrics and issues. However, the extent of that good news story has not been fully put in front of this Board.

Bipole III was in service as of July 4, 2018 with a revised net budget from \$5.04 billion to \$4.77 billion. Based on spending to December 31, 2018 there is a potential for further good news. This good news has a recurring annual benefit of \$17 million dollars or the equivalent of a one-time reduction in rates of 1%. We submit that Hydro has not demonstrated why there should be a delay in passing on this long-term benefit to ratepayers.

We submit Manitobans and Manitoba Hydro's other audiences such as the financial markets need to know that the Needs For and Alternatives To (NFAT) story is unfolding well. Manitoba Hydro is on track to have the first unit of Keeyask in service about 11 months earlier than was anticipated at the previous hearing, geotechnical risk issues are largely dealt with, the project is still tracking on budget at \$8.7 billion, Manitoba Hydro has managed interest risk on the Keeyask and Bipole III projects with a 20 year WATM at rates below what was projected and Keeyask will start generating income earlier than anticipated.

All other major projects appear to be tracking on budget.

Although there will always be risks related to water flow, Manitobans should be proud to know they have contributed to reserves which at the last rate hearing were⁸ already twice the level which would be required to deal with the negative financial impacts of a five-year drought.

It seems that without corporate strategic direction, Manitoba Hydro is focused on the short-term risks and events. Manitoba Hydro also seem to be obsessed with treasury during a period where it has overcome significant risks and hurdles. Manitoba Hydro has done a great job with its treasury and borrowings but the focus needs to see the big picture. The IFF has traditionally been a useful tool in assisting

⁸ See PUB Order 59/18 at p. 8.

to see the big picture. Manitoba Hydro's short term vision can be contrasted with the big picture and long term vision of Mr. Bowman and Mr. Rankie.

Onus and approach

Manitoba Hydro, as applicant, has the onus of proving its case. Part of proving its case is providing an Integrated Financial Forecast with supporting details. The challenge identified by Mr. Bowman and Mr. Rankie in conducting a fulsome review is that this fairly extensive evidence related to financial forecasting is missing.

We submit that it is appropriate for the PUB to be cautious in assuming that a 3.5% is needed or justified when the forecast on which such an increase might be grounded is missing.

In the absence of a proper evidentiary record there is no compelling evidence adduced by Manitoba Hydro that an increase greater than inflation is required. Mr. Bowman did not identify any negative material or sustained negative developments requiring an increase in rates. We submit that Manitoba Hydro has not adduced evidence of a material or sustained negative development on any of the major issues. Identifying possible variability in key metrics is not adducing evidence of a negative development needing to be addressed. Variability is part of business as usual for Manitoba Hydro.

Some of the evidence adduced by Mr. Rankie to give this Board an idea of what that good news story was qualified by, Manitoba Hydro in its submission yesterday as speculative. CAC is not the party which bears the onus in this hearing. The onus is on Manitoba Hydro. Simply saying that 3.5% should be given based on MH-93 trajectory does not meet the test. Simply focusing on the cost of absorbing Keeyask without details of how that can and will be done over the next 7 or 8 years, and without the puts and takes is not enough.

Hydro has raised possible variations in net income as a reason justifying the requested increase. We note that possible variations can be negative or positive. We saw this as this application evolved from requesting a 3.5% increase to avoid

a projected loss of \$28 million to now having projected income of \$64 million if a 0% increase is granted.

Generally, variations in net income are not a reason for rate request to achieve a higher income. For example, ratepayer has set aside substantial retained earnings to assist in managing variations caused by a prolonged drought.

Balancing

MIPUG has repeated that having a financially healthy utility is in the interest of ratepayers. MIPUG has always advocated for rate stability and certainty. MIPUG notes however, that every dollar in increased rates is a dollar out of their pockets. Taking millions of dollars out of every Manitoba Hydro customer, including industrial customers, is a dollar out of the economy in this Province should not be done lightly and should not be done without persuasive evidence from Manitoba Hydro.

Additional background and justification for MIPUG's recommendation is provided in the sections below.

Background

Manitoba Hydro's rate application for an across-the-board 3.50% rate increase effective June 1, 2019 was initially filed on the basis of financial need, as the utility was forecasting a net loss without the increase. The process and scope have not followed a traditional General Rate Application, most notably that Hydro was unable to file long-term forecasts in light of ongoing development of a Corporate strategic plan, the basis for a rate increase was focused on justification in the 2019/20 year.

Under this one year test, upon review of Hydro's approved 2019/20 budget, where Hydro's 2019/20 financial position improved substantially, a rate increase is not required to generate sufficient earnings in the 2019/20 year. This holds true when comparing the level of revenue anticipated in 2019/20 by the PUB when awarding final rate increases in the 2017/18 and 2018/19 GRA (where the 2019/20 forecast

year was \$64 million in MH-93 or as low as \$28 million depending on the forecasting methods used⁹). Hydro's updated application justifies the rate increase for two reasons:

1. Uncertainty in Net Income (weather/water conditions, interest rates, export market, construction schedules, and commodity prices); and
2. Impacts of Keeyask In-Service.¹⁰

In the context of Hydro's financials today, Hydro's one-year perspective in this proceeding has ignored the longer-term context, past and future, relevant to consideration for today's financial position. For example, comparing to IFF-14, which was the financial forecast underpinning Hydro's rate increases in 2014/15 and 2015/16, which were ultimately approved by the PUB in Order 73/15 at 2.75% for 2014/15 and 3.95% for 2015/16 (compared to Hydro's request of 3.95% for each year):

But in that IFF, we were trying to get over those five (5) major hills, major achievements, and it was all being achieved with no government support of the projects, which is unusual in Canada when you're doing large renewable projects.

In fact the government was adding charges related rather than support. We went through some of that evidence at that time, and we did some at the last hearing.

At that time, we were saying we were able to finance all of Hydro's ongoing operations over the ten (10) years with operating cash flow, including absorbing Keeyask and Bipole, plus all sustaining capital. That was being assessed over the ten (10) year horizon of the IFF.

Thinking about where we are now, we're debating whether we can achieve that each year. At that point, it was being achieved over a ten (10) year horizon. It wasn't even a test as to whether it was being achieved each year.

⁹ As reviewed in cross-examination with Mr. Bob Peters and Mr. Patrick Bowman transcript pages 669 - 671, reviewing MH-93 with a 20 year WATM from PUB-14 page 52 (sourced from Coalition/MH I-6b Attachment 1, Figure 5)

¹⁰ MH-25, Hydro Direct Evidence presentation, slides 9 - 10

And it was being done keeping retained earning levels near or above any estimate at that time a five (5) year drought. We're -- now got retained earning levels way beyond a five (5) year drought level.

For -- in context, when I say we're doing (sic) very well as this NFAT plan is unfolding and in context of the history, I'm saying that, in light of the fact that even in IFF-14, when all of these conditions were there, we were already doing quite well for absorbing a very, very challenging environment.¹¹

Establishing an appropriate level of rate increase in this narrow context reviewing only the 2019/20 year has been challenging. As noted by Mr. Bowman and Mr. Rankie, there exists tools that can be furthered along to help the PUB set rates that respond to current conditions and communicate appropriately to stakeholders including the financial markets and credit rating agencies that risks to Hydro's financial position have been reviewed and addressed. For Hydro's next full General Rate Application, this uncertainty analysis should be brought forward by Hydro with corrections as noted by Mr. Rankie:

MR. DARREN RAINKIE: So to remedy this situation, we recommended that PUB direct Manitoba Hydro to enhance its uncertainty analysis for the next GRA to provide a robust quantitative tool to further guide the incorporation of risk and financial reserve considerations into rate-setting, and in accordance with the policy directions from the PUB from Order 59/18 to consider a rule-based regulatory framework and a minimum retained earnings target or similar test for future GRAs.¹²

Additionally noted by Mr. Bowman for rate responsiveness, to help better analyze Hydro's rate request.

MR. BOB PETERS: Okay. Well, I'm not so sure you voted in favour of that last time. I think you may have shared a witness that spoke to that, but was -- at the last GRA, was -- was a technical conference on financial targets and minimum retained earnings -- was that endorsed by -- by yourself, Mr. Bowman?

MR. PATRICK BOWMAN: I -- I wrote some papers on the uncertainty analysis and talked about the -- the way that tool has evolved to be something that is extremely useful. It's extremely innovative

¹¹ Direct examination of Mr. Bowman, transcript pages 564 – 565, April 25, 2019

¹² Mr. Rankie direct examination, transcript page 748, April 29, 2019

compared to what you had before. It tells us way more than we ever did. And with one more tweak, if you like, where you can build some rate response into it, it could take us to an entire another place in how we talk about Hydro's risk and reserve levels.

And I think that's both for this room and for people outside the room. Once it gets boiled down to -- to some -- some clear messages. For example, this Board saying that they've got models that show that there's an 'X' percent -- 99 percent chance -- that they'll be able to -- to help Hydro avoid 'X' financial outcome with rate increases not higher than -- than 'Y' and people could understand that, then I think that would help communicate how regulatory action would occur, how -- how remote these chances are, and some of the same things that Mr. Colaiacovo talked in terms of how Bonneville Power talks about its risks.¹³

Taking Stock of Current Financial Position

1. **Bipole III in-service:** Now fully in-service as of July 4, 2018, Bipole III was under its \$5.04 billion control budget, coming in at a projected \$4.77 billion. As of December 31, 2018, \$4.467 billion has been spent, with remaining \$300 million budget expected to be spent on such things as final cleanup costs, decommissioning of temporary construction infrastructure, construction of permanent staff accommodations and a water treatment plant.¹⁴ This reduction accounts for \$17 million annual reduction in revenue requirement, representing a 1% of rates in perpetuity that has been avoided to the benefit of ratepayers.¹⁵ The unspent portion of the budget could potentially result in further savings to ratepayers, which will be better known at the next GRA. For the 2019/20 year, this unspent amount results in an additional \$13 million reduction to ratepayers, such that revenue requirement is a total of \$30 million less than forecast in MH-93.
 - a. Positive net income with Bipole III in-service, which does not have offsetting revenues, is a big deal. Bipole III deferral account (i.e. rate

¹³ Cross-examination between Mr. Bowman and Mr. Peters, transcript pages 663 – 664, April 25, 2019

¹⁴ Cross-examination between Ms. Bauerlein, Mr. Epp and Mr. Hacault, transcript pages 446 -

¹⁵ PUB/MH I-57

increases specifically for Bipole III of approximately 11.6%) has been helpful for ratepayers to avoid negative net income.

- b. Given that this deferral account payment will reduce in coming years, consideration needs to be given as to whether this requires eventual rate relief. This is a matter for a full GRA with a financial forecast, as the deferral will provide revenue requirement relief until 2023/24.¹⁶

2. Keeyask in-service early

- a. Hydro is projecting Keeyask to be in-service earlier than expected as of now, from first power in 2021/22¹⁷ to October 2020, 11 months earlier.¹⁸ Hydro's short-term view of this has presented Keeyask's in-service as a negative, summarized by Ms. Carriere:

MS. LIZ CARRIERE: Today, we're looking at an in-service of eighteen (18) months away, and we can't hope for interest rates to continue to be low. We can't hope for export prices to rise, or we can't hope for Mr. Cormie to make additional sales, because none of that is going to change the fact that we have Keeyask coming online, and we are running out of time to be able to address that.

I mean, we're talking about 6 or \$700 million in costs, and 250 to 350 million in offsetting revenue.¹⁹

Note, PUB/MH I-9 Updated which was based on the financial projections filed on February 14, 2019 shows costs of Keeyask escalating to \$500 million by 2022/23, of which approximately \$35 million is already in costs through capital tax. So approximately \$440 million in incremental costs once Keeyask is in-service, offset by \$250 - \$400 million in incremental additional revenue through export sales²⁰. Additional revenue needed to

¹⁶ PUB/MH I-11a

¹⁷ Appendix 6 – CEF18, page 15 of 43

¹⁸ Confirmed by Mr. Cormie, Transcript page 401, April 24, 2019

¹⁹ Cross-examination between Mr. Hacault and Ms. Carriere, transcript pages 482 – 483, April 24, 2019

²⁰ Depending on the reference, PUB-14 page 70 and pages 76 and 77 from the 2017/18 GRA

cover the costs of Keeyask are roughly 9%.²¹ Addressing this with a 1.5% rate increase today will reduce this deficit further, for a more detailed review of impacts at the next GRA. Mr. Rainkie also noted that the 18% rate impact calculation Hydro produced was nonsensical.²²

- b. As noted by Mr. Bowman in testimony, Keeyask in-service early should be viewed entirely as a positive for the utility and ratepayers:

MR. PATRICK BOWMAN: We're in a pretty good place, also, given that with respect to Keeyask and Bipole, you know, where we are at, I'm not sure eleventh hour, but certainly tenth hour of -- of these projects coming into service, risk being resolved, debt being locked in, all the other things that get resolved as you go through a capital project.²³

...

MR. PATRICK BOWMAN: We do know that Keeyask is headed for an earlier in-service date. It may not meet that in-service date. There is some -- some risk, of course, associated with it, but an earlier in-service rate means sooner revenues. And it means ongoing -- ongoing savings from not having some of the -- of the construction cost we talked about.

I find it hard to reconcile some of the comments that when we sat here last time, Keeyask was going to be later in service, about 8.7 billion, and now we're talking about being earlier in service.

But, also 8.7 billion, when we also hear that it costs a million dollars a day to run the camp and we know that interest during construction is accruing at about \$25 million a month to the project, if those things are stopping sooner, it is clearly a benefit.

Now, maybe we're still on track for eight point seven (8.7) and last time we were here we never were on track for eight point

²¹ Cross-examination between Mr. Peters and Mr. Bowman, transcript pages 685 – 687, April 25, 2019

²² Cross-examination between Mr. Rainkie and Mr. Bob Peters, transcript pages 970 – 971, April 29, 2019

²³ Direct examination of Mr. Bowman, transcript page 563, April 25, 2019

seven (8.7). I don't know the answer to that, but I find it hard to reconcile. For the purpose of this evidence, I've accepted the conclusion that there is no net cost reduction from Keeyask coming in sooner, nor a capital cost con -- reduction. We also know that Keeyask's risks are increasingly getting resolved compared to what was in the MH 93. And the example was given of geotechnical work. And that was at transcript 238.

The ground condition risk is primarily behind us. That was always cited as among the number one risk. We know that there's added export contracts compared to MH-93, when the SaskPower 215 megawatt was highlighted, the potential renewals of Xcel Energy, MSP agreements, or renewals of aspects of them, at least. The diversity aspects was discussed.²⁴

Also noted by Mr. Rainkie in direct examination:

MR. DARREN RAINKIE: I listened to the Manitoba Hydro witness panel evidence on day number 1 of the hearing with great interest, especially with respect to the concerns over the potential advancement of Keeyask. I appeared as a policy witness at the 2014 NFAT proceeding, and consistent with its business model, Manitoba Hydro proposed the advancement of Keeyask ahead of the need for domestic requirements, with the clear position that this advancement would benefit domestic customers by defraying a portion of the costs of the generating station. The recommendation for advancement of Keeyask was based on analysis of a wide range of possible financial outcomes and associated risks.

Myself and many other Manitoba Hydro witnesses, a number of which are in the current panel, testified that the Corporation could manage the risks, including multiple years of net -- of negative net income, and the credit rating implications, and the Corporation would take all necessary actions to manage its costs to mitigate the impact of the Capital Development Plan on domestic customers to the extent possible.

So fast forward five (5) years from the NFAT to 2019. The updated information that was presented at this hearing is that Bipole III has entered service \$270 million under budget, and that there is a good possibility of Keeyask being advanced -- think it was to October of 2020, if I understood the evidence correctly. The evocations of these

²⁴ Direct examination of Mr. Bowman, transcript pages 575 – 576, April 25, 2019

updates concerning about \$14 billion of investment have to be, without a doubt, the biggest good news story for Manitoba Hydro, its stakeholders, its bondholders, in the history of the Corporation, and from all perspectives, business, reputational, financial, and operational.

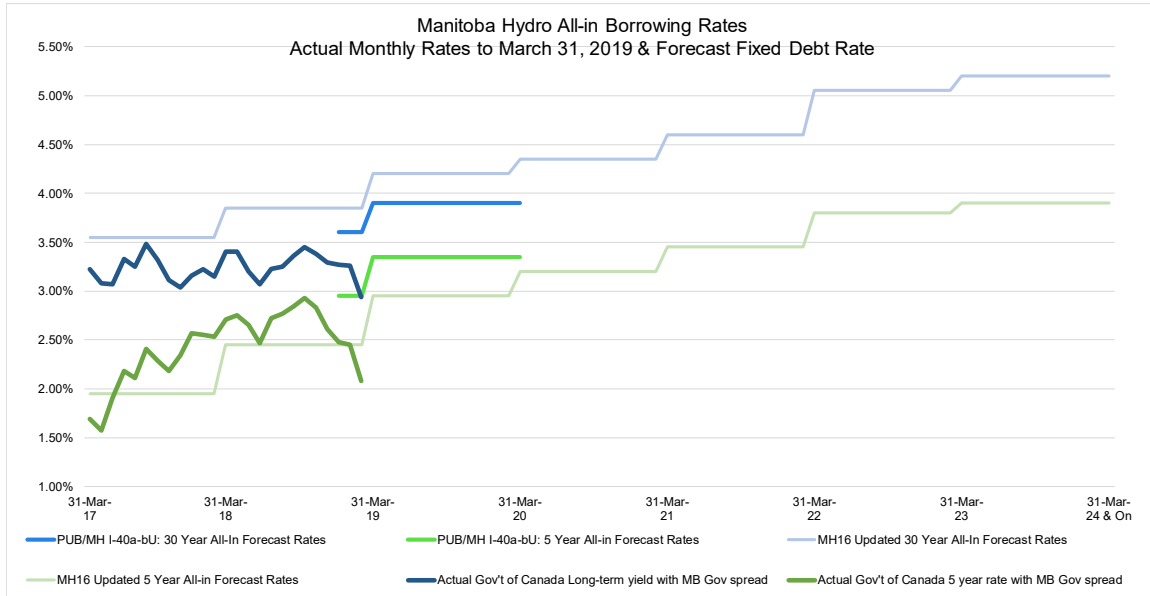
The advancement of Keeyask is not a negative change in circumstances that requires emergency regulatory action. It is the very delivery of the plan that was put forward by Manitoba Hydro at NFAT.²⁵

3. **2017/18 & 2018/19 GRA Financial Forecast Comparison:** What is known on the long-term forecast compared to the benchmark of MH-93, which was used by the PUB as the long-term financial forecast in the last GRA to set rates, has for the most part improved:
 - a. **Interest rates have remained low** – Hydro extensive capital borrowings for Keeyask, Bipole III and other major capital projects continues to benefit from very low interest rates, most recently for example Hydro locked in 49 year ultra-long debt at 2.91%, a rate much lower than included in Hydro financial forecasts.²⁶ While Hydro states this won't have immediate impacts in the 2019/20 test year, it does have long-term benefits for Manitoba Hydro ratepayers that will be seen in Hydro's next financial forecast. In addition, it can be assumed for the purposes of the 2019/20 year, while rates on particular days can not be held static, Hydro's borrowing rate incorporated in the 2019/20 approved budget is much higher for both long-term and short-term debt issuances of late, as seen in the reproduced chart below from PUB/MIPUG I-3a:

²⁵ Mr. Rainkie direct examination, transcript pages 703 – 704, April 29, 2019

²⁶ As discussed in cross-examination between Ms. Stephen and Mr. Peters, transcript pages 221 – 223, April 23, 2019

Figure 2: Manitoba Hydro All-in Borrowing Rates Actual Monthly Rates to March 31, 2019 & Forecast Fixed Debt Rate²⁷



b. Latest indications as of March 15, 2019 filed in MH-29 shows Weighted Average Interest Rate of debt issued for each year 2018/19 and forecast 2019/20 has decreased compared to PUB/MH I-38c Updated:

- i. For 2018/19 decreased from 4.25% to 4.08% (including debt guarantee fee) on \$3.550 billion of borrowings
- ii. For 2019/20 decreased from 4.71% to 4.37% (including debt guarantee fee) on a forecast \$2.014 billion in borrowings.
- iii. As noted in PUB/MIPUG I-3b-c:

As a rough measure, Hydro is presently borrowing at 0.5% or more lower than forecast since about February 2019. Hydro is presently borrowing approximately \$250 million per month (per

²⁷ MH16 Updated 30 Year & 5 Year All-In Forecast Rates as of MH-68 in the 2017/18 and 2018/19 GRA, slide 64; Current 30 Year & 5 Year All-In Forecast Rates as of PUB/MH I-40(a-b) Updated; Actual monthly rates as per PUB/MH I-40 and extended for January to March 2019 from Bank of Canada Benchmark bond yields long-term (V122544) and 5 year (V122540) with added Province of Manitoba spreads as provided for those months in PUB/MH I-40(a-b) Updated.

PUB/MH-I-8(c) updated, proceeds from long-term debt total approximately \$6 billion over 2018/19 and 2019/20). About 1/3 of debt is related to new capital (per PUB/MH-I-8(b) work in progress averages approximately \$7 billion over 2018/19 to 2019/20, out of approximately \$21 billion in long-term debt) so for each month that passes with 0.5% lower than forecast interest rates, Hydro's secures almost \$1 million per year in savings that will reflect on the income statement (0.5% times \$250 million times 2/3) with additional savings that will accrue in the Keeyask and MMTP projects. This \$1 million per year benefit that arises for each month interest rates stay at the current level (0.5% below forecast) is a long-term savings tied to the full WATM of new debt (e.g., savings every year for 20 years).

- iv. We also note Ms. Stephen's evidence that for the 2019/20 test year. Manitoba Hydro is essentially hedged in terms of movements in interest rates.²⁸ Manitoba Hydro's prefunded borrowing at \$1.1 billion is currently higher than its usual prefunded position.

- c. **New Export Contracts locked in** – since the last GRA, Hydro has locked in an additional 215 MW contract to Saskatchewan until 2052.²⁹ Especially compared to MH-93, which did not include any capacity benefits for uncontracted electric demand and assumed when export contracts ended, instead of renewals or new contracts, the surplus would be sold at opportunity prices.³⁰

- d. **O&M & Sustaining Capital Expenditures on track** – As per Exhibit MH-32 and COALITION/MH I-13gR, Manitoba Hydro is in the ongoing process of implementing savings initiatives for both capital and operational purchases to the benefit of \$105 million over three

²⁸ Transcript pages 227 – 228, cross-examination by Bob Peters

²⁹ Mr. Cormie in cross-examination with Mr. Hacault, transcript pages 432 – 433, April 24, 2019

³⁰ Discussed by Mr. Bowman at transcript pages 576 – 577, April 25, 2019

years. Additionally, Hydro is undergoing analysis to revise savings forecast to be complete in September 2019. Hydro has reduced EFT's by 14% with its workforce reductions³¹, however risks to O&M costs remain following the in-service of Keeyask and how Hydro handles the integration of currently capitalized employment and other operating expenses.

Additionally, as noted by Mr. Bowman regarding capital expenditures:

The key conclusion we had comparing MH-93 to the updated '19/'20 year is that long-term debt is lower by about .58 billion. The biggest contributor of that is capital investment. Cost control shows improvement, so plant in-service is down by .543 billion, which are both positive developments.³²

One would hope that in the upcoming GRA when an IFF gets filed that Manitoba Hydro would be able to help us understand whether the good news story of Bipole III being \$270 million under budget with a permanent annual savings of \$17 million is not isolated. The above good news story of lower long-term debt and lower plant in service may very well lead to a similar long term annual savings.

“NOISE” in the 2019/20 Electric Rate Application

1. Capitalized Interest and Cashflow:

In the hearing, the treatment of capitalized interest and Hydro's ability to cover interest payments was heavily scrutinized. It is MIPUG's position that interest coverage ratios can be informative, and where trends may exist to the positive or negative it may be cause for rate correction. But as a snap shot for one year, especially the 2019/20 year which is a heavy investment year for Hydro, interest coverage ratios that include capitalized interest are going to skew the picture. Hydro has included capitalized interest in its interest coverage ratio mainly as a presentation issue:

³¹ MH-25, Manitoba Hydro direct examination, slide 15

³² Direct examination of Mr. Bowman, transcript page 568, April 25, 2019

VICE CHAIR KAPITANY: So I wanted to go back to Mr. Peters's book of documents in his tab 12. And so the question was around page 97, and it was where we were talking about how the presentation had changed in terms of capitalized interest.

I just wanted to understand better what you were saying around the difference between investing activities and operating activities. And I thought I heard you say that in additions to capital assets, that's where you put the salaries of the people who were working, for example, on Keeyask.

So that would be treated as an investment. But the capitalized interest is not treated as an investment, it's treated as an operating activity. And that wasn't clear to me because it seems that both of them are items that would be used to invest in building Keeyask, as an example?

MS. SANDY BAUERLEIN: So I think I'll take that one. So I think the difference in terms of presentation is that those salaries of those employees going to Keeyask are going to stop, right.

Keeyask is going to be built, and as a result of that, we will no longer see those costs being in investing activities, those salaries. Interest payments will continue forever, right. We have -- not forever, but until the debt matures and you eventually are able to retire that debt if you can retire that debt.

So what it's trying to indicate it was just trying to make an awareness that we're going to have to make those interest payments, so you can classify it. We have shown it before in investing activities.

But we wanted to have that recognition that those payments and how much those payments are because they are going to continue. Once the asset's in service, they're still going to be there.

So I think that tries to explain why, you know, ourselves wanted to get a better understanding of what that amount would be, whereas, as I said, the salaries, those material costs associated with constructing Keeyask stop once Keeyask is in service.³³

Cash flow is not generally the primary topic one applies for considering the sufficiency of rates, especially given Hydro's hydraulic variability, and the income

³³ Transcript pages 335 – 336, April 24, 2019

statement has typically been the main financial statement for review.³⁴ As stated by both Mr. Bowman and Mr. Rainkie:

MR. PATRICK BOWMAN: And I do agree with Hydro when they say it's basically presentation issue. But as a presentation issue, we present things to convey certain messages. And I'd note there that there have – I have four (4) reasons I would take issue with Manitoba Hydro's approach.

One (1) is that it's not consistent with the use[d and] useful principles normally applied to regulating utilities.

The second, it's not consistent with PUB'S conclusion in 59/18, which I agreed with.

The third is it is purporting to show what happens when Keeyask comes online or this type of enduring obligation that won't go away when Keeyask construction ends, but yet it doesn't show the enduring benefit that occurs when Keeyask comes online, which is the fact that we're going to start getting export revenues, 360 million per PUB book page 76.

And the fourth is that there's no principle reason to treat interest different than other construction costs. And that's -- that's pretty much universally recognized when you're considering the capital cost of a project. Borrowing to fund a project is no different than - the rebar to build the project.³⁵

And Mr. Rainkie:

MR. ANTOINE HACAULT: And why are you saying, sir, that with respect to projects like Keeyask that the portrayal is preferred in one manner over the other?

MR. DARREN RAINKIE: Once again, I think when you broaden out and you look at -- let's think about this in terms of Manitoba Hydro's annual report.

There are four (4) places that I can think of where capitalizing interests comes up: on the balance sheet, on the income statement, on the cash flow statement, and in the capital coverage ratio calculation, right. So financial reporting is about communicating to all your stakeholders, you know, the results of your company and where you're going.

³⁴ Direct examination of Mr. Bowman, April 25, 2019, transcript pages 569 - 570

³⁵ Mr. Bowman direct examination, April 25, 2019, Transcript pages 571 - 572

So capitalized interest, on the income statement it's capitalized, on the balance sheet it's capitalized, in the capital coverage ratio it's taken out of there so it's a consistent treatment with the first two (2).

For some reason on the cash flow statement Manitoba Hydro has decided to reclassify that as an operating activity. So, like when you look at your overall financial reporting, you've got four (4) things you're communicating in your annual report; three (3) of them are one (1) way and one (1) of them is the other way. So, like, to me that creates a confusion in and of itself; not to mention the fact that Manitoba Hydro's a regulated Utility and normally the principles of regulation and rate setting are such that it's more than normally. It's pretty much the gold standard, if you like, that interest capitalized is part of a project until that project is in service. And then it becomes part of the revenue requirement.³⁶

For further evidence on the favourable position in which Hydro finds itself please review the transcript from pages 649 to 652. This good news.

MS. ODETTE FERNANDES: And so that \$30 million deficit that you calculated has the 3 1/2 percent increase imbedded into it?

MR. PATRICK BOWMAN: Yes, but the numbers we just ran are numbers from four (4) years in the future. So you would need that 3 1/2 percent plus another 30 million at some point during the next four (4) years in order to be fully cash positive in the first year or full year of Keeyask operation.

Also consider the following extract of Mr. Bowman's direct evidence:

MR. PATRICK BOWMAN: Hydro's approach basically putting in all of the Keeyask interest as it now exists. That will go up a little bit as Keeyask final spending on Keeyask occurs, it'll go up by about 37 million. And when Keeyask comes online we'll start paying some water rentals and we'll start paying some O&M costs; combined are about 30 million.

So in Hydro numbers that show this supposed conveying, the post-Keeyask world, you would take that deficit at the bottom of 197 million. You'd say, well, there's another 67 million in cash that's also going to come out because of extra interest for the ongoing borrowing

³⁶ Cross-examination between Mr. Hacault and Mr. Rainkie, April 29, 2019, transcript pages 787 - 788

and the O&M to end with about 264 million negative cash before we add Keeyask export revenues.

Well, Keeyask export revenues are about 360 million. So what that's telling me is that 2019's cash flows and 2019's rates are already sufficient to meet this cash test, meet this cash positiveness once Keeyask comes online.

It only can't it only fails to meet it in the years where you put in all of the worst parts of Keeyask, the cash outflows for interest, and none of the revenues that Keeyask will generate.

And this is where it's without trying to lament the point, this is where the lack of a long-term financial plan, I think, provides danger to everyone in over focusing on what is a temporary situation in the next few years, as were finally getting the projects online, and it doesn't show what happens when turned the corner.

And I think that's possible to have significant misinterpretation of the facts, significant failure to recognize what twenty-four (24) months from now looks like, whether you're – whether you're in Hydro's finance department or whether you're a lender or whether you're credit rating agency or whether you're a Public Utilities Board; that picture that says this is temporary is missing.

And I think we we're all challenged by not having that picture. For that reason, we also tried to look at the longer-term directional assessment, which goes to page 10 of the presentation.

And I spent a bit of time on some of the key aspects of MH-93 and - - and what we know has been updated directionally. Of course, we don't have a lot of this, we don't have quantitatively, and we certainly don't have it integrated quantitatively. But we do know the Bipole III has come in at a lower cost than MH-93 assumed; that's material.³⁷

All of this discussion surrounding how to present certain cash expenses was summarized by Mr. Rainkie in cross-examination by Mr. Peters when reviewing Hydro's Electric EBITDA Interest Coverage ratio of 1.61 in 2019/20:

MR. BOB PETERS: So how serious, in your view, is it that now the Utility is at 1.6, not 1.8?

MR. DARREN RAINKIE: In the era of major capital expansion where the company recognize this is going to happen and the capital markets have been preconditioned to this for half a decade or more

³⁷ Mr. Bowman, direct examination, transcript pages 572 – 575, April 25, 2019

at least, I don't think it's serious. As I talked about before, I think the capital markets have expressed their desire to place money in Manitoba with and recent debt issues.³⁸

2. Credit Rating Agencies:

We say the credit rating agency evidence introduced at the last minute through Hydro rebuttal is just noise. The proof is that capital markets issued a 49 year ultra long issuance at 2.91%, a \$1 billion USD issuance at 2.19% and that a recent issuance was at somewhere around 1.7%.³⁹

MR. ANTOINE HACAULT: Thank you. And then after our NFAT hearing, the next IFF that's shown is MH-14, correct?

MS. SHAWNA PACHAL: That's correct.

MR. ANTOINE HACAULT: And all the bonding agencies saw that IFF? Everybody knew what would -- Hydro was saying was going to happen when it was seeking rates back then in 2015, relying on that IFF, correct?

MS. LIZ CARRIERE: Yes --

MS. SHAWNA PACHAL: We would have --

MS. LIZ CARRIERE: -- they would have seen that in -- in the past. However, I think one (1) thing you have to take note of in here is that under both of those scenarios, you're talking about it. You can see that the 25 percent equity ratio is -- is achieved much earlier than the MIPUG scenario at the bottom is being completed. Your maximum levels of debt and your maximum levels of debt have gone up.

And in terms of long-term rate increases, the annual rate increases that were included there and indicative in those are not what were implemented. So there's if there's some deterioration, and those are the kinds of things that credit rating agencies would note, and they monitor from year to year.⁴⁰

Hydro noted that Moody's December 24, 2018 report on the MHEB reported on the weakening financial profile of Manitoba Hydro and that it might review Hydro's self-supporting status. Another credit rating agency, DBRS, was also noted by Hydro as questioning Hydro's financial health:

³⁸ Transcript pages 962 – 963, April 29, 2019

³⁹ Transcript pages 111 -113 and 221, cross-examination of Ms. Stephen by Mr. Peters

⁴⁰ Transcript pages 476 – 478, April 24, 2019

MS. SUSAN STEPHEN: They do indicate in their report that they at that point in time consider Manitoba Hydro's debt to be self-supporting, however, they also produced a commentary on Manitoba Hydro on the same date that they produced this DBRS Report on the Province of Manitoba, and in that report they indicate that should -- should Manitoba Hydro's finances continue to deteriorate, and the province has to assume responsibility for operating cost of debt servicing, that they could consider reclassifying a portion or all of Manitoba Hydro's debt to tax supported debt.⁴¹

As discussed at the last hearing, and noted by Mr. Rainkie⁴², the change in S&P's rating, no longer considering Hydro as self-supporting, which Hydro notes in its rebuttal evidence along with its weakening financial metrics⁴³, has to do with methodology changes, not specific to Hydro's financials. Additionally, Hydro no longer tracks S&P's metrics.⁴⁴

3. Negative Net Income/Net Losses:

Hydro, in response to Mr. Bowman's evidence, states that negative net income is a concern to credit rating agencies.⁴⁵ In cross-examination, Ms. Carriere stated that:

MR. BOB PETERS: Thank you, Ms. Carriere. Can the Board take from that answer, as well page 50 of the coalition -- I believe it's Exhibit 7-1 of their evidence -- that following the in-service of multibillion-dollar capital expansions, it's not unusual for there to be losses in the net income column?

MS. LIZ CARRIERE: There is potential for losses to be incurred, but again, that's under average water flow conditions. And when you combine that with the concerns that are being expressed by credit rating agencies, it makes sense to plan for a reasonable level of income in the very near future. When I think of a household budget, it doesn't make sense to plan your household expenditures, based on simply breaking even when you could have an emergency that comes up and you're going to have to cover that. So that's

⁴¹ Transcript pages 406-407, April 24, 2019

⁴² Cross-examination of Mr. Rainkie with Mr. Hacault, transcript pages 779 - 781

⁴³ MH-24, Manitoba Hydro Rebuttal Evidence, April 18, 2019, page 4 of 17

⁴⁴ Cross-examination of Ms. Susan Stephen by The Chairperson, transcript page 487, April 24, 2019

⁴⁵ MH-24, Manitoba Hydro Rebuttal Evidence, page 4 of 17

a concern with Hydro is that all of these forecasts are under average flows, and we need to prudently plan for a reasonable level of net income.

MR. BOB PETERS: The reason that there are losses following the in-service of multibillion-dollar projects is because Mr. Epp had told us that that's when the associated costs that had been previously capitalized need to now then be reflected on the income statement, correct?

MS. LIZ CARRIERE: That's correct.

MR. BOB PETERS: And, Ms. Carriere, I think you said it's not unusual for losses to result following the in-service of multibillion-dollar assets, but you qualified it to say that under average conditions.

MS. LIZ CARRIERE: That's correct.

MR. BOB PETERS: And that's -- the IFF plans for average conditions.

MS. LIZ CARRIERE: The IFF does plan for average conditions, yes. I'd just like to add that those -- those rate increases under average -- are under average conditions. If -- if you have a low flow, we might adjust for that in closer to the year or -- or slightly thereafter.

MR. BOB PETERS: What you're saying to the Board is that if the water conditions aren't average, that may give the Corporation a reason for seeking additional regulatory relief.

13 MS. LIZ CARRIERE: That's correct.⁴⁶

Mr. Bowman explained his position in his direct examination:

MR. PATRICK BOWMAN: There was -- there was a comment, is negative net income okay is the way was portrayed, that I was -- I was concluding that negative net income is okay. I don't think it's a fair summary of -- of what was in the evidence I prepared in MIPUG-5.

Negative net income is a necessary part of each IFF as part of managing the rate increases. It's part of transitioning in the unprecedented scale of capital. It was part of transitioning in the

⁴⁶ Cross-examination of Ms. Carriere and Mr. Peters, transcript pages 157 - 159, April 23, 2019

previous unprecedented scale of capital in 1992. And, in fact, the last time Hydro brought on major plant, limestone, they came to the Board with a forecast of net losses and the Board reduce (sic) the rate increase request.

It -- it became a -- that was 1992, Order 25/92. It's a -- it's a reality when you're dealing with this type of situation. It's also obviously part of the 2004 drought. That's all in our DNA now, if you like, and it'll be part of any other droughts or risks reliant on reserves.

As a matter of fact, there's no meaning to having reserves if there isn't an ability to have the negative income to effectively draw them so long as you're reserves are retained earnings. And I will say that, if in -- in the debate over this there was some very useful testimony from Mr. Colaiacovo at the previous GRA where I questioning of him as to whether negative net income was advisable or possible.

And then if this were to be a substantive debate on first principles, I think that that type information would need to be before the Board.

And I just want to conclude and say that the assertion of what is said in the evidence is not correct. And if that was a reason that Hydro's need to rebut, I wanted to allay any concerns that anybody would suggest that we should stop paying attention to comments from those outside. But obviously, positive net income is better than negative, all other things being equal, but as long as it's not the primary purpose of otherwise unneeded rate increases.

And I also want to emphasize that the tests that might be applied, I think there's a concern that we not abdicate to other bodies with other purposes, the tests that need to -- applied when considering the fair and reasonable level of rates, including credit rating agencies who have an entirely different purpose and an entirely different objective.

Would a lender or credit rating agency prefer that Manitoba Hydro never draws down it's reserves? Sure they would, but that's not the framework we've put in place for rates. We've put in place a framework for rates that -- that we will intend to draw on those reserves at times when we need to.

And if that offends someone at a credit rating agency, well, I think that's better than offending the purpose for which we've set up Manitoba Hydro the way we have.

On the comment about are we running out of time, which was made in the transcript on April 24th, I want to be clear that we're only running out of time if the intent is that rate increases now will save

Hydro from all net losses from Keeyask and Bipole coming into service in each year, and that's not a reasonable standard.⁴⁷

Further, Mr. Rainkie was also asked about net losses when Keeyask comes in service:

MR. BOB PETERS: But you are saying that it's not nonsensical that there likely is going to be some net loss when Keeyask fully comes into service?

MR. DARREN RAINKIE: Yes. But, as I indicated this morning, with some of the improvement that's already, like, in almost \$600 million of net debt that's already there, I don't know when you put it all in the mix what the real number is; nobody knows at this hearing, so that's the problem.

MR. BOB PETERS: And your point was Manitoba Hydro's previous IFFs have shown losses in consecutive years following the in-service of major plant?

MR. DARREN RAINKIE: Yes. And, in fact, the ones back in 2015 were much larger than in Exhibit 93.

I mean, it's a planned thing, sir, to when you have a generating station, that you're going to have some losses. It was understood by the company and stakeholders, the capital markets, as I said, for about the last five (5) or more years.⁴⁸

4. Water Flows:

In the last GRA, there was a lot of evidence brought forward on appropriate risk to include in rate setting, and the PUB accepted this evidence brought forward by Morrison Park Advisors (Mr. Colaiacovo) in Order in 59/18 that Retained Earnings should be used to manage drought risk in combination with regulatory action by the Board. That is to say the potential for losses due to low water flows should not be a rationale for rate increases unless those losses actually materialize. Much of Hydro's rationale for a rate increase in 2019/20 is the potential for water inflows to change in the remaining portion of the year. For

⁴⁷ Mr. Bowman direct examination, transcript pages 581 – 583, April 25, 2019

⁴⁸ Cross-examination between Mr. Rainkie and Mr. Peters, transcript pages 971 – 972, April 29, 2019

example in cross-examination with Mr. Peters, Hydro positioned its forecast net income as follows:

MR. BOB PETERS: On the left column called "Approved Budget 3.5 Percent," shows that with the 3.5 percent rate increase, the net income rises to \$115 million, correct?

MS. SANDY BAUERLEIN: Correct. Again, both have the assumptions of the -- the water flow conditions being average for the remainder.

MR. BOB PETERS: I take it from -- and your qualification of your last several answers Ms. Bauerlein, is that Manitoba Hydro is in better shape now than they were on November 30th, but there could still be a drought. That's --

MS. SANDY BAUERLEIN: I don't know if I characterize it as a drought, but I -- yes, things have improved. But we're just saying that there is also a risk that things can worsen. There's still many months left. And it was really evident last year.

You know, as we started, Mr. Cormie showed you the '18/'19 in his direct. We started with above average conditions, and by the end of August, we were below average.

So I mean, those months can be -- these next, you know, few months can be extremely critical for us. And that's the point, I think, we're trying to make with the Board.⁴⁹

As noted by Mr. Bowman:

MR. PATRICK BOWMAN: It's always true that higher rates could increase your net income so that you have less likelihood of a loss in a drought, but that always has to be put into context of long-term perspective, what is the likelihood, what is the probabilities, and whether that would indeed cause rate shock if that was -- if -- if something was to occur.

Those type of assessments can't be done on the one (1) year basis. And -- and trying to apply them to a one (1) year basis simply leads you to coming up with sort of perpetual large rate increases because I can always try to fund the theory of drought next year with net

⁴⁹ Cross-examination between Ms. Bauerlein and Mr. Peters, transcript pages 163 – 164, April 23, 2019

income, especially if I ignore that last I made a net income which helped build up reserves for that very purpose.⁵⁰

⁵⁰ Direct examination of Mr. Bowman, transcript pages 567 – 568, April 25, 2019