

## **MIPUG INTERROGATORIES TO CAC/MSOS**

**2010/11 & 2011/12 MANITOBA**

### **HYDRO GENERAL RATE APPLICATION**

**DECEMBER 17TH, 2010**

#### **MIPUG/CAC/MSOS (Matwichuk) I - 1**

**Reference:** Direct Evidence of M.G. Matwichuk Prepared for the Consumers Association of Canada and the Manitoba Society of Seniors, Question 7, pages 5-6

- (a) Is Mr. Matwichuk's primary concern that ratepayer's risk exposure to export revenue is assymetrical, i.e. that they bear the cost of lower than forecast export revenue without there being a mechanism to ensure they receive benefits of higher than forecast export revenues? Please discuss.

#### **Answer:**

- (a) Fundamentally, the record for the current general rate application proceeding outlines the potential for misaligned risk tolerances. Mr. Matwichuk's evidence addresses how to properly use the financial gains from favourable events to ensure that the domestic ratepayers receive the benefits of those events in the same manner as they bear the losses from unfavourable events.

As discussed in response to PUB/CAC/MSOS (Matwichuk) I-22 (d), there are three significant expected outcomes of the RSR, as follows:

Ratepayers bear the risk of actual net export revenue being lower than forecast. In response to bearing that risk, ratepayers should receive the benefits that accrue from actual net export revenue exceeding forecast.

Historically, it does not appear that there is an explicit link between favourable events and the benefits of those events to ratepayers. While rate increases or even delays in rate increases may have happened in response to circumstances (such as changes in water levels), the impetus for domestic rate impact would tend to rely on discretion of Manitoba Hydro. An explicit mechanism that would link the impact of events to domestic rates could obviate the need for Manitoba Hydro exercise that discretion.

The recommended RSR could act as a mechanism that would provide the explicit link. The recommended RSR is designed to be symmetrical such that ratepayers would both benefit from favourable events and bear the burden of unfavourable events, and both would be reflected in rates over a five year period, thus mitigating against a single year rate impact, either up or down. Please see the discussion under

Q.33 of the evidence regarding Table 4 and the responses to PUB/CAC/MSOS (Matwichuk) I-22 (a) – (c).

**MIPUG/CAC/MSOS (Matwichuk) I - 2**

**Reference:** Direct Evidence of M.G. Matwichuk Prepared for the Consumers Association of Canada and the Manitoba Society of Seniors, Question 15, page 14

- (a) Does Mr. Matwichuk agree with the NBF description that the primary source of net income variability relates to the substantial level of hydrology risk that is present in Manitoba Hydro's operations? Please discuss.

**Answer:**

- (a) Regarding the above, Mr. Matwichuk referenced an excerpt from the National Bank Financial ("NBF") evidence which included the following statement by NBF:

As previously discussed, Manitoba Hydro's financial results are subject to several volatility factors, most notably variances in export electricity prices, exchange rates and hydrology. The primary source of net income variability relates to the substantial level of hydrology risk that is present in Manitoba Hydro's operations.

Mr. Matwichuk does not have expertise in hydrology and hydrology risk, *per se*. However, based on the evidence on the record of this proceeding, it would appear that hydrology has a significant impact on export sales and the variability in export sales i.e. the financial impact of realizing hydrology risk would appear to be a significant cause of net income variability year to year.

Naturally, there are other factors that would affect net income variability in the year, such as wholesale energy prices, and over longer periods, such as debt (interest costs) and capital (depreciation). However, it would appear that the variability of water levels and associated matters lead to more uncertainty year to year and greater challenges in forecasting at the time of rate setting.

Apart from the NBF report, the record of this proceeding also contains the following passages with respect to variability of water flows and financial performance:

As noted previously, given its size, Manitoba Hydro has a very large position in power exports. As such, earnings derived from electricity exports are one of the most critical factors influencing corporate financial performance, and in turn, determine the stability of average domestic electricity rates.<sup>1</sup>

Variability in water inflows and temperature related-load have much more significant impact on optimal production schedules than market price variation.<sup>2</sup>

As a hydro-based system, drought periods have a significant adverse impact on power sales through reduced exports and consequently on net income. Conversely, high water flow periods contribute to more surplus power and export sales and higher net income and retained earnings.<sup>3</sup>

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<sup>1</sup> Manitoba Hydro, 20010/11 – 2011/12 GRA, Volume 2, Appendix 12.2, ICF Report, September 11, 2009, page 54

<sup>2</sup> KPMG Risk Report, "Manitoba Hydro – External Quality Review – Main Report, April 15, 2010, page 64

<sup>3</sup> KPMG Risk Report, "Manitoba Hydro – External Quality Review – Main Report, April 15, 2010, page 18

## **MIPUG/ CAC/MSOS (Matwichuk) I – 2**

**Reference:** Direct Evidence of M.G. Matwichuk Prepared for the Consumers Association of Canada and the Manitoba Society of Seniors, Question 15, page 14

- (b) Does Mr. Matwichuk believe that mechanisms to address drought risks to Manitoba Hydro and its ratepayers should be the primary focus of the present risk proceeding? Please discuss.

### **Answer:**

- (b) Mr. Matwichuk understands the current proceeding is a general rate application. The primary focus of a general rate application proceeding is to set just and reasonable rates. Rates will be set within the context of hydrology, as it impacts MH. As pointed out in his evidence and echoed in the MIPUG evidence<sup>4</sup>, the Board has set out its concerns regarding hydrology and other risks in a number of prior decisions. The developments with respect to, and following on, the NYC matters appear to have underlined those concerns. Based on prior decisions and the more recent developments, the Board undertook a more intensive review of risk in this current general rate application.

As noted by Mr. Matwichuk, his evidence recognizes the existence of risk including export revenue volatility and forecasting volatility as well as the financial consequences of risk.

It is assumed that, given the path that led to the examination of risk in this general rate application, the Board will conduct its assessment of risk, provide its findings and then consider viable solutions to deal with risk in the context of a general rate application and, specifically, domestic customer rates.

Mr. Matwichuk's evidence offers a viable solution to providing a simple mechanism to ameliorate risk to the domestic ratepayers whereby there is an explicit link of burdens and benefits to domestic rates, such that financial gains from favourable events to ensure that the domestic ratepayers receive the benefits of those events in the same manner as they bear the losses from unfavourable events. Please see the discussion under Q.33 of the evidence and the responses to PUB/CAC/MSOS (Matwichuk) I-22 (a) – (c) which outline the mechanics of the recommended RSR.

As outlined in PUB/CAC/MSOS (Matwichuk) I-22 (d), there are three significant expected outcomes of the recommended RSR.

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<sup>4</sup> Pre-filed Testimony of P. Bowman and A. McLaren, December 10, 2010, page 14, lines 17 – 25 and page 16, lines 6 - 18

**MIPUG/CAC/MSOS (Matwichuk) I - 3**

- (a) Under Mr. Matwichuk's proposed rate stabilization reserve, would charges to and from the RSR be reviewed and approved by the PUB? Please discuss.

**Answer:**

- (a) The amounts would be reviewed and approved by the PUB, since ultimately the amounts would impact rates. That being said, Mr Matwichuk anticipates that the amounts that either supplement or are drawn from the recommended RSR would be fairly mechanical to determine. It is expected this exercise would also be fairly simple and akin to a review of a disposition of a variance account or the gas variance account of Centra Gas Manitoba Inc.