

Manitoba Hydro 2021 Interim Electric Rate Application

Oral Submission

December 14, 2021

Agenda

- Legal Framework for an Interim Application
- Current Drought Conditions
- How Drought Risk is Addressed
- Financial Position of the Corporation
- Cost Containment
- Keyask In-Service Deferral Account
- Cost of Service Study
- 2022 General Rate Application
- Concluding Remarks

Legal Framework to Consider Interim Rate Applications

Interim Rate Application

“The board may, instead of making an order final in the first instance, make an interim order and reserve further directions, either for an adjourned hearing of the matter, or for further application.”

Section 47(2) of *The Public Utilities Board Act*

Interim Rate Application as Set Out by the PUB

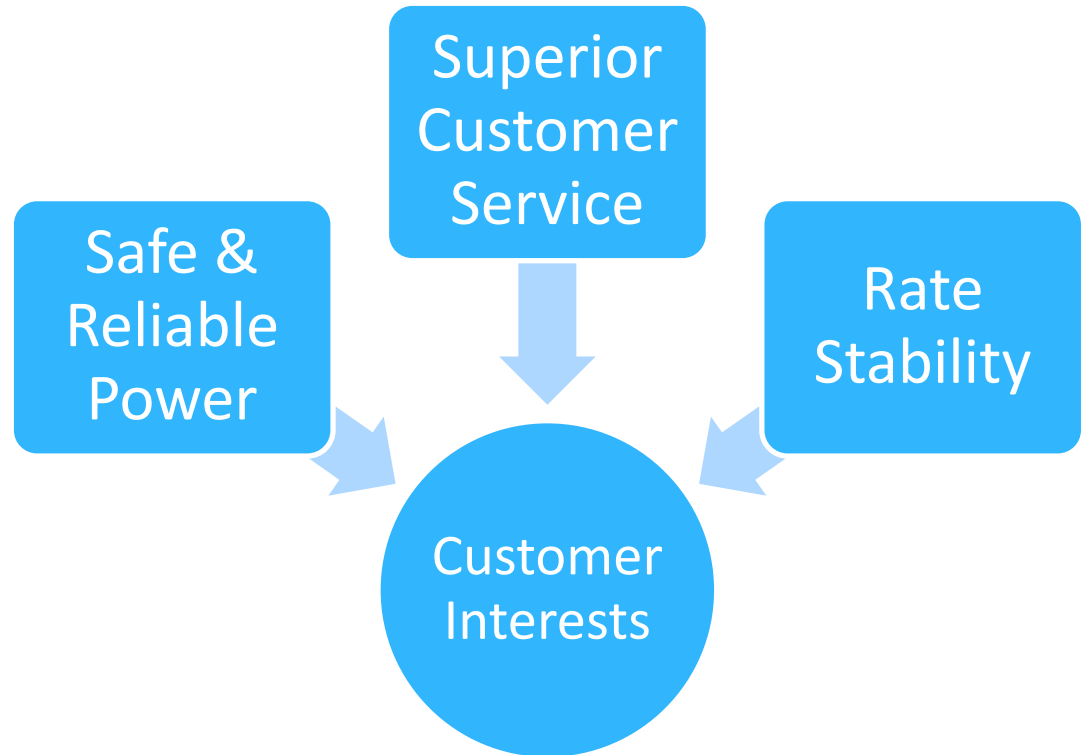
1. Would it be just and reasonable to grant interim rates?
2. Would Manitoba Hydro suffer a deleterious effect in the absence of an interim rate increase?

Order 49-14 at page 16.

Public Interest

“The PUB has two concerns when dealing with a rate application; **the interests of the utility's ratepayers, and the financial health of the utility.** Together, and in the broadest interpretation, these interests represent the general public interest.”

(Consumers' Assn. of Canada (Manitoba) Inc v Manitoba Hydro Electric Board, 2005 MBCA 55 at para 65)



Legislative Considerations

In reaching a decision pursuant to this Part, The Public Utilities Board may

(a) take into consideration

(i) the amount required to provide sufficient funds to cover operating, maintenance and administration expenses of the corporation,

(ii) interest and expenses on debt incurred for the purposes of the corporation by the government,

(iii) interest on debt incurred by the corporation,

(iv) reserves for replacement, renewal and obsolescence of works of the corporation,

(v) any other reserves that are necessary for the maintenance, operation, and replacement of works of the corporation,

(vi) liabilities of the corporation for pension benefits and other employee benefit programs,

(vii) any other payments that are required to be made out of the revenue of the corporation,

(viii) any compelling policy considerations that the board considers relevant to the matter, and

(ix) any other factors that the Board considers relevant to the matter; and

Legislative Considerations

The prices payable for power supplied by the corporation shall be such as to return to it in full the cost to the corporation, of supplying the power, including

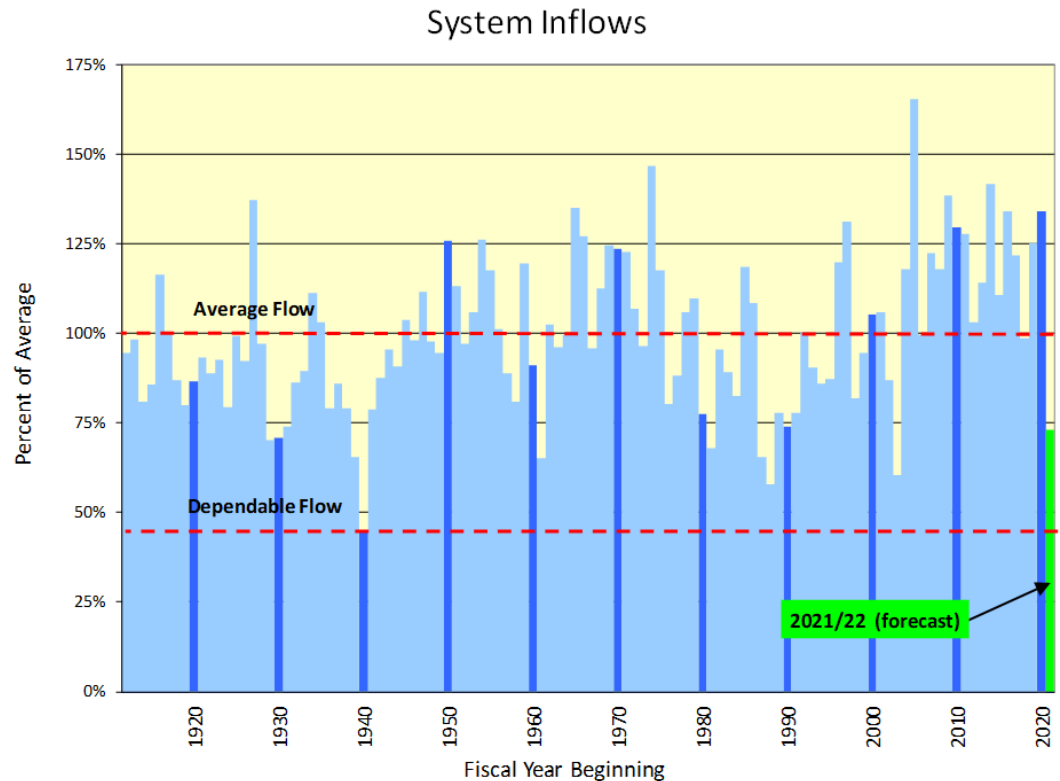
- (a) the necessary operating expenses of the corporation, including the cost of generating, purchasing, distributing, and supplying power and of operating, maintaining, repairing, and insuring the property and works of the corporation, and its costs of administration;
- (b) all interest and debt service charges payable by the corporation upon, or in respect of, money advanced to or borrowed by, and all obligations assumed by, or the responsibility for the performance or implementation of which is an obligation of the corporation and used in or for the construction, purchase, acquisition, or operation, of the property and works of the corporation, including its working capital, less however the amount of any interest that it may collect on moneys owing to it;
- (c) the sum that, in the opinion of the board, should be provided in each year for the reserves or funds to be established and maintained pursuant to subsection 40(1).

Manitoba Hydro Act, section 39(1)

Current Drought Conditions

Drought Conditions

- Since Fall of 2019 key parts of the watershed supplying Manitoba Hydro have received record low precipitation
- Precipitation in 2020/21 has been **below levels experienced in 2002/03 contributing to the 2003/04 drought**
- Manitoba Hydro is managing its operations to ensure energy reliability through management of its reservoirs



Current Drought Conditions

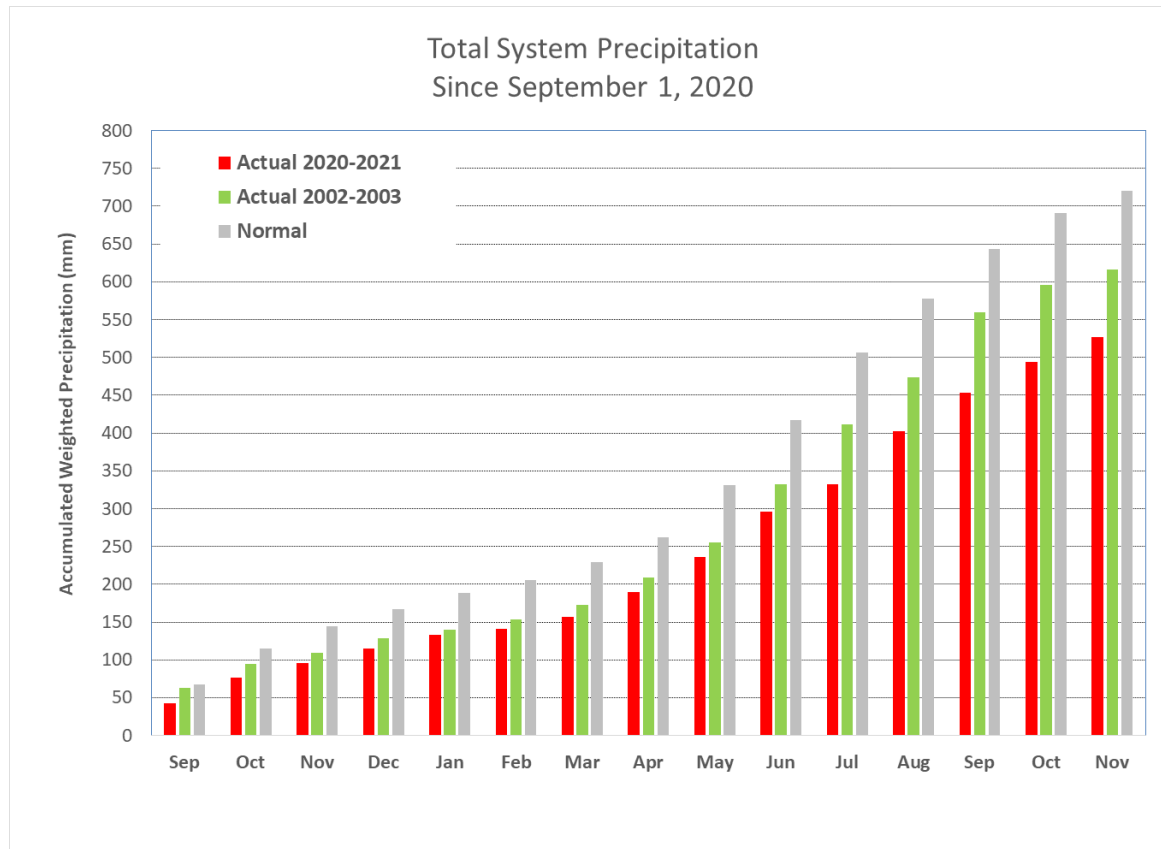
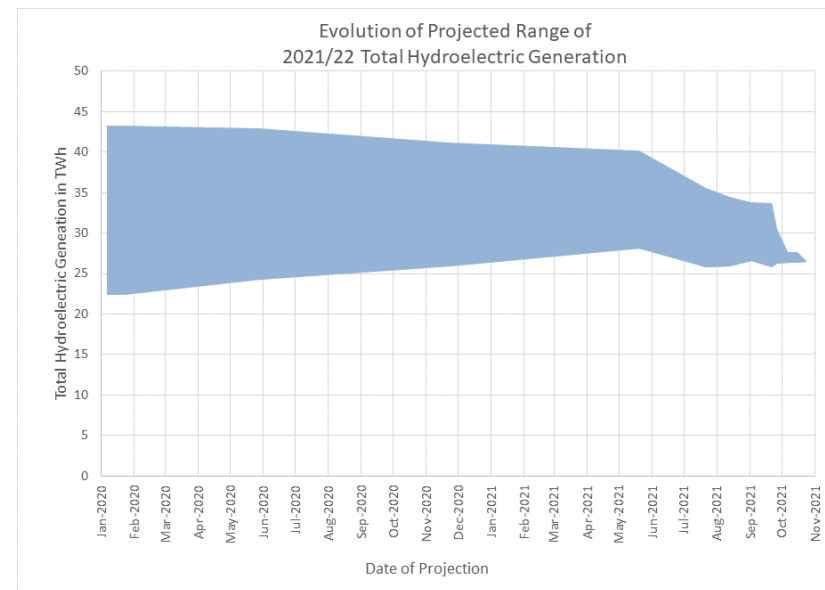


Figure 1: Total System Inflows since September 1, 2020

When did Drought Conditions Develop?

- Despite low precipitation there remained the potential for recovery in the event of late summer and fall precipitation
- Significant rainfall events in Fall are common and can dramatically impact Manitoba Hydro's financial position as experienced in fall 2018

Figure 10: Evolution of Range of Projected Hydraulic Generation



How Drought Risk is Addressed

Addressing Drought Risk

“Retained Earnings should be used to manage drought risk in combination with regulatory action by the Board. The Board further agrees that interest rate and export price risks over the long term should be addressed with rate increases as and when those risks materialize. Rates should not be set to increase Retained Earnings to manage those longer-term risks. As discussed elsewhere in this Order, the Board is prepared to consider regulatory action when required to address emerging risks facing Manitoba Hydro.”

Order 59/18 at p. 142 and Order 69/19 at p. 14-15 and 28-9

Retained Earnings

“Manitoba Hydro’s financial reserves, or Retained Earnings, are the sum of all profits received by Manitoba Hydro through customer revenues since the Utility’s inception, primarily from domestic ratepayers but also from export sales. **Manitoba Hydro’s financial reserves are not cash and are not retained in a bank account, but rather have been reinvested back into the Utility**, including through reducing the amount of new borrowing requirements. Put another way, **equity and Retained Earnings are debt that is avoided.**”

Order 59/18 at p. 49-50, emphasis added

Retained Earnings

- Relying upon retained earnings during periods of drought does not address the cash flow deficiency
- Manitoba Hydro anticipates **borrowing \$348 million** for core business operations in 2021/22 Forecast

Balancing Regulatory Action and Retained Earnings

Cash Flow Deficiency

Known costs associated with major capital projects being put in service

Highly leveraged position

Uncertainty and risks faced by the Corporation

Impacts on Customers of Rate Increases



Balancing Regulatory Action and Retained Earnings Impacts

- Manitoba Hydro's application will only generate \$27 million in 2021/22
 - Continue to forecast a loss of \$190 million
 - Retained Earnings will drop by 6.1%
- Manitoba Hydro's application represents the public interest by addressing the impacts of drought through both impacts to retained earnings and regulatory action

Limiting Relief to Only Address Drought

- The PUB ought to consider **all of the facts and circumstances** which confront Manitoba Hydro at this time
- To look at the financial impacts of drought in isolation is not just or reasonable

Financial Position of the Corporation

Where is Manitoba Hydro Today?

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

Electric Segment	2021/22	2021/22	
	Forecast	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%

Where is Manitoba Hydro Today?

- Manitoba Hydro is forecasting **\$398 million reduction** in net extra-provincial revenue
- Assuming a 5% rate increase, the Corporation will borrow \$348 million to fund core business operations
 - Carrying costs associated with this unplanned debt are approximately \$13 million annually

Where is Manitoba Hydro Today?

- Long term debt of \$24.428 billion
- **42 cents of every dollar** of revenue generated by Manitobans is going to pay interest
- Assuming a 5% rate increase, **net loss of \$190 million**

Where will Manitoba Hydro be in the Near Term?

- 2022/23 Preliminary Plan forecasts a net income of \$200 million
 - Includes \$88 million of additional revenues associated with the proposed rate increase
 - Includes \$127 million of non-cash revenue associated with the amortization of the Bipole III and Major Capital Deferral Accounts
 - Assumes a return to average water flows

Where will Manitoba Hydro be in the Near Term?

Figure 18: Revenue Requirement Impact of Major Capital Projects

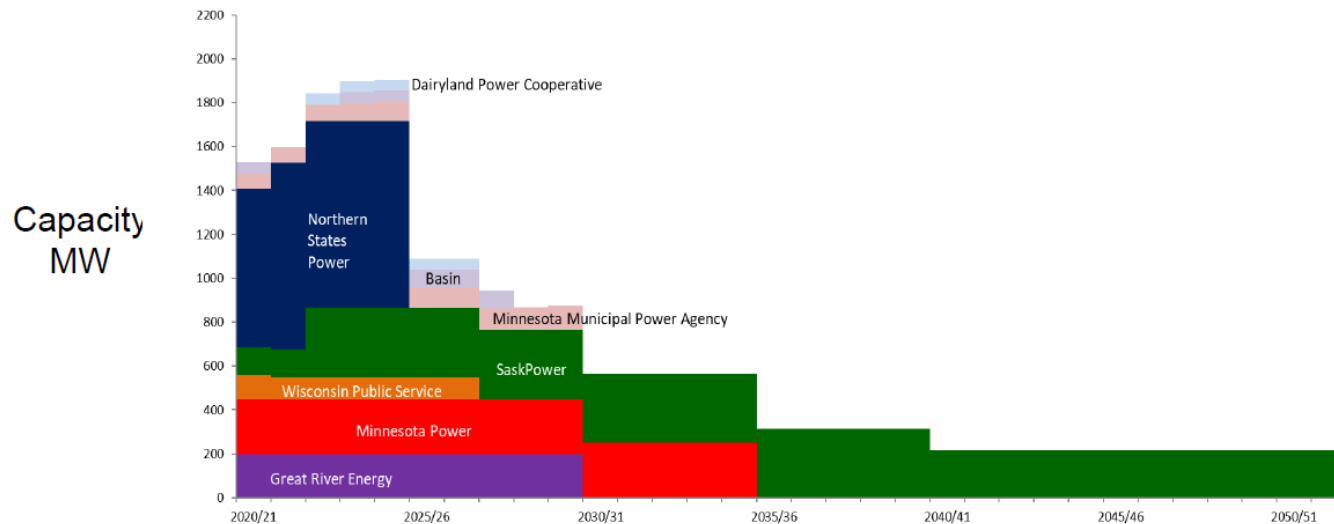
	2021/22	2022/23	2023/24
(\$ millions)			
Keeyask	282	499	526
Bipole III	327	316	316
MMTP	30	29	29
GNTL	66	64	64
Birtle	3	3	3
Gross Impact	708	912	938
Amort of Major Capital Projects Deferral*	(12)	(50)	(37)
Amort of Bipole III Reserve*	(77)	(77)	(20)
Net Impact	619	785	881

**Amortization of Capital Reserves projected to cease in 2023/24*

Where will Manitoba Hydro be in the Near Term?

Manitoba Hydro's 2021/22 Interim Rate Application
PUB MFR 15 - Attachment 1
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MH's Firm Export Contract Portfolio Summer Season 2020 - 2051



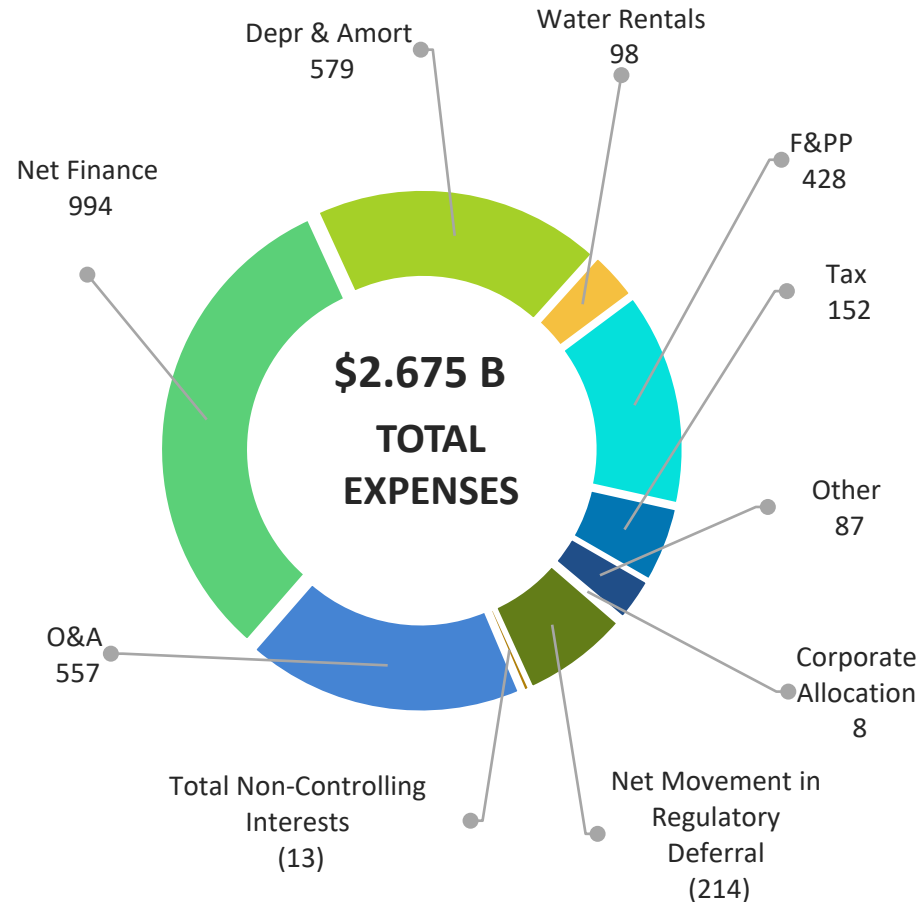
Rate Stability – Use of Historical Rate Paths

- The Utility has long recognized the need for steady rate increases of 3.5% or more to address the impacts of major capital expansion
- The PUB has granted rate increases with a view to smoothing the impacts of major capital projects coming into service
- Deferring required rate increases now, only pushes costs further down the road as Manitoba Hydro has to increase borrowings to meet its existing revenue requirements

Cost Containment

2021/22 Forecast Expenses

- Due to the capital-intensive nature of its business, Manitoba Hydro's expenses are largely fixed and include the carrying costs and operating costs on the assets used to serve customers
 - Net finance Expense (37% of expenses)
 - Depreciation & amortization expense (22% of expenses)
 - O&A expenses required to operate and maintain assets used to serve customers (21% of expenses)
 - Payments to government (16% of expenses)



Cost Containment

- Manitoba Hydro will continue to operate as efficiently as possible while providing safe and reliable service
- Even costs viewed as “controllable”, like Business Operating Capital and O&A expenses, are still subject to risks beyond Manitoba Hydro’s control:
 - Inflationary Pressures
 - Increasing assets that are now being operated and maintained;
and
 - Increasing number of customers served

Costs in Perspective

- From 2016/17 through to the 2022/23 Preliminary Plan Manitoba Hydro's electric O&A costs have seen a compounded annual growth of 1.75%, which is aligned with the compounded annual growth for Manitoba CPI of 1.73%
- During the same period, there has been an **increase in assets of approximately \$9 billion**

FTEs are at the lowest level in 20 years



This has been achieved despite:

- Additional operational requirements for major infrastructure (Wuskwatim GS, Riel, Keewatinohk Converter Stations, MMTP, Keeyask GS)
- Total assets in 2002 were 1/3 the current value
- Aging infrastructure demands
- Increased regulation (environmental, NERC, NEB/CER and safety)

O&A Expenses - FTEs

- Since 2015/16 Manitoba Hydro reduced its workforce by 15%, including reduction of senior management positions of approximately 25%
- Post-VDP staffing levels are the minimum staffing levels required to provide safe and reliable service and minimize lifecycle costs
- Manitoba Hydro plans to return to staffing levels post-VDP gradually over the coming 2 fiscal years

O&A Expenses – Employee Related Expenses

- Shift in resources from construction to operating and maintenance activities will increase O&A expenses
 - Estimated to increase O&A by \$27 million in the 2022/23 Preliminary Plan compared to 2019/20
- Compensation increases are driving increases in O&A
 - In 2021 the Manitoba Labour Board awarded general wage increases to IBEW employees totaling 3.5% which has an ongoing impact



O&A Expenses – Non-Salary Related

- Inflationary Pressures
- Environmental monitoring upon in-service of Keeyask
- Zebra mussel treatment
- Increased motor vehicle costs

Capital Expenses

- Investment in aging and failing assets is essential to providing safe and reliable energy
- Deferring capital investment increases risks of asset failure and maintenance costs
- 90% of capital spending is on “in-flight” projects and programs making deferral mid-project costly and inefficient

Keeyask In-Service Deferral Account

Keeyask In-Service Deferral

- Consistent with past accounting treatment (Limestone, Wuskwatim) CGAAP
 - Recognize costs on a pro-rata (per unit) basis, bringing 1/7th of the costs in-service with each unit of Keeyask
- IFRS requires recognition of the component costs when they are ready to be used versus on a pro-rata basis
 - Would result in earlier recognition of finance and depreciation expense
- Maintaining the Keeyask In-Service deferral is in the best interest of customers
 - Offsetting or reversing this deferral will result in greater losses in 2021/22 and lower net income 2022/23

Cost of Service Study

Cost of Service Study

- Proposed approach is consistent with the PUB's findings in Order 59/18 to migrate customers into the zone of reasonableness over 10 years
 - Below average rate increases for the Area & Roadway Lighting class and the General Service Small Non-Demand class offset by very modest 0.15% above average rate increases to all other classes

2022 General Rate Application

2022 General Rate Application

- Manitoba Hydro intends to engage with the PUB on the timing and parameters for its next multi-year GRA, after the current process concludes
- Manitoba Hydro looks forward in continuing to work collaboratively with the PUB to ensure an effective and efficient regulatory process in the best interests of Manitobans

Conclusion

*“as the Board has demonstrated in past decisions – including in years of drought where the Board awarded rates in excess of those sought by the Utility – **it will consider all of the facts and circumstances which confront Manitoba Hydro at that point in time in determining the appropriate rate relief. The Board is prepared to take regulatory action – whether through a rate rider, an interim rate increase, or a general rate increase – as required in times when emergent situations face Manitoba Hydro.**”*

Order 58/19 at page 62-63

Conclusion

- It is just and reasonable to grant interim rates
- Manitoba Hydro will suffer a deleterious effect in the absence of an interim rate increase
- Manitoba Hydro submits its application as proposed is in the public interest