

MANITOBA HYDRO
INTERIM RATES EFFECTIVE SEPTEMBER 1, 2012
& RESPONSE TO REQUEST FOR ADDITIONAL INFORMATION

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MANITOBA HYDRO
INTERIM RATES EFFECTIVE SEPTEMBER 1, 2012
& RESPONSE TO REQUEST FOR ADDITIONAL INFORMATION

1.0 INTRODUCTION

Manitoba Hydro filed Volume I of its 2012/13 & 2013/14 General Rate Application (“GRA” or the “Application”) with the Public Utilities Board of Manitoba (“PUB”) on June 15, 2012, followed by Volume II of the Application on July 6, 2012, and supplemented with a further filing on July 19, 2012, with information updated for actual results at March 31, 2012. Manitoba Hydro has applied, pursuant to sections 44(1) and 47(2) of *The Public Utilities Board Act*, for approval of rate schedules incorporating an across-the-board 2.5% increase on currently billed rates for all rate classes effective September 1, 2012, and interim approval of rate schedules incorporating a 6.5% rate increase effective September 1, 2012, on the full-cost portion of the rate applicable to general service and government customers in four remote communities served by diesel generation. Manitoba Hydro has also applied to maintain in base rates, the rates approved by the PUB in Orders 30/10 and 40/11 and include in current year revenues, the revenues previously billed and collected which have been accumulated in a deferral account pertaining to rates implemented April 1, 2010. Manitoba Hydro has also requested approval of a 3.5% increase in overall revenue effective April 1, 2013. Additional information will be filed with the PUB to support the proposed rate increase for April 1, 2013.

On July 9, 2012, the PUB requested additional information to assist in the consideration of Manitoba Hydro’s proposed interim rate increases effective September 1, 2012, and the subsequent GRA. The PUB also invited Manitoba Hydro to provide a written submission, at the same time as the requested additional information, with respect to its proposed September 1, 2012 interim rate increases.

On July 13, 2012, Manitoba Hydro advised the PUB of the materials that would be available for filing by July 23, 2012. Section 2.0 of this filing provides Manitoba Hydro’s written submission with respect to its proposed interim rate increases effective September 1, 2012, and Section 3.0 provides responses to the additional information requested by the PUB, as discussed in Manitoba Hydro’s letter of July 13, 2012.

1 **2.0 REASONS FOR SEPTEMBER 1 INTERIM RATE INCREASE**

2
3 The current market circumstances of low export prices continue to reduce extraprovincial
4 revenues compared to historical levels and have a significant negative impact on Manitoba
5 Hydro's current and projected net income and financial ratios.

6
7 Primarily as a result of the low export prices, the financial outlook for Manitoba Hydro's
8 electricity operations has significantly deteriorated since the 2010/11 & 2011/12 GRA
9 proceeding concluded. In the current Financial Forecast (IFF11-2), net income for
10 electricity operations for 2011/12 is projected to be \$60 million, which is a reduction of
11 \$65 million compared to the \$125 million that was projected in the previous forecast
12 (IFF10-2). While Manitoba Hydro's 2011/12 consolidated financial results will not be
13 publicly released until early August 2012, the Corporation can advise that the actual net
14 income from electricity operations is close to that which was projected in IFF11-2.
15 Further, while the Quarterly Report for the 3-month period ended June 30, 2012 cannot
16 be publically released until approximately mid-August, Manitoba Hydro can advise that a
17 substantial net loss on electricity operations has been incurred for the first quarter of the
18 2012/13 fiscal year.

19
20 Manitoba Hydro is projecting in IFF11-2 that net income for electricity operations for
21 2012/13 will be \$20 million. This includes the beneficial impacts of the 2.5% proposed
22 interim rate increase for September 1, 2012 together with the requested reinstatement of
23 the 1% rate rollback directed in Order 5/12. This represents a reduction of \$101 million
24 from the level of net income for electricity operations of \$121 million for 2012/13 that
25 was projected in IFF10-2. Should the requested rate increase and rollback reinstatement
26 not be approved, Manitoba Hydro is projecting that a net loss of \$35 million will be
27 incurred for the 2012/13 fiscal year. Manitoba Hydro is strongly of the view that
28 allowing the utility to incur a net loss on operations is not in the best interest of electricity
29 ratepayers and could result in the requirement for substantially higher rate increases in
30 the future.

31
32 The following table (Table 1) provides a forecast of electricity operations net income for
33 2011/12 and 2012/13 and the associated financial ratios with and without the proposed
34 rate increase and the reinstatement of the 1% rate rollback.

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Table 1 - Net Income - Electricity Operations		
(in millions of \$)	Projected Forecast	
	2011/12	2012/13
Revenue		
General Consumers Revenue		
- at approved rates	\$ 1,209	\$ 1,281
- 1% rate deferral	(23)	
Extraprovincial Revenue	363	341
Other Revenue	7	16
Total Revenue	1,556	1,638
Total Expenses	1,496	1,672
Non-controlling Interest	-	(1)
Net Income (loss) before proposed rate increases	\$ 60	\$ (35)
Proposed rate increases	-	20
Rate rollback reinstatement		35
Net Income after proposed rate increases & rate rollback reinstatement	\$ 60	\$ 20

Retained Earnings and Financial Ratios (before proposed rate increases)

Retained Earnings	2,387	2,352
Debt to Equity Ratio	74:26	77:23
Interest Coverage Ratio	1.10	0.96
Capital Coverage Ratio	1.13	1.06

Retained Earnings and Financial Ratios (after proposed rate increases & rate rollback)

Retained Earnings	2,387	2,411
Debt to Equity Ratio	74:26	76:24
Interest Coverage Ratio	1.10	1.05
Capital Coverage Ratio	1.13	1.19

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Manitoba Hydro requires the requested September 1, 2012 interim rate increase and rate rollback reinstatement to maintain net income and financial ratios in 2012/13 at acceptable levels and to preserve the financial integrity of the Corporation.

8
9
10
Even with the implementation of the proposed September 1, 2012 interim rate relief, the interest coverage ratio is projected to deteriorate to the 1.05 level in 2012/13, which is well below the 1.20 target level. Without the interim rate relief proposed for 2012/13 the

1 interest coverage ratio could further deteriorate below the 1.0 level which could raise
2 significant concerns on the part of credit rating agencies, given the importance of this
3 financial metric to the assessment of the credit worthiness of the Province and Manitoba
4 Hydro. While the 2.0% interim rate increase that was granted by the PUB effective April
5 1, 2012 contributes to partially offset the revenue deterioration in 2012/13, it is
6 insufficient to maintain the minimum acceptable level of net income and financial ratios.

7
8 Manitoba Hydro continues to aggressively pursue measures to ensure that the
9 Corporation's operating and capital expenditures are only those necessary to maintain
10 safe, reliable and efficient service to customers.

11
12 As indicated in the following table (Table 2) below and further explained in Appendix
13 5.6 of the Application, despite significant cost pressures in excess of inflation, Manitoba
14 Hydro is maintaining increases in OM&A costs below inflation for 2011/12 and 2012/13.
15 Manitoba Hydro's OM&A cost per customer shows decreases in both 2011/12 and
16 2012/13.

17
18 Despite Manitoba Hydro's success in controlling its costs of operations, there are real and
19 significant concerns about the aging infrastructure issue that is confronting electrical
20 utilities across North America. Please refer to Appendix 5.6 of the Application, as filed
21 with the PUB on July 19, 2012, for a further discussion on the aging infrastructure issue
22 and the potential impacts on Manitoba Hydro's system reliability and costs of operations.

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24

1

Table 2- OM&A Cost per Customer

(in thousands of \$)	2011/12 Actual	2012/13 Forecast
Electric OM&A (per Annual Report)	\$ 410,717	\$ 453,497
Less: Subsidiaries	7,414	6,531
Accounting Changes	34,973	67,059
Wuskwatim		7,881
Electric OM&A after adjusting for subsidiaries, accounting changes and Wuskwatim	\$ 368,330	\$ 372,026
% Increase	0.63%	1.00%
Number of Customers	542,490	549,150
Cost Per Customer	\$ 679	\$ 677
% Increase (Decrease)	-0.35%	-0.22%
Canadian CPI	1.90%	2.10%

2

3

4 The implementation of a rate increase of 2.5% effective September 1, 2012 together with
5 the 2.0% interim rate increase that was approved by the PUB effective April 1, 2012 will
6 produce a similar level of additional revenue in 2012/13 as would have been produced
7 had a 3.5% rate increase been approved for April 1, 2012, as was originally requested by
8 the Corporation. Manitoba Hydro continues to be of the view that this is the appropriate
9 level of electricity rate increase for 2012/13 considering all relevant factors.

10

11 In addition to the application for grid rate increases, Manitoba Hydro is seeking a 6.5%
12 interim rate increase, effective September 1, 2012, to the full cost portion of the rate
13 applicable to General Service (over 2000 kWh per month) and Government customers in
14 four remote communities served by diesel generation. This proposed increase is not cost
15 based, but is consistent with the 2.0% grid increase approved by the PUB in Order 40/11
16 effective April 1, 2011; the interim increase of 2.0% approved by the PUB in Order 32/12
17 effective April 1, 2012; and the proposed increase in rates of 2.5% effective September 1,
18 2012. If the rate increase was based on cost to serve these communities, the required rate
19 increase would be approximately 19% to those customers who pay the full cost rate.

20

21 The proposed interim rate increases are in keeping with Manitoba Hydro's approach to
22 implement regular and reasonable rate increases to ensure the maintenance of an adequate

1 financial structure. A sufficient level of equity allows the Corporation to withstand the
2 risks and uncertainties inherent in its operations and to address adverse financial
3 consequences outside of its control, and in doing so, promote rate stability and avoid the
4 need for large or sudden rate increases in the future. Regular and reasonable rate
5 increases ensure that the Corporation is able to generate sufficient funds to make the
6 necessary expenditures to continue to provide safe and reliable service to customers.

7
8 With respect to the necessity of generating sufficient funds to continue to provide safe
9 and reliable service to customers, Manitoba Hydro would like to comment on what
10 appears to be a misunderstanding related to “pre-funding” for major capital projects such
11 as Bipole III, Keeyask and Conawapa.

12
13 Manitoba Hydro has consistently maintained that current rates do not reflect any
14 associated costs for a capital project until such time as that project is placed in service.
15 This is a correct statement and is fundamental to accepted utility accounting practices in
16 Canada. This does not mean, however, that cash from current operations is not invested
17 in capital projects. To fully understand what might appear to be contradictory statements
18 with respect to funding of capital projects, it is necessary to take a step back and consider
19 the financial targets of Manitoba Hydro, and how those financial targets result in cash
20 generation for the Corporation. Manitoba Hydro’s financial targets are as follows:

21

<u>Ratio</u>	<u>Target</u>
Debt/Equity	Maintain a minimum debt/equity ratio of 75:25.
Interest Coverage	Maintain an interest coverage ratio of greater than 1.20.
Capital Coverage	Maintain a capital coverage ratio of greater than 1.20 (excepting major new generation and transmission).

22
23 Manitoba Hydro’s financial targets have been in place for many years and have been
24 accepted as reasonable by the PUB, by credit rating agencies, and by other stakeholders.
25 Manitoba Hydro’s financial targets are also generally consistent with other major
26 electrical utilities in Canada.

27
28 Accepting the financial targets means that for each year that the financial targets are
29 attained, surplus cash will be generated (i.e. cash over and above cash required to fund
30 day-to-day operations).

31

1 To elaborate on this point, the attainment of a debt/equity ratio of 75:25 means that 75%
2 of Manitoba Hydro's investment in fixed assets has been financed by debt and 25% has
3 been financed by equity or retained earnings. Therefore, rather than having retained
4 earnings deposited in an idle investment account, Manitoba Hydro's retained earnings are
5 invested in the fixed assets of the Corporation for the benefit of all ratepayers. Those
6 fixed assets include such projects as Wuskwatim, Bipole III, Keeyask, and Conawapa.

7
8 Similarity, the attainment of a 1.20 ratio for interest coverage and capital coverage
9 means, by definition, that funds are generated internally over and above the cash needed
10 to fund interest on debt and base capital. Again, these surplus funds are invested in
11 capital assets of the Corporation (including Wuskwatim, Bipole III, Keeyask, and
12 Conawapa).

13
14 To the extent that surplus cash is generated through the attainment of financial targets and
15 that surplus cash is used to invest in capital projects, current ratepayers receive an interest
16 credit similar to the credit they would receive if the cash was invested in savings bonds or
17 any other investment account. This interest credit is credited back to current operations
18 on Manitoba Hydro's income statement which, in effect, reduces the costs that current
19 ratepayers would otherwise incur. It is clear, therefore, that current rates do not include
20 any costs related to capital projects before those projects are placed in service.

21
22 In summary, Manitoba Hydro is seeking interim approval for proposed rate changes
23 effective September 1, 2012 for the following reasons:

- 24
- 25 1. The need is urgent to avoid continuing losses on operations;
 - 26
 - 27 2. Financial ratios are deteriorating and are projected to further deteriorate in the test
28 years;
 - 29
 - 30 3. It is essential that the financial and credit rating integrity of Manitoba Hydro be
31 maintained;
 - 32
 - 33 4. Prices on the export market are not expected to improve substantially in the near
34 term;
 - 35
 - 36 5. Costs are being well-controlled and cannot be reduced further without negatively
37 impacting the safety, reliability and efficiency of the power system;

- 1 6. The aging infrastructure issue will result in higher maintenance and capital costs
2 in the future;
3
4 7. There is a separate government-approved process to review Manitoba Hydro's
5 major capital projects; in the meantime, current rates do not include any costs
6 related to capital projects before those projects are placed in service; and,
7
8 8. Even with the proposed rate changes, electricity consumers in Manitoba will
9 continue to benefit from the lowest electricity rate structure in Canada (please
10 refer to Table 3 below).
11

Table 3- Utility Rate Changes

	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative Increases (including proposed)	Current Rates Index
Manitoba Hydro	0.0%	2.2%	5.0%	2.9%	2.8%*	2.0%	3.6% (proposed)	3.5% (proposed)	24.2%	100%
Hydro Quebec	5.3%	1.9%	2.9%	1.2%	0.4%	(0.4%)	(0.5)%	n/a	11.1%	108%
BC Hydro	1.5%	2.1%	0.8%	9.3%	7.3%	7.8%	7.1%	1.4% (proposed)	43.4%	116%
Sask Power	4.9%	4.2%	0.0%	8.5%	4.5%	0.0%	0.0%	4.9% (proposed)	30.0%	148%
New Brunswick Power	6.9%	5.9%	3.0%	3.0%	3.0%	0.0%	0.0%	n/a	23.7%	170%
Nova Scotia Power	8.7%	3.8%	0.0%	9.3%	0.0%	6.1%	8.7%	3.0% (proposed)	46.4%	194%

12
13
14 Manitoba Hydro believes that the evidence before the PUB provides prima facie support
15 for the requested interim rate increases and submits that considering the current financial
16 situation and outlook, it is appropriate to grant the interim rate relief requested effective
17 September 1, 2012, while at the same time proceeding with a full GRA process which
18 will include consideration of the interim rates together with a further rate increase of
19 3.5% on April 1, 2013. Granting interim rate relief for September 1, 2012 balances both
20 the needs of the utility and the interests of the public by maintaining the financial position
21 of the Corporation in the short-term, while allowing for a full review of the rate requests
22 during the 2012/13 and 2013/14 GRA process.
23

1 **3.0 PUB REQUEST FOR ADDITIONAL INFORMATION**

2
3 Manitoba Hydro is providing the following information in response to the PUB's request
4 for additional information as set out in its letter of July 9, 2013:

5
6 Item 1:

7 As discussed in its letter of July 13, Manitoba Hydro will provide copies of its audited
8 financial statements for the year ended March 31, 2012, the Manitoba Hydro-Electric
9 Board ("MHEB") 2012 Annual Report, and the MHEB Quarterly Report for the three
10 months ended June 30, 2012, once it is able to publically release these documents.

11
12 Item 2:

13 Attachment 1 provides a copy of Manitoba Hydro's 2012 Electric Load Forecast.

14
15 Item 3:

16 Attachment 2 provides the 2010/11 Power Resource Plan, and Attachment 3 provides the
17 2011/12 Power Resource Plan.

18
19 Item 4:

20 Attachment 4 provides a copy of the 2012 Economic Outlook.

21
22 Item 5 & 6:

23 Attachment 5 provides the revenue assumptions for IFF11-2.

24
25 Item 7:

26 Please see the following chart for a breakdown of the Board Approved rate increase from
27 the last GRA and those proposed in the current GRA.
28

MANITOBA HYDRO
GENERAL CONSUMERS REVENUE

Additional Information - Item 7
(000's)

	2009/10 Actual	2010/11 Actual	2011/12 Projected	2012/13 Forecast	2013/14 Forecast
Residential - Base Rates	\$ 475,986	\$ 488,667	\$ 461,277	\$ 502,154	\$ 512,621
General Service - Base Rates	668,905	677,884	690,723	705,789	720,526
Base Rates - 2009/10 (Includes 2.9% April 1, 2009 rate increase)	1,144,891	1,166,551	1,152,000	1,207,943	1,233,147
2010/11 Interim Rate Increase (2.9% April 1, 2010)	-	33,830	33,408	-	-
2010/11 Approved Rate Increase (1.9% April 1, 2010)	-	-	-	22,951	23,430
2011/12 Approved Rate Increase (2.0% April 1, 2011)	-	-	23,708	24,618	25,132
2012/13 Interim Rate Increase (2.0% April 1, 2012)	-	-	-	25,110	25,634
Interim & Approved Rate Increases	-	33,830	57,116	72,679	74,195
Deferred Revenue - 2010/11 & 2011/12 (1% rate rollback)	-	-	(22,894)	22,894	-
Deferred Revenue - 2012/13 & 2013/14 (1% rate rollback)	-	-	-	12,144	12,096
Deferred Revenue from 1% rate rollback	-	-	(22,894)	35,038	12,096
Additional General Consumers Revenue (2.5% September 1, 2012)	-	-	-	19,912	32,669
Additional General Consumers Revenue (3.5% April 1, 2013)	-	-	-	-	46,982
Additional General Consumers Revenue	-	-	-	19,912	79,651
Total Revenue	\$ 1,144,891	\$ 1,200,381	\$ 1,186,222	\$ 1,335,571	\$ 1,399,088

1
2 Item 8:
3 Attachment 6 provides an alternative IFF11-2 reflecting the final rate rulings in Order
4 5/12 as well as the refund of the deferral account over two years (not recommended by
5 Manitoba Hydro).

6
7 Item 9:
8 Attachment 7 provides the Proof of Revenue Schedule for the 3.5% interim rate increase
9 proposed by Manitoba Hydro in its Application for Interim Rates Effective April 1, 2012,
10 as originally filed March 30, 2012. Attachment 8 provides the Proof of Revenue Schedule
11 for the 2.0% interim rate increase approved by the PUB effective April 1, 2012, as
12 originally filed on April 3, 2012.

13
14 Item 10:
15 Attachment 9 provides the actual average monthly watershed flow data to June 2012, and
16 forecast data to December 2012.

17
18 Item 11:
19 The following provides the revenue requirement impacts for Wuskwatim in the 2012/13
20 and 2013/14 forecast years.

**Estimated Revenue Requirement Impact for Wuskwatim
 (\$Millions)**

Projected capital cost of Wuskwatim	\$ 1,672		
Internally generated funds (29%)	<u>(481)</u>		
Long term borrowing requirements	<u>\$ 1,191</u>		
		<u>2012/13</u>	<u>2013/14</u>
Long term financing cost @ 6%	\$ 65	\$	71
OM&A costs	8		10
Depreciation @ 1.5%	23		25
Capital tax and water rentals	10		11
Income statement impacts	<u>\$ 106</u>	<u>\$</u>	<u>117</u>

1
 2
 3 Further to our letter of July 13, 2012, there will be no Revenue Requirement impact for
 4 Keeyask, Conawapa or BiPole III in the test years as none of these projects have been
 5 approved and any costs associated with maintaining the in-service dates are not
 6 incorporated into the Revenue Requirement for purposes of establishing rates. Please see
 7 further discussion related to this matter in Manitoba Hydro's written submission in
 8 Section 2.0.

9
 10 Item 12:

11 Attachment 10 provides the extended 2011 Capital Expenditure Forecast for the years
 12 2022 through 2032.

13
 14 Item 13:

15 Manitoba Hydro filed Tab 13 of its GRA on Cost of Service, and the related appendices
 16 with the PUB on July 19, 2012.

17
 18 Item 14:

19 Appendix 5.6 was filed with the PUB July 19, 2012.