Direct Testimony of Patrick Bowman - Depreciation

Regarding the Manitoba Hydro 2023/24 & 2024/25 General Rate Application

On behalf of Manitoba Industrial Power Users Group (MIPUG)

June 5, 2023

Introductory Comments

Alternative 2 is recommended.

ASL/ALG best matches utility service provided by assets, with focus on achieving just and reasonable rates.

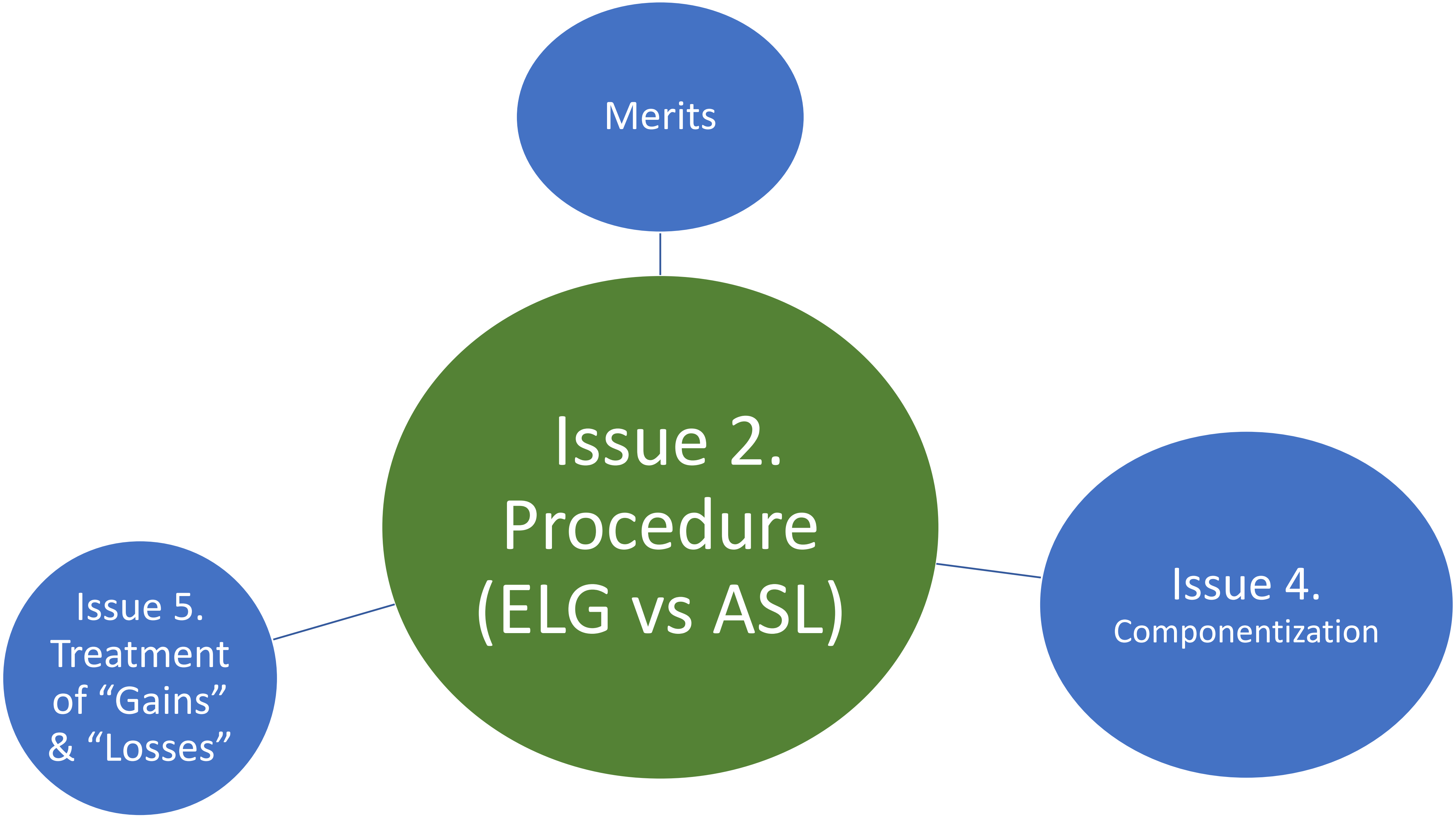
Consistent with long-term approach used by Hydro/PUB.

Outcomes reflect the most common utility approach in North America.

Prevents cost escalation driven by ELG.

Increases in depreciation are not appropriate when acc. depr. surplus is $0.7-$1.3B.

Yields potential benefits from added componentization.


Merits
Issue 2.
Procedure
(ELG vs ASL)
Issue 4.
Componentization
Issue 5.
Treatment
of “Gains”
& “Losses”

Overarching Issue

- **Issue 6: Deferral Accounts**
  - Critical to rate setting, establishes bottom line impact.
    - Ratepayers indifferent if costs are part of depreciation expense or regulatory deferrals.
    - PUB is not auditor – is prospective rate-setter.
  - All “deferred” amounts are just Accumulated Depreciation for regulatory purposes.
    - Change in methods; Gains and Losses; etc.
  - Best if deferral account use is minimized (easier), but not a requirement.

- **Related: Issue 1: Use of IFRS-compliant depreciation methodology**
  - Prospectively, Board must meet legislated requirements – just and reasonable rates (MH Act s. 39(4)(a)). Accounting comes second (see PUB-MIPUG-I-7).
  - All approaches are IFRS-compliant, as IFRS includes regulatory deferrals.
    - Perhaps not true for Alternative 3, if sustained.

ELG vs ASL/ALG

- **Merits:** Dealt with in evidence.
  - Main reason: ELG inferior as it does not match expense to consumption of utility services.
    - Also, assertion of precision presumes high quality actuarial projections.
  - ELG far more costly ($30M-$54M/year, apples-to-apples).[PUB Ex. 20 footnotes 2 and 3]
  - <u>Both</u> ELG and ASL recognize retirement dispersion.
- **Componentization:** Not a reasonable matter of distinction. Group accounting requires appropriate componentization regardless as to group procedure used. Hydro should probably add some components (ELG or ASL), but likely not as many as Alliance suggests (some are de minimus).
- **Gains and Losses:** Should be dealt with by ongoing depreciation studies. If must be booked, should be deferred over remaining life (very essence of group actuarial methods).
  - Otherwise, pancaking methods – take worst performing assets to income while still treating asset group as if it includes all assets, worst and best.

Cost Impact

- Depreciation Issues Document (Ex. PUB-20, page 20) shows scenario ASL/ALG (Alliance estimates) $267M increase in 20-year net income compared to ELG (without phase-in). [some degree of pancaking included]
- ASL/ALG (Concentric estimates) is much higher increased retained earnings over 20 years
  - $680M to $1B compared to GRA (i.e., ELG with phase-in). [30 yr to 70 yr amort. period for all; PUB/MH-I-32]
  - $730M compared to GRA. [amortize differences as per MH proposal; Coalition/MH-I-41d] [equiv. to Alternative 4 permanently]
  - $1.3B compared to GRA. [no amortization period for all; PUB/MH-I-111b-c and Coalition/MH-I-41c] [equiv. to Alternative 3 permanently]
- Likely final answer of ASL/ALG benefit is in the middle of this range.
- Hydro conclusion this does not change the rate path - focuses almost entirely on cash & debt – the change has material impacts on Net Income.
- Difference is not only from componentization – it is Alliance versus Concentric estimates of life.

Lesser Issue

- **Issue 3: Whole Life versus Remaining Life**
  - Never at issue in Manitoba.
  - Whole life provides better information.

Conclusions

- Alternative 2 is recommended.
- ASL/ALG best matches utility service provided by assets, with focus on achieving just and reasonable rates.
- Consistent with long-term approach used by Hydro/PUB.
  - All deferrals are effectively regulatory Accumulated Depreciation.
- Outcomes reflect the most common utility approach in North America.
- Prevents cost escalation driven by ELG ($267M-$680M over 20 years).
- Increases in depreciation are not appropriate when acc. depr. surplus is $0.7B-$1.3B. [Bowman Evidence, page 38]
- Yields potential benefits from added componentization.