Order No. 69/19

FINAL ORDER WITH RESPECT TO MANITOBA HYDRO'S 2019/20 GENERAL RATE APPLICATION

May 28, 2019

BEFORE: Robert Gabor, Q.C., Chair
Marilyn Kapitany, B.Sc., (Hon), M.Sc., Vice-Chair
Hugh Grant, Ph.D., Member
Shawn McCutcheon, Member
Larry Ring, Q.C., Member

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1.0 Summary of Board Findings

By this Order, the Public Utilities Board ("Board") approves new rates for Manitoba Hydro (or the "Utility") for the 2019/20 fiscal year. The Board finds that it is just and reasonable to approve a 2.5% rate increase for most customer classes, effective June 1, 2019. The Board finds that Manitoba Hydro does not require an increase to its revenues in 2019/20 fiscal year. All revenues from the 2.5% rate increase are to be placed in a deferral account for major capital projects currently under construction. The deferral account will partially mitigate future rate increases required when new major capital projects are in-service, consistent with the principles of rate stability and predictability. This increase will contribute additional revenues to Manitoba Hydro in 2019/20 and in future years.

The evidence in this proceeding demonstrates that Manitoba Hydro does not require a rate increase for its operations in 2019/20. Manitoba Hydro's initial General Rate Application ("GRA") for a rate increase of 3.5% for all customer classes, to be effective April 1, 2019, was filed on November 30, 2018 . It was based on the position that, without any rate increase, Manitoba Hydro was projecting a net loss of $28 million in the 2019/20 fiscal year (which runs from April 1, 2019 to March 31, 2020). Manitoba Hydro filed supplemental information on February 14, 2019, which showed a $92 million improvement in its financial forecast for 2019/20 with an updated projection of $64 million in positive net income in 2019/20 without any rate increase. With its requested 3.5% increase effective June 1, 2019, net income is projected to be $115 million in 2019/20.

A rate increase at the level of 2.5% with all revenues directed to a major capital project deferral account is just and reasonable. The Board will determine how the deferral account will be brought into Manitoba Hydro's operating revenues at a future GRA. The deferral account will help to offset higher rate increases when new capital projects enter into service in the next few years.

The Board anticipates the bill impact of the 2.5% rate increase to be a $2.34 increase in the monthly bill of a residential customer without electric space heat using 1,000 kilowatt-hours per month, and a $4.47 increase in the monthly bill for a residential customer with electric space heat using 2,000 kilowatt-hours per month.

The Board finds that it is just and reasonable to differentiate the June 1, 2019 rate increase to the General Service Small Non-Demand class such that a 2.5% increase to the class revenue target is reduced by an amount that will gradually move this class's Revenue to Cost Coverage ratio into the zone of reasonableness of 95-105% over a period of nine years.

A majority of the Board further finds that it is just and reasonable to approve no rate increase for the First Nations On-Reserve Residential and Diesel Zone Residential customer classes effective June 1, 2019.

The Board directs Manitoba Hydro to provide a compliance filing to the Board pursuant to the directives in this Order. The compliance filing shall be provided in a timely fashion to allow the Board no less than two business days to review and approve consumer rates effective June 1, 2019.

2.0 Background and Procedural History

Background

Under Manitoba law, the Board must set electricity rates for Manitoba Hydro's customers that are just and reasonable and in the public interest. In so doing, as confirmed by the Manitoba Court of Appeal, the Board balances the interests of Manitoba Hydro's ratepayers and the financial health of Manitoba Hydro. Together and in the broadest interpretation these interests represent the general public interest.

Pursuant to subsection 25(1) of *The Crown Corporations Governance and Accountability Act*, CCSM c C336, the prices charged by Manitoba Hydro with respect to the provision of power ("rates for services") are reviewed by the Board. No changes in rates for services can be made and no new rates for services can be introduced without the approval of the Board. Manitoba Hydro is required to submit proposals regarding rates to the Board for its review and approval.

When Manitoba Hydro applies to the Board for rate increases, Manitoba Hydro bears the statutory onus of demonstrating that the increases sought are just and reasonable.

Procedural History

By letter dated November 12, 2018, Manitoba Hydro advised of its intentions with respect to the filing of a 2019/20 GRA and requested the Board's concurrence with Manitoba Hydro's proposed approach to the process and the filing. In the November 12, 2018 letter, Manitoba Hydro stated that, based on its financial projections at the time and without any rate relief, it would experience a projected net loss in the 2019/20 fiscal year (the "test year"). Manitoba Hydro further advised that, with the most recent appointments to the new Manitoba Hydro-Electric Board of Directors ("MHEB"), a comprehensive review of Manitoba Hydro's operations, forecasts, and financial plans was being undertaken to allow the MHEB to establish a long-term financial plan for the Utility. As such, Manitoba Hydro was not in a position to file a long-term Integrated Financial Forecast ("IFF") for review by the Board. Manitoba Hydro further advised that, upon completion of the IFF incorporating the direction of the MHEB for Manitoba Hydro's financial plan, the Utility would submit a full GRA to the Board, anticipated to be filed in late 2019.

Manitoba Hydro proposed a limited process for the Board's review of an Application for a rate increase in the 2019/20 year "sufficient to generate a minimum level of net income such that the Corporation would avoid a projected net loss in the 2019/20 fiscal year." In support of such an Application, Manitoba Hydro proposed to file information based upon Manitoba Hydro's 2018/19 outlook (combining actual financial position as at March 31, 2018 and actual financial performance and water flow conditions to September 30, 2018) and an interim 2019/20 budget (incorporating fall 2017 planning assumptions and operating expenditures).

On November 21, 2018, the Board communicated by letter its willingness to consider a one-year rate increase application based on the financial information outlined in Manitoba Hydro's November 12, 2018 letter. The Board further stated that, as Manitoba Hydro would be seeking a final rate increase, the Utility would be required to file financial and economic information sufficient to satisfy its onus to demonstrate that the rate increase sought for the test year would be just and reasonable. Additionally the Board indicated that it required Manitoba Hydro to provide the most current information available.

On November 30, 2018, Manitoba Hydro filed its 2019/20 GRA, seeking a rate increase of 3.5% for all components of the rates of all customer classes (except the non-grid portion of Diesel Zone General Service rates), to be effective April 1, 2019. Manitoba Hydro projected the increase would generate additional annual revenues of $59 million and would result in what Manitoba Hydro described as a "modest contribution to financial reserves" and which results in a "modest level of net income" of $31 million in 2019/20. Without the requested 3.5% rate increase, Manitoba Hydro projected that it would experience a net loss of $28 million from electric operations.

On February 14, 2019, and as requested by the Board, Manitoba Hydro filed a Supplement to its 2019/20 GRA, which included updated financial statements and revenue information for 2018/19 and 2019/20, based on actual results as of December 31, 2018. Rather than the $28 million loss previously projected, without any rate increase, Manitoba Hydro now projected an improvement of $92 million, with positive net income of $64 million in 2019/20. Additionally for the 2018/19 fiscal year which ends March 31, 2019, Manitoba Hydro projected net income of $95 million, rather than the $51 million originally projected in the November 30, 2018 filing.

The improvement in financial results was attributed to improved water flow conditions and related higher net export revenues, as well as to lower levels of capital spending than planned in 2018/19 with associated lower borrowing requirements and finance expense. Despite the improved projected financial results, Manitoba Hydro submitted that the 3.5% proposed rate increase continued to be necessary and in the public interest. Manitoba Hydro took the position that, with a 3.5% rate increase in 2019/20, the Utility would be able to continue to plan for a modest level of net income in the event of low water flow conditions, and would reduce the likelihood of future rate shock to ratepayers given the anticipated additional net costs associated with the in-service of Keeyask.

By procedural Orders 1/19 and 9/19, the Board approved Intervener Status for Assembly of Manitoba Chiefs, Consumers Coalition, Manitoba Industrial Power Users Group, and Manitoba Keewatinowi Okimakanak, as well as the issues in scope for the hearing of the GRA. In Order 40/19, the Board confirmed the process and scope for the oral evidentiary portion of the hearing.

The oral evidentiary hearing was held on April 23, 24, 25, and 29, 2019. The Board heard closing submissions from Manitoba Hydro and all Interveners as well as reply submissions from Manitoba Hydro on May 1 and 2, 2019.

3.0 Rate Increase for 2019/20

In Order 59/18, the Board approved a 3.6% overall rate increase effective June 1, 2018. In that Order, the Board commented that the Integrated Financial Forecast ("IFF") scenario filed in the proceeding as Manitoba Hydro Exhibit 93 supported the Board's decision on the level of the overall rate increase. In particular, Exhibit 93 was directionally consistent with many of the Board's decisions, including continued deferral of $20 million in ineligible overhead costs, amortized at a 30-year rate, and Average Service Life depreciation methodology, without amortization of the difference with the Equal Life Group methodology.

The Exhibit 93 scenario resulted in equal annual rate increases of 3.57%, beginning in 2018/19. That scenario included: the Bipole III Transmission Reliability Project ("Bipole III") entering commercial service on July 31, 2018 at a cost of $5.04 billion; no additional export revenues related to uncontracted surplus electric capacity and the assumption of uncontracted surplus dependable energy export sales at opportunity prices; and in 2019/20 $61 million in net income with debt management based on a weighted average term to maturity of 12 years. Adjusting the weighted average debt term to maturity to 20 years, the net income would be forecast at $28 million for the 2019/20 fiscal year.

Exhibit 93 also reflected an $8.7 billion control budget for Keeyask and an in-service date for the first generating unit of August 2021. However, in the last GRA proceeding, the Independent Expert Consultants retained to assist in the Board's review of Manitoba Hydro's major capital projects testified that, without project management improvements by the Utility, the final cost of Keeyask could be in the range of $9.5 billion to $10.5 billion. While the Board accepted the control budget and construction schedule for rate-setting purposes in Order 59/18, the Board also recognized that these targets would only be met if Manitoba Hydro and the general civil contractor achieved a 10% improvement in productivity.

As detailed above, at the time of the November 30, 2018 GRA filing, Manitoba Hydro was projecting that without the proposed 3.5% rate increase, it would experience a net loss of

$28 million in 2019/20. However, the February 14, 2019 Supplement filing shows that Manitoba Hydro's financial position is projected to be improved in the test year, such that positive net income is projected even without a rate increase.

Since the filing of Exhibit 93 in the 2017/18 and 2018/19 GRA proceeding and the Board's issuance of Order 59/18, there have been a number of positive developments in Manitoba Hydro's operations and financial position, as detailed below:

- in the 2019/20 test year, without any rate increase, Manitoba Hydro is projecting a positive net income of $64 million, which is higher than the net income forecast in the financial projection produced in Exhibit 93 (which included annual 3.57% rate increases) at the last GRA, even without adjusting the weighted average term to maturity incorporated into the financial projections;
- Bipole III entered service on July 4, 2018, 27 days earlier than scheduled and at a capital cost of $4.77 billion, which is $270 million lower than projected. The lower capital cost means that Manitoba Hydro has $270 million less in debt borrowing requirements and that annual carrying costs are reduced by $17M;
- due to the lower capital cost of Bipole III as well as other reductions in capital expenditures from what was forecast at the last GRA, without a rate increase in the test year, Manitoba Hydro's net debt for 2019/20 is now projected to be $567 million lower than forecast in Exhibit 93;
- Keeyask's first generating unit may enter service as early as October 2020, approximately 11 months earlier than was anticipated at the last GRA. An earlier in-service date will result in Keeyask generating revenues earlier than projected. Project risks have also been reduced, as the work in 2018 on the South Dam has uncovered the riverbed, resulting in the elimination of geotechnical conditions as a top risk;
- the control budget for the Manitoba-Minnesota Transmission Project ("MMTP") remains unchanged, despite a delay in the commencement of construction to June 2019;

- interest rates have remained below the rates previously forecast and the current interest rate environment is favourable to Manitoba Hydro. Manitoba Hydro has secured long-term debt issuances at favourable interest rates, including 49-year debt at 2.91% and a five-year borrowing of $350 million US (equivalent to $466 million in Canadian dollars) at 2.19%; and
- Manitoba Hydro has completed a term sheet with SaskPower for a 215 MW 40-year power export sale contract, beginning in 2022.

In addition, since Manitoba Hydro's original GRA filing on November 30, 2018, there have been a number of positive developments in Manitoba Hydro's operations and financial position, as detailed below:

- Manitoba Hydro is projecting net income of $95 million in the 2018/19 fiscal year, which ended March 31, 2019, which is a $44 million increase from the net income projected in Manitoba Hydro's November 30 filing;
- following nine consecutive months of below average precipitation in 2018, water conditions have improved significantly. From September 2018 through to February of 2019, Manitoba Hydro's system water flows were above average. Since that time, water flows have tracked to average. These improved water flows resulted in higher than projected extraprovincial revenues and lower fuel and power purchases; and
- the export prices that have been realized to date by Manitoba Hydro were higher than projected in the November 30, 2018 filing, while the export prices forecast for 2019/20 are currently tracking to the same levels as forecast in the November filing.

Manitoba Hydro's Position

Manitoba Hydro maintains that a 3.5% rate increase for all customer classes effective June 1, 2019 is just and reasonable. Although Manitoba Hydro's financial projections for the test year have improved from the November 30, 2018 filing, the Utility argues that the rate increase remains appropriate as Keeyask entering service ahead of schedule will shorten the period in which to smooth customer rates to a higher level. As well, the rate increase is needed as the likelihood of a financial loss following an earlier in-service date for Keeyask is exacerbated. In this regard, Manitoba Hydro states that interest rate risk remains for the $4 billion of incremental borrowings that will be undertaken in the next few years as well as for the $4.8 billion of debt that requires refinancing over the five-year period following the test year.

Manitoba Hydro further submits that, while there have been positive changes in water flow conditions, there remains significant uncertainty in water supply for 2019/20 and significant risk of losses associated with below average water flows. Under Manitoba Hydro's analysis of net income sensitivities, there is a range of positive net income or negative net loss depending on the actual water flows experienced in the current fiscal year. In assessing the probabilities of water flow conditions in a given year, Manitoba Hydro does not assign weightings to the likelihood of any historical water flow conditions. This means that there is an equal likelihood of any historical water flow condition repeating in the future. In Manitoba Hydro's submission, the change in water flow conditions from the summer of 2018, which led to the November 30, 2018 Application, to the fall of 2018, which led to the February 14, 2019 Supplement, demonstrates the extreme variability in earnings associated with water flows.

Manitoba Hydro also says that it remains exposed to the impacts of colder than normal or warmer than normal winter weather as well as higher or lower export prices than forecast. If such risks materialize in the test year, the proposed rate increase would protect against financial loss.

Manitoba Hydro submits that the proposed 3.5% rate increase can be awarded without the Utility having filed a current IFF. The Utility states that the Board agreed to consider the rate application without an IFF and that the IFF is simply a tool that can be used in rate setting. Manitoba Hydro's position is that forecasts that have been filed in past proceedings as well as Exhibit 93 from the 2017/18 and 2018/19 GRA support a rate increase for 2019/20 at the level of 3.5% in order to offset potential losses and build a base for the costs that will enter into the Utility's revenue requirement when Keeyask enters service. Further, Manitoba Hydro maintains the trends from prior long-term forecasts provide the Board with directional support for a rate increase in 2019/20. Manitoba Hydro emphasizes the Board's prior approval of rate increases that, in the Utility's view, were intended to smooth the impacts of major projects entering service. Manitoba Hydro states that a 3.5% rate increase in the test year will provide additional revenues on an annualized basis in perpetuity, which will have a profound effect on the Utility's financial reserves, debt levels, and financial metrics.

Intervener Positions

The Consumers Coalition submits that, because Manitoba Hydro has not filed an IFF, the Board should consider only whether the proposed rate increase is necessary for the financial health of the Utility in the 2019/20 test year. It is the position of the Consumers Coalition that Manitoba Hydro does not require a 3.5% rate increase in the test year, based on the improved financial position contained in the Utility's February 14, 2019 Supplement. The Consumers Coalition argues that Manitoba Hydro's financial position has not deteriorated since the last GRA and that some risks – including drought, interest rate volatility, weather, and export prices – have decreased in the 2019/20 test year. Relying on the evidence of its expert witnesses, the Consumers Coalition states that a 3.5% rate increase is not required to reduce the risk of financial losses in 2019/20. A 1% rate increase combined with cost control measures is sufficient to minimize the risk of financial loss in the test year and a 2% rate increase is sufficient to minimize the risk of financial loss in the test year even without any adjustments for cost control.

The Consumers Coalition submits that the appropriate level of rate increase for the test year is 1.5% to all customer classes except for General Service Small Non-Demand. The Consumers Coalition adopts the evidence of its expert witnesses and states that, in combination with Manitoba Hydro exercising cost control of its Operating & Administrative expenses, a 1.5% rate increase will assist the Utility and consumers with the transition to

Keeyask entering service while also helping to manage the Utility's net income and cash flow considerations.

The Manitoba Industrial Power Users Group also submits that Manitoba Hydro has not justified a 3.5% rate increase based on financial need in the 2019/20 test year. In particular, in seeking a 3.5% rate increase, Manitoba Hydro has not accounted for the positive improvements in its financial position and operations since the last GRA, nor has the Utility demonstrated that there have been any material or sustained negative developments compared to what is embedded in Exhibit 93. Further, the Manitoba Industrial Power Users Group adopts the evidence of its expert witness and submits that Keeyask is expected to generate annual revenues of $360 million, which will also benefit the Utility's cash flow position once Keeyask enters service. However, this Intervener states that negative net income is normal when major new capital projects enter service and as part of managing the level of rate increases. The expert witness for Manitoba Industrial Power Users Group testified that reserves would not serve a purpose if there is no need to draw down reserves in periods of negative net income or drought; moreover, rate increases in 2019/20 should not be planned as a means of preventing all net losses from Keeyask and Bipole III entering service.

The Manitoba Industrial Power Users Group recommends a 1.5% rate increase in the 2019/20 test year, consistent with an inflationary increase. This Intervener states that a 1.5% rate increase should be granted solely as a rate-smoothing mechanism for the transition to higher rates when Keeyask enters service and due to the eventual end of the Bipole III deferral account amortization in 2023/24 (which annually contributes $78 million of previously deferred revenue to net income

Two Interveners - Assembly of Manitoba Chiefs and Manitoba Keewatinowi Okimakanak - focused their submissions on the level of rate increase that would be just and reasonable for the First Nations On-Reserve Residential customer class, discussed further below in section 7.0 of this Order.

Board Findings

Revenues from a Rate Increase are Not Required for 2019/20

The Board finds that Manitoba Hydro has not satisfied its onus to demonstrate that a 3.5% rate increase in 2019/20 is just and reasonable and in the public interest. The Board further finds that Manitoba Hydro has not established that it requires any additional revenues from a rate increase in 2019/20 to flow into the Utility's general revenues.

When Manitoba Hydro filed its GRA on November 30, 2018, it sought a 3.5% rate increase for all customer classes because, without a rate increase, it projected a net loss of $28 million in the 2019/20 fiscal year. The supplemental information filed on February 14, 2019 showed a $92 million improvement in its financial forecast for 2019/20 with an updated projection of $64 million in positive net income without any rate increase. With its requested 3.5% rate increase, effective June 1, 2019, net income would be projected to be $115 million.

Based on the supplemental financial information, it is not just and reasonable to order any rate increase in 2019/20 that would result in increased revenues flowing into the Utility's general revenues.

The Board finds that there are diminished risks of Manitoba Hydro's financial position deteriorating in the 2019/20 test year. As noted by the Board in Order 59/18, drought risk should be managed through retained earnings in combination with regulatory action by the Board. The Board reiterates:

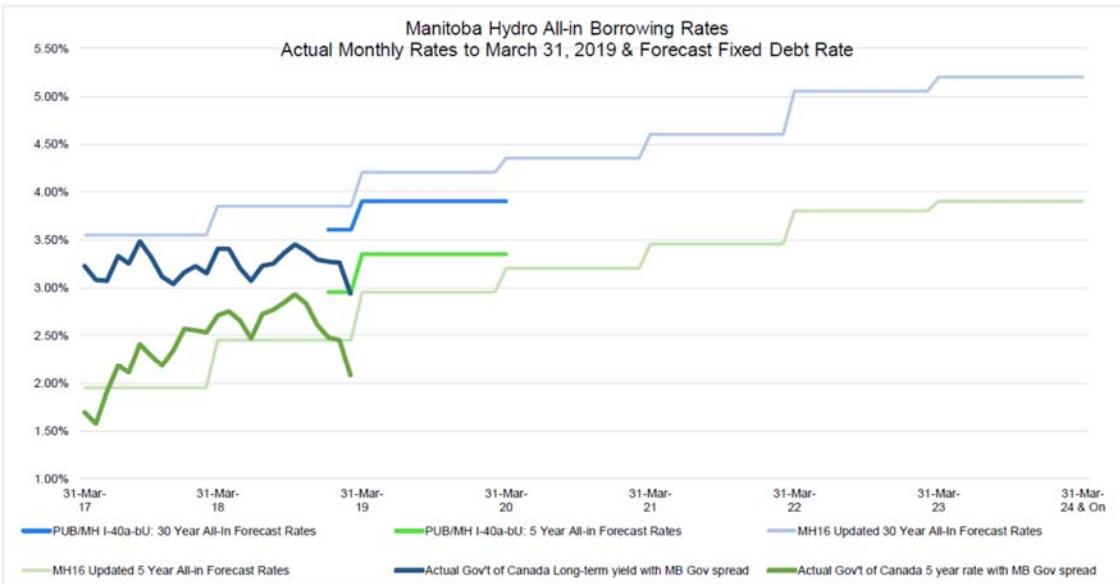
> *as the Board has demonstrated in past decisions – including in years of drought where the Board awarded rates in excess of those sought by the Utility – it will consider all of the facts and circumstances which confront Manitoba Hydro at that point in time in determining the appropriate rate relief. 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.

Manitoba Hydro experiences net income variability due to changes in water flow conditions. At the time of the November 30, 2018 GRA filing, there was a 50% likelihood that water flow conditions would result in negative net income if there was no rate increase in the test year. The improved water conditions incorporated into the February 14, 2019 Supplement filing, along with the other updates in that filing, now mean that the water flow risk has decreased to a 21% likelihood of negative net income in the 2019/20 test year. Put another way, and based on no rate increases in the test year, Manitoba Hydro is now expected to have positive net income in 79% of the water flow conditions experienced over the last 105 years, assuming Manitoba Hydro's other projections are achieved as forecast.

Similarly, interest rate volatility is no longer considered by Manitoba Hydro to be a top risk to 2019/20 net income due to pre-borrowing already undertaken by the Utility. As a result, interest rate volatility is expected to affect the net income in the test year by no more than a variation of plus or minus $7 million. For remaining borrowings, Manitoba Hydro acknowledged in its evidence that the current interest rate environment is favourable to Manitoba Hydro. Actual and forecast long-term interest rates are lower than compared to the interest rates incorporated into Exhibit 93. As shown in the figure below, actual long-term all-in forecast rates were an average of 0.5% lower for 2018/19 and, while average interest rates as of April 2019 were 0.18% higher in 2019/20, that does not account for recent debt issuances that include long-term borrowings at low interest rates.

Figure 2: Manitoba Hydro All-in Borrowing Rates Actual Monthly Rates to March 31, 2019 & Forecast Fixed Debt Rate[27]



Source: MIPUG-8 pg 16

Further, even without a rate increase, with low export prices or the warmest winter weather in 60 years, with all else remaining constant, net income in the test year will remain positive. It bears repeating that under average conditions Manitoba Hydro's current projections are that, without a rate increase, the Utility will have $64 million in net income in 2019/20.

Given the nature of Manitoba Hydro's operations, there are always risks that could affect the Utility's financial health. The Board finds that the chance that risks could materialize in the test year to the detriment of Manitoba Hydro's financial position is no higher than in any other year, and in the respects identified above, is diminished from the average. In these circumstances, it is not necessary to increase consumer rates to provide additional revenue to protect against the risk of financial loss in 2019/20.

Therefore, the Board finds that Manitoba Hydro does not have a current financial need for increased revenues from domestic ratepayers flowing to the Utility's general revenues in 2019/20.

A Rate Increase Directed to a Major Capital Deferral Account

The Board approves a 2.5% rate increase to all customer classes, except for General Service Small Non-Demand, the First Nations On-Reserve Residential and Diesel Zone Residential customer classes, and the non-grid portion of the Diesel Zone rates, effective June 1, 2019, with all additional revenue generated from this rate increase to flow into a major capital project deferral account ("Major Capital Deferral Account") to be established by Manitoba Hydro.

The rate increase approved by the Board is based on the need to enhance rate stability and predictability due to the upcoming in-service dates for major new capital projects. The evidence in the proceeding is that Keeyask could enter service as early as October 2020. As well, MMTP is scheduled to enter service in June 2020 and the Bipole III Deferral Account will be fully amortized into revenues as of 2023/24.

The Board finds that it should consider years beyond the test year in setting the rates for 2019/20. However, it is acknowledged that without Manitoba Hydro having filed a current IFF, the Board and all parties have been limited in their ability to assess the need for a rate increase in the test year based on Manitoba Hydro's future forecast levels of net debt, net income, and levels of reserves. Despite this limitation, the Board accepts the evidence of the expert witness for the Manitoba Industrial Power Users Group that the known fact of Keeyask entering service in either 2020/21 or 2021/22 at a control budget of $8.7 billion provides directional guidance. While the Board views the potential for an October 2020 in-service date for Keeyask as a positive development, the advancement of the Keeyask schedule also shortens the amount of time available for required higher customer rates to be smoothed in. The Board notes, however, that it is concerned that Manitoba Hydro did not present sufficient evidence to explain the Utility's position that an earlier in-service date would not result in cost savings for the Keeyask project. The Board directs Manitoba Hydro to file with the next GRA an explanation of the cost and revenue implications of the advancement in the Keeyask construction schedule from an in-service date of August 2021.

Keeyask is not the only major capital project with an anticipated 2020 in-service date. MMTP is scheduled to enter service in June 2020, and therefore the carrying costs of that project will also enter into Manitoba Hydro's revenue requirement. Moreover, if the construction of MMTP is delayed due to the timing of the issuance of necessary pre-construction federal permits, the costs of the project could increase and Manitoba Hydro will also incur additional costs for alternate arrangements to service the 250 MW sale to Minnesota Power that commences June 1, 2020.

As well, the known annual carrying costs of Bipole III provide further directional guidance as to the need for rate smoothing in the 2019/20 test year. The Bipole III Deferral Account established by the Board in Order 43/13 resulted in $392 million being collected as deferred customer revenues to be recognized as revenues through amortization over a five-year period beginning with the in-service date of Bipole III. However, the annual recognition of revenues from the Bipole III Deferral Account covers only a portion of the annual Bipole III carrying costs. Moreover, the Bipole III Deferral Account will be fully amortized and depleted in 2023/24, with the full amount of annual costs needing to be recovered by ratepayers beginning in 2024/25.

As the known costs of these major new generation and transmission capital projects will form a significant part of Manitoba Hydro's revenue requirement beyond the test year, it is appropriate to take steps today to assist in mitigating future rate increases. As such, the Board orders a rate increase of 2.5% in 2019/20 targeted to a Major Capital Deferral Account to assist in the transition to higher rates. This is consistent with the Board's long-standing concern that customer rate changes should be on a stable and predictable basis. Without implementing rate smoothing through a rate increase in the test year, combined with the capital costs of Bipole III and MMTP, the costs associated with Keeyask and the potential for those costs to enter into Manitoba Hydro's 2020/21 revenue requirement could lead to rate shock for consumers. The Board will determine how the deferral account will be brought into Manitoba Hydro's operating revenues at a future GRA.

The Board notes Manitoba Hydro has historically provided IFFs that included projections of equal annual rate increases premised on the Utility attaining a financial target over a specific timeframe, roughly 20 years. In prior Orders dating back to the time of the 2014 Needs For and Alternatives To Review, the Board relied on IFFs that included projected equal annual rate increases in the range of 3.57% to 3.95%.

As the MHEB is in the process of developing a new financial plan for Manitoba Hydro, those prior rate trajectories based on now out-dated financial targets are of questionable value in the current proceeding. However, those rate trajectories provide directional guidance to the Board in determining the appropriate level of the rate increase for 2019/20 to assist in smoothing consumer rates when major new capital projects enter service. This further supports the 2.5% rate increase approved by the Board.

The Board notes the evidence of the expert witness for the Manitoba Industrial Power Users Group that the Board's rate regulation of Manitoba Hydro has long used long-term financial forecasts as a tool in rate setting. This so-called "modified cost of service" approach allows for consideration of rate stability, measured rate transitions, and the appropriate level of customer-funded reserves. In the absence of a long-term financial forecast, the Board is challenged in its ability to assess the appropriate level of a rate increase in the 2019/20 test year to reduce the likelihood of future rate shock to consumers. While the evidence in this GRA establishes that it is just and reasonable to approve a 2.5% rate increase in 2019/20 for certain rate classes with the full revenues from the rate increase directed to a Major Capital Deferral Account, the Board expects that it will be necessary to assess future rates in the context of a long-term financial forecast given the expected in-service for Keeyask.

The limitations in this proceeding that arose from the Utility not filing an IFF demonstrate the importance of such long-term financial forecast being available as a tool in rate setting. The Board finds that it is not reasonable to consider another GRA absent a full IFF or other long-term financial forecast. The Board directs Manitoba Hydro to file with its next GRA filing an IFF or other long-term financial forecast in a form consistent with an IFF.

4.0 Operation & Administrative Expenses

Operating and administrative ("O&A") expenses are one of Manitoba Hydro's highest expense categories in its revenue requirement, at over half a billion dollars per year. These expenses primarily consist of wages and benefits, materials, contracted services, and overhead costs associated with operating and maintaining Manitoba Hydro's facilities and providing services to customers. O&A expenses do not include capitalized salaries and benefits for employees who work on capital projects, or materials and services related to those capital projects.

In February 2017, Manitoba Hydro began implementing a plan to reduce its total workforce by 15%, or 900 positions, through a combination of a reduction of the executive leadership and senior management teams and a Voluntary Departure Program. As of March 31, 2018, 821 employees were approved to leave under the Voluntary Departure Program resulting in annual employee-related cost savings of $92.6 million. Due to the timing of the Voluntary Departure Program, Manitoba Hydro was not able to file detailed O&A budgets and related detailed schedules as part of the last GRA. Although there were no detailed budgets, IFF16 incorporated forecast O&A expenses of $518 million in 2017/18, $501 million in 2018/19, and $511 million in 2019/20.

In Order 59/18, the Board accepted Manitoba Hydro's evidence that a detailed O&A forecast could not be filed at that time because of the ongoing Voluntary Departure Program. The Board directed Manitoba Hydro to file with its next GRA the details of its O&A expenditures. While the Board acknowledged Manitoba Hydro's efforts to implement cost containment measures, the Board recommended that Manitoba Hydro continue those efforts both in terms of staff reductions and supply chain management after the conclusion of the Voluntary Departure Program transition. The Board noted that in the 2014/15 & 2015/16 GRA, Manitoba Hydro expressed a commitment to reducing the growth of O&A expenses to 1% annually, excluding the impact of accounting changes.

In the current GRA, Manitoba Hydro relies on a high-level preliminary O&A target of $511 million, reflecting an inflationary increase of 2% over the $501 million of O&A expenses included in the 2018/19 Financial Outlook. The starting point for Manitoba Hydro's establishment of the $511 million O&A target for 2019/20 is the ending 2017/18 actual O&A result, which was used by the Utility to in calculating the 2018/19 O&A budget of $501 million. Manitoba Hydro then escalated the 2018/19 budget by 2% to arrive at the $511 million target for 2019/20.

Manitoba Hydro did not provide a detailed O&A budget for 2019/20. The targeted levels of total OM&A expense for 2018/19 and 2019/20 remain unchanged from what was forecast at the last GRA.

Manitoba Hydro's Position

Manitoba Hydro submits that the $511 million target is valid for rate-setting purposes. This target reflects an inflationary increase of 2% over the $501 million of O&A expenses included in the 2018/19 Financial Outlook. However, the $511 million target has been re-validated by Manitoba Hydro based on current staffing levels and current business requirements. Manitoba Hydro states that the $511 million target will not change with the development of a detailed O&A budget and that it is not possible to achieve further O&A reductions. Manitoba Hydro also stated that limiting growth in O&A expenses to 1% is not sustainable, given the significant staffing reductions that have already taken place, negotiated wage settlements, and cost escalation for materials and services.

Responding to the evidence of the expert witness for the Consumers Coalition, Manitoba Hydro submits that the $22 million reduction in O&A expense identified by that witness is not achievable. Manitoba Hydro states that, in order to reduce O&A expense by $22 million, a staffing reduction of 300 employees would be required – in addition to the 821 positions that have already been reduced through the Voluntary Departure Program. Further staffing reductions would significantly increase risks to public and employee safety, system reliability, and the ability of the Utility to provide reasonable levels of customer service. Regardless, Manitoba Hydro says that its levels of Equivalent Full-Time positions are comparable to the levels in 2004/05, despite growth in Manitoba Hydro's operations in the last 15 years. Further, Manitoba Hydro argues that reductions in O&A

expense in 2019/20 will not address the fundamental issue facing Manitoba Hydro's financial health: the significant revenue shortfall following the in-service date of Keeyask and associated transmission projects.

Intervener Positions

The Consumers Coalition, the only Intervener to take a position on this issue, argues that Manitoba Hydro has not provided key supporting evidence for its 2019/20 O&A target, particularly due to the fact that the Utility did not file an updated or detailed O&A forecast or budget for this test year. As such, the Consumers Coalition submits that the Board should not adopt Manitoba Hydro's O&A budget for rate-setting purposes.

Adopting the evidence of its expert witness, the Consumers Coalition takes the position that the $511 million O&A target for 2019/20 should first be reduced for rate-setting purposes to $495.6 million, and second, should further be reduced to $489 million through the use of an escalation number of 1%. The first budget reduction is to normalize both for an $8.1 million non-recurring increase in collection costs from 2017/18 (the starting point for the Utility's O&A target) and a $7.3 million provision for unallocated transitional contingency funds for which there are no planned costs. The second reduction, based on the use of a 1% escalation number, is recommended by this Intervener as a means of sending a signal to Manitoba Hydro to further reduce costs in a period of transition while reducing the trajectory of O&A costs going forward. The Consumers Coalition argues that these reductions are equivalent to a 1.9% rate decrease by 2022/23 for customers – or put another way, a 1.9% rate increase that Manitoba Hydro does not need to collect from ratepayers.

Board Findings

The Board finds that Manitoba Hydro's 2019/20 O&A target is not accepted for rate-setting purposes. First, the target is premised on a high-level target calculation from early 2017 for the 2017/18 year, and includes two prior non-recurring costs that should be normalized in establishing a target for rate-setting purposes.

The Board finds that the 2019/20 O&A target should be reduced by $8.1 million. This is the amount of a one-time increase in collection costs in 2017/18 as a result of an assessment of collectability of arrears. The $8.1 million was used in the calculation of the 2018/19 budget, which was in turn used in establishing the 2019/20 target. The Board does not accept that the 2019/20 test year O&A target should include this $8.1 million for rate-setting purposes, as it is a one-time occurrence.

Similarly, the Board finds that the 2019/20 O&A target should be reduced by a further $7.3 million – the amount included in the 2019/19 O&A budget to support transitional business requirements arising from the Voluntary Departure Program. This amount was unallocated to specific Operating/Corporate groups and was held as a contingency. These expenses were not incurred in 2018/19 and Manitoba Hydro is not planning for these costs in 2019/20. There are also no actual expenditures associated with this unallocated funding. For these reasons, the test year O&A target should also not include this $7.3 million expense for rate-setting purposes.

Removing both of these expenses from the 2019/20 O&A target reduces the target from $511 million to $495.6 million.

Second, the Panel finds that, in developing the 2019/20 O&A target for rate-setting purposes, an escalation of 1% above the 2018/19 Financial Outlook is to be used. The Utility's primary basis for the 2% escalation rate was that it is an inflationary increase. Manitoba Hydro's evidence did not establish that a 2% escalation rate should be used. Moreover, the Board is concerned that the use of a rate of escalation of 2% will erode all of the O&A savings achieved by Manitoba Hydro through the Voluntary Departure

Program and supply chain management within the early years of Keeyask entering service. This offsetting of savings would be inconsistent with the intent of the Voluntary Departure Program and contrary to the need for Manitoba Hydro to find savings in controllable costs during a period of major capital expansion and related rate pressures.

In the absence of evidence demonstrating the appropriateness of a 2% escalation number, the Board finds that a 1% rate of escalation is to be used for rate setting purposes. This is consistent with Manitoba Hydro's prior commitment dating back to 2013 to limit operating cost increases to 1% per year. As the Board stated in Order 59/18, the Board expects Manitoba Hydro continue its efforts to reduce O&A costs, both in terms of staff reductions and supply chain management. The Board reiterates that cost control should be ongoing, and that it should continue in the post-Voluntary Departure Program years.

Reducing the escalation rate to 1% further reduces the O&A target to $489 million, or $22 million less than Manitoba Hydro's $511 million target. This is equivalent to a 1.3% rate decrease for ratepayers in 2019/20 and will have enduring benefits for ratepayers over time.

The Board is concerned about the lack of detailed information provided by Manitoba Hydro in evidence to support the O&A expenditures incorporated into the filing. As noted by the expert witness for the Consumers Coalition, the Voluntary Departure Program was complete approximately one year ago. It is difficult to understand why Manitoba Hydro has not yet been able to develop a detailed O&A budget. Given the materiality of this expense in Manitoba Hydro's revenue requirement, the Board directs Manitoba Hydro to develop and file a detailed O&A budget with the next GRA filing and provide the year over year dollar and percentage increases for the past five fiscal years. That detailed O&A budget is to include the 2019/20 year, as well as similar detail in support of any years for which Manitoba Hydro seeks a rate increase.

5.0 Financial Ratios and Cash Flow

The MHEB is currently undertaking a comprehensive review of the Manitoba Hydro operations, forecasts, and financial plans which will allow them to establish a new financial plan and financial targets for the Corporation. As such, neither Manitoba Hydro's November 30, 2018 GRA filing nor its February 14, 2019 GRA Supplement filing focused on Manitoba Hydro's financial ratio targets.

In its filing, Manitoba Hydro did include Cash Flow Statements showing two methodological or presentation changes that the Utility made for financial reporting purposes in its most recent audited financial statements. The first is to use the Indirect Method of reporting cash flows rather than the previously used Direct Method. The second change is to record capitalized interest in Operating Activities rather than as previously presented in Investing Activities. By recording the interest paid on capital projects not yet in service in Operating Activities, approximately $300 million is moved from Investing Activities where the remainder of the costs of those capital projects under construction are recorded.

Manitoba Hydro's Position

Manitoba Hydro acknowledges the additional incremental revenue from the requested rate increases does not make a noticeable impact to the debt ratio and results in only minor improvements to the EBITDA Interest Coverage Ratio and the Capital Coverage Ratio in 2019/20. However, the Utility stresses that the additional rate increase revenue on an annualized basis in perpetuity has a profound impact on the financial reserves, debt levels, and financial metrics. Manitoba Hydro calculates the net present value of a 3.5% rate increase to be approximately $600 million (using a 6.0% nominal weighted average cost of capital discount rate).

Manitoba Hydro states that the two changes in the manner in which it presents its Cash Flow Statement were made based on the direction from its former Audit Committee;

however, Manitoba Hydro advises that the Utility's cash balances remain the same regardless of the changes in presentation.

Manitoba Hydro explains that its new presentation of the capitalized interest better shows the total interest expense paid by the Utility. Manitoba Hydro further explains that this new presentation mirrors what will happen when Keeyask enters service, when the interest expense related to Keeyask moves to the operating statement.

Manitoba Hydro argues that there has been additional scrutiny of Manitoba Hydro by a credit rating agency that has identified weakening of a financial metric used by that agency.

Intervener Positions

The expert witness for the Consumers Coalition accepts the Indirect Method of presenting the Utility's Cash Flow Statement as providing a finer level of detail in terms of understanding the cash flow from operations. This is because the Indirect Method starts with Net Income and then makes adjustments for non-cash expenditures such as Depreciation Expense.

However, the Consumers Coalition witness questions the change in reclassifying interest capitalized on capital projects from Investing Activities to Operating Activities as being potentially concerning from a rate-setting perspective. According to this witness, the change will alter the perception of the amount of cash flow that is available to meet financial obligations and fund sustaining capital expenditures on Manitoba Hydro's audited financial statements.

The Consumers Coalition's expert witness also indicates that the reclassification of capitalized interest from Investing Activities to Operating Activities is inconsistent with how capitalized interest is reflected in both the income statement and balance sheet. In the income statement and balance sheet, capitalized interest is presented as an Investing Activity for financial reporting purposes. As well, this witness notes that Manitoba Hydro is a regulated utility. The principles of regulation and rate setting are such that interest is normally capitalized as part of a project until the project is in service and then it becomes part of the revenue requirement.

The Consumers Coalition submits that Manitoba Hydro has not demonstrated that it is facing a cash flow challenge. Rather, it is the position of this Intervener that current rates are sufficient from a cash flow perspective.

The Manitoba Industrial Power Users Group submits that cash flow should not be the key consideration in analyzing the sufficiency of rates, given the Utility's hydraulic variability. Like the expert witness for the Consumers Coalition, the expert witness for the Manitoba Industrial Power Users Group states that capitalized interest for assets that are not used and useful should not be a factor for rate setting. In his view, interest for capital projects is no different than other cash expenditures needed for capital projects, such as materials and labour, which are capitalized. The Manitoba Industrial Power Users Group argues that, although interest coverage ratios can be informative in rate setting, the information conveyed by such ratios can be skewed when capitalized interest is treated as an Operating Activity.

The Manitoba Industrial Power Users Group also submits that the Board should not place weight on Manitoba Hydro's arguments about the alleged concerns of credit rating agencies.

Board Findings

The Board finds that the presentation in which capitalized interest is included in Operating Activities is not to be taken into account when considering cash flow sufficiency in a test year for rate setting purposes. The Board agrees with the expert witnesses for the Consumers Coalition and the Manitoba Industrial Power Users Group that the change in the presentation of capitalized interest on the Cash Flow Statement is inconsistent with rate setting principles and is potentially confusing to stakeholders. Should the amount of capitalized interest need to be presented separately from other aspects of Investing Activities, a new line item under Investing Activities would address that concern.

On the issue of financial metrics, the Board's views remain as expressed in Order 59/18, including:

> *…that debt-to-equity is a questionable metric for a vertically integrated monopoly Crown utility with a debt guarantee from the provincial government. The equity level target does not have the prominence suggested by Manitoba Hydro given the context in which the Utility operates. The concern regarding the value of the equity level target is compounded when Manitoba Hydro is going through an unprecedented major investment period to more than double the value of its assets in the next four years. As noted by Manitoba Hydro's external consultant KPMG, there is a "practical recognition that this target will not be met during a period of large capital expenditures when newly constructed assets are placed in service. Accordingly, the 75/25 could remain the long-term objective." The Board supports this view…. As such, the Board is not prepared to look at the issue of pacing to achieve a particular equity level target at least until the current phase of major capital construction is completed, now projected by Manitoba Hydro to be in 2024.*

As for reserves, the Board remains of the view that:

> *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.

In its written rebuttal evidence and in oral testimony, Manitoba Hydro also referenced a report from a credit rating agency in support of its argument that the Utility faces financial risks in the test year. The Board reiterates its findings from Order 59/18 that, "while important, care must be taken to avoid placing too much weight on reports by credit rating agencies." The Board continues to accept that the assessment of the financial health of a utility by credit rating agencies and by capital markets are related, but are not the same thing.

Manitoba Hydro testified that the new MHEB is currently undertaking a comprehensive review of the Utility's operations, forecasts, and financial plans to enable it to establish, first, a new Corporate Strategic Plan and, second, a new long-term financial plan for Manitoba Hydro. Included in that review and planning process is consideration for meetings with stakeholders. The Board sees an opportunity for Manitoba Hydro to meet with regulatory stakeholders to further understandings of the financial reserves required for the Utility and to be considered in rate setting. As such, prior to the MHEB's development of a new Corporate Strategic Plan and long-term financial plan, there should be engagement by Manitoba Hydro with stakeholders and the Board.

In an effort to assist the MHEB, the Board repeats its views from Order 59/18 that:

there is merit to gaining better understanding of the financial reserves required for Manitoba Hydro under various circumstances. This would include consideration of risk tolerances, what risks should be protected by reserves, and the circumstances which would guide the need for more aggressive rate increases to continue full cost recovery for Manitoba Hydro. The Board is mindful that the financing and depreciation expenses related to these new major capital assets entering service already require additional revenues from rate increases. Consideration of the appropriate level of financial reserves,

> *for example a minimum retained earnings test, is best done through a collaborative approach with stakeholders.*

The Board finds there is merit in a collaborative process as envisioned by the Board in Order 59/18. The Board directs Manitoba Hydro to participate in a technical conference hosted by Board staff or an external consultant appointed by the Board for the consideration of the use of rule-based regulation to provide guidance in the setting of consumer rates and of the question of the role and sufficiency of reserves in Manitoba Hydro's operations and the Board's rate regulation of the Utility. Board staff will invite Manitoba Hydro to a planning meeting to review and revise the draft scope of this technical conference before circulation for Intervener comments.

6.0 Revenue to Cost Coverage Ratios and Differentiated Rates

Manitoba Hydro's Cost of Service Study is used by the Board as a tool in setting rates. One of the outputs of the Cost of Service Study is the calculation of the total costs allocated to each customer class. The total allocated costs by customer class are compared against target class revenues, the ratio of which is called the Revenue to Cost Coverage ratio. If that ratio is less than unity (1.0) for a class, that means the revenue generated by the class is not sufficient to recover all the costs allocated and assigned to that class; conversely, if the ratio is greater than unity (1.0), then Manitoba Hydro is recovering more revenue from the class than its allocated and assigned costs.

Due to the inherent lack of precision in a Cost of Service Study, a zone of reasonableness is used to target the Revenue to Cost Coverage ratios of the customer classes. The Board has approved the use of a zone of reasonableness of 95-105% in assessing the Revenue to Cost Coverage ratios of Manitoba Hydro's customer classes. Revenues that are within this range are deemed to represent full cost recovery.

In Order 59/18, the Board directed the use of the Revenue to Cost Coverage ratio output of the Cost of Service Study to more closely align the revenues collected from each customer class with the costs of the electrical system that are caused by each class. Specifically, the Board approved different rate increases than the average overall rate increase for certain customer classes in order to begin to move the General Service Small Non-Demand, General Service Large 30-100kV, and General Service Large >100kV customer classes into the zone of reasonableness. For the June 1, 2018 rate increase, the Board directed Manitoba Hydro to assume a 10-year timeframe to move all classes within the zone of reasonableness, with the rate increase impact of doing so shared across all customer classes either below or within the zone of reasonableness.

The Board also noted in Order 59/18 the expected effect of Bipole III entering service on the class Revenue to Cost Coverage ratios. As Bipole III is considered to be a Generation asset in the Cost of Service Study, the Revenue to Cost Coverage ratio of classes with a greater proportion of allocated Generation costs relative to their total costs automatically decreases with the in-service of Bipole III, without any rate differentiation. As such, although the Board directed the beginning of implementation of differentiated rates in 2018/19, the Board also held that it would examine the Revenue to Cost Coverage ratios arising from the Prospective Cost of Service Study filed with the next GRA to consider the effect of Bipole III entering service.

Manitoba Hydro did not file a new Prospective Cost of Service Study with the current 2019/20 GRA. The Utility advises that, while it completed modifications to the cost allocation model to reflect most of the Board's directives from Order 59/18, a new Prospective Cost of Service Study will not be developed until after the MHEB approves a new IFF. Manitoba Hydro continues to study the Service Drop allocator and treatment of Common Costs and intends to have the review completed in time for the next Prospective Cost of Service Study.

In the Information Request process in the current GRA, Manitoba Hydro provided a high-level indication of the anticipated shift in functionalized costs and Revenue to Cost Coverage ratios in 2019/20 with Bipole III now in service, as well as the rate differentiation required to bring all classes within the zone of reasonableness if implemented over different time periods. The information filed by Manitoba Hydro reflects the asymmetrical increase in costs by function resulting from the incorporation of the Bipole III revenue requirement into the Cost of Service Study, as explained above. The result is that the Revenue to Cost Coverage ratios of the General Service Large class are significantly decreased, with the 30-100kV and >100kV sub-classes moving into the zone of reasonableness without any further rate differentiation. The Revenue to Cost Coverage ratio of the Area & Roadway Lighting customer class is significantly increased, from 100.3% to 118.7%.

This high-level illustrative Cost of Service Study output includes the modifications to the cost allocation model discussed above and embeds certain assumptions related to the treatment of Bipole III costs. The table below also assumes that the revenue shortfall that would result from the below-average rate changes for the General Service Small Non-

Demand and Area & Roadway Lighting customer classes would be recovered through additional rate increases above the requested 3.5% from customer classes below unity.

At June 1, 2018 Rates

	Initial RCC including BPIII	Annual Differentiation 1 Year	Annual Differentiation 5 Years	Annual Differentiation 9 Years	Final RCC
Residential	96.5%	2.00%	0.40%	0.22%	98.5%
First Nations On Reserve	93.1%	2.12%	0.42%	0.23%	95.1%
GSS ND	116.7%	-10.02%	-2.09%	-1.17%	105.0%
GSS D	101.8%	0.00%	0.00%	0.00%	101.8%
GSM	97.5%	1.01%	0.20%	0.11%	98.5%
GSL 0-30kV	96.1%	2.43%	0.48%	0.27%	98.5%
GSL 30-100kV	104.6%	0.00%	0.00%	0.00%	104.6%
GSL >100kV	101.9%	0.00%	0.00%	0.00%	101.9%
Area & Roadway Lighting	118.7%	-11.56%	-2.43%	-1.36%	105.0%

Source: AMC/MH I-5

Manitoba Hydro's Position

Manitoba Hydro is seeking an across-the-board rate increase of 3.5%, to be applied to all components of all customer class rates, excepting the non-grid portion of the Diesel class rates. Manitoba Hydro advises that it intends to continue the migration of customer classes into the zone of reasonableness in its next GRA, based on the results of its next Prospective Cost of Service Study.

Manitoba Hydro says that most classes have moved to within the zone of reasonableness with the addition of the Bipole III revenue requirement to the Cost of Service Study, with only General Service Small Non-Demand and Area & Roadway Lighting above 105%. Manitoba Hydro notes that the expert witnesses for the Manitoba Industrial Power Users Group and the Consumers Coalition generally accept that any rate increase should be applied on an across-the-board basis, except for the Consumers Coalition's evidence that the General Service Small Non-Demand class should receive a less-than-average increase. Manitoba Hydro agrees that there is a strong likelihood that, due to the current Revenue to Cost Coverage ratio differential, the General Service Small Non-Demand class cannot be brought into the zone of reasonableness while maintaining the current consolidated rate structure with the General Service Small Demand and General Service Medium classes. However, Manitoba Hydro argues that rate stability and price signaling support maintaining class consolidation, and therefore foregoing rate differentiation for the General Service Small Non-Demand class, in the near term until possible rate alternatives can be evaluated.

Although Manitoba Hydro does not support rate differentiation for the General Service Small Non-Demand customer class at this time, it acknowledges that it is likely possible to maintain the current rate structure and implement a lower-than-average rate increase for this class, depending on the level of differentiation.

Intervener Positions

The Consumers Coalition submits that any rate increase granted should be across-the-board to all rate classes, with the exception of the General Service Small Non-Demand customer class, which should receive a smaller-than-average rate increase. This Intervener argues that, as Manitoba Hydro did not prepare a new Prospective Cost of Service Study, key evidence is lacking to support any other rate differentiation. This Intervener also adopts the evidence of its expert witnesses and takes the position that the Area & Roadway Lighting customer class should receive any across-the-board rate increase ordered by the Board. This customer class benefits from how Demand Side Management costs are allocated following Cost of Service Study methodology changes directed in Order 164/16 and there is not enough information on the current record to support giving this class a lower–than-average rate increase at this time.

Should the Board direct further rate differentiation, the cost of any lower-than-average rate increase should, in the position of the Consumers Coalition, be borne by all classes within the zone of reasonableness as well as the Area & Roadway Lighting class. The Consumers Coalition also submits that the Board should direct Manitoba Hydro to prepare an updated Prospective Cost of Service Study for the next GRA and all subsequent GRAs.

The Manitoba Industrial Power Users Group submits that the granting of a rate increase should be on an across-the-board basis to all customer classes. The expert witness for this Intervener testified that the evidence filed in this GRA does not meet the evidentiary standard to award differentiated rates.

Board Findings

The Board finds that the approved 2.5% rate increase is to be applied to all customer class rates, except for the First Nations On-Reserve Residential customer class, the Diesel Zone Residential customer class, the General Service Small Non-Demand customer class, and the non-grid portion of the Diesel Zone rates. Other than these exceptions, which are discussed further below, the Panel finds that there is to be no rate differentiation between the classes. The evidentiary basis for further rate differentiation is lacking due to the fact that Manitoba Hydro did not file a new Prospective Cost of Service Study. As well, the Panel acknowledges that the addition of the Bipole III revenue requirement to the Cost of Service Study will likely move the majority of the classes within the zone of reasonableness without any further rate differentiation.

The Board directs Manitoba Hydro to prepare and file a new Prospective Cost of Service Study with the next GRA. The Board will examine the Revenue to Cost Coverage ratios arising from this Prospective Cost of Service Study and will consider adjustment to the differentiation of rates as necessary.

The Board directs Manitoba Hydro to adjust class revenue targets to continue the migration of the General Service Small Non-Demand customer class into the zone of reasonableness. Manitoba Hydro is to continue on the 10-year timeframe for class revenue to cost coverage ratio movement established by the Board in Order 59/18, such that the rate differentiation directed in this Order is on the basis of the General Service Small Non-Demand customer class moving within the zone of reasonableness in nine years from the 2019/20 test year.

The Board notes the evidence of Manitoba Hydro that the rate differentiation for the General Service Small-Non Demand customer class is possible, even with the continued class consolidation with the General Service Small Demand and harmonization of General Service Small rates with General Service Medium rates.

The Board directs Manitoba Hydro to adjust the rates for the General Service Small Demand and General Service Medium classes such that the class revenue targets are increased by 2.5%, consistent with the rate increase to the Residential, General Service Large, and Area & Roadway Lighting classes. The treatment of the General Service Small Demand and General Service Medium rates differs from those of the other classes because the General Service Small Non-Demand and Demand classes are consolidated and share the same tariff, which in turn is harmonized with the General Service Medium tariff.

The Board directs Manitoba Hydro to study and report at the next GRA on the issues associated with rate differentiation of the General Service Small-Non Demand customer class. This study is to include the intra-class impacts of any required rebalancing of customer, energy, and demand charges, whether consolidation of the General Service Small Non-Demand and General Service Small Demand tariffs remains appropriate, and whether harmonization of the General Service Small and General Service Medium rates remains appropriate. As part of this study, Manitoba Hydro is to consider class cost characteristics, load profiles, and bill frequencies of the General Service Small and General Service Medium classes that will provide the necessary information to evaluate rate design options. The Board recommends that Manitoba Hydro consider incorporating into this study the Utility's response to Order 59/18 Directive 28, which requires Manitoba Hydro to report on the rationale for the declining block rate design for General Service classes and an evaluation of the block thresholds and charges.

The Board finds that the rates for the Area & Roadway Lighting customer class are not to be further differentiated at this time. There is insufficient evidence on the record of this proceeding to support rate differentiation for this class at this time. The Board also notes the evidence of the witness for the Consumers Coalition regarding the effect of the allocation of Demand Side Management costs being to potentially artificially move the class outside the zone of reasonableness.

7.0 Bill Affordability and First Nation On-Reserve Residential Rate

In Order 59/18 the Board set out its long-held concerns and the lengthy history with utility bill affordability issues, which will not be repeated in this Order. Beginning with Order 116/08, the Board has concluded that it has jurisdiction to order the implementation of a bill affordability program.

The majority of the Board in Order 59/18 directed Manitoba Hydro to establish a First Nations On-Reserve Residential customer class for existing First Nations. There was no rate increase for that class, such that the rate for that customer class was maintained at the August 1, 2017 approved Residential Rate. Manitoba Hydro was kept whole as the foregone revenues from the First Nations On-Reserve customer class had been factored into the level of the average general rate increase granted to all other customer classes.

As found by the Board in Order 59/18:

> *The creation of this customer class is justified by the need to address energy poverty on-reserve, supported by evidence that 96% of First Nations people on-reserve live in poverty and that reserves in Manitoba have the highest rates of child poverty in Canada. In addition, the poor housing stock on reserves in Manitoba and the fact that the vast majority of First Nations on-reserve residential customers (61 out of 63 First Nations communities) have no access to the more economical option of natural gas for heating exacerbate the issue of energy poverty. In his testimony, Manitoba Hydro's President and Chief Executive Officer described the housing conditions on First Nations reserves that he has visited as "abysmal". This results in residents on First Nations reserves having to use more energy to heat their homes. On average, First Nations on-reserve customers consume more energy than off-reserve residential customers, despite the efforts of Manitoba Hydro to use demand side management programming to improve energy efficiency for homes on reserves. Taken together, these factors*

lead to higher utility bills and a population of Manitobans that is disproportionately vulnerable to rate increases.

Manitoba Hydro's Position

Manitoba Hydro requests that the June 1, 2019 proposed 3.5% rate increase be applied to the First Nations On-Reserve Residential customer class, while preserving the rate differential that was directed in Order 59/18. Manitoba Hydro notes that it is seeking to overturn the Board's decision to direct the creation of the class at the Manitoba Court of Appeal. According to Manitoba Hydro, increasing the rate to this new class now will mitigate the potential hardship to the customers in the class in the event the Manitoba Court of Appeal accepts the Utility's position in striking down this customer class.

Intervener Positions

The Assembly of Manitoba Chiefs maintains that the evidence is uncontroverted that the customers in this new First Nations On-Reserve Residential class will be disproportionately and negatively affected by the rate increase proposed by Manitoba Hydro. This Intervener submits that the Utility has failed to justify any rate increase for this class and that for 2019/20 no rate increase should be approved for the First Nations On-Reserve Residential class.

The Assembly of Manitoba Chiefs filed expert evidence in this proceeding which reviewed Manitoba Hydro's 2017 Residential Energy Use Survey. While the data are primarily used by the Utility to develop its annual Load Forecast, the information collected also serves as a basis in designing programs and services to assist customers. This Intervener's witness excerpted several data sets to show that energy poverty is higher on First Nations reserves, average consumption is higher, and household income is much lower compared to Manitoba Hydro's residential base. At the last GRA, this witness reported that energy poverty appeared to be substantially higher on First Nations reserves than among the general population. The Assembly of Manitoba Chiefs says that the updated 2017 Residential Energy Use Survey data confirms that conclusion.

The Assembly of Manitoba Chiefs says that Manitoba Hydro was kept whole in Order 59/18 as other 1000 kWh per month customers of the Utility paid an additional $0.12 per month. Should a 0% rate increase be approved for this class in 2019/20, revenue neutrality for Manitoba Hydro would be maintained through 1000kWh per month customers paying an additional $0.09 per month.

This Intervener acknowledges that the appropriate differential or spread between the First Nations On-Reserve Residential rate and the rate for other Residential customers should be addressed at a full GRA with a proper evidentiary record, which is lacking in this proceeding.

Manitoba Keewatinowi Okimakanak submits that the rate freeze for the First Nations On-Reserve Residential class should be maintained pending the Court of Appeal process. This Intervener identifies options for addressing the foregone revenue including the diversion of water rental fees, allowing the revenue shortfall to fall to Manitoba Hydro's Net Income, or for the Board to factor in the cost into the average rate increase granted in the 2019/20 test year to all other customer classes. However, the preference of this Intervener is that other customer classes not make up the revenue shortfall through paying higher rates as this Intervener acknowledges that an additional rate increase on top of any rate increase approved by the Board could represent a hardship for some ratepayers.

Manitoba Keewatinowi Okimakanak also supports a process with a more robust evidentiary base and dialogue for the next GRA. In the position of this Intervener, this includes the need for Manitoba Hydro to engage with First Nations communities prior to the next GRA to provide notice of the Utility's rate plans, and to gain mutual understandings of interests, issues, and concerns. Manitoba Keewatinowi Okimakanak also maintains that the Provincial Government should divert a portion of the water rental fees to implement, support, and maintain a comprehensive government bill affordability program.

The Consumers Coalition submits that there is no cost of service basis to maintain the current First Nations On-Reserve Residential rates, meaning that this class's Revenue to Cost Coverage ratio is already below unity and outside of the zone of reasonableness used in assessing rates. While the monthly differential paid by other customers is small, some of those other customers may also be suffering similar affordability issues as those on-reserve customers. This Intervener maintains that the Provincial Government is best placed to address energy poverty through taxpayer funded programs.

Board Findings

The majority of the Board finds that it is neither just and reasonable nor in the public interest to approve any rate increase for the customers in the First Nations On-Reserve Residential class or for the customers in the Diesel Zone Residential class. The rates for these customers will remain at the rates approved effective August 1, 2017.

This First Nations On-Reserve Residential customer class and the related affordability measure of no rate increase for that customer class in 2019/20 are also consistent with the principle of reconciliation, the ongoing process of establishing and maintaining mutually respectful relationships between Indigenous and non-Indigenous peoples.

The Board agrees with the Interveners that submitted that the appropriate differential or spread between the First Nations On-Reserve Residential and Diesel Zone Residential customer class rates and the rate for other residential customers should be addressed at the next full GRA with a full evidentiary record.

The Board also agrees with the Consumers Coalition that the Provincial Government is best placed to address energy poverty through taxpayer funded programs. The Board reiterates its statements in Order 59/18 that the First Nations On-Reserve Residential customer class with a differentiated rate to address energy poverty on Manitoba reserves is an appropriate starting point for bill affordability in Manitoba. As the Board found in Order 59/18, it is a "modest first step in addressing bill affordability."

The Board continues to be of the view that there should be a broader bill affordability program to address energy poverty experienced by Manitoba ratepayers. However, due to administrative complexities and cost concerns, it is not feasible for Manitoba Hydro to implement a broader bill affordability program at this time. The Board acknowledges that this results in some obvious anomalies where one household on-reserve has a lower electricity rate than a nearby off-reserve household living in comparable circumstances. The Board reiterates its conclusion in Order 59/18 that these complexities and anomalies are best addressed by a more comprehensive government bill affordability program. With the introduction of a comprehensive government bill affordability program, the First Nations On-Reserve Residential customer class and lower rate built into the 2018/19 and 2019/20 years may no longer be required.

Dissenting Decision and Findings of Board Member Ring

As I did in Order 59/18 and Order 90/18, I accept that the Board has the jurisdiction to create a lower-income customer class such as the First Nations On-Reserve Residential class.

However, for my reasons as enunciated in Order 59/18, I also cannot agree with the majority's decision of a continued rate increase exemption in 2019/20 for a new customer class of First Nations On-Reserve Residential ratepayers. In brief, and beyond the issue of this being a matter outside of the role of this Board, the approach taken is still significantly under-inclusive. I agree with the Consumers Coalition that bill assistance targeted only at on-reserve First Nations customers excludes too many vulnerable consumers. First Nations customers on reserve are not the only ratepayers who experience energy poverty, nor are they the only ratepayers who have no choice but to heat with higher-cost options such as electricity as opposed to natural gas. There is a role for the Provincial Government as to the affordability of energy bills rather than the Utility or its regulator.

8.0 Regulatory Schedule and Compliance with Board Directives

From its initial letter of November 12, 2018 to its closing submissions, Manitoba Hydro has advised the Board that the MHEB is presently undertaking a review of the Utility's Strategic Plan, from which they will develop financial targets, rate strategies, and a long-term financial forecast. As part of that process, the MHEB will determine the financial targets for the Corporation, the pace at which those targets will be achieved, and any new strategies or undertakings that come out of the planning process or alter the direction of the company.

Manitoba Hydro has also advised the Board that it intends to file a complete GRA by late 2019. As communicated to the Board in the Utility's November 12, 2018 letter, the next GRA will include an Integrated Financial Forecast. In that GRA filing, Manitoba Hydro says that it will address the Board's directives from Order 59/18 not completed in time for the current GRA and deferred to the next GRA process.

As well as the general agreement among the parties as to the value brought to the rate-setting process from the filing of an IFF, as detailed below, the Board heard from some witnesses and parties that the regulatory process would be enhanced through Intervener involvement in reviewing Manitoba Hydro's compliance with Board directives.

Manitoba Hydro's Position

Manitoba Hydro advises that a more comprehensive and thorough review of the Board's prior directives that remain outstanding will occur at the next full GRA.

Manitoba Hydro does not support an Intervener request for direct involvement in clarifying the scope of a Board directive, suggesting alternative approaches, or assisting in determining the priority and timing of directives. The Utility maintains that only the Board can interpret the intent of its directives and whether the Utility has complied.

Manitoba Hydro does not accept the position of the Consumers Coalition that the Utility should conduct a review of its ratemaking principles. Rather, Manitoba Hydro says that certain of its existing ratemaking principles may be given more weight or prominence depending on the specific circumstances of future applications.

Intervener Positions

The Consumers Coalition, the only Intervener to address this issue, suggests that there is a role for Intervener participation in reviewing compliance filings by the Utility. In the view of this Intervener, this is warranted as some directives are recommended by Interveners or have a particular effect on those customers represented by Interveners.

The Consumers Coalition also recommends Manitoba Hydro undertake a review, concurrent with its Board's overall review and strategic planning, of the rate design principles that the Utility wants to apply going forward. This Intervener cites the Board's comprehensive review of the Cost of Service Study Methodology in 2016 but says that a corresponding review of ratemaking principles should also occur.

Board Findings

The Board finds that there is to be no role for Interveners in the Board's consideration of the Utility's compliance filing. The Board agrees with Manitoba Hydro that the Board is best positioned to determine whether the Utility complied has complied with directives. Should an Intervener be aggrieved by any aspect of a compliance filing and Order, that party can seek to have the compliance Order reviewed and varied under The Public Utilities Board Act and the Board's Rules of Practice and Procedure.

The Board has initiated a process whereby prior directives and the status of those directives will be posted on the Board's website. Comments from the parties are always welcome.

The Board finds that additional information should be provided in the compliance filing to this and subsequent Orders. In the compliance filing, Manitoba Hydro is to update the test year financial forecast reflecting the directions in this Order. In the case of the current GRA, this means Manitoba Hydro is to file an updated projected 2019/20 budget.

Even without Manitoba Hydro having a current IFF, the Board agreed to consider a one-year rate application to determine whether rate increases in 2019/20 are in the public interest. The Board appreciates that the MHEB is currently involved in a detailed and lengthy review that is to provide direction to the Utility to incorporate into its next IFF. This Order provides directives designed to assist in the MHEB's review and planning process before it finalizes its review.

As well, as set out above, the Board directs that Manitoba Hydro's next GRA, expected to be filed in late 2019, is to be filed with an IFF or other long-term financial forecast. The Board notes the unusual nature of this proceeding and, while due to the ongoing review and planning process by the new MHEB, emphasizes the importance of a regular regulatory schedule and complete regulatory filings. While it will not be a directive of this Board in this Order, regular review and consideration of ratemaking principles should be part of routine utility planning, especially when the majority of a utility's revenues come from consumer rates set by the regulator. This topic may be further explored when the Board reviews prior directives at the next GRA.

9.0 IT IS THEREFORE ORDERED THAT:

1. Manitoba Hydro's Application for a 3.5% across-the-board rate increase effective June 1, 2019 **BE AND HEREBY IS DENIED** as filed.

2. A 2.5% rate increase to the Residential, General Service Small-Demand, General Service Medium, General Service Large, and Area & Roadway Lighting customer classes and to the grid portion of the Diesel Zone General Service rates effective June 1, 2019, with all revenues generated being placed into a Major Capital Deferral Account **BE AND HEREBY IS APPROVED**.

3. A 2.5% rate increase to the revenue target of the General Service Small Non-Demand class **BE AND HEREBY IS APPROVED,** altered as follows: Manitoba Hydro is to implement differentiated rates to continue to move the Revenue to Cost Coverage ratio of the General Service Small Non-Demand customer class into the zone of reasonableness, assuming a 9-year timeframe to move the class within the zone of reasonableness.

4. There shall be no rate increase to the components of the First Nations On-Reserve Residential customer class and Diesel Zone Residential class rates.

5. Manitoba Hydro recalculate and file, for Board approval, a schedule of rates reflecting the rate increases and rate differentiation approved in this Order effective June 1, 2019, together with all supporting schedules including proof of revenue, customer impacts, and test year revenue requirement. The compliance filing shall be provided in a timely fashion to allow the Board no less than two business days to review and approve consumer rates effective June 1, 2019.

6. Manitoba Hydro file with the next GRA an explanation of the cost and revenue implications of the advancement in the Keeyask construction schedule from an in-service date of August 2021.

7. Manitoba Hydro file with its next GRA filing an Integrated Financial Forecast or other long-term financial forecast in a form consistent with an Integrated Financial Forecast.

8. Manitoba Hydro develop and file with the next GRA a detailed Operating & Administrative expense budget. That detailed budget is to include the 2019/20 year, as well as any years for which Manitoba Hydro seeks a rate increase together with comparison of year-over-year dollar and percentage increases for the last five years.

9. Manitoba Hydro participate in a technical conference hosted by Board staff or an external consultant appointed by the Board for the consideration of the use of rule-based regulation to provide guidance in the setting of consumer rates and of the question of the role and sufficiency of reserves in Manitoba Hydro's operations and the Board's rate regulation of the Utility.

10. Manitoba Hydro study and report at the next GRA on the issues associated with rate differentiation of the General Service Small Non-Demand customer class, including the intra-class impacts of any required rebalancing of customer, energy, and demand charges, whether class consolidation and harmonization with General Service Small Demand and General Service medium classes should continue, and class cost characteristics, load profiles, and bill frequencies.

11. Manitoba Hydro prepare and file a new Prospective Cost of Service Study with the next GRA.

Board decisions may be appealed in accordance with the provisions of Section 58 of *The Public Utilities Board Act*, or reviewed in accordance with Section 36 of the Board's Rules of Practice and Procedure. The Board's Rules may be viewed on the Board's website at www.pub.gov.mb.ca.

THE PUBLIC UTILITIES BOARD

"Robert Gabor, Q.C."
Chair

"Kurt Simonsen"
Associate Secretary

Certified a true copy of Order No. 69/19 issued by The Public Utilities Board

Associate Secretary

Appendix A: Appearances

PARTY	LEGAL COUNSEL
The Public Utilities Board	Bob Peters, Dayna Steinfeld
Manitoba Hydro	Odette Fernandes, Marla Boyd, Matthew Ghikas
Assembly of Manitoba Chiefs	Senwung Luk, Corey Shefman
Consumers Coalition	Byron Williams, Katrine Dilay
Manitoba Industrial Power Users Group	Antoine Hacault
Manitoba Keewatinowi Okimakanak Inc.	Jared Wheeler, Marcus Buchart

Appendix B: Parties of Record and Hearing Witnesses

PARTY	WITNESSES
Manitoba Hydro	Sandy Bauerlein, Corporate Controller, Corporate Controller Division, Finance & Strategy, Manitoba Hydro;
	Liz Carriere, Director, Rates & Regulatory Affairs Division, Manitoba Hydro;
	David Cormie, Director, Wholesale Power and Operations Division, Manitoba Hydro;
	Greg Epp, Manager, Financial Planning Department, Manitoba Hydro
	Lois Morrison, Interim Co-Lead, Marketing and Customer Service, Manitoba Hydro;
	Shawna Pachal, Acting Chief Finance and Strategy Officer, Manitoba Hydro;
	Susan Stephen, Treasurer, Manitoba Hydro
Assembly of Manitoba Chiefs	Philip Raphals, Executive Director, Helios Centre;
Consumers Coalition	Kelly Derksen, Principal, Kelly Derksen Consulting;
	William O. Harper, Independent Consultant;
	Darren Rainkie, Principal, Darren Rainkie Consulting
Manitoba Industrial Power Users Group	Patrick Bowman, Principal, InterGroup Consultants Ltd.
Manitoba Keewatinowi Okimakanak Inc.	(No Witnesses)