MANITOBA HYDRO
2012/13 & 2013/14 GENERAL RATE APPLICATION

OPERATING, MAINTENANCE & ADMINISTRATIVE EXPENSE

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1.0 OVERVIEW

The purpose of this Appendix is to provide an analysis of Manitoba Hydro's Operating, Maintenance and Administrative (OM&A) costs on an actual and forecast basis. The responsibilities for operating, maintaining and administrating the utility are conducted through its Business Units. The roles and functions of each Business Unit along with an overview of the budgetary control and management reporting process is described in Tab 3 of this Application.

OM&A costs are recognized in accordance with Canadian Generally Accepted Accounting Principles and apportioned to gas & electric utility operations through an integrated cost allocation methodology. In 2013/14 Manitoba Hydro will be transitioning to International Financial Reporting Standards (IFRS) and the impact on OM&A expenditures has been reflected in the forecasted costs for that period.

2.0 OM&A CORPORATE SUMMARY

The following table presents a summary of the OM&A costs and operating costs per customer for electric operations:

(in thousands of $)	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Forecast	Average Annual Increase
Electric OM&A (per Annual Report)	$ 379,697	$ 403,067	$ 410,717	$ 453,497	$ 538,770	
Less: Subsidiaries	2,146	6,121	7,414	6,531	6,945	
Accounting Changes	11,240	30,910	34,973	67,059	139,974	
Wuskwatim				7,881	9,635	
Electric OM&A after adjusting for subsidiaries, accounting changes and Wuskwatim	$ 366,311	$ 366,036	$ 368,330	$ 372,026	$ 382,216	
% Increase	4.28%	-0.08%	0.63%	1.00%	2.74%	1.71%
Number of Customers	532,359	537,229	542,490	549,150	555,651	1.05%
Cost Per Customer	$ 688	$ 681	$ 679	$ 677	$ 688	
% Increase (Decrease)	3.32%	-0.98%	-0.35%	-0.22%	1.54%	0.66%
Canadian CPI	1.40%	3.30%	1.90%	2.10%	2.00%	2.14%

As indicated in the above table, Manitoba Hydro has maintained the average annual increase in OM&A costs below inflation from 2009/10 through 2013/14 despite significant cost pressures and growth in the numbers of customers served. The average annual increase in OM&A costs over the 5 year period is 1.71% compared to the average annual increase in the Canadian CPI of 2.14%. OM&A cost per customer is forecast to increase by an average of only 0.66% per year over the 2009/10 to 2013/14 period.

Significant cost pressures continue to be experienced by Manitoba Hydro for key input costs including fuel, commodities, and other materials. The following table reflects information from Statistics Canada of relevant input cost increases for Manitoba Hydro:

Commodity	% Increase (January 2009 to December 2011)
Mineral Fuels	97%
Non-Ferrous Metals	47%
Wire and Cables >1000v	22%
Ferrous Materials	6%

The Corporation also continues to experience wage pressures in order to attract and retain talented employees in the increasingly competitive energy sector. According to Statistics Canada, the industrial aggregate of weekly earnings in the utility sector showed an increase in weekly earnings of 6.5% from October 2009 to October 2011. Since 2009/10, Manitoba Hydro has also experienced a substantial increase in pension benefit costs due to investment fund losses as a result of the economic downturn.

3.0 AGING INFRASTRUCTURE

Similar to other energy utilities in North America, Manitoba Hydro's generation, transmission and distribution assets have reached an age where overall condition is placing greater risk on reliable electric service. Many components of the electrical system were installed during urban and rural electrification and some assets have been in service more than 70 years.

Historically, the reliability performance of Manitoba Hydro's electrical system has been excellent. Recently, however, system reliability performance has begun to degrade and asset condition is a contributing factor. Evidence of reliability degradation is that the average number of annual customer outages has increased by 20% (1.7 vs. 1.4) over the past three years and the average duration of an outage increased by over 30% (2.4 hours vs. 1.8 hours).

In terms of Manitoba Hydro's ability to accommodate new load growth, 37 of 97 distribution stations in the City of Winnipeg are being operated beyond their technical limitations with that number increasing at a rate of two per year. A further 20 stations are within 20% of their maximum capability suggesting severe limitations to provide electricity service to expanding residential subdivisions or to large business developments. Eight stations are at least 60 years old. Public safety is becoming an increasing concern as the number of streetlight standards and manholes are beginning to fail at greater rates.

The availability of Manitoba Hydro's generating units has also declined with a significant deterioration in availability of units along the Winnipeg River System due to age of equipment, unknown failure modes and deferrals of capital projects.

Given the state of Manitoba Hydro's assets, over the next 20 years substantial increases in capital investment & maintenance budgets incremental to approved levels is required to upgrade aging distribution and generation infrastructure to avoid large-scale and long-duration outages. On the distribution system alone, it is estimated that incremental funding of approximately $50 million per year will be required (over and above what's included in approved operating and capital budgets).

4.0 ACCOUNTING CHANGES

Changes in accounting practices and policies have had a significant impact on the Corporation's OM&A expenditures over the period reviewed in this Application. These changes are primarily a result the planned implementation of IFRS in 2013/14 including related changes in prior years to support the transition.

Since 2009/10 Manitoba Hydro has removed approximately $23 million from its overhead capitalized with a further $27 million forecasted in 2012/13. Items removed from overhead capitalized include interest on equipment and facilities, building depreciation and operating costs, IT infrastructure and related support as well as various corporate department costs. Manitoba Hydro has also reduced the capitalization of intangible asset costs.

With the implementation of IFRS in 2013/14, overhead capitalized will be reduced by a further $36 million reflecting the removal of training, service area costs, administrative & clerical support and divisional and department management costs. In addition, Manitoba

Hydro Power Smart programs costs, Site Remediation costs and Regulatory costs will have to be expensed as incurred, as they will no longer be eligible to be treated as rate regulated assets under IFRS.

In 2011/12, it was necessary for Manitoba Hydro to reduce its discount rate for the valuation of its pension and benefit obligations reflecting industry trends to calculate rates in accordance with recent guidance from the Canadian Institute of Actuaries and lower interest rates in general. Further changes in 2013/14 under IFRS include the elimination of the amortization of past service costs and transitional adjustments related to pension and benefits.

Accounting reclassifications including the transfer of the payments to the Town of Gillam and the Frontier School Division to Capital & Other Taxes and Operating Expense Recoveries to Other Revenue have also impacted OM&A costs.

It should be noted that the increase to OM&A expense as a result of reduced capitalization of overhead will be offset, to a large extent, by reduced depreciation and amortization. The timing, however, will result in higher net costs in the year earlier years.

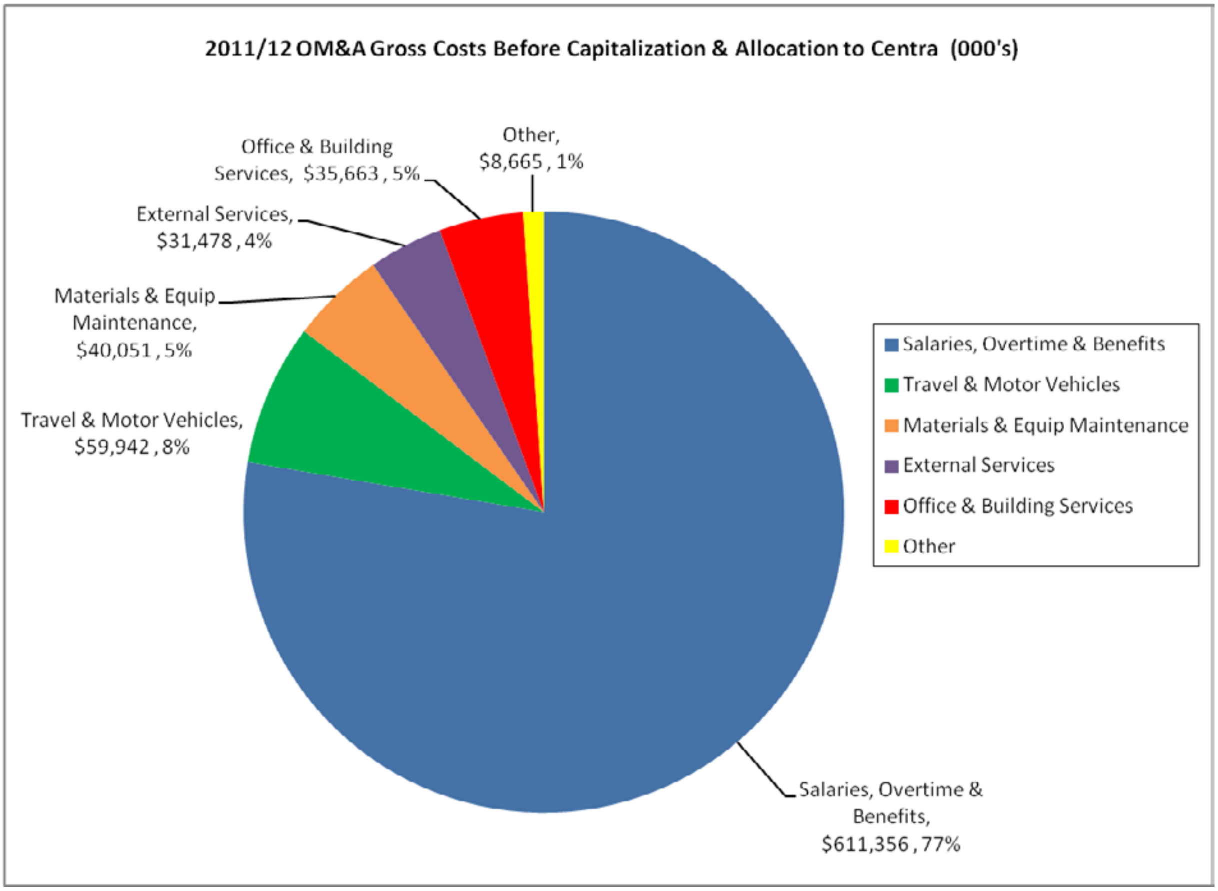
The following table provides a summary of the accounting changes by fiscal year:

SUMMARY OF ACCOUNTING CHANGES - ELECTRIC OPERATIONS
(in thousands of dollars)

	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Forecast
Reduction to Costs Capitalized					
Stores Overhead	$ 5,100	5,202	5,306	5,412	5,520
Executive Costs	2,000	2,040	2,081	2,122	2,165
Property Taxes on Facilities	2,000	2,040	2,081	2,122	2,165
Interest on Common Assets (Facilities & Equipment)		11,165	11,388	11,616	11,848
General & Administrative Departmental Costs		4,500	4,590	4,682	4,775
Interest on Motor Vehicles		3,780	3,856	3,933	4,011
IT Infrastructure & Related Support				17,100	17,442
Building Depreciation & Operating Costs				9,500	9,690
Technical & Softskills Training					10,450
Service Areas (Management Accounting, HR, Safety, etc.)					8,550
Administrative & Clerical Support Staff					8,550
Division & Department Manager					6,650
Fleet & Stores Administration					1,900
	9,100	28,727	29,302	56,488	93,717
Intangible Assets					
Ineligible for Capitalization	4,080	4,162	4,245	4,330	4,416
Rate Regulated Accounts					
Power Smart Program					31,713
Site Remediation					4,586
Regulatory Costs					1,344
	-	-	-	-	37,643
Pension & Benefits					
Change in Discount Rate			3,445		
Unamortized Past Service Amendments for Retiree Health Spending					(1,647)
Past Service Pension Costs					(521)
	-	-	3,445	-	(2,169)
Reclassifications					
Wire & Telecom Services	3,060	3,121	3,184	3,247	3,312
Funding Payments (Town of Gillam & Frontier School Division)	(5,000)	(5,100)	(5,202)	(5,306)	(5,412)
Operating Expense Recoveries				8,300	8,466
	(1,940)	(1,979)	(2,018)	6,241	6,366
Total	$ 11,240	$ 30,910	$ 34,973	$ 67,059	$139,974

5.0 COST ELEMENT OVERVIEW

The following chart provides a graphical depiction of the major cost element components of OM&A expenditures for 2011/12 actual expenditures.



The following table provides a summary of Manitoba Hydro's actual and forecast costs over the 5 year period, along with explanations for those cost elements that have significantly increased or decreased.

MANITOBA HYDRO
OPERATING, MAINTENANCE AND ADMINISTRATIVE COSTS BY COST ELEMENT

(In thousands of $)	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Forecast	Average Annual % Inc/(Dec)	Notes
Wages, Salaries	$ 407,988	$ 425,158	$451 925	$ 476,887	$ 486,425	4.5%	1
Overtime	50,307	50,704	54,987	56,005	57,126	3.3%	2
Employee Benefits	83,013	95,376	104,444	109,649	111,842	7.8%	3
Employee Safety & Training	4,284	3,863	3,909	4,914	5,013	4.8%	4
Travel	32,435	32,594	31,266	32,405	33,053	0.5%	
Motor Vehicle	24,281	24,436	28,676	24,784	25,280	1.6%	
Materials & Tools	26,897	28,105	26,663	27,173	27,716	0.8%	
Consulting & Professional Fees	14,814	11,157	10,250	11,639	11,872	-4.3%	5
Construction & Maintenance Services	20,109	22,657	21,228	18,706	19,080	-0.9%	
Building & Property Services	22,931	21,944	21,386	22,396	22,843	0.0%	
Equipment Maintenance & Rentals	14,379	14,165	13,388	14,476	14,766	0.8%	
Consumer Services	5,798	5,086	5,365	5,284	5,389	-1.6%	
Collection Costs	4,599	4,497	4,034	4,347	4,434	-0.7%	
Customer & Public Relations	8,155	7,905	8,093	6,949	7,088	-3.2%	6
Sponsored Memberships	1,325	1,917	1,608	1,081	1,103	-0.6%	
Office & Administration	15,320	14,316	14,277	15,263	15,569	0.5%	
Computer Services	983	1,003	861	909	927	-1.1%	
Communication Systems	1,772	1,678	1,683	1,683	1,717	-0.7%	
Research & Development Costs	3,952	3,651	2,796	3,509	3,579	-0.9%	
Miscellaneous Expense	1,190	1,264	2,032	1,213	1,237	7.2%	
Contingency Planning	-	-	-	278	2,875		
Operating Expense Recovery	(21,580)	(23,004)	(21,716)	(9,787)	(9,983)	-13.0%	7
Total Costs	722,951	748,471	787,155	829,765	848,951	4.1%	
Capital Order Activities	(224,298)	(243,545)	(268,651)	(246,065)	(250,986)	3.1%	8
Capitalized Overhead	(60,151)	(47,336)	(53,084)	(69,434)	(70,823)	5.9%	
Operating and Administration Charged to Centra	(60,951)	(60,644)	(62,117)	(67,300)	(68,646)	3.1%	
Subsidiaries	2,146	6,121	7,414	6,531	6,945		
IFRS Changes					71,574		
Wuskatim GS for Full Year In-Service	-	-	-	-	1,754		
OM&A Attributable to Electric Operations per Annual Report	**$ 379,697**	**$ 403,067**	**$ 410,717**	**$ 453,497**	**$ 538,770**		
Less:							
Subsidiaries	2,146	6,121	7,414	6,531	6,945		
Accounting Changes	11,240	30,910	34,973	67,059	139,974		
Wuskwatim				7,881	9,635		
OM&A Attributable to Electric Operations after adjusting for subsidiaries, accounting changes and Wuskwatim	**$ 366,311**	**$ 366,036**	**$ 368,330**	**$ 372,026**	**$ 382,216**		

Cost Change Explanations

1) Wages & Salaries increased by an average of 4.5% per year primarily as a result of contract settlements with bargaining units and increases in numbers of equivalent full time employees (EFTs). EFT additions were required to support the Corporation's capital programs as well as new trainees in the Operating Technician Trainee program to address current and expected attrition levels. In addition, increases in EFTs were necessary for higher maintenance requirements at hydraulic, thermal and converter stations. See section 6.0 Business Unit & EFT Overview for further details.

2) Overtime increased by an average of 3.3% as a result of protection of key in-service dates for maintenance and capital projects, system emergencies as well as increased costs due to impact of union contract settlements. Manitoba Hydro has experienced an increase in the number and frequency of major storms including severe lightening, wind and rainstorms in the spring and summer months as well as wind, ice and snowstorms during the fall and winter months. These storms resulted in extensive service interruptions to many communities. In addition, high water levels resulted in flooding in the Assiniboine and Souris River basins and Lake Winnipeg in the spring/summer of 2011. Overtime hours were required to facilitate plant relocation, maintain electrical service to customers and to provide clearances and conduct safety watches.

3) Employee Benefits increased by an average of 7.8% primarily due to higher pension costs due to losses incurred as a result of the economic downturn impacting returns on pension investments. Other factors include a reduction in the discount rate for the valuation of Manitoba Hydro's pension and benefit obligations, impact of wage increases and enhanced coverage for extended health benefits including vision care, chiropractor, dental and prescription drug coverage.

4) Employee Training & Safety increased by an average of 4.8% primarily as a result of increased trainee levels in the Operating Technician Trainee Program. This program offers cross-functional training to employees providing them with mechanical, electrical and station operator skills thereby increasing their responsibilities and enhancing their value to the corporation.

5) Consulting & Professional Fees decreased by an average of 4.3% primarily as a result of extraordinary expenses incurred for the Risk Management Review in fiscal 2010 as well as ongoing cost constraint measures.

6) Customer & Public Relations decreased by an average of 3.2% as a result of lower corporate donations due to cost constraint measures.

7) Operating Expense Recovery decreased by an average of 13% primarily due to the accounting reclassification of certain miscellaneous third party revenue items to Other Revenue. Items reclassified include electrical inspection fees, non-routine charges to customers (e.g. special read fees, disconnect fees), charges to Manitoba Telephone System (MTS) for use of microwave system and goods and services sold to outside parties.

8) Capital Order Activities increased by an average of 3.1% due to higher charges to new generation & transmission projects (e.g. Bipole III, Riel Station, Keeyask, Conawapa) and an increase in capital projects providing new service extensions to customers.

6.0 BUSINESS UNIT OM&A & EFT INCREASES

The following tables provide the Business Unit OM&A & EFT breakdowns.

MANITOBA HYDRO
OPERATING, MAINTENANCE AND ADMINISTRATIVE COSTS BY BUSINESS UNIT

(In thousands of $)	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Forecast	Average Annual % Inc/(Dec)	Notes
President & CEO	$ 31,578	$ 28,835	$ 28,328	$ 28,692	$ 29,239	-1.8%	1
Corporate Relations	4,697	4,739	3,025	4,491	4,585	3.8%	2
Finance & Administration	108,914	106,528	107,443	114,343	118,816	2.3%	3
Power Supply	147,073	150,120	155,084	177,882	187,031	6.3%	4
Transmission	92,302	90,493	89,261	104,662	107,265	4.1%	5
Customer Services & Distribution	111,068	106,707	110,045	130,355	132,916	4.9%	6
Customer Care & Marketing	42,395	41,446	43,703	52,249	95,922	26.6%	7
Business Unit Total*	**538,027**	**528,867**	**536,889**	**612,673**	**675,774**	6.1%	

*Note: Does not include allocations to capital and Centra Gas.

Cost Change Explanations:

1) The President & CEO area decreased by an average of 1.8% primarily due to reduced consulting services and professional fees as a result of the Risk Management review in fiscal 2010 & lower donations due to cost constraint measures.

2) The Corporate Relations Business Unit increased by an average of 3.8% due to higher wages as a result of union contract settlements and accounting changes reflecting costs no longer eligible for capitalization.

3) The Finance & Administration Business Unit increased by an average of 2.3% primarily due to accounting changes reflecting costs no longer eligible for capitalization including Rate Regulated and departmental administrative and support costs. Higher wages and salaries as a result of union contract settlements have been partially offset by lower building and property costs due to the cessation of leasehold rentals as a result of the move to Manitoba Hydro Place and ongoing cost constraint measures including the freeze on the filling of vacant positions.

4) The Power Supply Business Unit increased by an average of 6.3% primarily as a result of increases in EFTs necessary for increased maintenance of hydraulic and thermal stations, converter stations and control structures in order to supply secure

energy and capacity to meet system needs. EFT increases are also due to higher trainee levels to address existing staff shortages and future anticipated attrition levels. The increase in costs also reflects impacts of union contract settlements and accounting changes including Rate Regulated and departmental administrative and support costs no longer eligible for capitalization. Fiscal 2012/13 also includes a partial year in-service of the Wuskwatim Generating Station with a full year in 2013/14.

5) The Transmission Business Unit increased by an average of 4.1% as a result of union contract settlements and merit as well as costs to support environmental and NERC regulatory requirements. The increase in costs also reflects accounting changes including Rate Regulated and departmental administrative and support costs no longer eligible for capitalization and the reclassification of Operating Expense Recoveries to Other Revenue. These increases are partially offset by cost constraint measures including the freeze on the filling of vacant positions.

6) The Customer Service & Distribution Business Unit increased by an average of 4.9% as a result of contract settlements, overtime costs associated with system emergencies including flood damage and repair costs in 2011 and additional costs for meter change activity to comply with new Measurement Canada Standards. The increase also reflects accounting changes including departmental administrative and support costs no longer eligible for capitalization and the reclassification of Operating Expense Recoveries to Other Revenue. These increases are partially offset by cost constraint measures including a freeze on the filling of vacant positions, reductions in discretionary overtime and non-essential motor vehicles.

7) The Customer Care and Marketing Business Unit increased by an average of 26.6% primarily due to accounting changes including Rate Regulated (DSM programs - $42.6 million), departmental and administrative support costs no longer eligible for capitalization, and the reclassification of Operating Expense Recoveries to Other Revenue. Other cost increases including the impacts of union contract settlements have been partially offset by cost constraint measures.

MANITOBA HYDRO
EQUIVALENT FULL TIME EMPLOYEES BY BUSINESS UNIT

	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Forecast	2013/14 Forecast	Average Annual % Inc/(Dec)	Notes
President & CEO	116	123	127	126	126	2.1%	1
Corporate Relations	73	69	69	75	75	0.8%	
Finance & Administration	1,010	1,009	983	1,003	1,003	-0.2%	
Power Supply	1,679	1,796	1,853	1,972	1,972	4.1%	2
Transmission	1,342	1,365	1,354	1,385	1,385	0.8%	3
Customer Services & Distribution	1,678	1,704	1,701	1,731	1,731	0.8%	4
Customer Care & Marketing	532	528	521	549	549	0.9%	
Total	6,429	6,594	6,608	6,842	6,842	1.6%	

EFT Change Explanations:

1) The increase in EFTs in the President & CEO area is primarily due to additional positions for the strategic review function, corporate security and legal functions.

2) The increase in EFTs in the Power Supply Business Unit is due to the filling of new and existing vacant positions to support the following functions:
   - Increased operating and maintenance requirements for hydraulic, thermal and converter stations and control structures including the in-service of the Wuskwatim GS in 2012/13. Vacancies in the northern part of the province had been exceptionally high due to attraction and retention issues;
   - Higher trainee levels in the Operating Technician Trainee Program;
   - Project management functions for capital programs including support for new generation capital projects (e.g. Keeyask, Conawapa, Bipole III), environmental assessment licensing and Needs For & Alternatives To (NFAT) process;
   - Environmental management, engineering, protection and monitoring including greenhouse gas and air emissions;
   - Other areas include operations of the Grand Rapids Fish Hatchery, operations and maintenance of the new High Voltage Test Facility, condition assessments and performance testing and analysis, hydrometric and hydraulic engineering as well as aboriginal participation negotiations.

3) The increase in EFTs in the Transmission Business Unit is due to additional positions to support the Transmission capital program including major projects such as Riel Station and Bipole III. Positions are required for project management, engineering design, contract management and construction activities. New positions are also required to support environmental requirements.

4) The increase in EFTs in the Customer Service & Distribution Business Unit is primarily due to additional EFTs to address capital programs with a focus on customer driver requirements in rural areas, meter change activities to comply with the new Measurement Canada Standards, repatriation of the line locate program from Manitoba Hydro Utility Services (MHUS) and overtime requirements for system emergencies and protection of in-service dates.

7.0 ONGOING COST CONTRAINT MEASURES

Manitoba Hydro continues to take a number of measures to constrain the growth in OM&A costs. These measures include the following:

- External hiring freeze (unless specifically approved by the President & CEO)
- Restrictions on out-of-province travel
- Overtime restrictions (except to respond to system emergencies and to maintain the safety and reliability of the energy supply system)
- Reductions in community sponsorships and donations
- Further leveraging of technology to improve operational efficiencies