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The Honourable Kerr Twaddle

March 17, 2011

VIA E-MAIL

Mr. Hollis Singh
Manitoba Public Utilities Board
400 - 330 Portage Avenue
Winnipeg, MB R3C 0C4

Dear Mr. Singh:

Re: 2011 Interim Rate Consideration Hearing
Our File No. 15198 WSG

I am providing these written comments to supplement the oral presentation made by Dr. Miller at the hearing on March 9, 2011.

Jurisdiction of the Board to make an interim order regarding rates

RCM/TREE argued in January, 2010 that the *Public Utilities Board Act* (the "Act") gives to the Board the jurisdiction to make an interim order. In PUB 18/10, all members of the Board held that the Board has the jurisdiction to order an interim rate increase.

The submissions by CAC/MSOS and MIPUG would seem to suggest that the decision of *CRTC v. Bell Canada* sets standards that must be met in an interim rate application. The argument would appear to be that Manitoba Hydro has earned higher than anticipated revenues and that therefore an interim rate cannot be justified. It is the position that RCM\TREE that in the *Bell Canada* case, the Supreme Court of Canada was dealing with the facts before it. The court was not, in our submission, establishing a framework against which all interim rate applications must be judged. The court was not stating that the circumstances in *Bell Canada* are mandatory requirements that must be met in deciding interim rate applications.

In the present case, the Act gives to the Board a wide discretion to make an interim order in s. 47(2). It is the position of RCM/TREE that the Board has the jurisdiction to consider the facts before it to determine whether or not an interim rate order should be made.

Position of RCM/TREE on the interim rate increase

A. A long-term view is appropriate for Manitoba Hydro rate setting

RCM/TREE take a long-term view on rate setting. Manitoba Hydro's revenue stream is extremely volatile due to the variability in water flows and short-term export prices. We believe that rates should be adequate for the longer term, rather than stop and start increments based on the current year's fortunes. In support of this outlook, we point to the following evidence:

- on page 14 of Mr. Warden's direct evidence (Exhibit 12), the forecast equity ratio over 20 years is presented. Although in the 2 test years the ratio slightly exceeds the 25% target, for the next 13 years, the equity ratio falls under the target by up to 5%. It is our view that the 25% equity should be treated as a long-term target as opposed to an upper boundary with a corresponding curtailment of rate increases whenever that point is reached

- the graph on page 30 of Mr. Warden's direct evidence points out that Manitoba Hydro's rates have increased substantially less than the Consumer Price Index for Manitoba since 1998/99, even though the gap is currently on a trajectory to close

- the table on page 31 of Mr. Warden's direct evidence indicates that Manitoba Hydro's cumulative rate increases since 2006 are lower than other Canadian utilities, aside from Hydro Quebec. At the same time, Manitoba Hydro has maintained lower rates than those charged by Hydro Quebec

- looking forward, Mr. Warden informed us that BC Hydro is asking for a 9.73% annual increase for each of the next 3 years, or a cumulative 32% (transcript, page 4179, lines 4-10)

Manitoba Hydro's rates are likewise on a trajectory to increase, but at a far more modest level, in order to maintain equity in a period of high capital investments. Both the ICF and KPMG consultants endorsed the soundness of Hydro's capital investment strategy, particularly pointing to the gains in reliability and export capacity created by the associated transmission investments in the US. Even under the no-sale alternative, significant investments in system reliability and future supply are needed to meet Manitoba's needs. By any measure, Manitoba Hydro will require an increase in its revenues.

Conclusion

The evidence presented points to a need for rising rates to maintain equity during a "decade of investment". Skipping a rate increment in the second test year would not only deprive the corporation of income for the year, but also have negative revenue impacts into the future by setting a lower baseline for future increases.

B. Risks are asymmetrical

Risk is a defining topic for this GRA. We have referred to the need to keep in mind investment requirements and targeted equity ratio for the long term in the face of fluctuating revenues. It is clear, however, that the fluctuations to the negative side of revenue expectations can be much more severe than variations to the positive side.

On page 66 of his direct testimony (Exhibit 55), Mr. Rose presented a graph of Variation of Flow Related Revenue. The graph shows that in the deepest droughts, losses would exceed $600 million, other factors being equal, compared with gains of just over one-third of that amount in the best years.

Mr. Warden presented a sensitivity analysis on IFF 10 on page 40 of his direct evidence, which indicated the negative implications of drought on retained earnings over the next decade, higher than forecast capital expenditures and higher than forecast load growth in Manitoba. A favourable variation in high export prices is the main potential offset on the positive side.

Conclusion

The asymmetrical distribution of risk severity on the negative side, particularly from drought, underscores the need to build and maintain sufficient retained earnings and to provide the revenue stream from rates to do that. Reduced capitalization treatment of some items in the migration to IFRS accounting could affect the statement of retained earnings as well.

C. COS and rate design

RCM/TREE are of the view that, on the basis of evidence so far considered, a rate increase in the amount applied for by Manitoba Hydro is warranted, either now or in the near future. The main reservation we have against doing it now on an interim basis instead of waiting for a final order is that it could entrench further existing sub-optimal cost allocations and rate designs at the expense of greater reform that might ensue in the final order.

It is not clear how far further refinement of the COSS or of cost allocations will go in this round, since Manitoba Hydro has commissioned an external review. There are significant improvements to rate design that are possible and which we hope to see implemented.

D. Regulatory burden

This extraordinary hearing for a two-year rate application is likely to encompass a year and nine months from initial filing to final order, at a minimum. This extended period has permitted a deeper examination of risks and of the financial implications of capital investment plans than normal. In keeping with our long-range view for rate setting, we believe it could make sense to ease the regulatory burden on Manitoba Hydro, the intervenors and the PUB to make a three-year determination through 2012/2013.

E. Recommendation

RCM/TREE recognize that there is a balancing act that must be considered when deciding on an interim rate. There is a concern for the revenue position of Manitoba Hydro, both in the short and long terms. There is also a concern for the final decision of the Board. Does an interim rate interfere with the final decision?

We present two options that we would recommend:

1. One option is that the Board grant an interim rate at this time in line with the request made by Manitoba Hydro or close to it. The rate increase would be applied across the board against the various rate classes.

   The Board would then make the necessary adjustments to the rate design in the Final Order. The Final Order would conceivably lower rates for some classes and increase rates for other classes.

This option is appealing to RCM/TREE because it would preserve the financial integrity of Manitoba Hydro. The negative aspect is that it might require changes to rates in short order. This could be confusing to some.

2. A second option would be to delay the rate increase entirely until the Final Order is issued. The Final Order would of necessity need to include a larger rate increase in order to make up the foregone revenue. The Final Order would include allocation and rate design changes.

This option is appealing to RCM/TREE in that there would be only one period of change. The rate increase and the rate design changes would be implemented at the same time. The process might be less confusing to the consumers. The negative aspect is that it is possible that the larger increase would still not recoup the revenues that are being foregone by virtue of the delay. This option is less attractive the longer the delay in issuing the Final Order.

In considering these two options, RCM/TREE are of the view that if the Final Order is not likely to be issued until November or December, the second option presented becomes significantly less attractive. A long delay would result in a significant amount of foregone revenue that would have to be made up. Further, a later Final Order would also of necessity come shortly before the next increment. RCM/TREE recognize that the Board is the party in control of the timing of the Final Order. We therefore leave it to the Board to ponder the likelihood of an early or a late Order in deciding between our two options.

Yours very truly,

GANGE GOODMAN & FRENCH

Per:

William S. Gange

WSG/lc