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The Public Utilities Board of Manitoba
400-330 Portage Avenue
Winnipeg, Manitoba R3C 0C4

Attention: Mr. Hollis Singh, Executive Director and Board Secretary

Dear Mr. Singh:

Re: Manitoba Hydro interim rate application

CAC Manitoba appreciates the opportunity to reply to the request of Manitoba Hydro for an interim rate increase of 3.95% and the indication by Manitoba Hydro that it will be seeking finalization in the fall of 2014 of the interim rate increase as well as further increases for 2015/16 and 2016/17.

Position on Interim Rate Increase

Based on the attached memo (Appendix A), CAC Manitoba is writing to express its opposition to an interim rate increase of 3.95%. In the respectful view of CAC Manitoba, even a preliminary analysis of the proposed rate increase suggests that the 3.95% request is materially inflated. Given that a strong case could be made that Hydro could meet its financial targets in 2014/15 without any rate increase, CAC Manitoba would suggest that an interim rate increase of no more than the rate of inflation is the maximum that should be approved. Based on ongoing concerns with Hydro's management of its capital expenditures, preferred development plan and O, M and A, CAC MB may seek a full roll back of any interim rate increase in the next GRA.

Position on Proposed Hearing for the Fall of 2014

CAC Manitoba is gravely concerned with the suggestion that Manitoba Hydro would be seeking rate increases for the 2016/17 year in the fall of 2014. As the attached table (Appendix B) demonstrates, over the past decade there has been a material disconnect between the predictions of Manitoba Hydro and subsequent reality. CAC Manitoba is very uncomfortable relying upon the forecasts of Manitoba Hydro beyond a 12 month to 18 month period. CAC Manitoba would suggest that any General Rate Application be restricted to the current year and if necessary the 2015/16 year.

Thank you for your consideration of these comments

Yours truly,

B Froese,

for BYRON WILLIAMS
Director

BW/ah

cc: CAC Manitoba
Board Counsel
Manitoba Hydro

Attachments

Appendix A

MANITOBA HYDRO'S

2014/15 INTERIM RATE INCREASE REQUEST

1. REQUEST

- On March 12, 2014 Manitoba Hydro filed a request for an interim rate increase. Specifically the request sought "approval, on an interim basis, of a 3.95% general rate increase effective April 1, 2014, sufficient to generate additional revenue of $56 million in 2014/15, to be applied on an across-the-board basis for all customer classes."[1]
- Manitoba Hydro has indicated that it intends to file a General Rate Application in the fall of 2014 wherein it will seek final approval for any increase flowing from its Interim Rate Application and seek further increases for 2015/16 and 2016/17[2].

2. STATED REASONS FOR THE APPLICATION

Rate Stability

1. Application is based on IFF-13 which indicates that regular annual rate increases of 3.95% are needed for each year of the forecast in order for the Corporation to attain its financial objectives.[3] As a result, approval of 3.95% for 2014/15 will promote rate stability

Financial Integrity

Approval of the proposed rate increase is needed to maintain net income and financial ratios for 2014/15 at acceptable levels and preserve the financial integrity of the Corporation. Including the proposed rate increase, the forecast net income from Electric operations is $55 million for 2014/15; the equity ratio is projected at 22%; and, the interest coverage 29 and capital coverage ratios are projected at 1.09 and 0.87, respectively, for 2014/15.

- Absent the proposed rate increase, a net loss of $1 million is projected in 2014/15, the equity ratio is projected to decline to 21%, and the interest coverage

1 Application, page 1

2 PUB/MH I-4 a)

3 Application, page 4

and capital coverage ratios are projected to deteriorate to 1.00 and 0.78 respectively in 2014/15 (well below the 1.20 target levels). [4]

- Absent the 2014/15 rate increase, Manitoba Hydro would experience a further loss of $49 million in 2015/16 even if it obtained a 3.95% increase effective on April 1, 2015. In this scenario, projected retained earnings are forecast to be $56 million and $105 million lower in 2014/15 and 2015/16 respectively[5].

Export Revenues

- Manitoba Hydro's net extra-provincial revenues are projected at $139 million in 2013/14 and $118 million in 2014/15. The projected increase in net extra-provincial revenues over the previous forecast MH12, and the $100 million levels experienced in 2011/12 and 3 2012/13, reflect the current favourable water conditions and marginally higher export prices. However, the projected levels of net extra-provincial revenues are still significantly lower than the level of between $170 million and $370 million experienced in the 2007/08 to 2010/11 period. It is necessary to gradually increase customer rates over time to address this reduction in net extra-provincial revenues.[6]

Ageing Infrastructure

- Manitoba Hydro's infrastructure is ageing and increased costs are necessary to maintain infrastructure in a safe and reliable manner.[7]

3. OBSERVATION REGARDING "STATED REASONS"

3.1 Actual Results for 2012/13

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4 Application, page 4

5 Application, page 14

6 Application, page 5

7 Application, page 1

- IFF-13 shows forecast net income for electric operations for 2013/14 of $116 M.[8]. This is in contrast to an actual net income (electric operations) of $78 M for 2012/13[9]. The difference is $36 M.
- Third Quarter Results for 2013/14 report an electric operations net income of $78 M versus a result of -$24 M for the first three quarters of 2012/13[10]. A difference of more than $100 M.
- Manitoba Hydro has indicated that the forecast for 2013/14 was not updated for the Third Quarter Results.[11]
- It has also indicated that the 2013/14 actual results are not available for public release[12].
- When asked[13] about the discrepancy in 3rd Quarter versus full year results for 2012/13 versus 2013/14 Manitoba Hydro indicated that:
    - Manitoba Hydro recorded $35 M in revenue for 2012/13 in March 2013 from the reinstatement of the 1% rate deferral which increased 2012/13 net income.
    - There was an additional $10 in non-recurring other income recorded in 2012/13.

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8 Appendix 1, page 32

9 Application, page 12

10 Manitoba Hydro's Quarterly Report, December 2013 – Appendix 3

11 PUB/MH I-6 c)

12 PUB/MH I-6 a)

13 CAC/MH I-13

However, even if one attributes the entire $10 M non-recurring net income to electric operations the adjusted net income for 2012/13 would be $33 M ($78 - $35 - $10) which is only $83 M less than the forecast for 2013/14 used in the IFF.

- Manitoba Hydro has also indicated[14] that the 2013/14 forecast in the IFF13 does not reflect the impact on revenues of the colder winter in early 2014 – which will also improve the 2013/14 results.
- Forecast export revenues reported in IFF13 for 2013/14 are $408 M. However the response to PUB/MH I-27 a) indicates that actual export revenues for 2013/14 were $419 M (i.e. Dependable Sales ($182 M) + Opportunity Sales ($203 M) + System Merchant Sales ($34 M)).

All of these factors would suggest that the actual results for 2013/14 will show higher levels of net income than currently forecast by Manitoba Hydro in IFF13 – leading to Manitoba Hydro being in a better financial position than indicated.

3.2 Forecast OM&A for 2014/15 (net of IFRS impacts)

- Manitoba Hydro has indicated that it plans to hold OM&A increases to 1%/annum starting in 2015/16[15]. When asked why this same constraint was not implemented for 2014/15, Manitoba Hydro indicated that the increase was not limited to below inflationary levels due to higher pension and other benefit costs[16]. However, in response to CAC/MH I-3, annual OM&A costs net of IFRS and pension adjustments were provided and the values shown for 2012/13 and 2013/14 are $383 M and $392 M respectively – an increase of 2.3% which is in excess of inflation.
- Furthermore, in response to PUB/MH I-16 b) Manitoba Hydro indicated that the detailed annual budget process for fiscal 2014/15 was currently underway and would incorporate further cost containment measures. It is not clear if these further cost containment measures are already reflected in IFF13.

-> Budgetary details not yet available for scrutiny.

->In any event, the implementation of cost control measure that limited the 2014/15 OM&A (net of pension and IFRS impacts) to a 1% increase would lead to a reduction in OM&A costs of $5 M.

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14 PUB/MH I-28.

15 Application, page 4

16 CAC/MH I-14 b)

3.3 Capital Taxes

- During the current NFAT proceeding it came to light that Manitoba Hydro does not capitalize "capital taxes" attributable to assets that are under construction[17].
- The amounts are material. Information is not readily available on the total assets under construction at the end of 2013/14 – which would be the basis for the 2014/15 capital tax calculation[18]. However, PUB/MH I-17 a) reports construction in progress for just major generation and transmission projects to be $2.2 B at the end of 2012/13. Applying the capital tax rate of 0.5% to this value would yield capital taxes on assets under construction of $11 B[19].

-> It can be expected that this treatment will be "fully explored and tested" during the GRA which will finalize any interim rate approved at this time.

3.4 IFRS

- Indeed there are still outstanding Directives related to IFRS from Order 43/13[20].

- In its submission MIPUG[21] has noted that changes to accounting procedures due to the transition to IFRS in 2015/16 have not been fully vetted. Issue raised by MIPUG include:

- Whether the elimination of the annual provision for Net Salvage should be advanced to 2014/15 as opposed to waiting to 2015/16 as proposed by Manitoba Hydro. Impact would be a benefit in 2014/15 of $62 M.

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17 MIPUG/MH I-2 c)

18 MIPUG/H I-2 c)

19 MIPUG/MH I-2 d)

20 Order 43/13, page 5

21 April25th, 2014 Submission, page 2

- Whether the current Average Service Life (ASL) depreciation method should be maintained. Impact in years subsequent to 2014/15 would be in the order of $37 M (as compared to the proposed conversion to the Equal Life Group method) and would grow further when/if additional major assets are added.

-> The ultimate implications of Manitoba Hydro's transition to IFRS are still unknown and the impact in 2014/15 and subsequent years could be less than indicated by Manitoba Hydro in its Interim Rate Application.

3.5 Aging Infrastructure/Asset Condition Assessment

- Manitoba Hydro has been raising issues of aging infrastructure since the 2008-2009 GRA[22]. However, it still has yet to provide Asset Condition Assessments for two of its major business units: Generation and Transmission[23]. Such assessments are critical to ensuring that Manitoba Hydro truly understands the condition of its assets; has properly identified/prioritized its re-investment needs and, thereby, justified its proposed spending.

3.6 Long Term Financial Integrity/Rate Stability

- The even 3.95% rate increases set out in IFF13 through to 2031/21 are based on Manitoba Hydro implementing its Preferred Development Plan, in anticipation of a 2022/23 "need date" for domestic reliability[24] included bringing Keeyask into service in 2019/20 and Conawapa into service in 2026/27[25].
- Recent developments at the NFAT proceeding currently taking place before the PUB have raised significant issues regarding the need date for domestic reliability as well as the economics of the preferred plan. The acknowledgement that higher levels of DSM are economic has altered the in-service date for new resources just to meet

22 2008/09 GRA, PUB/MH I-63 a)

23 MIPUG/MH I-1 d)

24 NFAT Application, Chapter 4, page 4

25 Appendix1, page 6

domestic need to roughly 2030[26]. Further, changes in capital cost estimates for Keeyask and Conawapa indicate that the Preferred Plan is no longer the most economic plan[27].

- Even with the higher capital costs, the higher levels of DSM now give rise to Plans with lower average rate increases need through to 2031/32 than the 3.95% that still meet Manitoba Hydro's financial targets at that point in time[28]. For example Plan 1 (All Gas), whose economics is virtually equivalent to that of the preferred plan requires annual increases of 3.36% per annum when combined with higher levels of DSM[29].
- Given these recent changes it appears imprudent to be guided by the rate increases originally required by the preferred plan in determining long term prospects for rate increases.

26 NFAT Exhibit MH-95, page 129

27 NFAT Exhibit MH-129-7, page 2 and Exhibit MH-104-15

28 NFAT Exhibit 104-12-1 and 104-12-2

29 NFAT Exhibit 104-12-2

Appendix B

The Credibility Gap

ISSUE	Manitoba Hydro – Then	Situation - Now
WUSKWATIM	At the time of the CEC assessment the operating statements for the Wuskwatim partnership indicated positive net income results for all years following the in-service of the station even under the Low Export Price scenario. (CAC/MSOS/NFAT/S/11 a Table: A.25).	Wuskwatim partnership losses are projected to exceed $170 M over the next three years (PUB/MH I-14)
DECADE OF INVESTMENT/ DECADE OF RETURN	The ten-year period to 2020 is being referenced as "the decade of investment" in which major investments, totalling $16.5 billion, are being made to Hydro's generation, transmission and distribution systems. The decade following 2020 is being referenced as "the decade of returns" in which significant benefits are returned to the energy ratepayers of Manitoba. (2011-12 GRA, Tab 2, page 3) These plans will involve the investment of approximately $18 billion over the next 10 years which will generate significant returns for Manitobans over ensuing decades. (2012 Annual Report, page 53) These plans will involve the investment of approximately $20 billion over the next 10 years which will generate significant returns for Manitobans over ensuing	Additional average electric rate increases of 3.95% per year are projected each April from 2014/15 through 2032/33. (IFF13, page 2)

	decades. (2013 Annual Report, page 61)	
DSM	The Commission wishes to emphasize that its recommendation to proceed with the Projects is based upon MH's commitment to also maximize the benefits of both demand side management (DSM) and supply-side enhancement initiatives (SSE) (which are discussed below) as well as the Projects. (CEC Wuskwatim NFAT Report, page 31) We aggressively promote energy conservation through a multitude of residential, commercial and industrial Power Smart* programs. (MH - 2010/11 Annual Report, page 8) We also aggressively promote energy conservation through a multitude of Power Smart programs. (MH - 2011/12 Annual Report, page 18) Manitoba Hydro's DSM plan involves a continued commitment to pursuing the maximum cost effective DSM savings achievable. (2012/13 & 2013/14 GRA, Tab 7, page 2)	Program Impacts at the Meter - 2013 PS Plan (2014-2028)- 687 GWh (NFAT, Appendix E) - 2014 PS Plan (2015-2029) – 2438 GWh (NFAT, MH Exhibit 180)
FUTURE NEED DATE	Based on the current supply and demand assumptions for energy, the Manitoba Hydro system will have a dependable energy surplus until the year 2022/23 at	Need Date with DSM2 (reduced somewhat) 2029-2030. (NFAT MH Exhibit 127-9, page 21)

	which time there will no longer be sufficient dependable energy available to meet the forecasted Manitoba energy demand and export commitments. (NFAT August 2013, Tab 4, page 14)	