# Manitoba Hydro
# 2015 General Rate Application

## Final Argument


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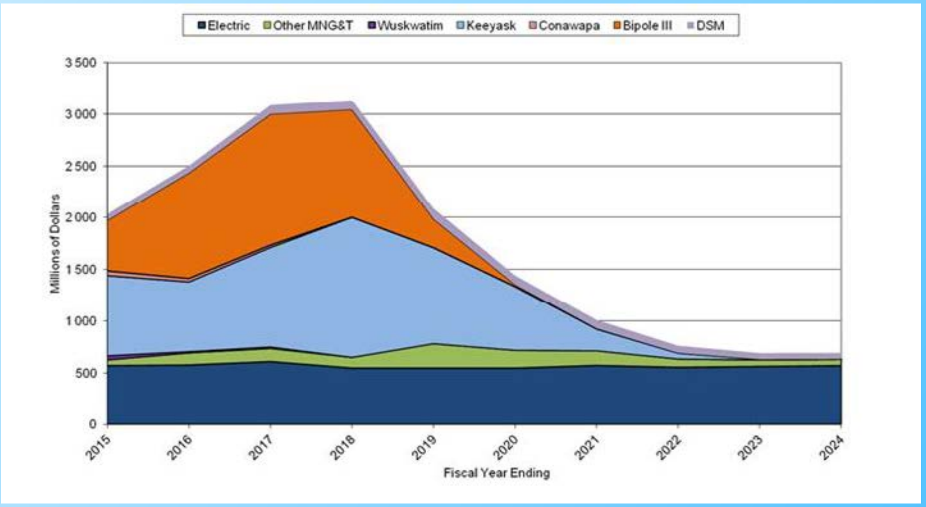
Legal Counsel

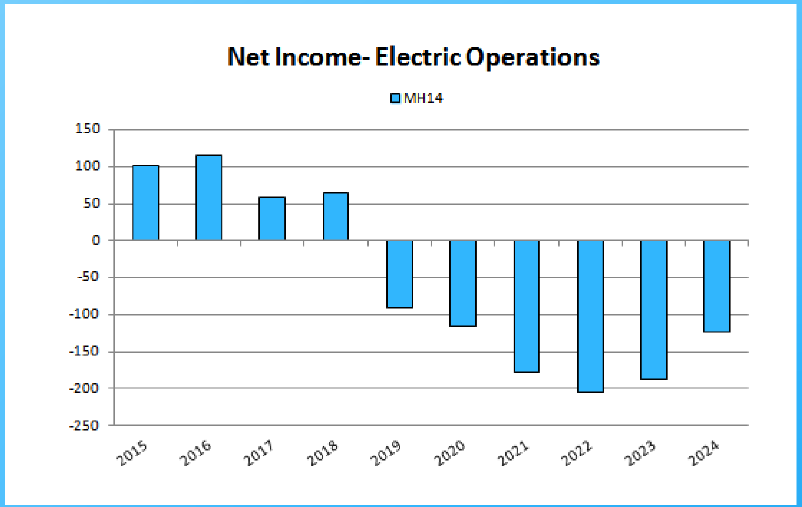
Manitoba Hydro

# The Future is Now

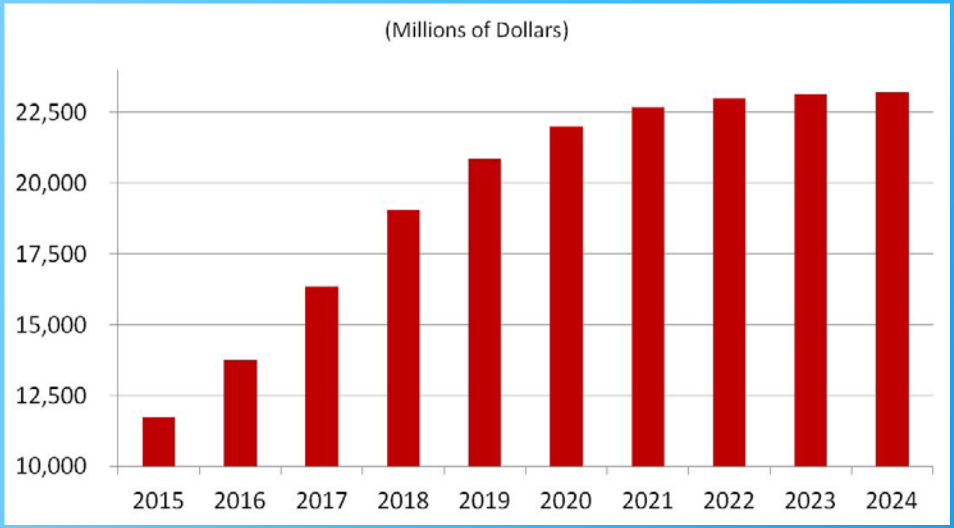
## Capital Expenditure Forecast




## Net Income (loss) with 3.95% Rate Increases




## Net Debt with 3.95% Rate Increases

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# Overview & Approvals Sought

# 2015 General Rate Application

- Final approval of 2.75% interim rate increase effective May 1, 2014
- Approval of a 3.95% rate increase for 2015/16
  - $3.20 increase in monthly bill of residential customer without electric space heat
  - $6.11 increase in monthly bill of residential customer with electric space heat
- Final approval of LED Rates effective August 1, 2014
- Changes to SEP and CRP Terms & Conditions
- Final approval of Interim Orders on SEP, and CRP
- Approval to rescind DSM deferral account



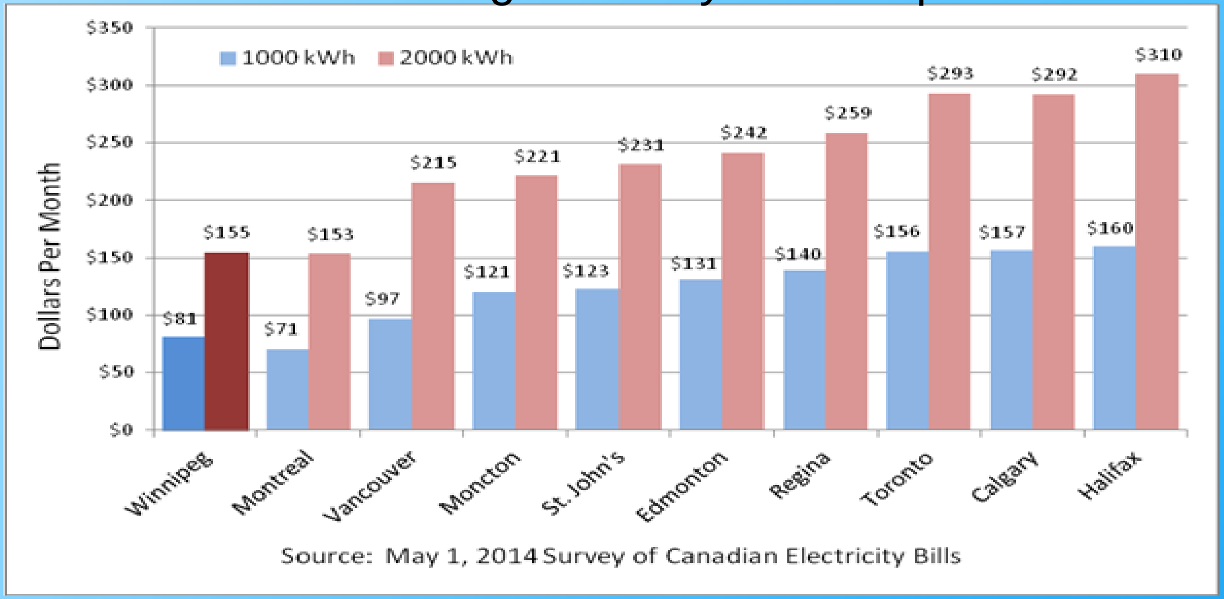
Manitoba Hydro

# Corporate Strategic Plan (CSP)


- CSP sets out Manitoba Hydro's Vision & Mission and outlines 7 Key Areas of Focus to meet Manitobans' long-term energy needs and achieve operational excellence.
- Manitoba Hydro is committed to providing high system reliability, excellent customer service and affordable rates.
- Manitoba Hydro receives customer satisfaction ratings that are consistently higher than the national average for Canadian electric utilities.

# Manitoba Hydro Offers Affordable & Competitive Rates to Customers

Residential Average Monthly Bill Comparison




- Manitoba's rates are affordable for Manitoba families and support the competiveness of Manitoba businesses.
- Manitoba Hydro has amongst the lowest average retail electricity rates in North America.
- Manitoba enjoys a distinct advantage over most Canadian jurisdictions with respect to average monthly bills of residential customers.



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# Legislative Framework

Section 2 of *The Manitoba Hydro Act*:

**Purposes and objects of Act**

2 The purposes and objects of this Act are to provide for the continuance of a supply of power adequate for the needs of the province, and to engage in and to promote economy and efficiency in the development, generation, transmission, distribution, supply and end-use of power and, in addition, are

(a) to provide and market products, services and expertise related to the development, generation, transmission, distribution, supply and end-use of power, within and outside the province; and

(b) to market and supply power to persons outside the province on terms and conditions acceptable to the board.



Manitoba Hydro

# Legislative Framework

## Section 39(1) of *The Manitoba Hydro Act*:

SALE OF POWER

**Price of power sold by corporation**

39(1) The prices payable for power supplied by the corporation shall be such as to return to it in full the cost to the corporation, of supplying the power, including

(a) the necessary operating expenses of the corporation, including the cost of generating, purchasing, distributing, and supplying power and of operating, maintaining, repairing, and insuring the property and works of the corporation, and its costs of administration;

(b) all interest and debt service charges payable by the corporation upon, or in respect of, money advanced to or borrowed by, and all obligations assumed by, or the responsibility for the performance or implementation of which is an obligation of the corporation and used in or for the construction, purchase, acquisition, or operation, of the property and works of the corporation, including its working capital, less however the amount of any interest that it may collect on moneys owing to it;

(c) the sum that, in the opinion of the board, should be provided in each year for the reserves or funds to be established and maintained pursuant to subsection 40(1).



Manitoba Hydro

# Legislative Framework

## Section 40(1) and 40(2) of *The Manitoba Hydro Act*:

**Establishment of reserves**

40(1) The board shall establish and maintain, and may adjust as required, such reserves or funds of the corporation as are sufficient, in the opinion of the board, to provide

(a) for the amortization of the cost to the corporation of the property and works, (whether as a whole or in its component parts), of the corporation during the period, or remaining period, of the useful life thereof;

(b) insurance, for which provision is not otherwise made, against loss or damage to any property of the corporation, or to the persons or property of others, caused by or arising out of the works or operations of the corporation;

(c) for the stabilization by the board of rates or prices for power sold by the corporation, the meeting of extraordinary contingencies, and such other requirements or purposes as in the opinion of the board are proper.

**Use of reserves**

40(2) The reserves created pursuant to subsection (1) may be used or employed by the board

(a) towards the reservation and setting aside of the sinking fund established under section 41;

(b) towards the renewal, reconstruction, or replacement, or depreciated, damaged, or obsolescent property and works;

(c) towards restoration of any property lost or damaged, or the payment of any claims, in respect of which a reserve as insurance has been established;

(d) in such manner towards the stabilization of rates or prices for power, the meeting of extraordinary contingencies, and for such other requirements or purposes, as the board in its discretion deems proper; and

(e) subject to the approval of the Lieutenant Governor in Council, towards the cost of construction of new works and extensions, improvements, or additions, to any property and works of the corporation.



Manitoba Hydro

# Legislative Framework

Section 4 of *The Crown Corporations Review & Accountability Act*:

PART IV

PUBLIC UTILITIES BOARD REVIEW OF RATES

**Hydro and MPIC rates review**

26(1) Notwithstanding any other Act or law, rates for services provided by Manitoba Hydro and the Manitoba Public Insurance Corporation shall be reviewed by The Public Utilities Board under *The Public Utilities Board Act* and no change in rates for services shall be made and no new rates for services shall be introduced without the approval of The Public Utilities Board.

**Definition, "rates for services"**

26(2) For the purposes of this Part, **"rates for services"** means

(a) [repealed] S.M. 1995, c. 33, s. 5;

(b) in the case of Manitoba Hydro, prices charged by that corporation with respect to the provision of power as defined in *The Manitoba Hydro Act*;

(c) in the case of the Manitoba Public Insurance Corporation, rate bases and premiums charged with respect to compulsory driver and vehicle insurance provided by that corporation.

**Application of Public Utilities Board Act**

26(3) *The Public Utilities Board Act* applies with any necessary changes to a review pursuant to this Part of rates for services.

**Factors to be considered, hearings**

26(4) In reaching a decision pursuant to this Part, The Public Utilities Board may

(a) take into consideration

(i) the amount required to provide sufficient moneys to cover operating, maintenance and administration expenses of the corporation,

(ii) interest and expenses on debt incurred for the purposes of the corporation by the government,

(iii) interest on debt incurred by the corporation,

(iv) reserves for replacement, renewal and obsolescence of works of the corporation,

(v) any other reserves that are necessary for the maintenance, operation, and replacement of works of the corporation,

(vi) liabilities of the corporation for pension benefits and other employee benefit programs;

(vii) any other payments that are required to be made out of the revenue of the corporation,

(viii) any compelling policy considerations that the board considers relevant to the matter,

(ix) any other factors that the board considers relevant to the matter; and

(b) hear submissions from any persons or groups or classes of persons or groups who, in the opinion of the board, have an interest in the matter.

# Manitoba Hydro's Capital Investment Drivers & Borrowing Requirements

# Capital Investment Drivers & Borrowing Requirements

Manitoba Hydro is entering a period of extensive investment in its infrastructure in order to:

1. Meet the growing energy needs of Manitoba
2. Replace aging utility assets that are approaching the end of their service lives
3. Address capacity constraints on its existing system



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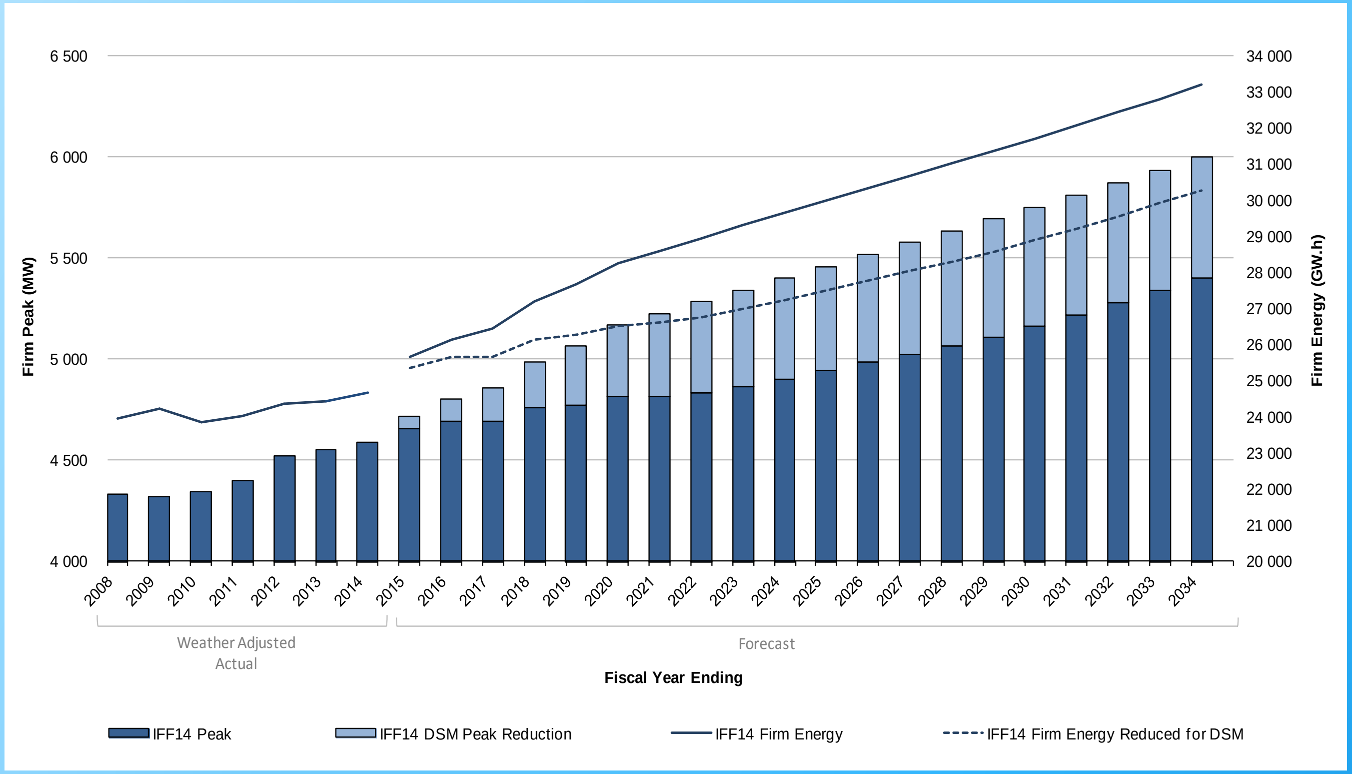
# Manitoba Hydro is Entering a Period of Extensive Capital Investment

## Forecast Load Growth Before and After Impact of DSM




- Investment is required to meet growing energy needs of Manitoba.
- Even with load reductions from the higher levels of Power Smart investment, demand for electricity is continuing to grow due to increases in population, higher average energy usage and industrial & commercial customer expansion.

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# Keeyask Project

- Estimated cost = $6.5 B
- Date approved = July 2014
- Construction start = July 16, 2014
- First Unit In Service Date = November 2019
- Partnership between Manitoba Hydro and the four Keeyask Cree Nations
- Consists of:
  - Keeyask Generating Station
  - Keeyask Infrastructure
  - Keeyask Generation Outlet Transmission

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# Bipole III Reliability Project

- Environmental Act Licence Received August 14, 2013
- Construction started September 2013
- Budget = $4.65 B/ July 2018 ISD
- Consists of:
  - Keewatinohk Converter Station
    - 80 Km North East of Gillam Manitoba
  - Keewatinohk Construction Camp
    - 600 man construction camp
  - HVDC Transmission Line
    - ~1400 km transmission line
  - Riel Converter Station
    - Rural Municipality of Springfield
  - 2 Ground Electrodes



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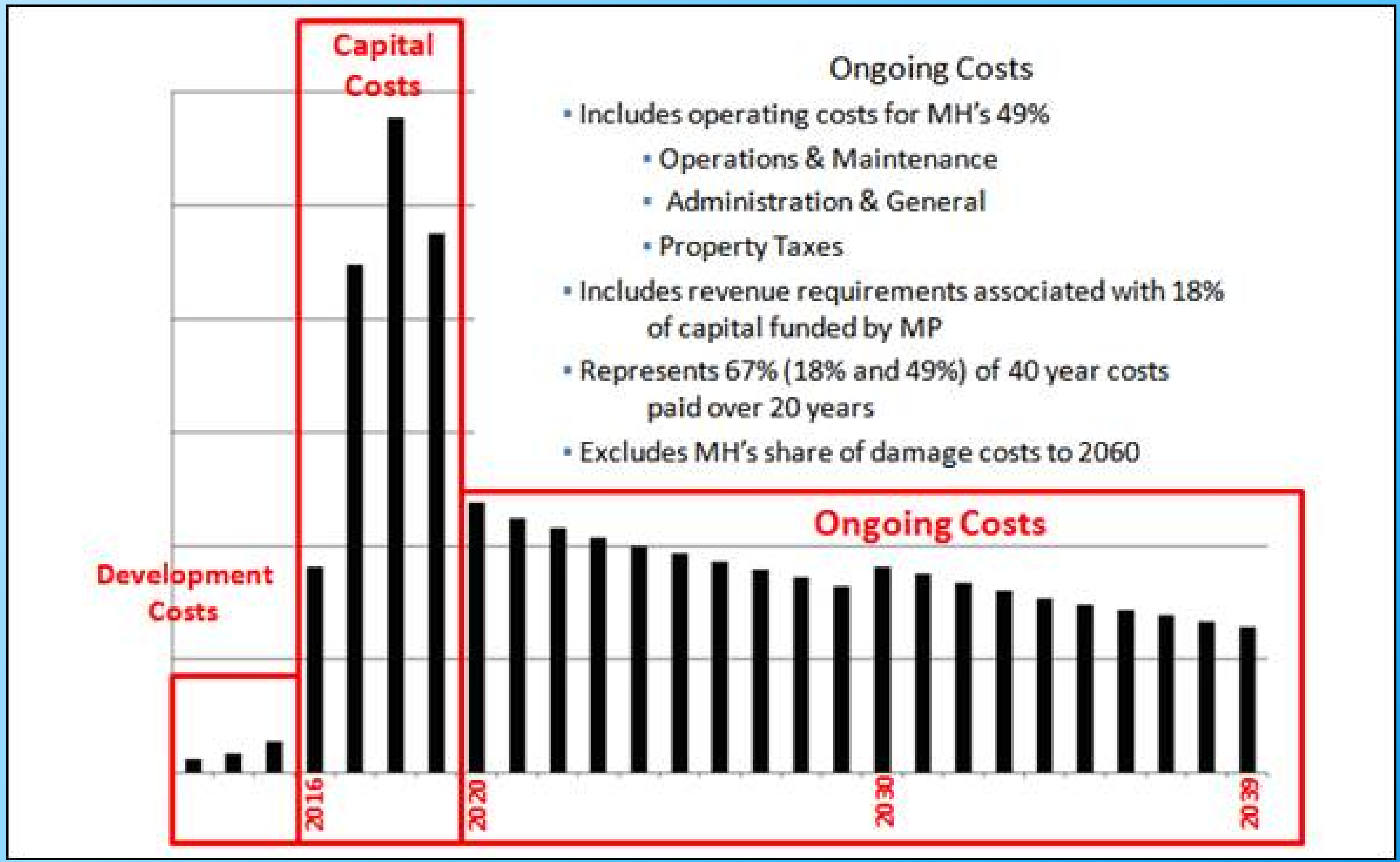
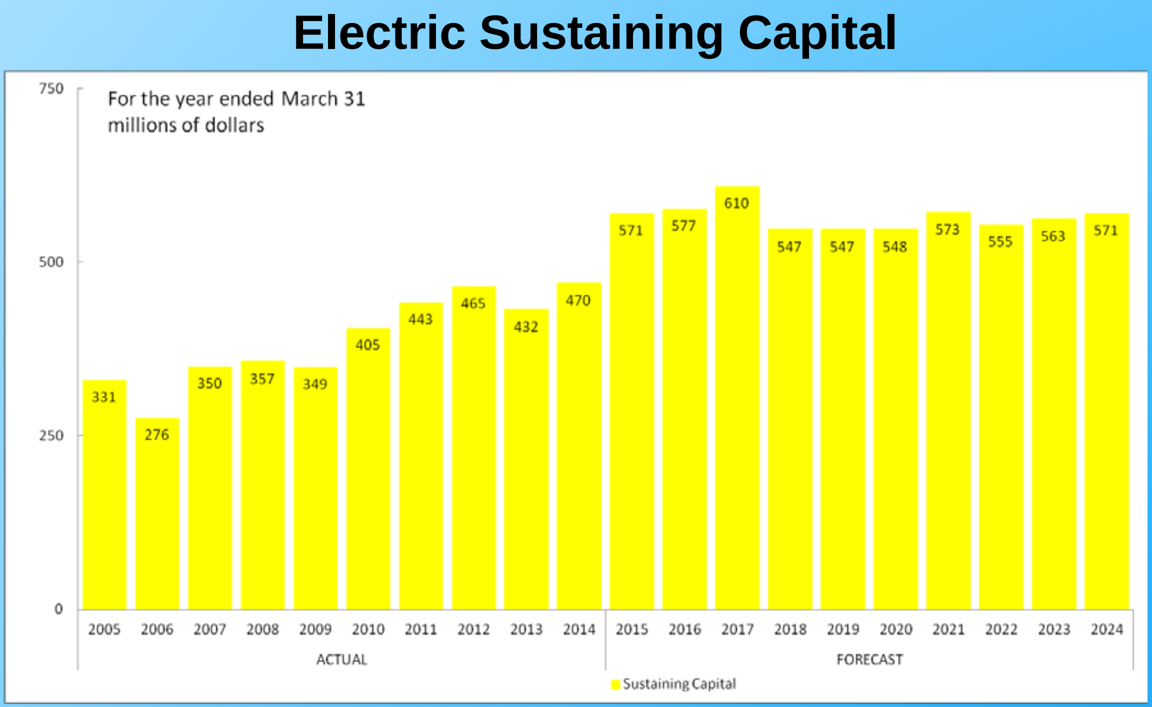
# MH's GNTL Funding Timeline



# Sustaining Capital Investments



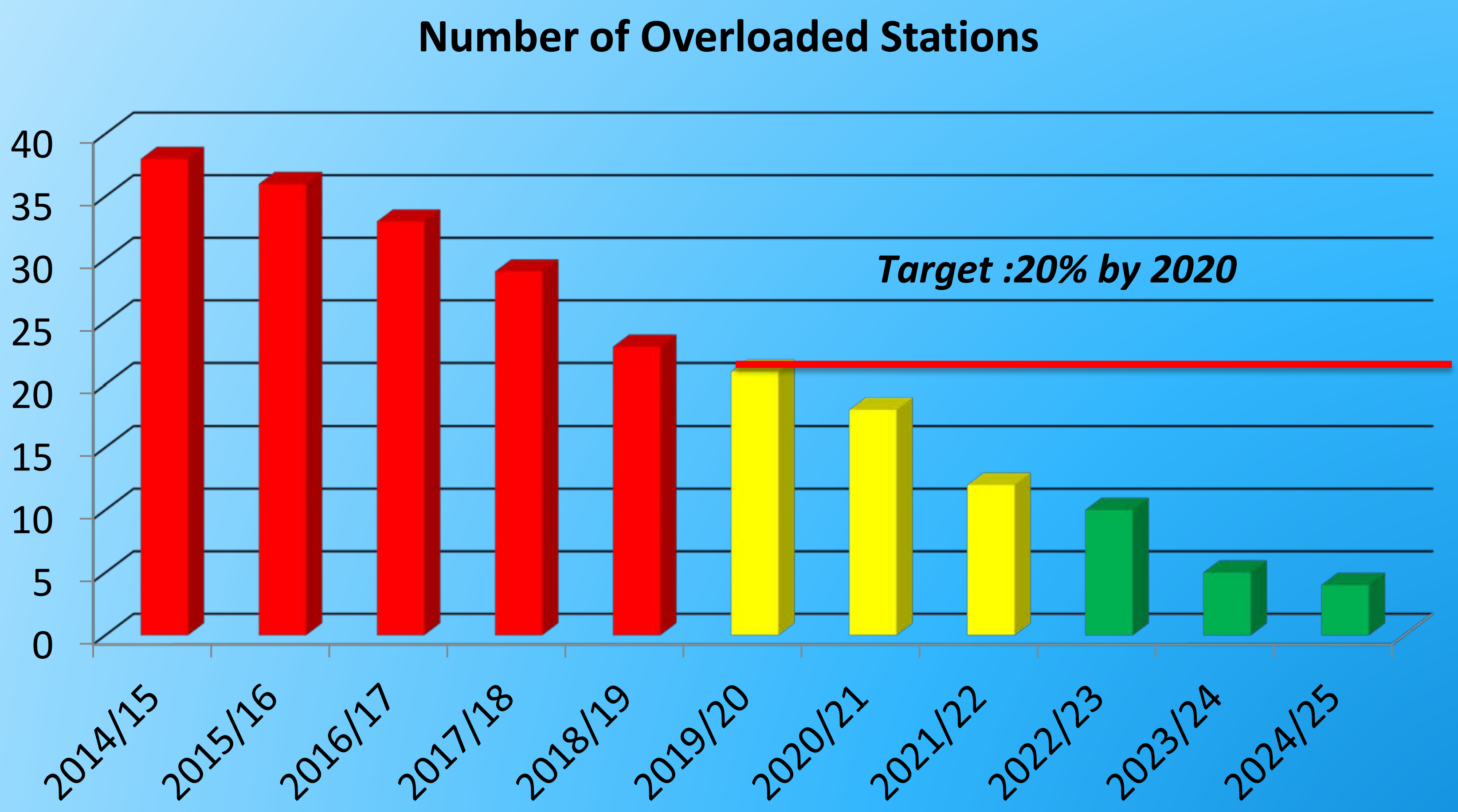

- To maintain reliability and address anticipated load and customer growth, Manitoba Hydro will need to increase its sustaining capital expenditures over previous levels in order to maintain safe and reliable service
- The magnitude of this investment is approaching a total of $5.7 billion by 2024 and is broad-based with significant capital investment requirements in the operational areas of generation, transmission and distribution.

# Examples of Distribution Assets in Very Poor Condition



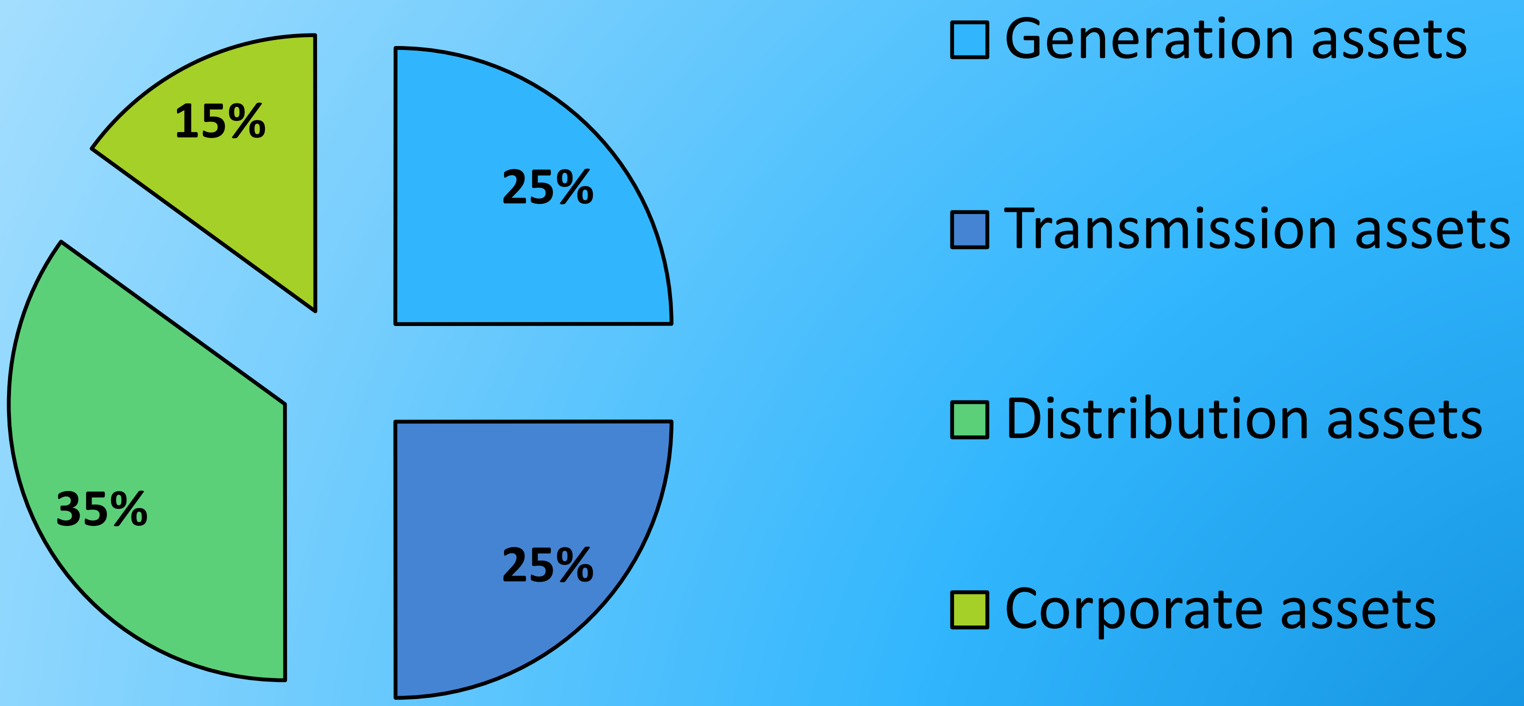

Manitoba Hydro

# Overloaded Stations in Winnipeg



# Sustaining Capital Investments

- $5.7 billion over the next ten years
- Asset portfolio allocation:

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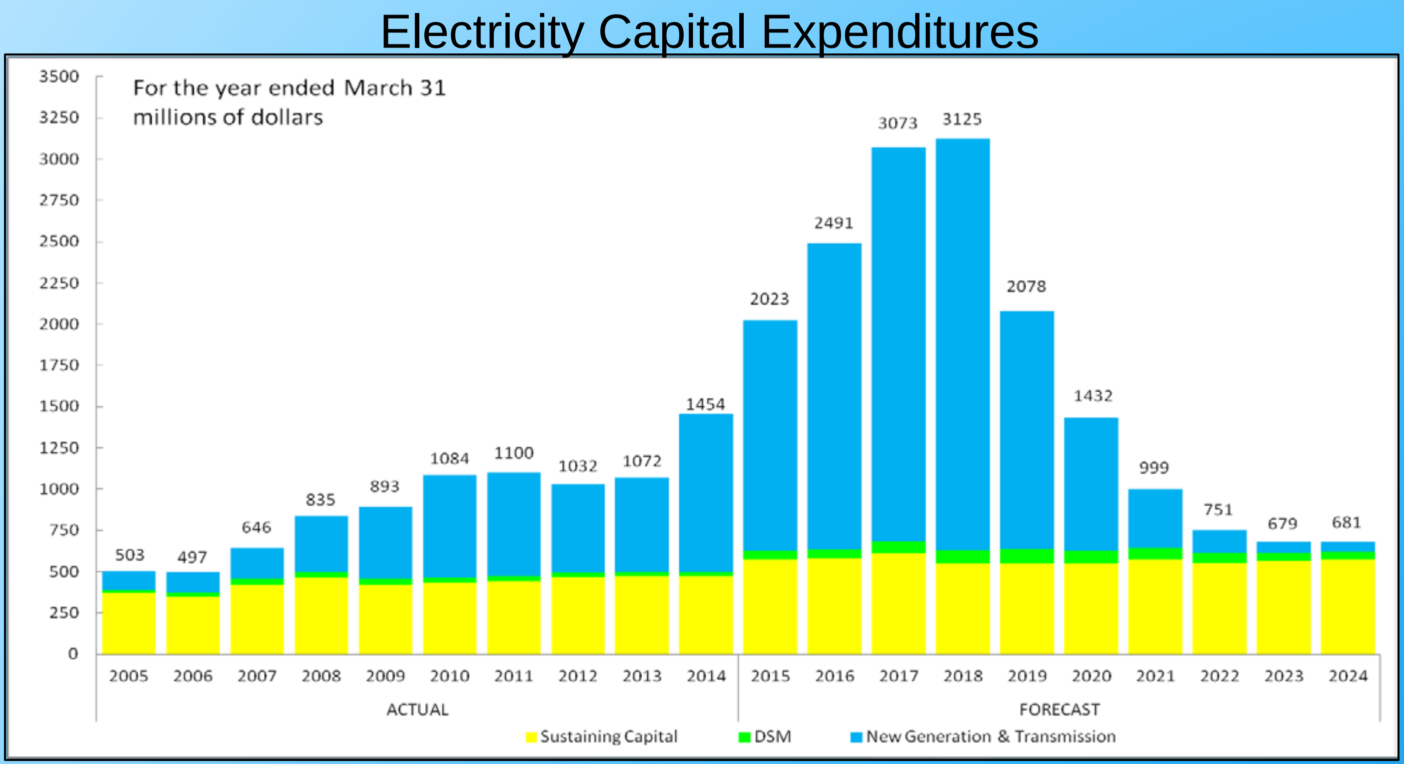
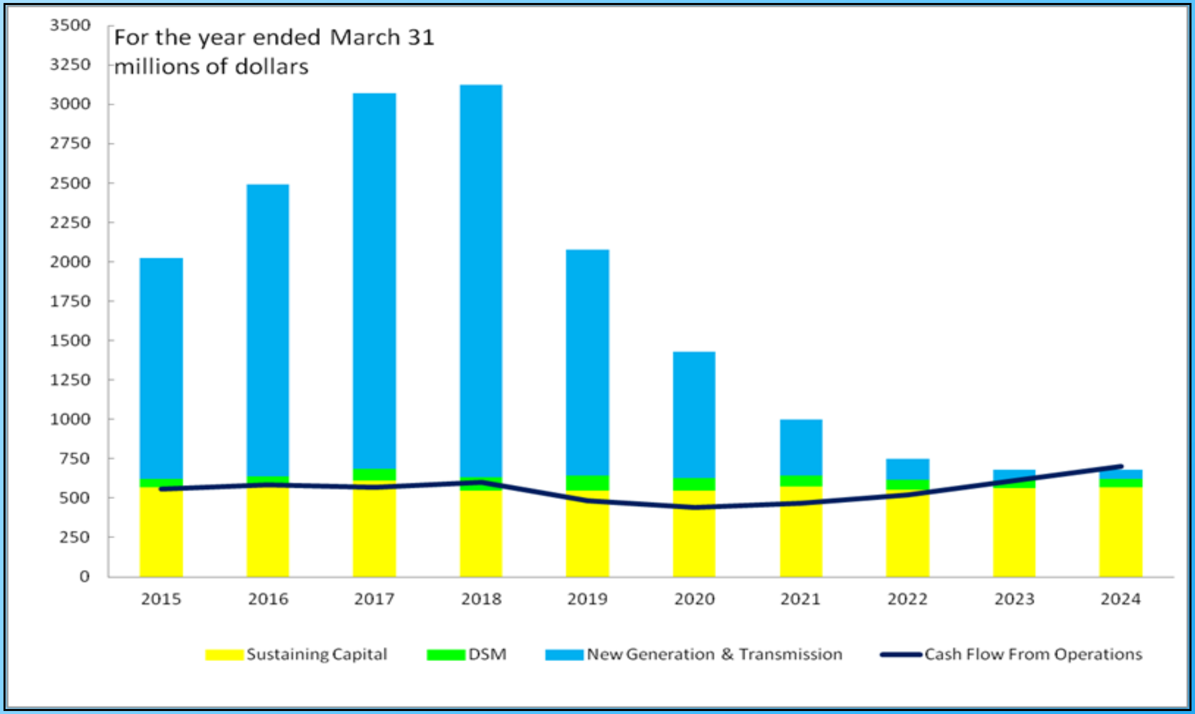
# Manitoba Hydro is Entering a Period of Extensive Capital Investment




- The level of total investment will be significantly higher in the next 10 year period (peaks at $3.1 billion in 2017/18) than in the prior 10 years. Investment cost will be many multiples higher than the historic cost of the existing asset base.

# Cash Flow from Operations will be Insufficient to Fund Capital Expenditures

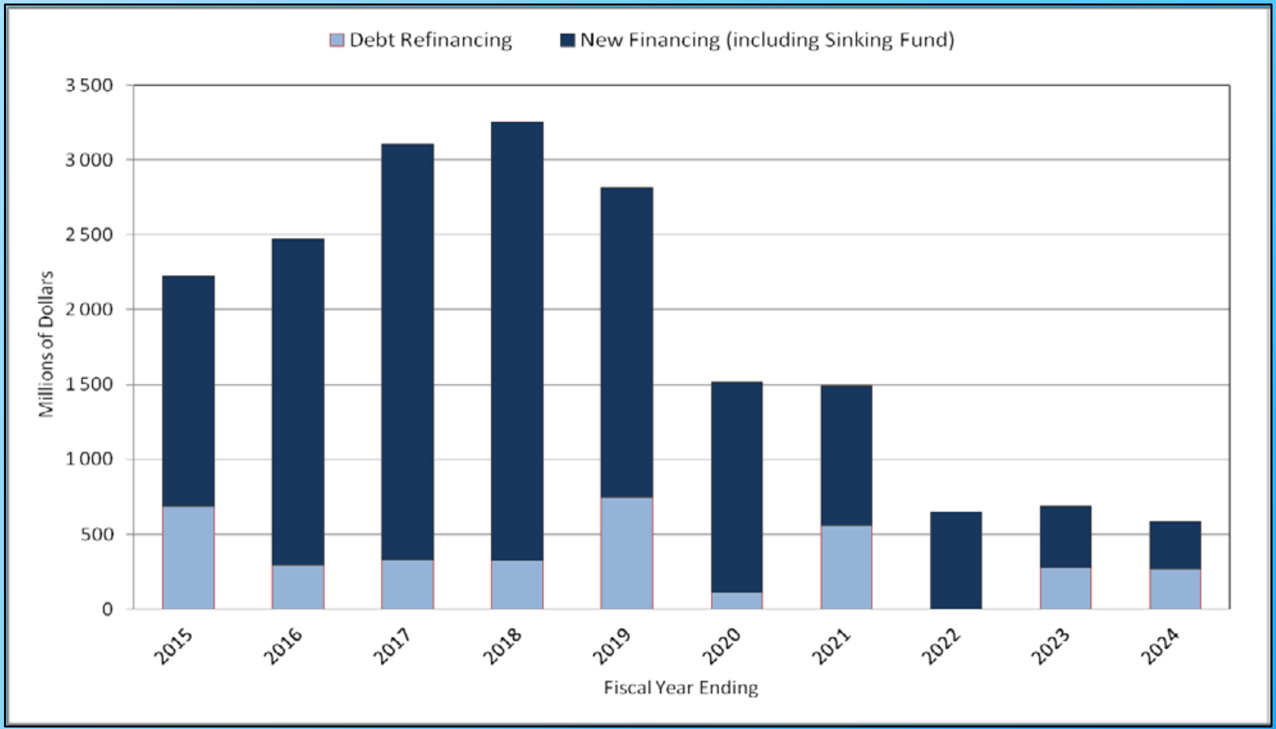
Electricity Capital Expenditures & Cash Flow from Operations with 3.95% Rate Increases




- Manitoba Hydro does not have access to share capital like private utilities and must rely on a combination of internally generated cash and debt financing to fund its capital investment program.
- Cash flow from operations (including projected rate increases) will not be sufficient to fully fund sustaining capital requirements and Major Generation & Transmission capital will be funded through debt financing.

# Investment Requirements will Lead to Unprecedented Levels of Debt Financing

Projected Electric Operations Borrowing Requirements




- Including debt refinancing requirements for existing debt, total debt requirements will peak at levels in excess of $3 billion per year – which are unprecedented levels in Manitoba Hydro history.
- Given the period of intensive capital investment , it is critical that Manitoba Hydro maintain access to low cost financing as customers pay financing costs through rates.



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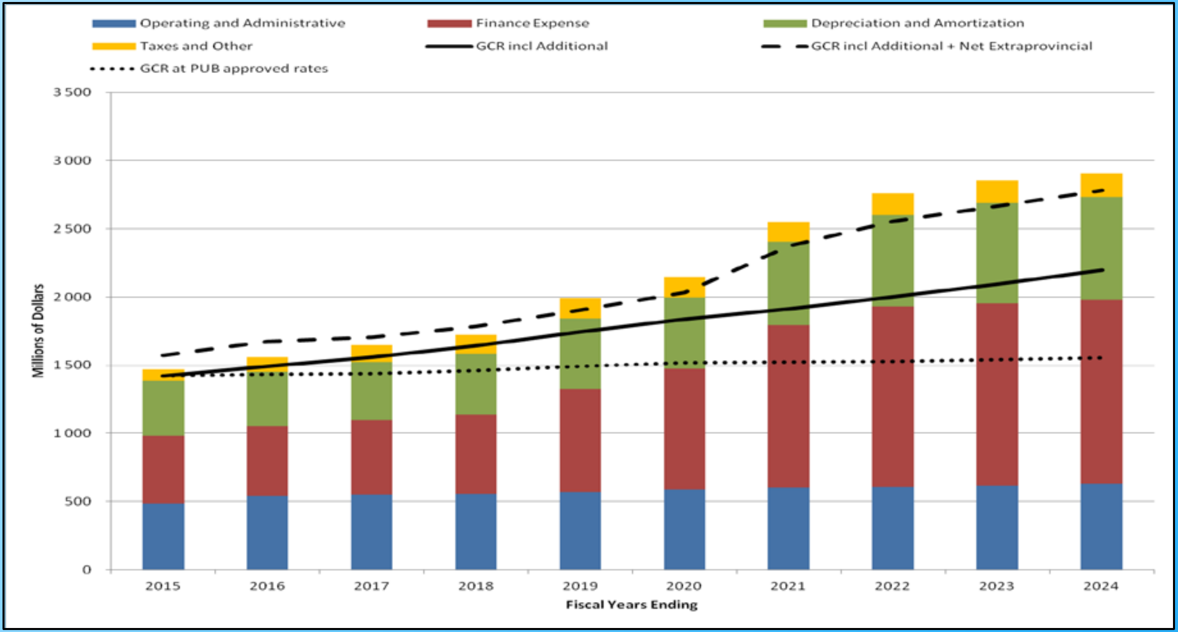
# Reasons for Proposed Rate Increases

# Carrying Costs on Electric Assets are Expected to Double in Next 10 Years

Electric Expenses Compared to Revenues

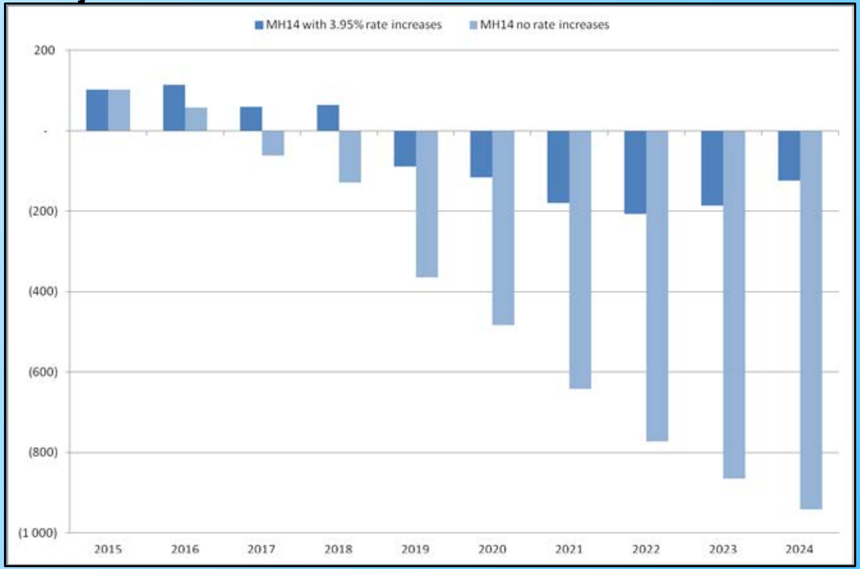



- Required capital investment is projected to double the asset base and carrying costs of electric operations in the next 10 years.
- Over the 10 year period, total electric costs are projected to double from $1.5 billion to $3 billion, primarily due to increased finance & depreciation costs. Finance expense is projected to increase from $500 million to $1.3 billion over the next ten years with the projected 3.95% rate increases. Operating costs are relatively constant.
- The proposed and indicative rate increases accumulate to 42% by 2024, thus resulting in projected losses of $900 million on electric operations between 2019 – 2024.

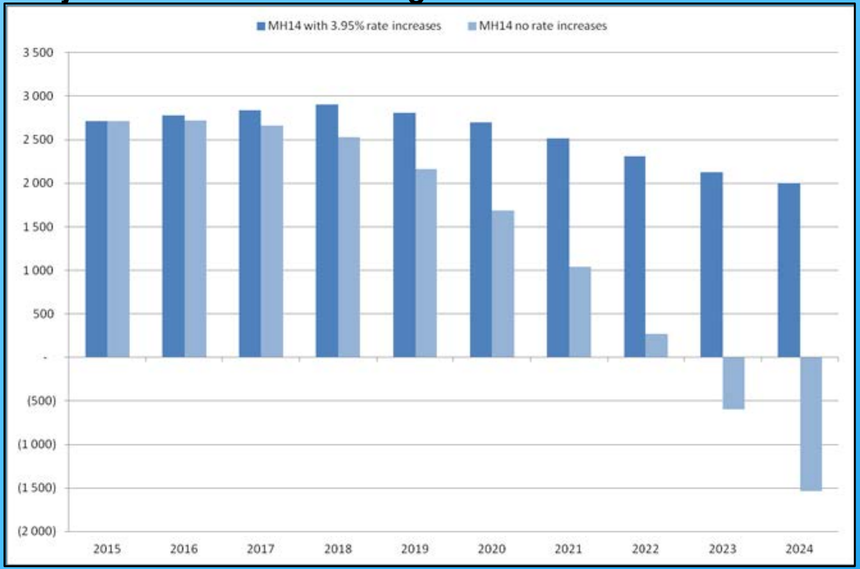
# Investments in Capital Assets Will Place Pressure on Manitoba Hydro's Financial Strength

MH14 3.95% Rate Increases and MH14 No Rate Increases

**Projected Net Income**




**Projected Retained Earnings**




- The proposed and indicative 3.95% rate increases accumulate to 42% by 2024, but capital-driven carrying costs increase 100%, resulting in projected losses of $900 million between 2019 and 2024.
- Financial reserves (retained earnings) are projected to decrease from $2.7 billion to $2.0 billion by 2024 with the 3.95% rate increases.
- Without the proposed and indicative rate increases, reserves would be totally depleted by 2023.



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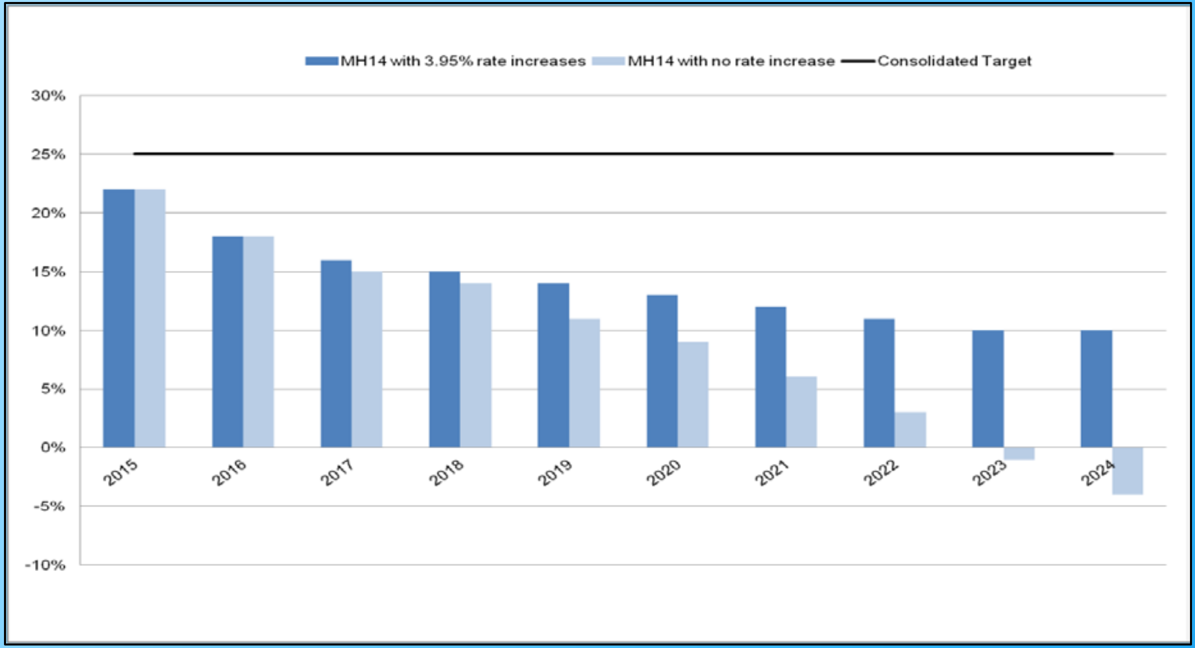
# Investments in Capital Assets Will Place Pressure on Manitoba Hydro's Financial Strength

MH14 3.95% Rate Increases and MH14 No Rate Increases

Projected Equity Ratio




- Equity ratio is projected to deteriorate to 10% by 2023 with the 3.95% rate increases – well below the 25% target level.
- This is at a time when other crown owned electric utilities have equity ratios that are higher than Manitoba Hydro or have plans to strengthen their equity ratio.

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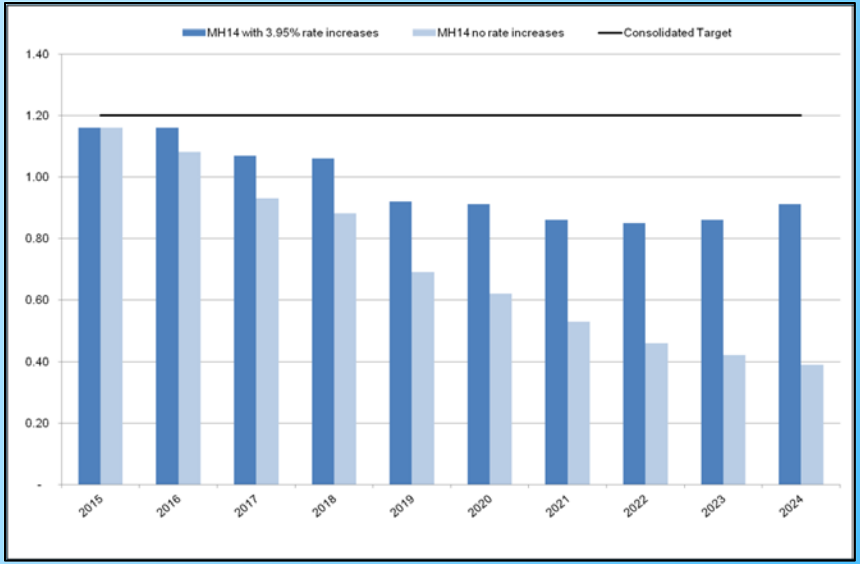
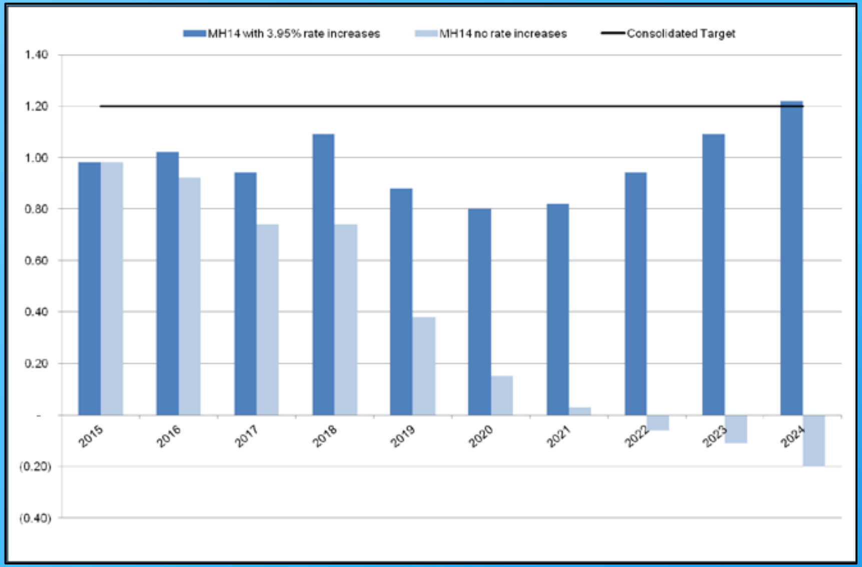
# Investments in Capital Will Place Pressure on Financial Strength

MH14 3.95% Rate Increases and MH14 No Rate Increases

**Projected Interest Coverage**



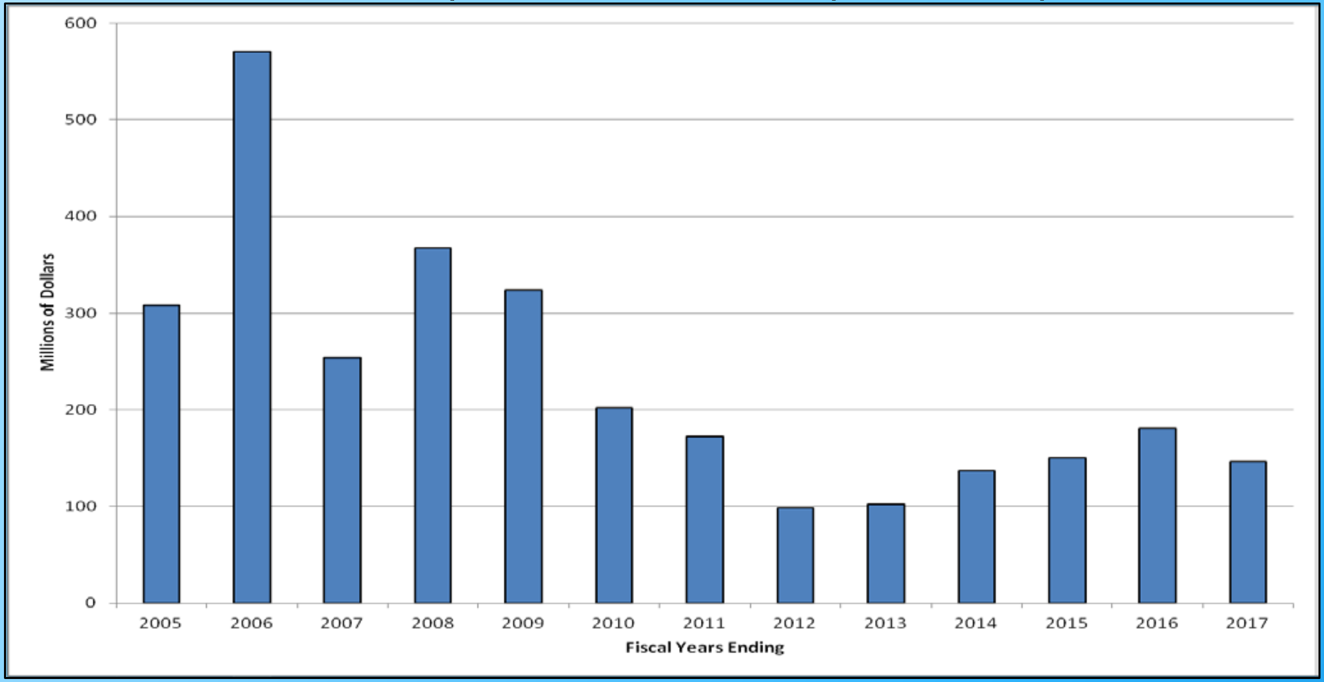

**Projected Capital Coverage Ratio**




- Interest coverage and capital coverage are projected to be well below the target levels of 1.20 for most of the years of the forecast with the 3.95% rate increases.

# Rates Have Not Increased to Fully Compensate for Reductions in Net Extraprovincial Revenue

Net Extraprovincial Revenue (2015-2017)




- Historically, Net Extraprovincial revenues have enabled Manitoba Hydro to maintain lower electricity rates for Manitobans (averaged $365 million/year between 2005-2009).
- Net extraprovincial revenues have not been as strong as in previous years (projected at $147 million to $181 million between 2015 to 2017).
- Rates need to gradually increase to compensate for this reduction.



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# Rate Proposals Maintain Net Income and Financial Ratios at Acceptable Levels

| Retained Earnings and Financial Ratios (without proposed rate increases) | Forecast 2015 | 2016 | 2017 |
|---|---|---|---|
| Net Income (electric operations) | $ 102 | $ 58 | $ (58) |
| Retained Earnings (electric operations) | $ 2,717 | $ 2,721 | $ 2,663 |
| Debt to Equity Ratio (electric operations) | 78:22 | 82:18 | 85:15 |
| Interest Coverage Ratio (electric operations) | 1.16 | 1.08 | 0.93 |
| Capital Coverage Ratio (electric operations) | 0.98 | 0.92 | 0.74 |

| Retained Earnings and Financial Ratios (including proposed rate increases) | 2015 | 2016 | 2017 |
|---|---|---|---|
| Net Income (electric operations) | $ 102 | $ 115 | $ 59 |
| Retained Earnings (electric operations) | $ 2,717 | $ 2,778 | $ 2,837 |
| Debt to Equity Ratio (electric operations) | 78:22 | 82:18 | 84:16 |
| Interest Coverage Ratio (electric operations) | 1.16 | 1.16 | 1.07 |
| Capital Coverage Ratio (electric operations) | 0.98 | 1.02 | 0.94 |

- Approval of the proposed rate increases are necessary to maintain net income and financial ratios for 2015/16 and 2016/17 at acceptable levels and to promote longer term rate stability for customers.
- Absent the proposed rate increases, Manitoba Hydro is projecting net income of $58 million in 2016 and a loss of $58 million in 2017. Equity ratio, interest and capital coverage ratios would decline to 15%, 0.93, and 0.74 in 2017, respectively.



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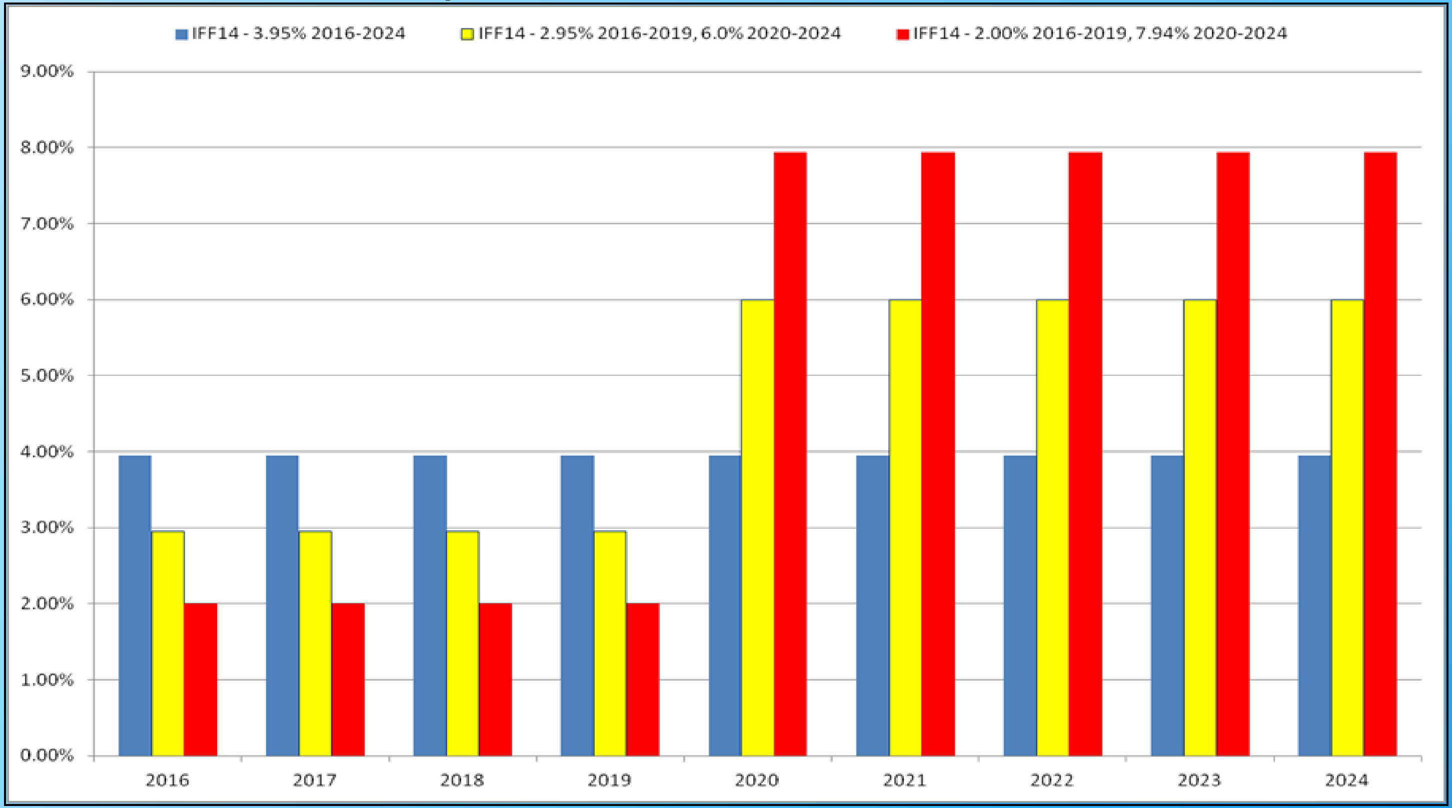
# Risks if Proposed Rate Increases are Not Granted

# Increased Risk to Customers of Rate Instability and Rate Shock

Projected Rate Increase Scenarios




- Lower rate increase scenarios of 2% and 2.95% for the next 4 years (2016 to 2019) require compensating increases of 6% and 8%, respectively, between 2020 to 2024 to achieve the same financial position (a 10% Equity Ratio by 2024).
- Gradually increasing rates by 3.95% promotes rate stability & predictability and reduces the risk of rate shock to customers in the future.



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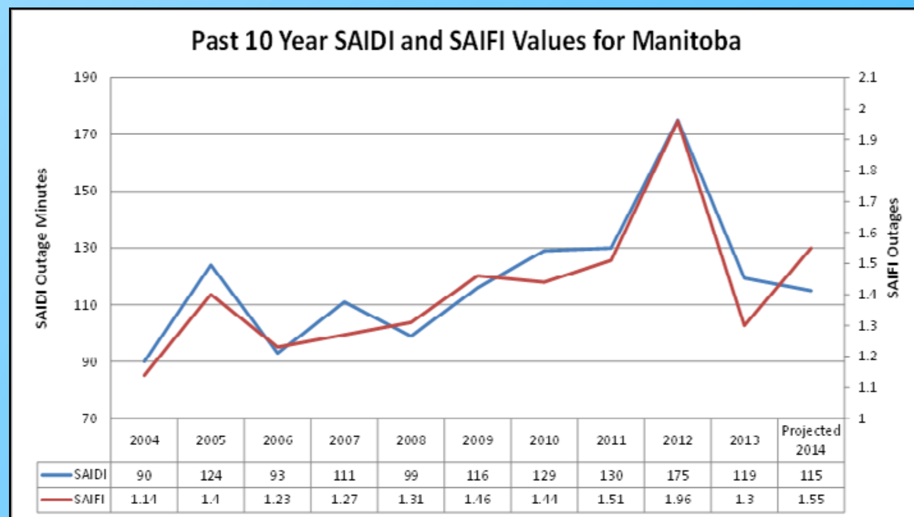
# Increased Risk to Customers of Decline in Service & Reliability

**SAIDI and SAIFI Indictors**




- Manitoba Hydro’s reliability performance shows an increased trend of outage frequency and duration; asset age and condition is a major contributing factor.
- The proposed rate increases will enable Manitoba Hydro to be in a better position to fund the necessary investments to continue to provide the high level of safe and reliable service to which customers are accustomed.
- Between 2004 and projected 2014, SAIDI is up 28% and SAIFI is up 36%



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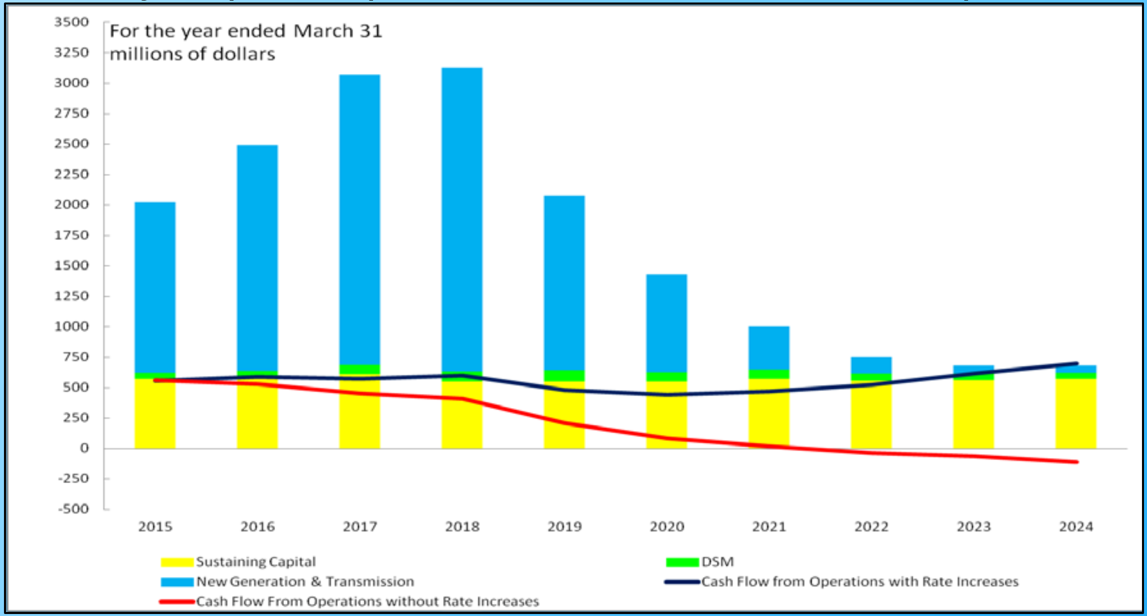
# Increased Borrowing Requirements Result in Higher Levels of Debt and Carrying Costs, which Need to be Recovered from Customers

Electricity Capital Expenditures & Cash Flow from Operations



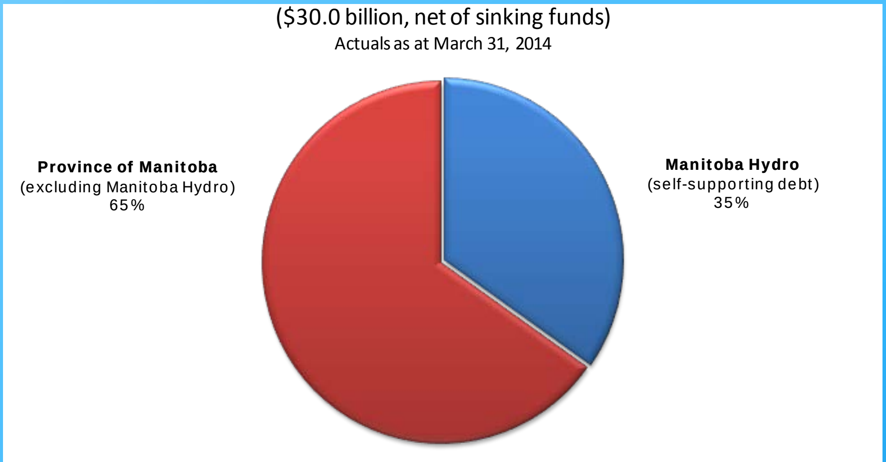

- Without the proposed and indicative rate increases, Manitoba Hydro would be required to fund an increasing portion of its sustaining capital expenditures through debt financing as opposed to cash flow generated from operations.
- The proposed and indicative rate increases reduce the need for borrowing and additional financing costs that must be borne by customers through rates.

# Potential Negative Implications to Provincial Credit Rating and Manitoba Hydro's Borrowing Costs

**Provincial Long Term Credit Ratings Comparison**

| Province | Standard & Poors | DBRS | Moody's Investors Service |
|---|---|---|---|
| British Columbia | AAA | AA (high) | Aaa |
| Saskatchewan | AAA | AA | Aaa |
| Alberta | AAA | AAA | Aaa |
| Manitoba | AA | A (high) | Aa1 |
| Ontario | AA- | AA (low) | Aa2 |
| Nova Scotia | A+ | A (high) | Aa2 |
| Newfoundland & Labrador | A+ | A | Aa2 |
| Québec | A+ | A (high) | Aa2 |
| New Brunswick | A+ | A (high) | Aa2 |
| Prince Edward Island | A | A (low) | Aa2 |

**Composition of Province of Manitoba Debt**




- Manitoba Hydro's debt forms a significant portion of total provincial debt and the Corporation's financial performance is a contributing factor toward the stability of the Province's credit rating.
- The proposed and indicative rate increases are necessary to continue to demonstrate to credit rating agencies that the regulatory framework in Manitoba is supportive of Manitoba Hydro's self-supporting financial status and that the Corporation can recover its actual costs of providing service to customers.



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# The PUB Recognized the Importance of Manitoba Hydro's Financial Strength in Order 43/13

The Board is concerned that, by moving towards a 90:10 debt-to-equity ratio by the end of the decade, there will be an insufficient retained earnings reserve to deal with droughts and other risks such as infrastructure failure or rising interest rates.

………..

The Board notes that Manitoba Hydro shares the benefit of the flow-through credit rating of the Province, which affords it preferential interest rates on its debt and access to funds to meet its major capital spending program. However, as its debt grows, there is a potential for Manitoba Hydro's financial condition to affect the credit rating of the Province. It is important that Manitoba Hydro remains a financially strong and viable organization.

**Source: Manitoba Public Utilities Board Order No. 43/13 dated April 26, 2013 (page 23)**

- In Order 43/13, the PUB recognized the importance of Manitoba Hydro's financial strength to deal with financial risks and to ensure that the credit rating of the Province is not negatively impacted.



Manitoba Hydro

# Manitoba Hydro is Effectively Controlling its Costs to Maintain Projected 3.95% Rate Increases



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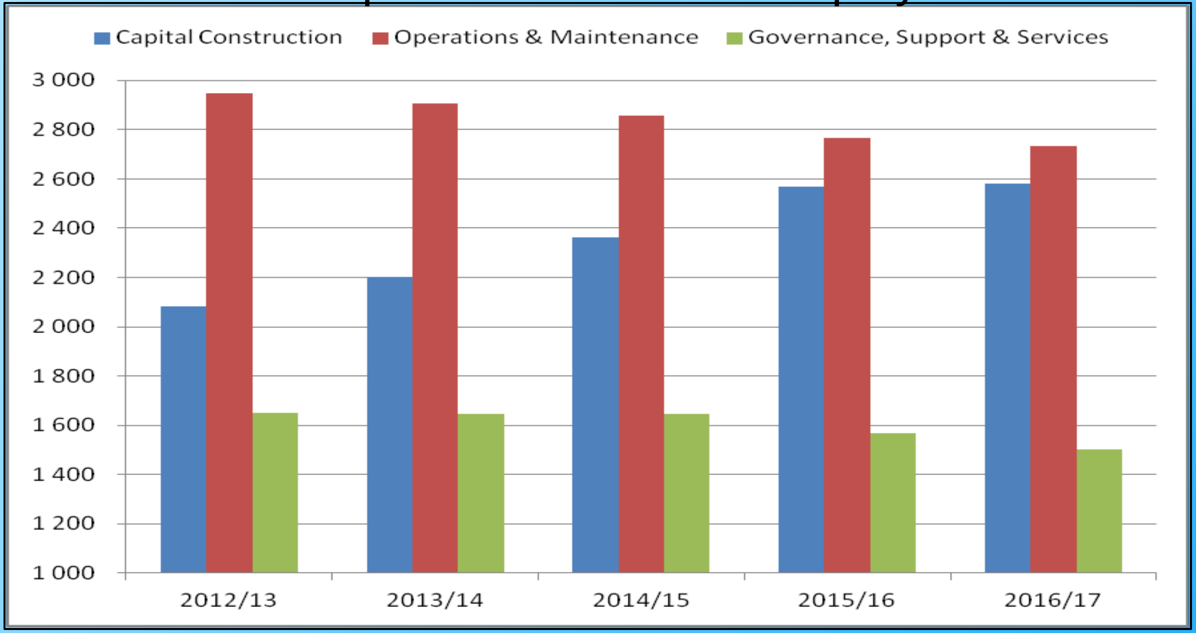
# Manitoba Hydro is Effectively Controlling Costs to Maintain Projected 3.95% Rate Increases

Total Equivalent Full Time Employees




- Manitoba Hydro is committed to carefully managing its costs and utilizing resources efficiently and effectively to provide maximum value to ratepayers.
- An extensive review of the staff compliment was undertaken in 2014 and resulted in plans to reduce approximately 330 operational positions over the 3 years between 2015 to 2017 which represents 8% of current EFTs charged to operating costs.
- Consistent with this plan O&M and Governance/Support/Services EFTs are projected to decrease. Capital Construction EFTs will increase due to the extensive capital program.



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# Demonstrated Progress on Operational Staffing Reductions

**Position (or Equivalent) Cost Reductions for 2014/15**

| | Actual Position Reductions 2014/15* | Projected Reductions 2014/15 | Higher/lower than projected |
|---|---|---|---|
| President & CEO | 2 | 2 | 0 |
| General Counsel & Corporate Secretary | 2 | 1 | 1 |
| Human Resources & Corporate Services | 53 | 33 | 20 |
| Corporate Relations | 6 | 3 | 3 |
| Finance & Regulatory | 6 | 4 | 2 |
| Generation Operations | 41 | 9 | 32 |
| Major Capital Projects | 3 | 1 | 2 |
| Transmission | 49 | 30 | 19 |
| Customer Service & Distribution | 49 | 46 | 3 |
| Customer Care & Energy Conservation | 21 | 16 | 5 |
| Total | 232 | 146 | 87 |

*Source: MH Exhibit 101

- Manitoba Hydro has demonstrated progress on staff reductions by achieving a total reduction of 232 operational positions as of March 31, 2015, which is 87 positions ahead of the commitment target for 2014/15 of 146 positions.
- The quantum of the cumulative savings associated with the position reductions will be $35.8 million by the end of 2016/17, which is equivalent to over a 2% rate increase.



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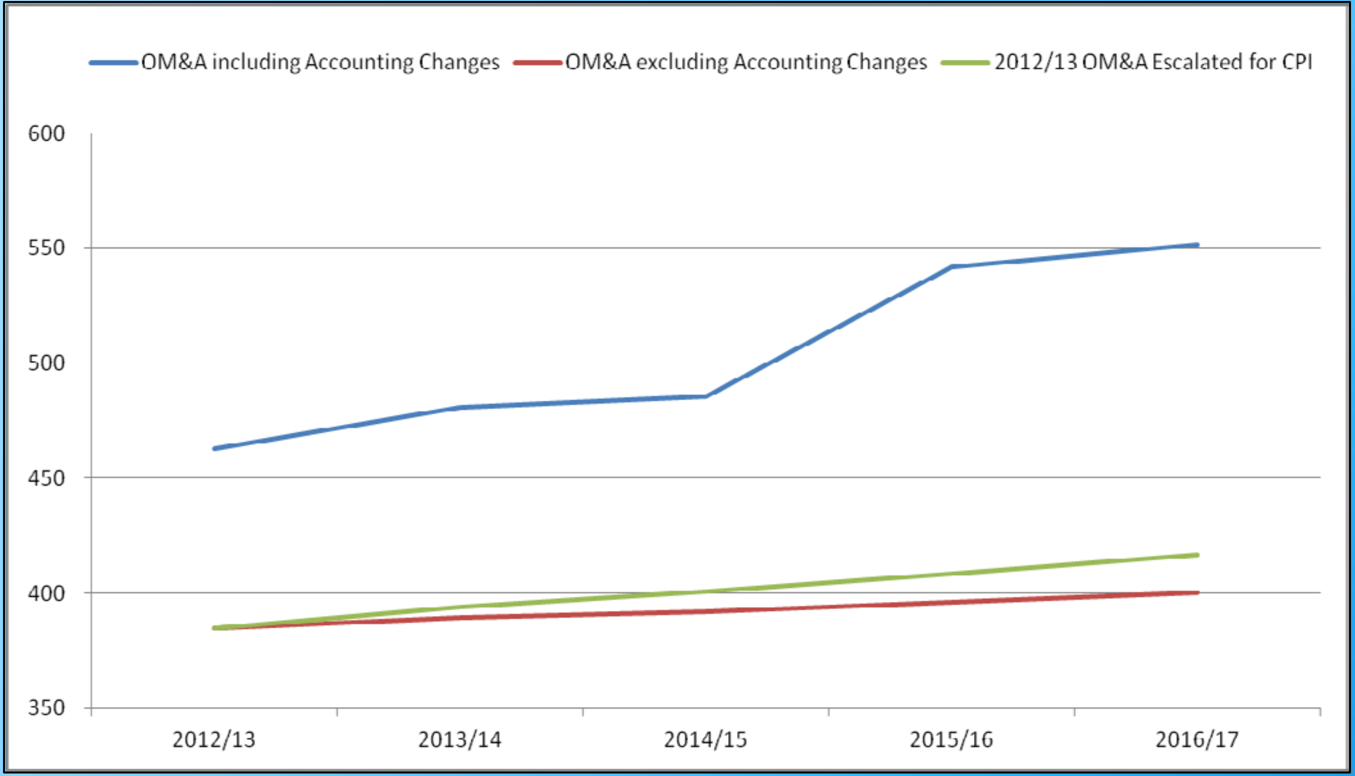
# Manitoba Hydro is Effectively Controlling Costs to Maintain Projected 3.95% Rate Increases

Operating, Maintenance & Administrative Costs




- Operational position reductions and other cost saving initiatives will allow Manitoba Hydro to limit OM&A cost increases to 1% per year (below inflationary levels) excluding the impacts of accounting changes.
- This is consistent with the PUB's expectations from Order 43/13.



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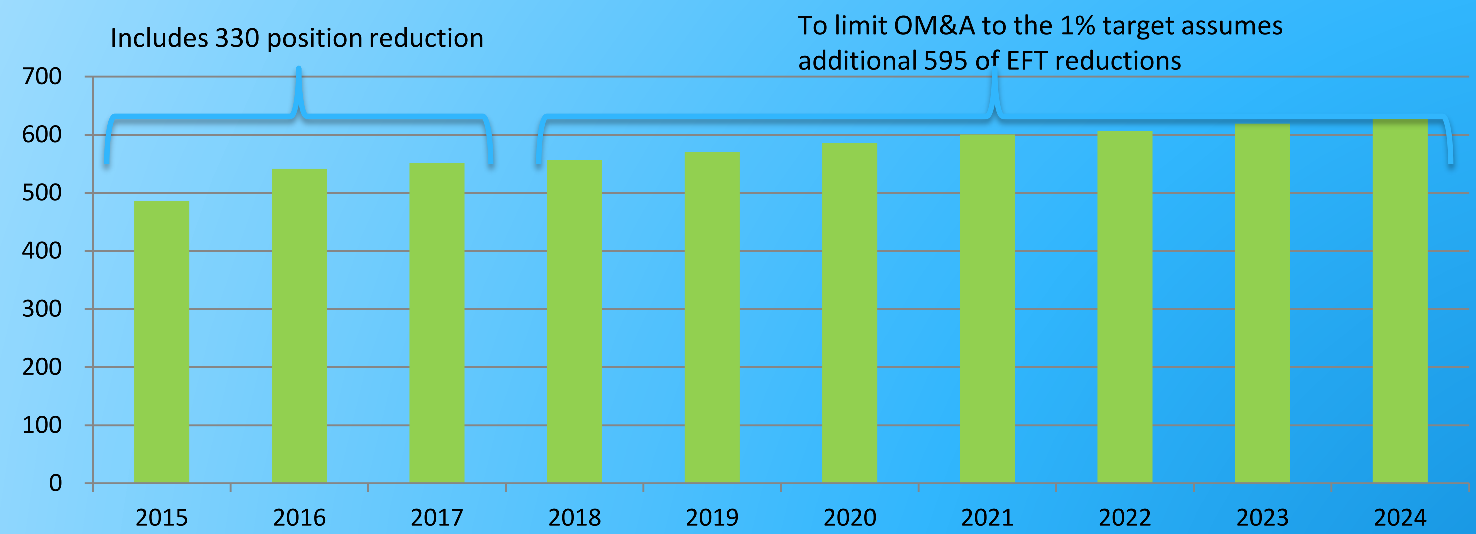
# The Vacancy Rate Used in Manitoba Hydro's Forecast is Appropriate

- Previous strategy – OM&A growth of 1.9% (excluding accounting changes) over 2009/10 – 2013/14 was achieved in part by holding vacancies, which explains the higher actual vacancy rates in previous years. Salary costs have increased by 4% annually.
- Go forward strategy – OM&A targets are achieved primarily as a result of elimination of positions by taking advantage of attrition opportunities through the use of technology, changing work process, etc. therefore lower forecasted vacancy factor is appropriate.
- The 2014/15 actual vacancy factor was 5.5%.




- Further reductions through artificial changes in the vacancy rate are not plausible as they would impair Manitoba Hydro's ability to provide safe and reliable service.

Manitoba Hydro

# Manitoba Hydro’s Reply to Areas of Concern

# Kicking 3.95% Rate Increases Further Down the Road

- 3.95% not a new concept– IFF12 (November 2012)

- COALITION urging the PUB to send a signal

- MIPUG wait and see until the next GRA

# COALITION’s Argument is the Same

PUB - MANITOBA HYDRO GRA 02-25-2013

5815

acceptable from our client's perspective. And certainly our -- our clients seek a signal from this Board directing Hydro to come in with a plan of less than inflation while maintaining necessary service standards.

# COALITION’s Argument is the Same

You almost want to -- if you send a signal -- in our client's view, if one grants Manitoba Hydro what it's seeking, you -- you send a signal that could be misinterpreted.  And the -- the signal could be misinterpreted in that it's a -- you know, mis-estimate as you will, you'll get what you -- what you say you need.  And that's a concern from our client.

Transcript page 5856- 2012 General Rate Application

# Rate Increases are Required Notwithstanding More Favourable Near-term Financial Results

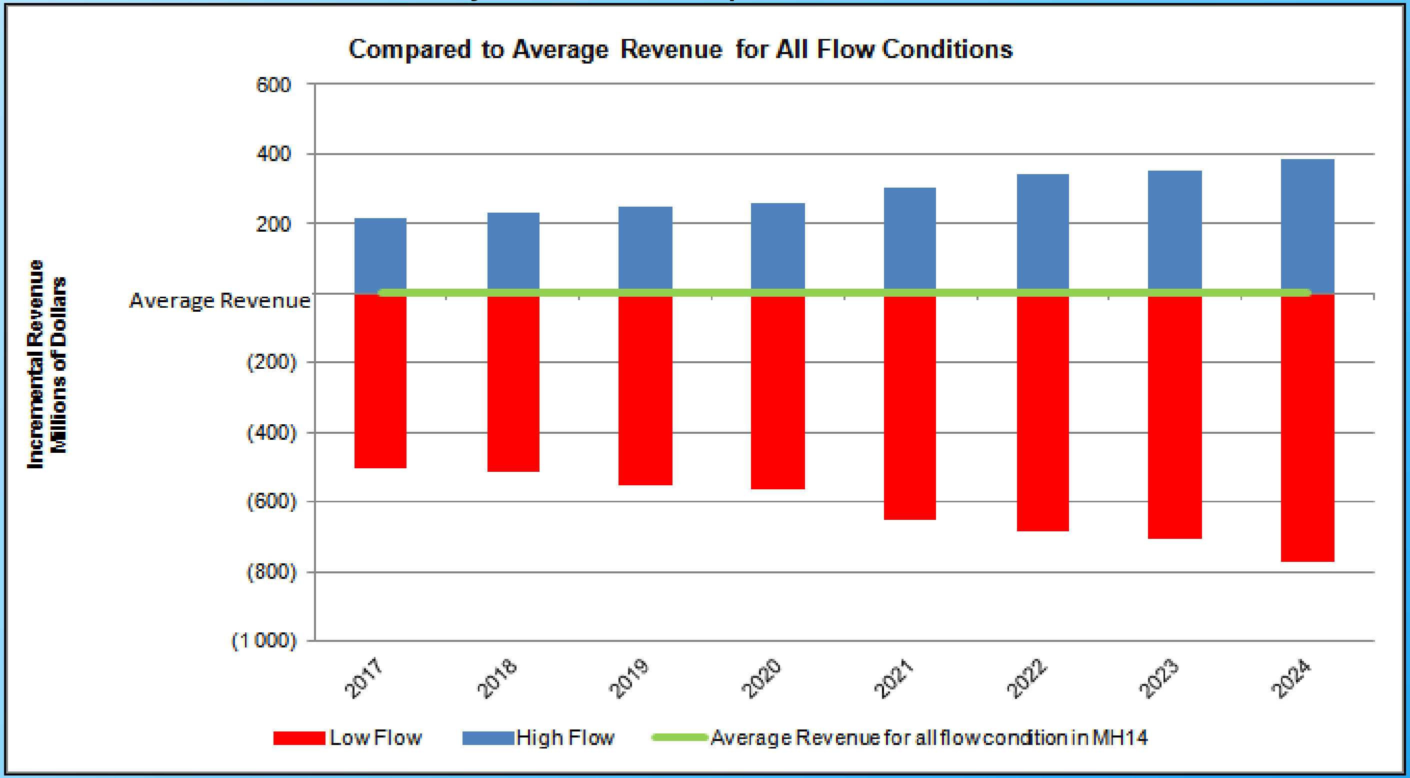
Comparison of Electric Operations Net Income MH14 to MH13
(including proposed and indicative rate increases)

| | Forecast 2014/15 | Forecast 2015/16 | Forecast 2016/17 | 10 Year Cumulative to 2023/24 | 20 Year Cumulative to 2033/34 |
|---|---|---|---|---|---|
| Current Forecast (MH14) | $ 102 | $ 115 | $ 59 | $ (559) | $ 3 003 |
| Previous Forecast (MH13) | 55 | 12 | 19 | (85) | 4 775 |
| Increase/ Decrease | $ 48 | $ 103 | $ 41 | $ (474) | $ (1 772) |

- In the near-term to 2016/17, projected Net Income from Electric Operations (including proposed rate increases) is higher in MH14 compared to MH13 largely due to the favourable water flow conditions, as well as lower finance and depreciation expense.
- There are lower net earnings projected in the remaining years of MH14 – resulting in lower cumulative earnings of approximately $500 million to 2024. Lower rate increases in 2015/16 would further exacerbate the situation.

# Rate Increases are Required Notwithstanding More Favourable Near-term Financial Results

Variability of Net Extraprovincial Revenue




- Manitoba Hydro's financial results are subject to significant volatility based on potential changes in water flow conditions that can change quickly.
- It is necessary that rate increases be implemented gradually, even in years with favorable water flows & financial results, to balance out the inevitable years with lower water conditions in order to maintain average rate increases of 3.95% over the long term.

# Rate-setting with a longer term perspective

- Manitoba Hydro follows a cost of service rate-setting approach that does not set rates based strictly on costs.
- Manitoba Hydro strives to propose rates that cover the costs of providing service, including financing costs and an annual contribution (net income) to financial reserves (retained earnings) for the purposes of rate stabilization.
- The 3.95% rate increases are the minimum necessary to address core earning requirements and preserve rate stability for customers.
- The 3.95% rate increases assist Manitoba Hydro in managing the decline in its financial strength during the period of intensive capital investment but do not allow it to pre-fund future investment requirements.

# A Long Term Rate-Setting Perspective is Beneficial to Customers

*"In order to reconcile the variability of the Manitoba Hydro revenue stream with the stability desired by many of Manitoba Hydro's customers, the Board ought to look at setting rates on the basis of longer term trends as opposed to the actual results of last year's revenues or the short-term conditions, be they favourable or unfavourable. GAC is of the view that the current longer term trends point strongly in the direction of requiring more revenue for Manitoba Hydro"*

**Source:** **Green Action Centre (page 3 of its written submission) as part of Manitoba Hydro's Application for Interim Electric Rates effective April 1, 2014**

- Setting rates considering longer term revenue requirements is the prudent approach and is in the best interests of customers.
- Focusing on the shorter term financial outlook will only defer the required rate increases to future periods and inevitably result in rate instability for rate-payers – especially considering the upcoming period of extensive investment.

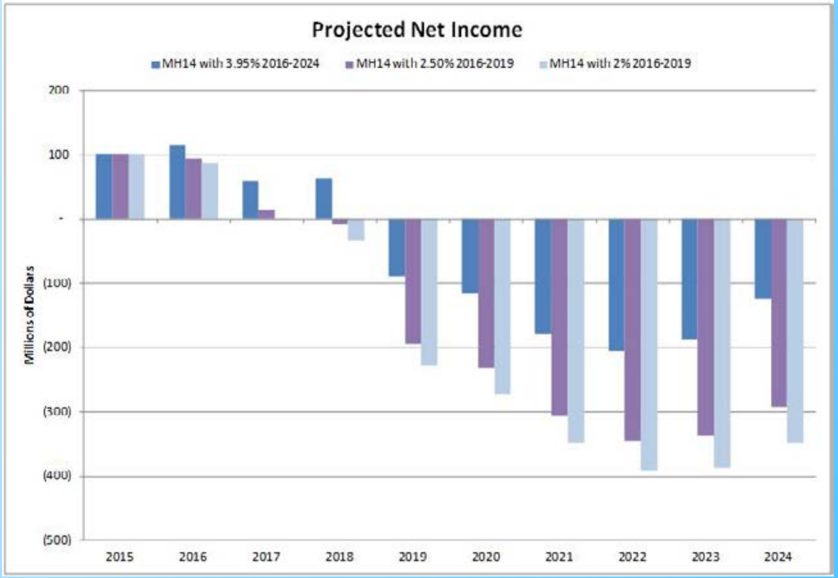


Manitoba Hydro

# Inflationary Rate Increases are Not Sufficient to Maintain Rate Stability for Customers

MH14-3.95% (2016-2024), MH14- 2.50% (2016-2019), and MH14- 2.0% (2016-2019)

**Projected Net Income**




**Projected Retained Earnings**


- Projected increases in Manitoba Hydro's revenue requirement are largely driven by the extensive investments made on behalf of customers – these are much more significant than inflationary cost pressures.
- Inflationary rate increases will jeopardize Manitoba Hydro's ability to provide rate stability to customers as it will be unable to recover its costs and ensure sufficient financial reserves are in place. Financial reserves would be less than half the cost of a prolonged drought.

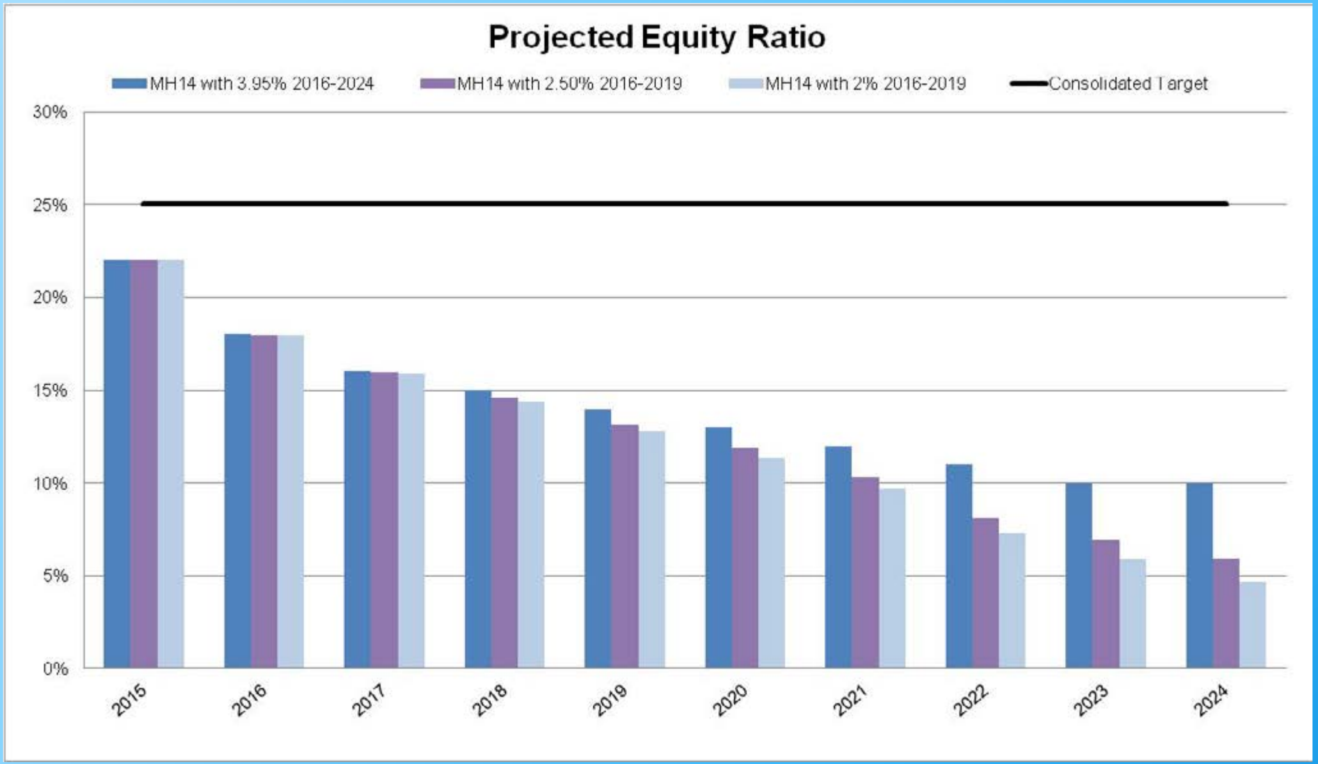


Manitoba Hydro

# Inflationary Rate Increases are Not Sufficient to Maintain Rate Stability for Customers

MH14-3.95% (2016-2024), MH14- 2.50% (2016-2019), and MH14- 2.0% (2016-2019)

**Projected Equity Ratio**

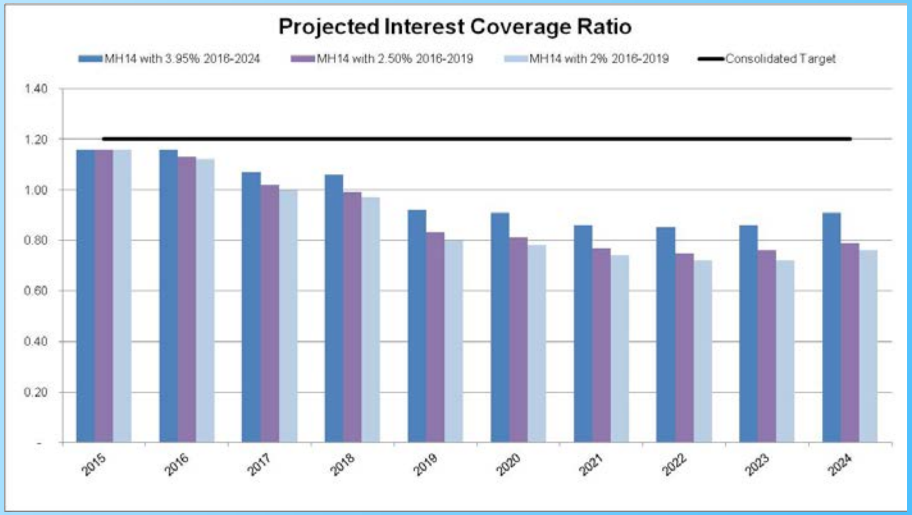



- Inflationary rate increases would result in an equity ratio well below minimum acceptable levels and approaching zero.

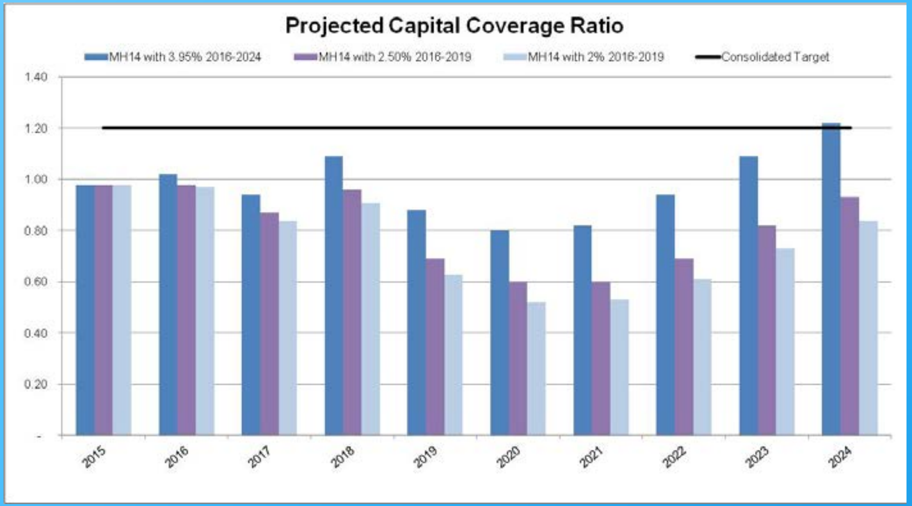
# Inflationary Rate Increases are Not Sufficient to Maintain Rate Stability for Customers

MH14-3.95% (2016-2024), MH14- 2.50% (2016-2019), and MH14- 2.0% (2016-2019)

Projected Interest Coverage




Projected Capital Coverage Ratio




- Inflationary rate increases would result in Interest and Capital Coverage ratios well below minimum acceptable levels.



Manitoba Hydro

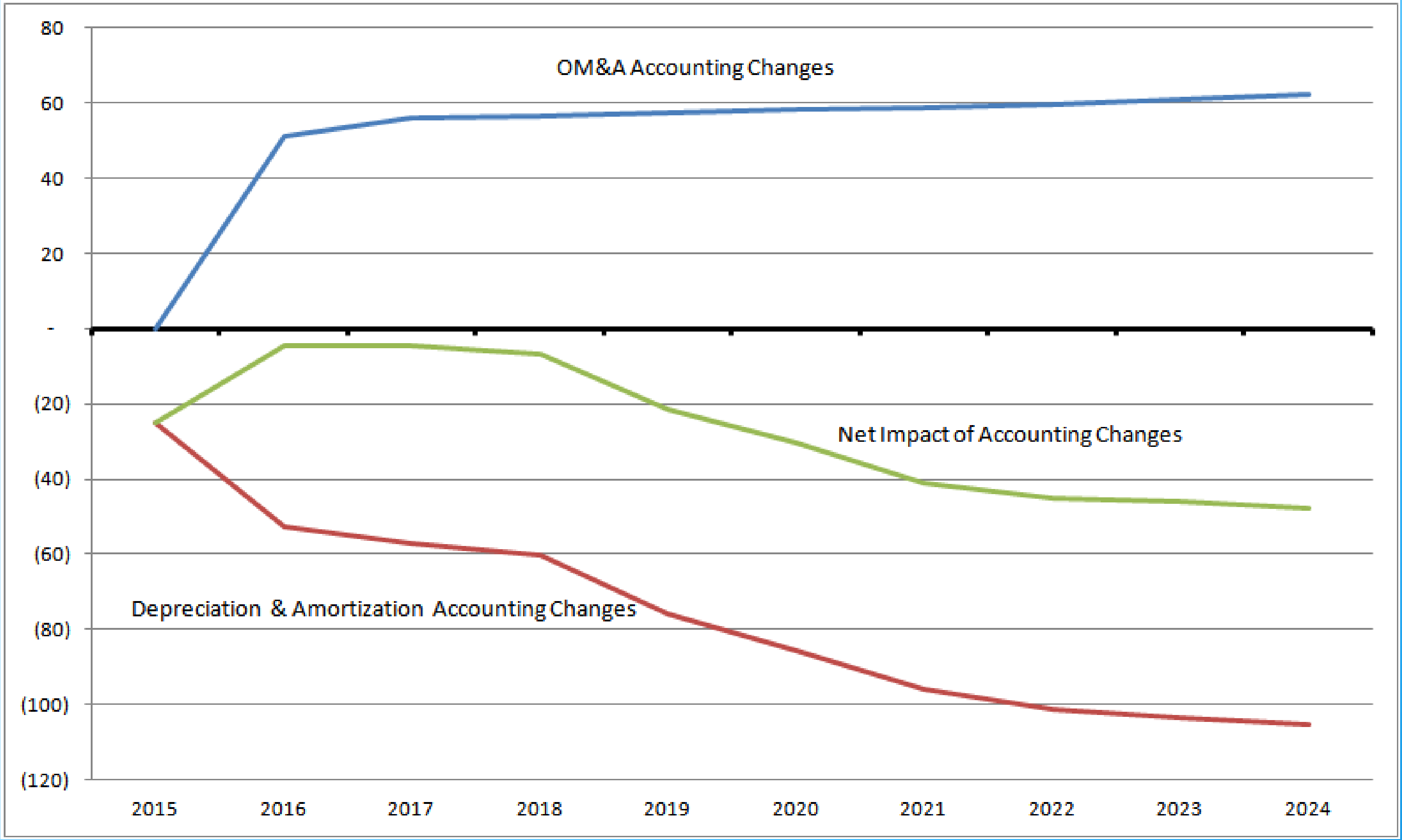
# Proposed Rate Increases are Not Being Driven by Aggressive Accounting Policy Selection

Accounting Policy & Estimate Changes

| **Accounting Policy & Estimate Changes**<br>Electric operations (in millions of $s) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** |
| OM&A Expense Changes | | 51 | 56 | 57 | 58 | 58 | 59 | 60 | 61 | 62 |
| Depreciation Expense Changes | (25) | (53) | (57) | (60) | (76) | (86) | (96) | (101) | (103) | (105) |
| Other | | (3) | (3) | (4) | (3) | (3) | (4) | (4) | (3) | (4) |
| Total Increase (Decrease) in Revenue Requirement | (25) | (4) | (4) | (7) | (22) | (31) | (41) | (45) | (46) | (48) |

- Manitoba Hydro is making a number of prospective accounting changes for financial reporting purposes in 2014/15 and 2015/16 – including further changes to the level of capitalized overhead and depreciation methodologies as part of the conversion to IFRS in 2015/16.
- Depreciation decreases will more than offset OM&A increases – such that accounting changes are not driving the increase in revenue requirements and the need for rate increases.
- Given there is no harm to ratepayers, use of IFRS for rate-setting purposes is fair and appropriate.

# Accounting Changes are a Net Reduction to Revenue Requirement




- The net accounting changes are a decrease and are not contributing to the $900 million in losses between 2019 to 2024.

# What is driving the $900 million losses in 2019-2024

- Significant increase in carrying costs associated with Bipole III, sustaining capital expenditures, demand side management, and Keeyask Generating Station.

- Lower general consumers revenue due mainly to increased demand side management savings.

- Lower projected net extraprovincial revenues due to lower projected export prices, partially offset by increased energy available for export as a result of increased demand side management.



Manitoba Hydro

# There is No Need for Differences for Financial Reporting and Rate-Setting under the Cost of Service (COS) Rate-Setting Methodology

- COS rate-setting methodology used to set electric rates in Manitoba does not determine rates strictly on the basis of costs.

- COS rate-setting methodology together with Manitoba Hydro's approach of regular and reasonable rate increases has flexibility to recognize changes in cost levels into rates gradually over time – rendering separate accounting policies for financial reporting and rate-setting unnecessary.

- COS rate-setting methodology eliminates excessive regulatory deferral accounts and multiple asset sub-ledgers.

# Impacts of Two Sets of Asset Sub-ledgers

- Differences between financial reporting and rate setting must be recognized in regulatory deferral accounts (Example - differences in depreciation method and/or capitalization of overhead costs)

- Two sets of detailed asset sub-ledgers will be required to support the balances in regulatory deferral accounts

- Impacts accounting system and business processes

- Onerous and costly – discussed by Ms. Bauerlein and Ms. Hooper on transcripts 3616 – 3618

- Not achievable for 2015/16 fiscal year

# Impacts of Two Sets of Asset Sub-ledgers

- 93,000 asset records and growing  x 2
- Thousands of transaction each month x 2
- Differences will grow over time, difficult to perform reconciliations and audits 20 years down the road
- Impacts not only the financial statements:
    - Monthly and quarterly financial reporting x 2
    - Financial forecasts (IFF) x 2
    - Depreciation studies x 2
    - Annual audit of plant assets x 2
- Inconsistent with direction to control OM&A costs
- Cost to convert ($2-$3 million) and ongoing (not determinable)



Manitoba Hydro

# Manitoba Hydro has Managed the Impact of ELG through Removal of Negative Salvage from Depreciation Rates

| Depreciation Policy & Estimate Changes<br>Electric operations (in millions of $) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|
| Average Service Life Changes (2014 Depreciation Study) | (25) | (29) | (30) | (30) | (34) | (38) | (43) | (41) | (43) | (42) |
| Negative Salvage | | (60) | (63) | (67) | (86) | (96) | (107) | (117) | (117) | (119) |
| Other | | (0) | (2) | (4) | (5) | (7) | (9) | (10) | (12) | (14) |
| Change to IFRS Compliant Depreciation (ELG) | | 36 | 38 | 41 | 49 | 55 | 63 | 67 | 68 | 69 |
| Subtotal Depreciation Changes | (25) | (53) | (57) | (60) | (76) | (86) | (96) | (101) | (103) | (105) |

- Manitoba Hydro made a policy decision in 2010 to move to the Equal Life Group (ELG) depreciation method to aid transition to IFRS.
- Manitoba Hydro made an explicit policy decision at the same time to remove net salvage from depreciation rates upon transition to IFRS to manage both the financial reporting and rate-setting impacts of the move to ELG – this results in a significant decrease in depreciation expense.
- Manitoba Hydro is requesting the PUB to review depreciation changes on an overall basis for rate-setting purposes – consistent with the regulatory principle of "fairness".

# Tests to Approve the ELG Method

- Is ELG a reasonable depreciation methodology for rate-setting purposes?

- From an overall perspective, is there any harm to customers?

# ELG Method is a Reasonable Method for Rate-Setting

- More robust method – improved matching of depreciation to consumption of assets
- Used by other utilities in North America
- Satisfies the precision requirements of IFRS
- Testimony of Ms. Lee not objective (TP 4096) *“I just have a fundamental concern with the ELG procedure”*



Manitoba Hydro

# Manitoba Hydro's Plant Records are Appropriate to Apply the ELG method

- 94% of Manitoba Hydro's accounts have complete retirement history
- As discussed by Mr. Kennedy (TP 3519) *"Manitoba Hydro records are definitely sufficient for applying the Equal Life Group method. In fact, I consult with thereabouts 80% of the utilities across this country. And I would suggest that the Manitoba Hydro plant accounting records are at the top of the group, or within the very top of the group of regulated utilities that I have the opportunity to work with."*



Manitoba Hydro

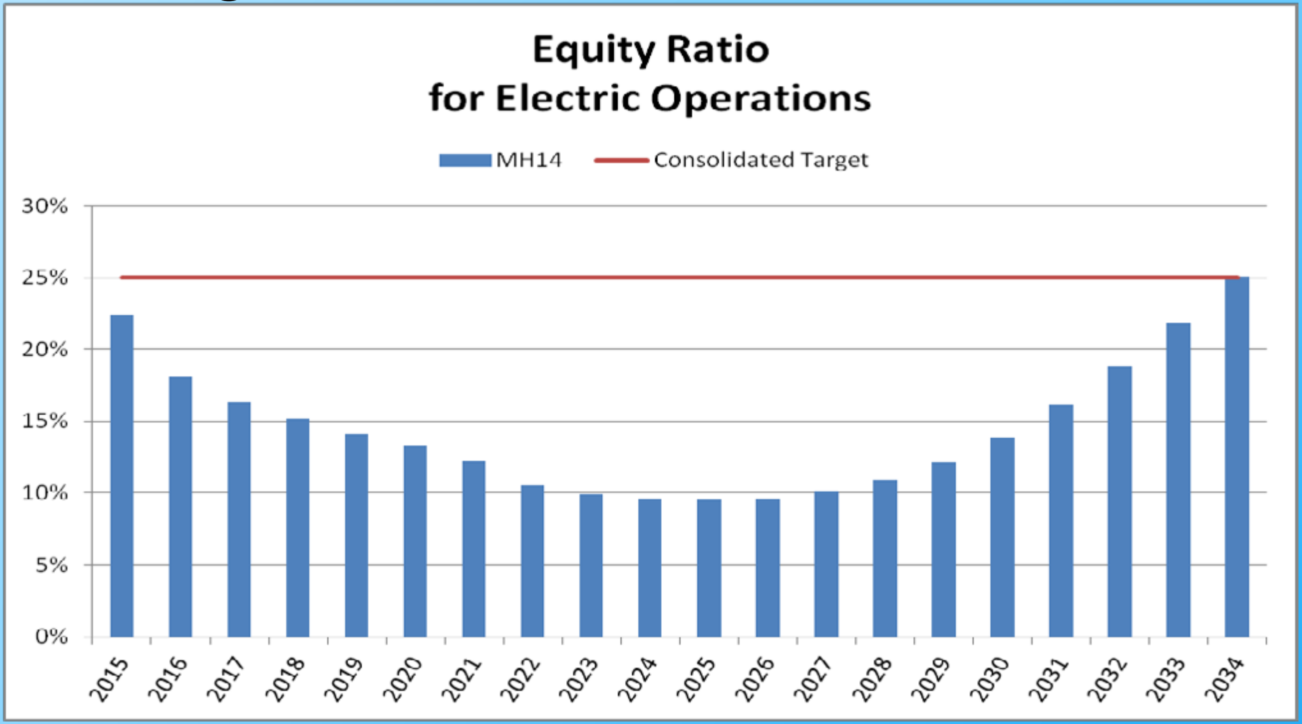
# The PUB Rejected Intervenor Recommendations to Adjust Accounting Policies to Lower Rate Increases in Order 43/13

Interveners recommended various accounting changes to lessen rate increases over the test years. The Board rejects this approach as it would have the effect of reducing Manitoba Hydro's revenues, weakening its financial position, and increasing borrowing costs. It is important that Manitoba Hydro remain a financially strong and viable organization. The Board supports the staged approach to accounting changes planned by Manitoba Hydro.

**Source:** **Manitoba Public Utilities Board Order No. 43/13 dated April 26, 2013 (page 10)**

- At the last GRA, MIPUG and CAC recommended that the PUB not accept overhead changes and to remove Net Salvage from depreciation rates in advance of IFRS conversion for rate-setting purposes – in order to justify lower rate increases.
- The PUB rejected this approach in Order 43/13 – noting potential weakening of Manitoba Hydro's financial position and increased borrowing costs.
- Excessive use of rate regulated accounting is not the solution for rate stability for future customers.

# Manitoba Hydro is Projecting Deterioration of its Financial Ratios to Mitigate the Rate Increases to Customers




- Higher rate increases in the order of 5.5% to 6.0% for the next four years would be necessary to reduce the losses that are projected in the next 10 years and maintain financial reserves at current levels.
- The 3.95% proposed and indicative rate increases are the minimum that are necessary to manage the deterioration in projected financial results and ratios in the next 10 years.
- Relaxing the longer term financial targets will not negate the need for the requested rate increases of 3.95%.

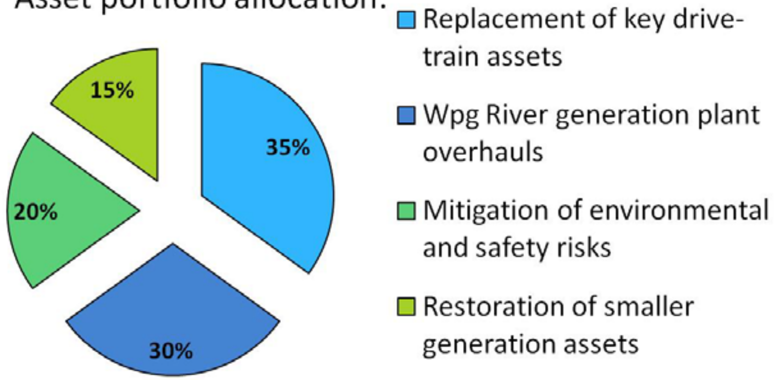


Manitoba Hydro

# Sustaining Capital Investments

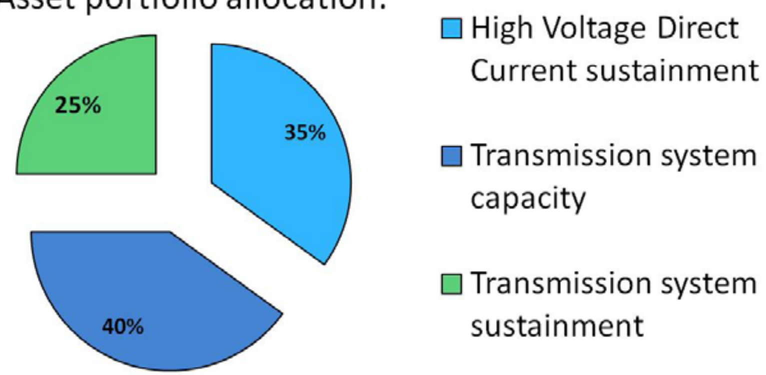
## Generation

- $1.3 billion over the next ten years
- Asset portfolio allocation:



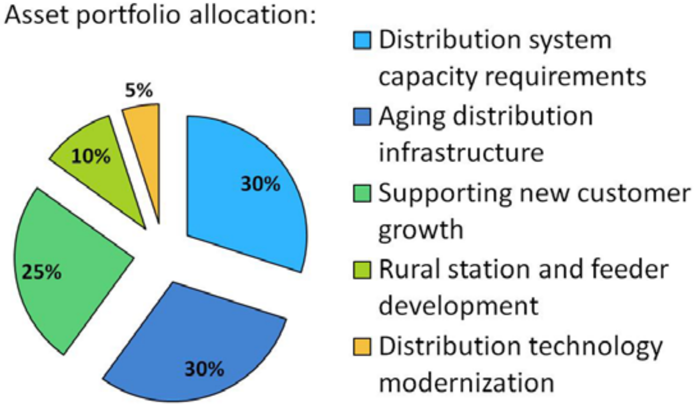

## Transmission

- $1.3 billion over the next ten years
- Asset portfolio allocation:




## Distribution

- $2.2 billion over the next ten years
- Asset portfolio allocation:






Manitoba Hydro

# Pacing & Prioritizing Sustaining Capital

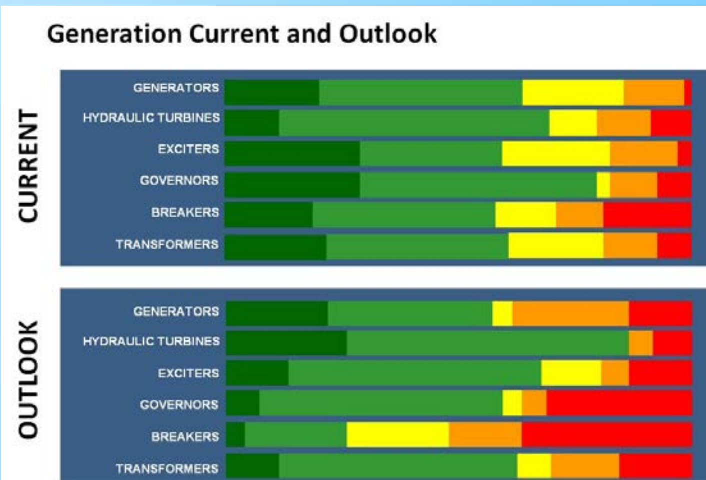
- As discussed by Mr. Morin (TP 752-755), even with the forecast level of sustaining capital expenditures, system reliability is expected to decrease.
- Once a system starts to lose that performance, it is a major undertaking to correct it.
- Manitoba Hydro has maintained its assets very well and significantly extended asset lives.
- However, the assets have reached the point where they require replacement to maintain reliability.

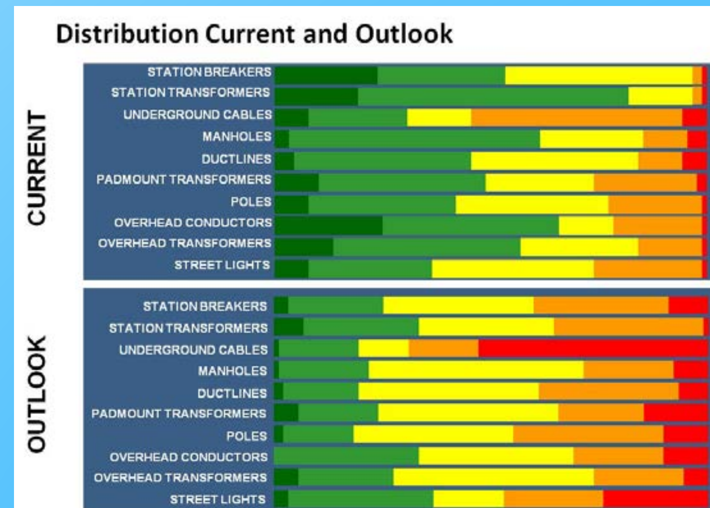
# Aging Infrastructure

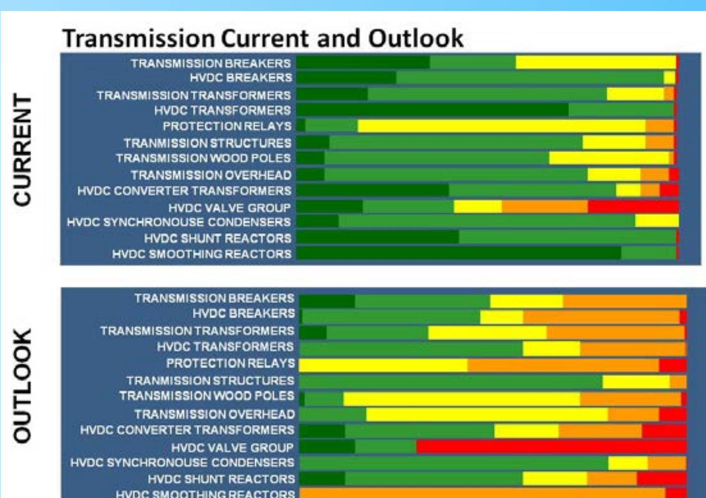
- The Asset Condition Report was developed to help illustrate the impacts of Aging Infrastructure
- Manitoba Hydro does not replace assets based solely on age
- Assets are replaced on risk and/ or economics
- Age in conjunction with current assessment data is used for long term planning
- Manitoba Hydro's prudent asset management strategies have allowed many assets to remain in-service well beyond industry norms

# Staying ahead of wave of capital investment requirements

Asset Health Indices- Current & 20 Year Outlook




- As a larger portion of assets age beyond life expectancy, system failure and customer outages are expected to occur on a more regular basis.
- Replacement rates and associated capital funding for the majority of Manitoba Hydro's asset types need to be increased to better align with life expectancy.

VERY GOOD

GOOD

FAIR

POOR

VERY POOR

Manitoba Hydro

# Other Issues to be Addressed in Written Final Argument

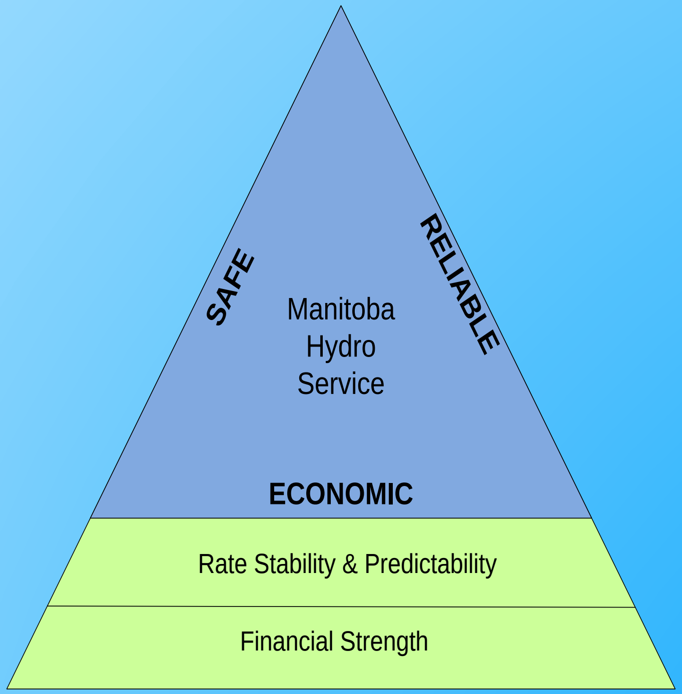
- Low Income Issues
- Demand Side Management
- Curtailable Rate Program
- Surplus Energy Program
- Area & Roadway Lighting

# 2015 General Rate Application

- Final approval of 2.75% interim rate increase effective May 1, 2014
- Approval of a 3.95% rate increase for 2015/16
  - $3.20 increase in monthly bill of residential customer without electric space heat
  - $6.11 increase in monthly bill of residential customer with electric space heat
- Final approval of LED Rates effective August 1, 2014
- Changes to SEP and CRP Terms & Conditions
- Final approval of Interim Orders on SEP, and CRP
- Approval to rescind DSM deferral account

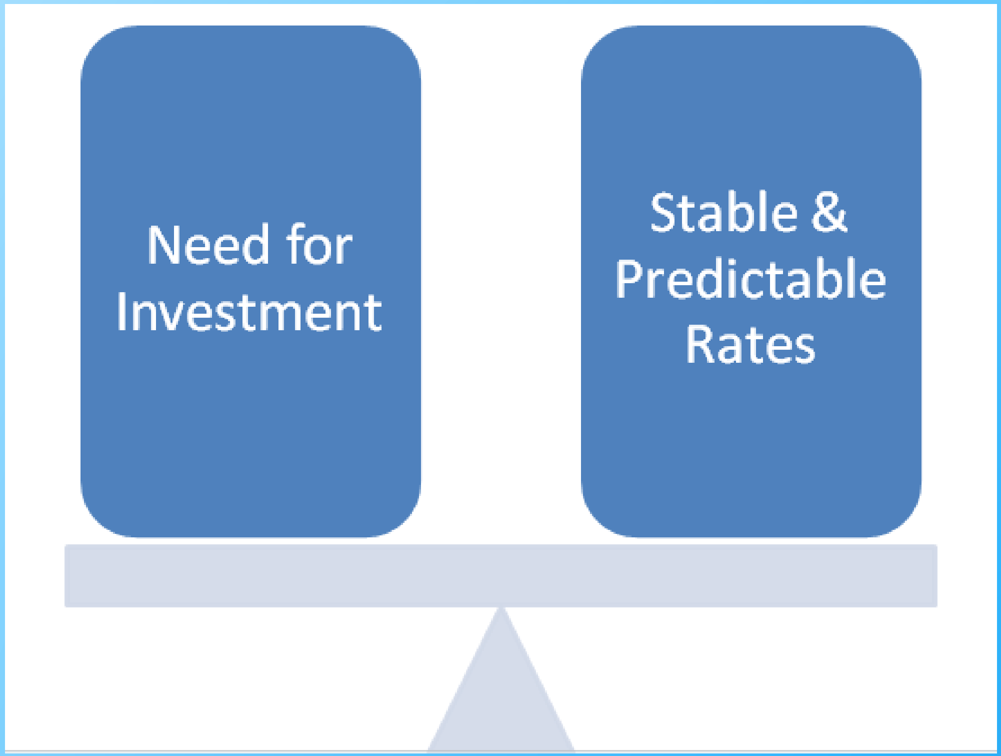
# Rate Stability for Customers Dependent on Financial Strength of the Corporation

Foundation of Safe, Reliable and Economic Service




- Rate stability & predictability for customers depends on the continued financial strength of Manitoba Hydro.
- Without the necessary rate increases, there is significant risk to customers of volatile rate changes and a need for sudden or larger rate increases in the near future. This risk is particularly acute in the upcoming period of extensive capital investment.

# Balancing the Need for Investment with Stable & Predictable Rates




- The required capital investment means that rates will need to increase over the next decade to fund these investments.
- Manitoba Hydro believes that the proposed rate increases carefully balance the need for investment and providing stable, predictable rates for our customers.



Manitoba Hydro

# Manitoba Hydro is Seeking Further Direction from the PUB on Rates for 2016/17

- Manitoba Hydro's view is that the investment requirements of the next decade support a long-term approach to setting revenue requirements.
- Manitoba Hydro has included its forecast for the 2016/17 fiscal year in its Application, and has requested a 3.95% rate increase effective April 1, 2016.
- Pending regulatory schedule- Cost of Gas Application, Cost of Service Review
- Manitoba Hydro has provided sufficient information for April 1, 2016.
- In the alternative, Manitoba Hydro is seeking direction from the PUB with respect to April 1, 2016 interim rates.

# Manitoba Hydro's Plan
# Steady and Calm

- Manitoba is in an enviable position with one of the most reliable, sustainable and affordable power systems in Canada
- As indicated by Mr. Rainkie (TP 2039)- Manitoba Hydro is asking Manitobans to invest in their own power system that has provided safe and reliable service for decades



Manitoba Hydro

# The Proposed Rate Increases are Essential to Provide Customer Value

The revenues from the proposed rate increases are necessary so that Manitoba Hydro can deliver on its mandate by:

- Continuing to deliver a reliable energy supply to Manitobans by funding the necessary investments to respond to the need for system growth and asset replacement;
- Funding Power Smart programs to assist customers in meeting their energy needs in a cost effective manner;
- Continuing to provide rates that are affordable for Manitoba families and that support the competitiveness of Manitoba business; and,
- Ensuring rate stability and predictability for customers by maintaining its financial strength.

# Thank you