

# MANITOBA HYDRO 2023/24 & 2024/25 GENERAL RATE APPLICATION

## ASSEMBLY OF MANITOBA CHIEFS

### CONSUMERS COALITION/KELLY DERKSEN INFORMATION REQUESTS

**AMC/CC I-1**            **Reference: Kelly Derksen Evidence, page 6**

**Preamble:**

“MH has proposed to apply the 2.4% equally to the Monthly Basic Charge and Volumetric Rate for the Residential Class.”

**Request:**

1. Can you provide any comments on whether a difference in the split between fixed and volumetric charges would help in resolving the difference in rate increases being proposed for the different customer classes? In particular, any comments on changes to fixed and volumetric charges for residential customers.

**Response:**

To some degree, yes. Rate design tools such as inverted rates can be useful for efficient pricing. Similarly, heavier weight on either fixed or volumetric charges may be useful in relaxing the bill impact to certain customers within a class. For example, if correlation between lower-than-average usage and lower income households was established, it would be beneficial to these customers to lower the fixed basic month charge and increasing the volumetric rate to moderate the bill impact to low-income households, all else equal.

Rate design changes are intended to shift cost between customers within a class and to elicit certain customer behaviours. Effective rate designs can also result in lower cost allocation to the class over time. However, rate design alone cannot effectively achieve efficient pricing in all circumstances.

**AMC/CC I-2****Reference: Kelly Derksen Evidence, page 34****Preamble:**

“The over-emphasis on cost causation as based on the mechanical output of PCOSS24 has resulted in MH proposing rate differentiation by class that ignores the highly unstable cost basis resulting from a culmination of a number of profound changes including the addition of significant generation and transmission investment, record high net export revenue, and the significant reduction to payments to government, at the great expense of other critical criteria of efficiency and fairness.”

**Request:**

1. Are you proposing a ranking criteria in order to set rates? If so, can you provide that ranking and an appropriate weighting of the different criteria?

**Response:**

No, a ranking criteria is not being proposed. While perhaps conceptually appealing in the current circumstances, such an approach may be difficult to operationalize in order to establish the proper prioritization and weighting of criteria. Also, it is possible that a ranking criteria along with an analytical framework may not be able to consider all the impacts necessary for assessing class RCC and potential rate differentiation by class. One purpose of such a ranking criteria would be to modify the target revenue-to-cost ratio for each class but that would require some basis for establishing the appropriate zone of reasonableness on a class-by-class basis, which may be difficult and less transparent.

**AMC/CC I-3****Reference: Kelly Derksen Evidence, page 35****Preamble:**

“Manitoba Hydro stated that as a public crown-owned utility, rate setting ultimately must deal with issues beyond cost causation and in the absence of being handled through cost-of-service methodology, may alternatively be handled through allowing more variation in Revenue to Cost Ratios. MH found that while a COS study is a useful tool in assessing the fairness of rates and is the primary tool to be used to assess the allocation of costs between customer classes, that costs the flowing from the COS study are not the only measure by which to test the reasonableness of rates.”

**Request:**

1. Are you proposing a Revenue-to-Cost Ratio of 90-110 for residential customers, or do you believe that a Revenue-to-Cost Ratio of 90-110 would be reasonable?
2. Can you please provide the rate impact if the Revenue-to-Cost were to be expanded to 90-110 for residential customer class, as well as the subsequent cost for other rate classes?

**Response:**

Yes, a Revenue-to-Cost Ratio of 90%-110% ZOR is reasonable. As discussed in the independent report of Kelly Derksen, a wider ZOR either explicitly or implicitly, such as 90% to 110%, compared to current, considering MH's operations, better allows for the necessary flexibility and judgement required in the third phase of ratemaking, the rate design phase, to assess RCCs and interpret the output of Phase II (COS). A wider range is necessary to consider i) other ratemaking objectives other than embedded cost causation as reflected in the COSS as the PUB found in a number of Orders including and since 164/16; ii) the imprecision of allocating nearly \$25 billion of infrastructure cost, which has doubled in the last several years, the majority of which is jointly serving all MH customers; iii) the variability in export revenues that occur in Manitoba Hydro's operations; and iv) to reduce the potential volatility in rate differentiation by class that is inevitable due to changes in export revenue. Ms. Derksen is of the view that by comparison, the 95% - 105% bandwidth cannot reasonably cover the full range of uncertainty in the RCC ratios associated with these issues in the context of MH's operations.

It is clear that any rate differentiation that has occurred over the last couple of years has been ineffectual, but for the GSS ND class, because of the significant increase in generation and transmission investment and export revenues. It is in these types of circumstances that meaningful movement into the ZOR is ineffective. And, with a ZOR as tight as 95% - 105% given MH's operations, will most certainly lead to more rate instability.

As can be seen in the table provided in the response to PUB/COALITION I-16, which provides the RCCs by class going back to 1999, a 90% to 110% ZOR better accommodates the actual circumstances of Manitoba Hydro. Even a 90% - 110% cannot accommodate the variability in RCCs to the GSL classes that can occur at record levels of NER, which are a function of the export market in which Manitoba Hydro operates

coupled with high water conditions as reflected in the current PCOSS24. But that circumstance is expected to self correct according to Manitoba Hydro's evidence.

The RCC of the GSS ND class, on the other hand, is fairly resistant to COS methodology changes, significant generation and transmission additions, as well as distortions caused by NER. Ms. Derksen concluded in her written report that the circumstance of the GSS ND is a good case for a lower-than-average rate increase. It is highly unlikely that a lesser than average rate increase for the GSS ND will be precipitated by the need for a greater than average rate increase for this class.

Manitoba Hydro is a nearly \$25 billion vertically integrated hydraulic electric utility with the majority of investment being joint cost-related, shared by all customers. COS must ultimately allocate this \$25 billion of shared assets to its 500,000 customers. In addition, COS must also allocate NER, which is currently over \$1 billion, roughly 1/3 of MH's total annualized revenue requirement in 2023/24. The current ZOR suggests that the results of the allocation of \$25 billion of assets is accurate to +/- \$150 million ( $\$3 \text{ billion} * 5\%$ ), while at the same time allowing the PUB the flexibility to address other ratemaking objectives including fairness and other criteria in arriving at fair and equitable utility rates viewed to be in the public interest, within that same tolerance level.

It is noteworthy that there are a wide variety of approaches used to classify and allocate generation, transmission, and distribution costs in COS. In addition, there are variety of approaches used for rate rebalancing. As Ms. Derksen's Evidence identifies, BC Hydro and Hydro Quebec both have RCCs that vary a great degree from their stated ZOR.

On a final note, as discussed in response to PUB/Coalition IR I-18, there are a number of counter-intuitive and perverse results flowing from PCOSS24 that make it very difficult to accept the results of PCOSS24 a face value. A wider ZOR range is also necessary to accommodate these kinds of occurrences.

**Preamble:**

“The record levels of NER underpinning PCOSS24 by which MH’s rate differentiation proposals are based, are forecast to decline starting in the second Test Year 2024/25 and continue to decline thereafter, and thus the RCC’s will largely self-correct. It is perplexing why the Residential class (and also other classes) is imposed a 0.4% larger than average increases because of a windfall of NER that is not expected to continue.”

**Request:**

1. Do you accept that residential customers, particularly those from First Nations, are the most impacted by Manitoba Hydro’s hydroelectric facilities?
2. If so, can you provide comments on the fairness of allocating a greater percentage of export revenues to non-residential customers who are the least impacted by Manitoba Hydro’s electric facilities?

**Response to 1) and 2):**

The response is provided from a utility ratemaking perspective rather than from a socio-economic perspective.

As Ms. Derksen’s evidence states, for much of the period between 1995 and 2016, Manitoba Hydro vigorously argued that the results of its COS could not be relied upon for cost depiction by class and class rate differentiation. MH expressed concern about what it characterized as distorted RCC ratios and an unfair allocation of costs to the Residential class. During this time, MH implemented, as approved by the PUB, across-the-board rate increases almost exclusively during this period to attempt to address the fairness issue. As discussed further in response to PUB/Coalition I-3, despite the disproportionate benefit to the two largest GSL classes from the COS treatment of NER, MH has also proposed a nearly 1% higher rate differential for the Residential class compared to the GSL classes, which conflicts with the very fairness issue that MH attempted to address for nearly two decades. At a minimum, one would expect explicit recognition of this fairness issue to the Residential class be raised by MH in the current GRA and offer rate proposals to address it. This is one of the reasons that Ms. Derksen is proposing an across-the-board rate increase for all classes other than GSS-ND.

In terms of providing comments on the fairness of allocating a greater percentage of export revenues to non-residential customers who are the least impacted by Manitoba Hydro's electric facilities, it has been a long-standing issue before the PUB since at least 1995. The results of PCOSS24 serve to demonstrate that this issue has only been amplified as NER is now large enough to nearly offset the entire annualized generation and transmission revenue requirement in PCOSS24. MH's inaction is not only disappointing but concerning for the captive Residential class.

**AMC/CC I-5                      Reference: Kelly Derksen Evidence, page 42**

**Preamble:**

"The theoretical ideal of rates based on marginal cost suggests that rates based on embedded costs should not fall below marginal cost. With the profound cost changes as a result of the addition of major generation and transmission infrastructure, it is not surprising that MH's marginal cost has declined substantially since the 2017/18 GRA. This occurs because, in the short term, there is sufficient capacity and energy without requiring new infrastructure, so the marginal cost to serve a new customer is very low. But even so, embedded cost still falls below marginal cost for the GSL>100kV class (5.13 vs. 5.26) and which results in a revenue to cost ratio below 1;"

**Request:**

1. Are you proposing, or would you propose, a regulator-imposed floor for rates that would ensure that embedded costs cannot be below marginal costs (i.e., when that occurs, the rate would be based on marginal costs rather than embedded costs)?

**Response:**

No. While from a theoretical perspective, embedded cost should never fall below marginal cost, Ms. Derksen is not proposing marginal cost-based rates. There is substantial complexity, controversy and perhaps a lack of transparency in arriving at what would constitute marginal cost-based rates, even in the short term, and one of the reasons that marginal cost-based rates are not commonly used in utility rate-setting.

That said, it is entirely reasonable and appropriate that a proxy for marginal rates be determined as per Table 12 of Ms. Derksen's evidence, that is used as a directional guide in the assessment of the reasonability of class rate differentiation and rates.

**Preamble:**

“As discussed throughout this Evidence, the cost structure of MH has been profoundly changed with the addition of generation and transmission infrastructure along with record level export revenues. Even if no methodological changes occur to the cost-of-service study, the cost allocation to classes is subject to change due to: (1) Depreciation of large assets such as generating and transmission; (2) additions to Distribution investment (3) increases in Net Income; (4) decreases in Water Rentals and the Provincial Guarantee Fees; (5) Changes in the cost of capital as applied to rate base; and (6) Differences in the mix of customers and loads.”

**Request:**

1. Is this an exhaustive list or are there other factors to consider?

**Response:**

No, this list was not exhaustive but captures the most material factors.