

**REFERENCE:**

Application Pages 9, 18 and Figure 9 & PUB MFR 18, Page 4

**PREAMBLE TO IR (IF ANY):**

On page 18 of the Application, Figure 9, Manitoba Hydro provided a calculation of forecast net extraprovincial revenues (NER) for 2021/22 based on current water conditions (October 20, 2021) of \$111 million.

In PUB MFR 18, Page 4, Manitoba Hydro provided a table with a range of potential NER for 2022/23 based on 40 potential inflow scenarios, with the lowest flow scenario (#1) producing a projected NER of approximately \$302 million.

On Page 9 of the Application, Manitoba Hydro indicates that the 2021/22 Budget and 2022/23 Preliminary Plan now assume a shorter record of 40 more recent water flows as compared to the 100+ years that was previously used for determining average NER for budgeting purposes and that “recent historic flow data has greater temporal and spatial resolution compared to older records.”

**QUESTION:**

- a) Please explain which of the 40 potential inflow scenarios best fits the forecast NER for 2021/22 of \$111 million.
- b) Please explain the factors or circumstances that would result in the lowest water flow scenario NER for 2022/23 of \$302 million being approximately 2.7 times ( $\$302/\$111 = 2.72x$ ) higher than the forecast NER for 2021/22.
- c) Please explain/elaborate on why more recent water flow data has greater temporal and spatial resolution.
- d) Please provide the rationale underlying the change from using a historical record of 100+ years of water flows to a shorter record of 40 years of more recent historic flow. Please also explain the process undertaken by Manitoba Hydro to decide on and implement this change.

**RESPONSE:**

- a) In terms of total simulated hydraulic generation, the flow year used to prepare the 2021/22 Budget that produced the hydro generation closest to the 2021/22 Forecast is the 1987 hydrologic year.
- b) The main factors driving the year over year difference in NER between 2021/22 Forecast and the low flow scenario used in the 2022/23 Preliminary Plan are export and import prices. As shown in Table 1, in the 2022/23 low flow scenario, year over year dependable revenues are up \$117 million largely due to the commencement of the 215 MW SPC Sale and 100 MW WPS Sale. This is offset partly by reduced opportunity exports of \$40 million. Although the overall volume of purchases in the low flow scenario for 2022/23 is similar to the 2021/22 Forecast (differing by 16 GWh), the cost of purchases is approximately \$98 million less, primarily due to lower forecast prices overall and lower on peak purchase volumes.

Table 1: Year over year reconciling of 2021/22 Forecast to low flow scenario underlying 2021/22 Budget

		Revenue/Cost in \$ millions	Energy in GWh
<b>2021/22 Forecast NER / Net Export Energy</b>		<b>\$111</b>	<b>384</b>
Year-Over- Year Change	+ Dependable Revenue	\$117	967
	+ Opportunity Revenue	\$(40)	(421)
	- Imports/Purchases	\$(98)	16
	- Water Rentals	\$2	-
	+ Other NER	18	-
<b>2022/23 Low Flow NER / Net Export Energy</b>		<b>\$302</b>	<b>914</b>

Hydraulic generation in the 2021/22 Forecast is 26.4 Terrawatt-hours (“TWh”) which is similar to the low flow scenario used in the 2022/23 Preliminary Plan which produces 26.6 TWh. There is less storage drawn in the low flow year for 2022/23 Preliminary Plan as compared to what is projected to occur through 2021/22. The effect of difference in storage draw is offset by the additional generation from Keeyask, which will be fully in service in 2022/23.

In addition to actual total inflows and market prices, factors such as the timing of and distribution of inflows, weather driven impacts on domestic demand, and generation and transmission availability, will ultimately impact the difference in NER between the 2021/22 Forecast and what actually transpires in 2022/23.

- c) Early periods of the flow records are based on monthly flows as compared to more recent data which is based on daily average observations.

The long-term flow data has lower spatial resolution consisting of 16 inflow locations in the hydraulic network modelled using this data, as compared to 41 flow locations that are used in modelling the system with more recent records. For example, with more recent higher spatial resolution data, 17 inflow locations are modelled in the Winnipeg River Basin. In contrast, the Winnipeg River flows are represented as a single location in the long-term records at Slave Falls generating station, which is downstream of the major reservoirs in that basin.

For the very early portion of the record, flow was not recorded in the sub-basins of many inflow locations, and inflows were statistically reconstructed using monthly and annual water level, flow, and precipitation observations in other proxy sub-basins. These flow reconstructions were performed on a monthly timestep for use in modelling at the monthly timescale, and a daily estimate is unavailable.

- d) Manitoba Hydro has a long record of historical water level and flow and uses this for planning and operational reliability purposes. The shorter record of 40-year duration is used for near-term operations planning and budgeting only.

Manitoba Hydro has been adding new tools to improve inflow forecasting and system modelling for operations planning. This requires historical data with greater resolution. As indicated in part c) older stations in many locations were limited and did not always collect daily data. In some cases, historical records were extended or analyzed with adjacent basin information to prepare a more basin wide representation. While these extended and/or expanded records of the information can facilitate modelling on longer

time steps, such as monthly and seasonally, these records are not detailed enough for finer resolution modelling. More recent information collected since major Manitoba Hydro projects have been operational, over the past 40 years, provide a more complete set of information (higher spatial and temporal resolution data) required to undertake more detailed inflow modelling. As a result, Manitoba Hydro has adopted the use of the 40-year record for this purpose.

Higher spatial and temporal resolution data enables more detailed system modelling which can better inform operations planning. Using this data to simulate the test year and budget provides better representation of current conditions and planned operations are better reflected in Manitoba Hydro's financial forecasts. For example, in the longer flow record, the Winnipeg River is lumped as a single inflow location. The record does not specifically reflect more recent changes to operating rule curves in the basin, such as the International Joint Commission ("IJC") rule curves for Rainy Lake and Namakan Lake Rule Curves that were implemented in 2000, limiting the drawdown of these reservoirs. The IJC Rule Curves were later updated in 2018, again altering the regulation of these reservoirs. The more recent record represents the evolving operating priorities of the Lake of the Woods Control Board which is responsible for regulation of major storage reservoirs in Ontario. The enhanced spatial resolution of the 40-year record permits the modelling of upstream reservoirs including the impact of current storage levels and better reflects short-term inflows into the Manitoba Hydro system based on the most current operating rules and priorities.

Although the record is shorter, the last 40 years of record include a range of flow conditions from drought to floods.

Using a more recent record of flows also inherently captures potential impacts of climate change in near term forecasts. It has been observed that the timing of freeze-up and melt has changed over the period of the long-term flow record.

In terms of process, Manitoba Hydro reviewed the impact of using the long-term record versus the 40-year record in simulating *average* net export revenues for financial forecasting purposes. It was shown that average net export revenue estimates were consistent relative to the level of uncertainty involved. For example, the difference in

average Net Extraprovincial Revenue (“NER”) between the 40-year record and the 100+ year record is an increase of \$18 million or approximately 3% relative to the 2022/23 Preliminary Plan. Please also refer to PUB/MH I-3.

As explained in Manitoba Hydro 2017/18 & 2018/19 General Rate Application COALITION/MH I-62a-e, prior to MH16, Manitoba Hydro had used a single flow case to forecast net export revenues for the test year. Manitoba Hydro will continue to review the use of flow records for financial forecasts for the test year and Budget purposes.

**REFERENCE:**

Revised Coalition MFR 22 (b), Coalition MFR 22 (a), PUB MFR 19 and Appendix 6, Page 12 (2019/20 Electric Rate Application)

**PREAMBLE TO IR (IF ANY):**

In the revised Coalition MFR 22 (b), Manitoba Hydro filed a table of Electric O&A and a table of Corporate FTE's - from 2016/17 actual results to 2022/23 preliminary plan forecast, which is summarized as follows:

- 2016/17 Actual - \$536 million & 6,411 FTE's
- 2017/18 Actual - \$517 million & 5,998 FTE's
- 2018/19 Actual - \$508 million & 5,475 FTE's
- 2019/20 Actual - \$512 million & 5,393 FTE's
- 2020/21 Actual - \$534 million & 4,954 FTE's
- 2021/22 Forecast - \$557 million & 5,022 FTE's
- 2022/23 Preliminary Plan - \$595 million & 5,420 FTE's

In that revised MFR Manitoba Hydro indicates that "From 2016/17 through to 2022/23, Manitoba Hydro's electric O&A expenditures have seen a compound annual growth of 1.75%, which is aligned with the compounded annual growth of Manitoba CPI of 1.73% during that same period...In addition, with the winding down of major capital projects, O&A costs are going up as there is a shift from resources working on construction activities, focused on large hydro-electric and transmission line development, to operating activities in support of Strategy 2040 and building up the capability to meet the evolving energy landscape...Manitoba Hydro currently has an external hiring plan in place to return to pre-pandemic FTE levels which will allow Manitoba Hydro to ensure that it can continue to provide safe and reliable service to its customers."

In Coalition MFR 22 (a), when Manitoba Hydro was asked if it had considered potential deferrals or reprioritization of capital expenditures in the event of financial distress due to drought, it stated "Manitoba Hydro's fleet of assets is aging, and sustaining capital expenditures are essential to keep the reliability and safety of the system at acceptable

levels, as aging infrastructure continues to be a top risk for the corporation...Deferring investments will generally erode value by increasing risks associated with the aging assets, increasing costs associated with remediation of those risks, decreasing asset reliability, or some combination of the three.”

On PUB MFR 19, Page 11, Manitoba Hydro indicates that it is forecasting total Business Operations Capital of \$523 million in 2021/22 and \$545 million in 2022/23 - for a total of \$1.068 billion over those two years. At the 2019/20 Electric Rate Application, Manitoba Hydro’s CEF (Appendix 6, Page 12) forecasted total Business Operations Capital of \$533 million in 2021/22 and \$563 million in 2022/23 - for a total of \$1.096 billion over those two years.

**QUESTION:**

- a) Please describe the primary drivers of the \$83 million or 16.2% projected increase in Electric O&A between the 2019/20 actual (the last Electric Rate Application) and the 2022/23 preliminary plan.
- b) Please explain why Manitoba Hydro is planning to increase its Electric O&A by \$38 million (\$595 - \$557) or 6.8% and increase its FTE’s by 398 (5,420 - 5, 022) or 7.9% in 2022/23 - given its concerns over the financial health of the Corporation as a result of the 2021/22 drought and potential for continued drought into 2022/23.
- c) Please confirm that on an overall basis, Manitoba Hydro is planning to spend a consistent amount of Business Operations Capital in 2021/22 and 2022/23 of approximately \$1.068 billion as was previously planned at the 2019/20 Electric Rate Application and has not re-prioritized this level of spending based on concerns over the financial health of the Corporation as a result of the 2021/22 drought and potential for continued drought into 2022/23.

**RESPONSE:**

- a) When comparing the 2019/20 Electric O&A actual costs to the 2022/23 Preliminary Plan, there were several factors outside of Manitoba Hydro’s control that were the primary drivers of the cost increases. These include an increase in employee benefit costs due to discount rate changes, salary increases for IBEW employees ordered by the

Manitoba Labour Board in August 2021 and a shift from resources working on capital construction projects to operating and maintenance activities. This is described further below.

Firstly, in March 2020, Manitoba Hydro made a year end adjustment to its 2019/20 employee benefits costs to reflect lower costs as a result of an increase in the discount rate seen through the market reaction to the onset of the pandemic. This artificially reduced O&A costs in 2019/20. The following year, Manitoba Hydro saw a significant increase in O&A primarily attributable to higher employee benefit costs resulting from a decrease in the discount rate, with the partial recovery of the market, in addition to a higher vacation expense as a result of the remeasurement of the vacation liability necessitated by employees taking less vacation than the prior year caused in part by the impact of COVID-19. Employee benefits in 2019/20 were \$124 million compared to \$176 million in 2020/21. It should also be noted that in 2020/21 Manitoba Hydro was at its lowest level of FTEs even though employee benefits were at its highest point.

Secondly, in August 2021, the Manitoba Labour Board ordered salary increases for IBEW employees retroactive to January 1, 2019 as well as a one-time special payment to a majority of IBEW employees.

Additionally, with the winding down of the major capital projects, there is a shift from resources working on construction activities focused on large hydro-electric and transmission line development to operating activities resulting in higher O&A costs. Employment of staff hired specifically to work on the major capital projects ended following completion; however, for those staff remaining with Manitoba Hydro, their work shifted to operating and maintenance activities. This results in an increase of \$27 million in the 2022/23 Preliminary Plan compared to 2019/20. During Manitoba Hydro's peak construction period (2016/17 and 2017/18) Manitoba Hydro's workforce was deployed 43% to construction activities. As these major projects are completed, the level of deployment to capital construction work was 40% in 2019/20 and is expected to decrease to 33% in the 2022/23 Preliminary Plan.



b) Electric O&A costs are increasing \$38 million from 2021/22 to 2022/23 primarily as a result of:

- Higher wages and salaries, due to:
  - additional FTEs – FTEs are at their lowest levels since before the purchase of Winnipeg Hydro in 2002. The current level of FTEs needs to be addressed to ensure that Manitoba Hydro can continue to provide safe and reliable service to its customers and implement initiatives to respond to the evolving energy landscape. See PUB/MH I-5 for further information on the increase to FTE levels.
  - approved salary increases – in August 2021, the Manitoba Labour Board ordered General Wage Increases (GWI) for IBEW employees retroactive to January 1, 2019. Additionally, in October 2021, Manitoba Hydro approved a GWI for all Corporate Exempt staff, effective January 1, 2021. These increases have been reflected in the 2022/23 Preliminary Plan; and,
- Increased non-salary costs, including environmental monitoring required at Keeyask upon it being placed in-service, treatment of zebra mussels at generating stations, and motor vehicle costs including fuel and travel related to customer work with the return to normal operations. These costs are necessary to operate and maintain the electrical system.

c) Please see Manitoba Hydro's response to PUB/MH I-7.

**REFERENCE:**

Application, Pages 7 and 8, PUB MFR's 4, 6 and 8 & Coalition MFR 22; Manitoba Hydro 2017/18 & 2018/19 General Rate Application PUB/MH I-3a

**PREAMBLE TO IR (IF ANY):**

On Page 7 of the Application, Manitoba Hydro states that "Should the proposed interim rate increase be approved it is anticipated to generate \$27 million of incremental revenue in 2021/22 and \$88 million in 2022/23 ...when considering the level of increase to request in this Application, Manitoba Hydro considered the following: The need to limit further deterioration in Manitoba Hydro's financial health. Even with the proposed 5.0% revenue increase Manitoba Hydro is projecting a net loss of \$190 million in 2021/22, along with a deterioration in its debt ratio to 87% in 2021/22 and 88% in 2022/23."

On Page 8 of the Application, Manitoba Hydro states that "Drought has both an operational and financial impact on Manitoba Hydro. Manitoba Hydro plans and operates its system knowing that droughts will occur at some time in the future."

In PUB MFR 4, the MHEB Quarterly Report for the three months ended June 30, 2021, Manitoba Hydro states "Manitoba Hydro is currently projecting breakeven net income for the 2021-22 fiscal year compared to the budgeted net income of \$190 million. The significant decrease in net income is primarily driven by lower experienced and projected revenues due to reduced volumes available for sale in the export market as a result of unfavorable water conditions."

In PUB MFR 8, Manitoba Hydro states that "...it is important to recognize that retained earnings are not a cash reserve, as demonstrated by incremental borrowings in the current year."

In Coalition MFR 22, Manitoba Hydro states that "Manitoba Hydro is, however, anticipating issuance of a small amount of commercial paper. It should be noted that the increased limit of \$1.5 billion for the commercial paper program has not been approved for use, nor guaranteed as of yet, by the Province of Manitoba."

In PUB MFR 6, Manitoba Hydro provides calculations of the Debt Ratio, EBITDA Interest Coverage Ratio and Capital Coverage Ratio for 2021/22 and 2022/23, including the impacts of the proposed 5.0% rate increase.

**QUESTION:**

- a) In terms of managing liquidity risk, please explain if Manitoba Hydro has or is anticipating any problems in accessing debt through long-term advances from the Province of Manitoba in 2022/23. If so, please provide specific evidence to that effect including whether and how this is affecting Manitoba Hydro's financial situation. Please also explain Manitoba Hydro's plans in terms of maintaining cash reserves and making sinking fund withdrawals for 2022/23.

**RESPONSE:**

Manitoba Hydro has experienced problems in accessing debt through long-term advances from the Province in the past, though it is difficult to anticipate the events that precipitate dislocations in the financial markets. Market liquidity risk for Manitoba Hydro is the risk that the utility will not be able to access sufficient cash via the Province of Manitoba's debt financing from the financial markets in order to meet its obligations. At the beginning of the pandemic in March 2020, financial markets experienced a period of severe dislocation. Unlike during the financial crisis of 2008, the short term markets also experienced dislocation and Manitoba Hydro could not issue commercial paper. Further, no provincial public syndicated deals were transacted for a period of a month and a half following this disruption.

Manitoba Hydro is legislated under *The Manitoba Hydro Act* to make sinking fund contributions to the Province of Manitoba annually. Sinking fund balances are a restricted source of liquidity as the balances can only be withdrawn for debt maturities.

Throughout the capital expansion, the Corporation's investing activities have exceeded the cash flow from operations required by the Corporation. Given that the cash flow requirements are being met through borrowing, Manitoba Hydro has not maintained a

balance in the sinking fund since 2016 and has no plans or capacity to do so in 2021/22 or 2022/23.

**REFERENCE:**

Application, Pages 7 and 8, PUB MFR's 4, 6 and 8 & Coalition MFR 22; Manitoba Hydro 2017/18 & 2018/19 General Rate Application PUB/MH I-3a

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In PUB MFR 6, Manitoba Hydro provides calculations of the Debt Ratio, EBITDA Interest Coverage Ratio and Capital Coverage Ratio for 2021/22 and 2022/23, including the impacts of the proposed 5.0% rate increase.

**QUESTION:**

b) Please provide the forecast net income and retained earnings for 2021/22 and 2022/23, as well as the Debt Ratio, EBITDA Interest Coverage Ratio and Capital Coverage Ratio calculations assuming the following rate increases effective January 1, 2022 and keeping the assumed rate increase for 2022/23 at 0%:

- i. 0%
- ii. 1%
- iii. 2%
- iv. 3%
- v. 4%.

**RESPONSE:**

The table below summarizes the forecast net income, retained earnings, Debt Ratio, EBITDA Interest Coverage Ratio, Capital Coverage Ratio, Cash Surplus/(Deficiency) to Fund Core Business Operations and Revenue as a Percent of Interest Paid for 2021/22 and 2022/23, for the requested 0%, 1%, 2%, 3%, and 4% January 1, 2022 rate increases.

	Forecast		Preliminary Plan		Scenario i 0% Jan 1, 2022		Scenario ii 1% Jan 1, 2022		Scenario iii 2% Jan 1, 2022		Scenario iv 3% Jan 1, 2022		Scenario v 4% Jan 1, 2022	
	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23	2021/22	2022/23
\$ in millions														
<b>Proposed Rate Increase</b>	<b>5.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>1.0%</b>	<b>0.0%</b>	<b>2.0%</b>	<b>0.0%</b>	<b>3.0%</b>	<b>0.0%</b>	<b>4.0%</b>	<b>0.0%</b>		
Additional Domestic Revenue	\$27	\$88	\$0	\$0	\$5	\$18	\$11	\$35	\$16	\$53	\$22	\$70		
Net Income/(Loss)	(\$190)	\$200	(\$217)	\$111	(\$211)	\$129	(\$206)	\$147	(\$201)	\$164	(\$195)	\$182		
Retained Earnings	\$2 885	\$3 084	\$2 858	\$2 969	\$2 863	\$2 992	\$2 868	\$3 015	\$2 874	\$3 038	\$2 879	\$3 061		
Debt Ratio	87.0%	87.6%	87.1%	88.1%	87.0%	88.0%	87.0%	87.9%	87.0%	87.8%	87.0%	87.7%		
EBITDA Interest Coverage Ratio	1.36	1.78	1.34	1.70	1.34	1.72	1.35	1.73	1.35	1.75	1.36	1.77		
Capital Coverage	0.80	1.48	0.75	1.32	0.76	1.35	0.77	1.38	0.78	1.42	0.79	1.45		
Interest Paid as a % of Total Revenue	42%	37%	43%	39%	42%	38%	42%	38%	42%	38%	42%	38%		
Cash Surplus/(Deficiency) to Fund Core Business Operations	(\$348)	\$51	(\$375)	(\$37)	(\$370)	(\$19)	(\$365)	(\$2)	(\$359)	\$16	(\$354)	\$34		

**REFERENCE:**

Application Pages 6, 7 and 51, PUB MFR 9 & Coalition MFR 23

**PREAMBLE TO IR (IF ANY):**

On Page 51 of the Application, Manitoba Hydro states that “The corporation has thoroughly demonstrated that the proposed general revenue increase is required to address the unexpected costs due to the drought, including the annual carrying costs on the borrowings of \$348 million...In addition, as has long been projected, Manitoba Hydro now faces increased carrying costs with the major capital projects that are now being placed in-service. These costs are increasing Manitoba Hydro’s revenue requirement by \$619 million in 2021/22...the proposed 5.0% general revenue increase, which is aligned with the increase approved by the PUB following the last drought in 2004...”

On Page 6 of the Application, Manitoba Hydro states “The interest costs on the borrowings...will amount to an estimated annual cost of \$13 million per year or nearly equivalent to a 0.8% of an electric rate increase.”

In Coalition MFR 23, Manitoba Hydro states “... as set out in Section 1.3 of the Application, this interim rate application is driven by deterioration of the Corporation’s financial health caused by the current drought conditions and upward pressure on Manitoba Hydro’s revenue requirements associated with several major capital projects being placed in-service.”

On Page 7 of the Application, Manitoba Hydro states that “...when considering the level of increase to request in this Application, Manitoba Hydro considered the following: The need to preserve intergenerational equity, by recovering the carrying costs on the additional borrowings...in 2021/22, as these costs should not be deferred to be recovered from future customers; and...The need for rate stability and predictability for customers. Manitoba Hydro has been projecting the need for annual rate increases of at least 3.5% since 2009.”



**QUESTION:**

- a) Please reconcile the requested interim rate increase of 5.0% with the estimated carrying costs of the drought of approximately an 0.8% rate increase.
- b) Please elaborate on why Manitoba Hydro considers a one-year drought event as an intergenerational equity issue between current and future customers – particularly when considering that Manitoba Hydro has received (and past and current customers have paid) rate increases in 16 out of the last 17 years of better than average water flows, based on forecasts in these rate applications that used a 100+ years of water flow conditions as an assumption (which inherently includes low flow and drought considerations).

**RESPONSE:**

- a) The current drought conditions have very significantly impacted Manitoba Hydro's financial position in 2021/22. The 2021/22 Forecast projects a reduction in net extraprovincial revenues of \$398 million compared to the 2021/22 Budget. As a result, Manitoba Hydro must borrow \$348 million in 2021/22 to fund core operations, which represents 90% of the projected loss in net extraprovincial revenue. Manitoba Hydro believes the proposed 5% rate increase is modest given the severe impact of the present drought; 0.8% of this increase is necessary just to cover the annual interest costs of \$13 million on borrowings required in 2021/22 to fund core operations.

Since 2009, Manitoba Hydro has been projecting the need for annual rate increases of at least 3.5% each year. These projected increases considered the significant revenue requirement impacts that would occur when the Major Capital Projects are placed in-service, which impacts are now coming to fruition as MMTP, the Birtle Transmission Line, GNTL, and five of seven units of the Keeyask Generating Station have been placed in-service. In 2021/22, Manitoba Hydro's projected revenue requirement associated with the Major Capital Projects will reach \$619 million.

Manitoba Hydro's 2021/22 Budget assumed a range of water flow conditions for the year based on the 40-years of historic flows and assumed 3.5% rate increase effective October 1, 2021. The 2021/22 Budget projected sufficient earnings and cash flow to

avoid borrowing to fund core business activities, an EBITDA interest coverage ratio just under 1.7, maintained the debt ratio at 86% and prevented interest paid as a percentage of total revenue from exceeding 40%. As the drought conditions developed and became more severe into the late fall, it became obvious that the budgeted 3.5% rate increase was no longer sufficient to support Manitoba Hydro's deteriorating financial health.

It is important to note that even with the proposed modest 5.0% increase, given the extreme circumstances of the drought and the significant financial impact to Manitoba Hydro, the 2021/22 Forecast projects a (\$190) million net loss, 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 of 42% (from 40%).

Manitoba Hydro believes the proposed 5% rate increase is modest given the current circumstances and is fully required to address the very severe impact of the present drought and avoid further deterioration of the financial health of the utility at a time when, as has been predicted for the last decade, revenue requirement is now increasing rapidly as major capital projects are put in service.

- b) Manitoba Hydro views the significant borrowings required to fund core operations in 2021/22 to be an issue that merits consideration of intergenerational equity, among other regulatory principles. Where just and reasonable, costs incurred to serve customers in a given period should be paid by the customers who receive that service.

While water conditions have been above average for the past several years and contributed to higher retained earnings, the borrowings required to fund core operations this year as a result of the drought demonstrate the simple fact that retained earnings are not a cash reserve. Throughout the capital expansion, the Corporation's investing activities have exceeded the cash flow from operations required by the Corporation. Given that the cash flow requirements are being met through borrowing, Manitoba Hydro has not maintained a balance in the sinking fund since 2016 and has no plans or capacity to do so in 2021/22 or 2022/23.

Manitoba Hydro's balance sheet is highly leveraged with a projected equity ratio of 87.0% in 2021/22 and 87.6% in 2022/23, which restricts the corporation's financial flexibility to respond to unexpected events. A weakening of Manitoba Hydro's financial metrics, if not supported by rate increases to temper the impacts of the drought, may lead credit rating agencies to no longer view Manitoba Hydro as self-supporting, and may result in a credit rating downgrade(s) to the Province. This rating action would result in additional financing costs for both the Province and Manitoba Hydro, which would be borne by taxpayers and Manitoba Hydro's customers for years to come.

Manitoba Hydro lacks material liquid assets to meet the risk of future losses. Even modest reductions in revenue require additional cash borrowing which further strains and deteriorates the financial health of Manitoba Hydro. This is evident in the current drought, where Manitoba Hydro is required to borrow \$348 million (90% of the expected reduction in net extraprovincial revenue) in order to fund operations in 2021/22.

In Order 59/18, the PUB noted that it is prepared to consider regulatory action when required to address emerging risks facing Manitoba Hydro, specifically referencing a drought situation that Manitoba Hydro has just experienced. The proposed 5% rate increase is modest given the very severe impact of the present drought while reasonably balancing the impact to customers. Part of this increase is required to recover the annual interest costs on these borrowings to avoid an unfair burden from being shifted to future customers.

**REFERENCE:**

Application Pages 40, 41 and 43 & PUB MFR 20

**PREAMBLE TO IR (IF ANY):**

On Page 40 of the Application, Manitoba Hydro states “PCOSS21 reflects Manitoba Hydro’s approved budget for the 2020/21 fiscal year and incorporates significant new capital additions such as Bipole III, MMTP, GNTL and partial in-service for the Keeyask Generating Station.”

PUB MFR 20 – PCOSS21 – does not provide the assumptions with respect to the partial in-service of the Keeyask generating station.

**QUESTION:**

Please provide the assumptions with respect to the partial in-service of the Keeyask generating station in PCOSS21, including the number of units assumed to be in-service in 2020/21 and the revenue requirement attributed to Keeyask that is included in PCOSS21.

**RESPONSE:**

The revenue requirement for Keeyask generating station in PCOSS21 reflects a forecast June 2020 in-service date for the first unit, with five of the station’s seven units in service by the end of the study period.

The revenue requirement for Keeyask in the study is comprised of:

	\$ Millions
Operating	8
Depreciation	43
Interest	200
Total Revenue Requirement	252

**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.