

**Assembly of Manitoba Chiefs
Book of Documents
Manitoba Hydro 2021/22 Interim Rate Application
December 13, 2021**

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REFERENCE:

Application, page 44 of 51.

PREAMBLE TO IR (IF ANY):

Current rates for Diesel Residential customers are 9.6% lower than rates of all other residential customers. In Order 100/20, the PUB found that “the Diesel Zone Residential rate should be maintained at the approved August 1, 2017 Residential rate pending the Board’s review of a Diesel Zone-specific rate application and Diesel Zone Cost of Service Study filed by Manitoba Hydro.” While a Diesel Zone Cost of Service Study has not yet been filed, Manitoba Hydro is proposing to limit further divergence between the Diesel Residential and grid Residential rates given the much higher cost to serve customers within the diesel zone.

QUESTION:

Please provide the cost to Manitoba Hydro of keeping the current rates for Diesel Residential customers at their current level given a full Cost of Service Study has not been filed?

RESPONSE:

On an annualized basis, and assuming the resulting shortfall was not to be recovered from another customer class, foregoing the proposed rate increase to the Diesel Residential class would cost Manitoba Hydro approximately \$42,000.

1 winter loads in 2021/22, followed by severe drought and above normal winter loads
2 in 2022/23.

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4 The drought conditions have resulted in a significant reduction in projected net
5 extraprovincial revenues of \$398 million in fiscal 2021/22 compared to the 2021/22
6 Budget. This reduction is the primary driver behind a negative swing of \$366 million
7 in projected results, from net income of \$177 million in the 2021/22 Budget, to a net
8 loss of \$190 million the in 2021/22 Forecast (which includes water conditions to
9 October 20, 2021). With the rain season ending, it is very unlikely that water
10 conditions will materially change during the remainder of the 2021/22 fiscal year.

11 ***Manitoba Hydro's 2021/22 Forecast projects the requirement for higher energy***
12 ***imports/purchases in order to serve demand, at a time when energy market prices***
13 ***are rising. As discussed in Section 2.2, Manitoba Hydro has taken steps to mitigate***
14 ***this price risk, but uncertainty related to energy market prices still remains.***

15
16 In addition to the anticipated net loss of \$190 million for the electric operations,
17 Manitoba Hydro is anticipating a cash shortfall in 2021/22 that will further weigh on
18 the financial health and self-sustainability of Manitoba Hydro. As shown in Figure 11
19 below and in response to PUB MFR 6, it is anticipated that Manitoba Hydro will have
20 to borrow \$348 million to fund core operations in 2021/22. Core operations are
21 defined as all costs, both capital and operating, excluding major capital projects. The
22 interest costs on the borrowings to fund core operations in 2021/22, if not repaid in
23 future years, will amount to an estimated annual cost of \$13 million per year⁵ or
24 nearly equivalent to 0.8% of an electric rate increase. ***Manitoba Hydro's balance***
25 ***sheet is already highly leveraged and the corporation expects to spend 42% of all***
26 ***revenues on interest costs in fiscal 2021/22.*** According to Moody's, Manitoba Hydro's
27 financial metrics are among the worst, if not the worst in the country when compared
28 to other peer crown utilities:

29 ***"Moody's adjusted EBITDA to interest expense ratio was 1.4x, EBIT to interest***
30 ***expense was 0.8x and debt to book capitalization was 89%. These financial***

⁵ Estimated annual interest cost on \$348 million borrowed at the corporations projected cost of borrowing

REFERENCE:

Application, page 24 of 51, figure 11, and page 24 of 51, line 13-22.

PREAMBLE TO IR (IF ANY):

Figure 11: Financial Metrics 2021/22 Forecast Compared to the 2021/22 Budget

Electric Segment	2021/22 Forecast	2021/22 Budget	Change
Proposed Rate Increase	5.0%	3.5%	1.5%
Net Income/(Loss)	(\$190)	\$177	(\$366)
Net Export Revenue	\$111	\$509	(\$398)
Cash Surplus/(Deficiency) to Fund Core Business Operations	(\$348)	\$62	(\$410)
EBITDA Interest Coverage Ratio	1.36	1.68	(0.32)
Interest Paid as a % of Total Revenue	42%	40%	2%
Debt Ratio	87%	86%	1%

The 2021/22 Forecast, which incorporates actual water conditions to October 20, 2021 and assumes a 5.0% rate increase effective January 1, 2022, projects net extraprovincial revenue of \$111 million, a (\$190) million net loss, and \$348 million of additional borrowings to fund core business activities. This is resulting in a 1% deterioration of the debt ratio to 87%, an EBITDA interest coverage ratio of 1.36 (from 1.68) and interest paid as a percentage of total revenue increases to 42% (from 40%). Even with a 5% rate increase, Manitoba Hydro must borrow approximately 90% of the projected \$398 million in lost extraprovincial revenue/increased fuel and power purchases resulting from the current drought.

Manitoba Hydro suggests that the loss in net extraprovincial revenue is all a result of the drought.

QUESTION:

- a) Please confirm that Manitoba Hydro is calculating the cost of the drought as the loss in net export revenue relative to the forecast, or as \$398 million.

- b) Please confirm that export revenue is the combination of both export prices and export volumes. If confirmed, please qualitatively explain the proportion of the reduction in net export revenues related to export prices compared to export volumes
- c) Please explain how the drought impacted export prices, and not only export volumes.

RESPONSE:

- a) Confirmed.
- b) As shown in Figure 9 of the Manitoba Hydro's Application, the 2021/22 Forecast of total extra-provincial revenues are projected to be \$168 million lower than the 2021/22 Budget, opportunity import purchases are expected to be \$262 million higher than the budget and total water rentals & assessments are expected to be \$32 million lower than budget due to lower expected hydraulic generation as a result of the drought. Approximately 90% of the export revenue reduction is due to lower export volumes and approximately 50% of the increase to opportunity import purchases are due to higher import volumes. 100% of the reduction to water rentals & assessments is due to lower hydraulic generation.
- c) While it is conceivable that Manitoba Hydro's drought operations would have some effect on supply and demand balances within the MISO footprint due to less exports and more imports coming from Manitoba Hydro, the vast size of the MISO footprint compared to this effect makes fully understanding this impact extremely difficult. As described on pages 14 and 15 of Manitoba Hydro's Application, there are numerous factors contributing to the current volatility in energy market prices, including rising natural gas prices both globally and within the MISO region. Furthermore, MISO has hundreds of market participants, all independently participating in the MISO market at the same time contributing to the determination of export market prices so isolating specific impacts to any one market participant is very difficult.

REFERENCE:

Application p.16; Appendix 2

PREAMBLE TO IR (IF ANY):

Manitoba Hydro states: “Hedging involves Manitoba Hydro entering into fixed price purchase arrangements to reduce the price risk for its future projected import requirements. These fixed price arrangements allow Manitoba Hydro to ‘hedge’ against the risk of increased energy market prices. Manitoba Hydro has substantially hedged its projected imports for the November 2021 to March 2022 timeframe, as well as entered into arrangements for fixed price firm delivered natural gas supply for energy generation purposes.”

QUESTION:

Please explain how Manitoba Hydro determined the level of hedged volumes by month and explain whether Manitoba Hydro hedged electricity volumes that could potentially exceed its required imports, for example in the event of a warm winter. Explain how Manitoba Hydro is protected from a situation where its financial hedges are not backed by physical import purchases and discuss the potential financial implications of such a situation.

RESPONSE:

Manitoba Hydro simulated operations for 2021/22 based on a range of potential future water supply conditions. As explained on page 18 of the Application, in summer 2021 forecasting considered that flows could transition to any one of 40 potential inflow scenarios by the end of the fiscal year based on historic transition statistics. As the rain season came to a close, Manitoba Hydro assumed a progressively narrower range of potential flow conditions. Accordingly, the range of projected hydroelectric generation also narrowed, as shown in Figure 10 of the Application.

For each flow scenario used in its simulations, Manitoba Hydro determined the net volume of variable-priced (i.e. price risk exposed) volume of import or export activity, by month and

by period (i.e. on or off peak). This evaluation created a distribution of net variable-priced volumes for use in hedging decisions.

Manitoba Hydro employed a balanced approach throughout its hedging activity that would greatly reduce the likelihood of purchasing financial hedges that would not be supported by physical import purchases. Manitoba Hydro's hedging strategy has been continuously updated and reviewed as both water supply and export market conditions have evolved. Manitoba Hydro's balanced hedging strategy has taken into consideration potential future variability to forecasted hydraulic conditions, identified periods where market price volatility and import requirement may be higher, and assessed and pursued hedging options for both electricity and natural gas to diversify our hedging portfolio. With all this taken into consideration, in the unlikely event that actual conditions did deviate to a point where Manitoba Hydro no longer required any purchased financial hedges, these positions can be sold back to the export marketplace through multiple ways to still give Manitoba Hydro future optionality and flexibility if such an instance was to occur.

1 The development of these price scenarios and the potential impact of these scenarios
2 on net extraprovincial revenue are commercially sensitive, as public release of this
3 information could detrimentally impact Manitoba Hydro's competitive position in
4 future hedging transactions with commercial counterparties. As such, this information
5 is being filed in confidence with the Public Utilities Board only.

6

7 There is the potential for Manitoba Hydro to further mitigate the price risk associated
8 with the high price and extreme price scenarios through entering into further fixed
9 price hedge arrangements, if market opportunities present themselves. However, as
10 further hedges are executed it reduces the opportunity to benefit (improved net
11 extraprovincial revenue) from any reduction in actual market prices (i.e. movement in
12 prices from the base case towards the Low-Price scenario). While these
13 considerations need to be balanced, energy market prices continue to trend upwards
14 and as such Manitoba Hydro intends to pursue further hedging opportunities, where
15 appropriate, to mitigate the risk of higher prices.

16

17 **3.0 MANITOBA HYDRO'S FINANCIAL METRICS AND NEED FOR RATE INCREASES TO** 18 **REMAIN SELF-SUPPORTING**

19

20 **3.1 Financial Metrics**

21 Although no longer on the legislative agenda, Manitoba Hydro supports the debt ratio
22 targets that were outlined in the previously proposed legislation, which are
23 summarized below.

- 24 • 87% by March 31, 2025
- 25 • 84% by March 31, 2030
- 26 • 78% by March 31, 2035
- 27 • 70% by March 31, 2040

28

29 The combination of debt ratio targets and achievement dates establishes a general
30 and reasonable roadmap to gradually reduce the utility's leverage over a 20-year
31 period. Manitoba Hydro's net debt is expected to exceed \$24 billion following the
32 completion of the major capital projects. The focus for the next decade will be on

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Manitoba Hydro’s 2021/22 Forecast, which was approved by the Manitoba Hydro-Electric Board on November 10, 2021, clearly establishes that the current drought conditions have severely impacted Manitoba Hydro’s financial health with very limited opportunity for additional water inflows to contribute to a recovery in the remainder of fiscal 2021/22. These undisputable and uncontrollable deleterious impacts to Manitoba Hydro’s financial health warrant the modest general revenue increase requested in this Application given the current circumstances as detailed herein.

To be responsive to the MFRs approved by the PUB on October 19, 2021 seeking information relating to the 2022/23 fiscal year, Manitoba Hydro is also providing a 2022/23 Preliminary Plan to help inform the PUB’s review of this Application. This Preliminary Plan has not yet been approved by the MHEB or provided to the Treasury Board in accordance with the annual summary budgeting process. Manitoba Hydro is not requesting approval of an increase for 2022/23 as part of this Application and as a simplifying assumption has not assumed a rate increase in the 2022/23 Preliminary Plan filed with this Application.

1.3 Reasons for the Application

Due to the effective merging of the process and the information requested as part of the Status Update Proceeding with this Application, a significant amount of additional evidence is being provided by Manitoba Hydro that exceeds what would normally be required to support the need for immediate interim relief from the impacts of the drought.

Drought risk is the risk of low water inflows and storage, as well as energy market prices that can significantly impact Manitoba Hydro's financial position and operations. Manitoba Hydro is committed to provide reliable energy service our customers, and the corporation is engaged in planning, development and operation of systems to mitigate the impact of the drought. As discussed in Section 2.1 of the Application, Manitoba Hydro reduced outflows from Lake Winnipeg and Grand Rapids to near minimum starting in July 2021 to ensure that firm demands could be met assuming: drought conditions persisted for the remainder of the year, above normal

effective June 1, 2019 and set aside in a deferral account to help mitigate the depreciation and finance expenses when the Keeyask Generating Station and other major capital projects are placed in-service. In this Application, Manitoba Hydro is seeking approval to dispose of this deferral account balance by recognizing these amounts in revenues over a period of 24 months. The proposed disposition of the balance serves to reduce Manitoba Hydro's revenue requirement, and as such does not represent a rate increase. This is demonstrated in Figure 18 of the Application, which shows that with the proposed disposition of the Major Capital Projects Deferral and previously PUB-approved disposition of the Bipole III Deferral, the revenue requirement impact associated with the Major Capital Projects is reduced from \$708 million in 2021/22 to \$619 million.

The proposed amortization period of 24 months is a similar timeframe over which the revenues in this account were collected from customers. Lengthening the amortization period to 36 months would result in less revenue being recognized over this period resulting in greater losses than currently projected in 2021/22 (approximately \$4 million) and lower projected net income in 2022/23 (approximately \$16 million), at a time when Manitoba Hydro's revenue requirement is increasing as major projects are placed in service. As a result, Manitoba Hydro does not believe lengthening the amortization period is in the best interest of customers.

Consistent with the treatment of the Bipole III Deferral Account, Manitoba Hydro would cease funding the Major Capital Project Deferral effective December 31, 2021, and the revenues from the 2.5% increase effective June 1, 2019 previously deferred will flow to Manitoba Hydro's general revenues.

Please also see Manitoba Hydro's response to PUB/MH I-6.

REFERENCE:

Application Page 8 & Coalition MFR 24

PREAMBLE TO IR (IF ANY):

On Page 8 of the Application, Section 1.3, Manitoba Hydro states that “...the proposed 5.0% general revenue increase reasonably balances the financial needs of Manitoba Hydro by addressing the very severe and immediate financial impacts of the drought, and impact on customers during the current pandemic and period of higher inflation.”

In Coalition MFR 24, Manitoba Hydro was asked how it balanced the financial integrity of the Corporation with the impact of the proposed interim rate increase on customers. The response was a reference back to Section 1.3 of the Application. Section 1.3 of the Application does not outline the factors that Manitoba Hydro considered in balancing the interests of customers and how these factors were weighted into the request for a 5.0% interim rate increase.

QUESTION:

Please elaborate on the factors that Manitoba Hydro considered and how it balanced the rate impacts on customers with concerns over the financial health of the utility.

RESPONSE:

In considering and balancing the impact of the proposed rate increase and the financial health of the utility, the Corporation considered the financial impacts of the drought in 2021/22 and in the near term. As noted in the Application, Manitoba Hydro is anticipating a reduction in net extraprovincial revenue of \$398 million in 2021/22 as a result of the drought. As set out in Coalition/MH I-3b, absent any rate relief, Manitoba Hydro is projecting a net loss of \$217 million in 2021/22 and a cash deficiency to fund core operations of \$375 million. This significant financial impact will deteriorate the financial position of the utility in every metric and limit its capacity to address future risks (including

continued drought, weather events, and changes in energy market prices and interest rates).

If Manitoba Hydro were to consider the level of increase strictly from a financial perspective, a rate increase greater than 12% would be required to recover this level of net losses over a 12-month period, and a rate increase of approximately 21% would be required to recover the borrowings to fund core operations over a 12 month period. With consideration of the impact on customers in mind, Manitoba Hydro recognizes that it is not possible to recover fully from the drought in one year and smoothing the impact of the drought by capping the proposed rate increase at 5% is appropriate in the circumstances.

In determining the proposed level of increase in this Application, Manitoba Hydro considered the principles of rate stability and predictability for customers and the current pandemic, period of higher inflation and high natural gas costs. Given the very severe and immediate financial impacts of the drought with the existing financial circumstances of the Corporation, the proposed 5.0% rate increase reasonably balances the financial health of the utility with the impact on customers.

Land & Territorial Acknowledgment

We acknowledge these lands and pay our respects to the ancestors of these territories. The legacy of the past remains a strong influence on Manitoba Hydro's relationships with Indigenous communities today, and we remain committed to establishing and maintaining strong, mutually beneficial relationships with Indigenous communities.