Depreciation Issues Document
Manitoba Hydro 2023/24 & 2024/25 General Rate Application

Presentation to the Manitoba Public Utilities Board

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1. Background

- Current Depreciation issues go back to the findings in Board Order 43/13, issued April 26, 2013
- Primary driver for change was the required implementation of IFRS
- Key Finding: *"The Board also is concerned that not enough information has been provided to date to assess the true impact on ratepayers of a switch to Equal Life Group." Section 6.2.0, pg. 18*

1. Background (cont'd.)

- In this proceeding, Board Order 42/23 identified the following six policy issues related to the appropriate choice of a depreciation methodology:

  1. The use of an IFRS-compliant depreciation methodology for rate-setting purposes;
  2. The use of the Average Service Life (ASL) procedure as opposed to the Equal Life Group (ELG) procedure;
  3. The use of the remaining life technique as opposed to the whole life technique;
  4. The required level of componentization;
  5. The treatment of interim gains and losses; and
  6. The establishment and disposition of deferral accounts.

1. Background (cont'd.)

- The six issues identified are the only depreciation-related issues on which the Board invited oral evidence. All other depreciation issues are to be limited to written evidence.
- The parties were requested to arrange for a discussion between their respective depreciation experts ahead of the hearing in an attempt to find common ground and narrow the areas of disagreement
- The Board offered Elenchus Research Associates (Elenchus) as a facilitator

2. Process

- Three technical conferences to discuss the identified depreciation policy issues were held between Manitoba Hydro, advisors for the PUB and Interveners, but without direct involvement of the respective clients.
- Informal, without prejudice, non-binding, non-transcribed
- Ian Innis (Elenchus Research Associates) facilitated discussions between the following parties:
  - Manitoba Hydro (team led by Alastair Fogg & Michelle Hooper)
  - Emrydia (Dustin Madsen – witness for GSS/GSM representative)
  - Patrick Bowman (MIPUG)
  - Darren Rainkie (Coalition)

2. Process

- Technical conferences were held on:
  - April 13, April 18, May 2
- The first technical conference involved counsel, subsequent conferences did not
- All parties cooperative and engaged throughout the process
- Joint *Depreciation Issues Document* issued May 10
- Filed as PUB-20

3. Areas of Agreement

The following outlines areas of consensus between the Parties:

- ✓ it is preferable for Manitoba Hydro to <u>apply the same depreciation methodology for financial reporting</u> (i.e. an IFRS compliant methodology) and rate- setting purposes
- ✓ <u>the whole life technique should continue</u> to be used for the calculation of depreciation
- ✓ <u>judgement</u> is required in order to determine the <u>appropriate level of componentization</u> and it should be based on significance/materiality
- ✓ <u>amortization periods</u> for depreciation related regulatory deferral accounts are <u>required</u>.

3. Areas of Agreement (cont'd.)

Determining the appropriate level of componentization for an IFRS-compliant ALG depreciation method.

- ✓ All Parties agree that judgement is required in order to determine the appropriate level of componentization to achieve IFRS compliance and that <u>IFRS compliance could be achieved with ALG with a lower level of componentization</u> than identified in the Alliance study.

- ✓ Manitoba Hydro should <u>continue to review its componentization</u> as part of future depreciation studies, regardless of whether a change to an ALG procedure is made. Any changes to componentization should be based on significance/materiality

3. Areas Where There is NOT Full Agreement

The Parties acknowledge that either approach (ALG or ELG) is rational, systematic, and implementable but differ in their views on the merits and drawbacks of the two approaches, and whether both approaches lead to just and reasonable rates.

- ❖ The Parties did not agree on whether one of the depreciation procedures was preferable over the other or whether both methodologies provide just and reasonable rates for customers.
- ❖ The Parties did not reach consensus on the approach used to calculate losses for ELG and ALG.

3. ALG vs. ELG – Net Income Impact

- Assuming deferral of gains and losses to isolate the impact of ALG vs. ELG , depreciation expense under an ALG approach is on average $15 million lower year-over-year compared to depreciation expense under an ELG approach. All else being equal, the resulting impact is that over the 20-year forecast period cumulative net income is $267 million higher if an ALG methodology is applied vs. an ELG methodology. (pg. 20)

4. Development of Alternatives

- MH, MIPUG and GSS/GSM have identified two primary, combined approaches (Alternatives 1 and 2) to address the identified depreciation issues.
- These two approaches are aligned with the areas of consensus and consider the financial implications
- The Coalition submits that full compliance with the PUB's directives on depreciation has not been met in the current proceeding and an interim decision (Alternative 3 or 4) should be considered.

4. Summary of Alternatives

Four Alternatives, presented as “package deals”

Alternative	Description
Alternative 1 (MH, MIPUG and GSS/GSM)	Accept IFRS-ELG as presented in the Amended Financial Forecast Scenario Cease gain & loss deferral and depreciation method deferral, amortize deferral balances and phase-in ELG depreciation Depreciation determined using IFRS-ELG effecting September 1, 2023, with phase-in and no deferral of gains and losses While Alternative 1 assumes a phase-in of ELG depreciation over 15 years with amortization over 30 years and does not include the deferral of gains and losses, Manitoba Hydro is open to consideration of deferring gains and losses and alternate approaches to the proposed 15-year phase-in (based on the analysis outlined in Section 7) together with an ELG approach.

4. Summary of Alternatives (cont'd.)

Alternative	Description
Alternative 2 (MH, MIPUG and GSS/GSM)	Accept IFRS-ALG, with implementation following a further regulatory review process to finalize componentization Convert to ALG following completion of a further review process as defined by the PUB, continue gains and losses deferral, continue depreciation methodology deferral until ALG transition; commence amortization of deferral balances effective September 1, 2023 Depreciation determined using IFRS- ALG effective April 1, 2026, with deferral of gains and losses, without phase-in.

4. Summary of Alternatives (cont'd.)

Alternative	Description
Alternative 3 (Consumers Coalition)	Continue with previous CGAAP-ASL on an interim basis without amortization of the existing deferral accounts1 until the PUB opines on depreciation matters Continue depreciation methodology and gains and losses deferrals without amortization until the PUB opines on depreciation matters
Alternative 4 (Consumers Coalition)	Continue with previous CGAAP-ASL on an interim basis and commence amortization of the existing deferral accounts until the PUB opines on depreciation matters Continue to defer depreciation methodology differences and gains and losses until the PUB opines on depreciation matters, commence amortization of deferral balances effective Sept, 2023

4. Summary of Alternatives (cont'd.)

- Manitoba Hydro considers Alternative 1 preferable, but Alternative 2 is also viable,
- MIPUG and GSS/GSM recommend Alternative 2 and Coalition recommends either Alternative 3 or 4.
- The alternatives do not represent a negotiated outcome, or a indicate agreement by the intervenor entities.

4. Summary of Alternatives - Coalition Concerns

- Based on the need to refine componentization and the potential for different financial impacts resulting from that refinement of componentization, Coalition submits that full compliance with the PUB's directives on depreciation have not been met in the current proceeding, and that a final decision on depreciation matters cannot be made at this time. (pg. 24)

5. Other Observations

- With or without the deferral of gains and losses, for both ALG and ELG, the same debt-to-capitalization target continues to be achieved in 2039/40 based on an identical rate path (pg. 17)
- The primary reason why the proposed rate path to achieve the assumed debt ratio target by 2039/40 is unchanged, is due to a minimal change in net debt since depreciation is a non-cash item. (pg. 18)
- The treatment of gains and losses does not significantly impact proposed rates for the Residential, General Service Small (GSS) and General Service Medium (GSM) classes regardless of which depreciation procedure is used. (pg. 19)

5. Other Observations (cont'd.)

- When the depreciation procedure is isolated, despite the difference in cumulative net income between ALG and ELG, assuming a constant rate path, the same target debt-to-capitalization ratios would be achieved by 2039/40. (pg. 21)

- The selection of depreciation procedure does not significantly impact the proposed rates by customer class. (pg. 23)

Questions?