SUBMISSION ON BEHALF OF

THE MANITOBA INDUSTRIAL POWER USERS GROUP

IN REGARD TO AN INTERIM RATE INCREASE

FOR MANITOBA HYDRO EFFECTIVE APRIL 1, 2014

Submitted to:

The Manitoba Public Utilities Board

On behalf of:

Manitoba Industrial Power Users Group

April 25, 2014

On March 12, 2014 Manitoba Hydro filed a request for an interim rate increase of 3.95% effective April 1, 2014. Given the time pressures facing all parties, Manitoba Industrial Power Users Group's (MIPUG's) response below is a truncated analysis of issues arising from IFF-13. Past MIPUG interim rates submissions have focused on widely accepted principles used in Canada for awarding interim rates – the presumption is in favour of not awarding interim rates as, by definition, these rates are not fully and publically tested. Principles that act in support of awarding interim rates relate to urgency, imminent risks to financial health of utility, and inability to continue to provide safe service. MIPUG relies on these previous submissions provided to the Board in respect of the legal and practical limitations to implementing interim rates, without repeating the full argument herein. At the same time, MIPUG recognizes that in past decisions in Manitoba, as well as in other parts of Canada, interim rates can be a tool, albeit inferior, for addressing process efficiency, as well as rate stability and easing rate shock; it does so without waiving its legal position in respect of possible future submissions[1].

For ease of reference s. 48 of the Manitoba *Public Utilities Board Act* provides as follows [emphasis added]:

> Orders involving expense to parties to be after notice and hearing
>
> 48 **The board shall not make an order** involving any outlay, loss, or deprivation to any owner of a public utility, or any person without due notice and **full opportunity to all parties concerned, to produce evidence and be heard at a public hearing of the board, <u>except in case of urgency</u>;** and in that case, as soon as practicable thereafter, the board shall, on the application of any party affected by the order, re-hear and reconsider the matter and make such order as to the board seems just.

MIPUG submits that the Public Utilities Board (Board) should not award Manitoba Hydro an interim rate increase at this time at the magnitude requested by Hydro. Instead, two alternative approaches should be considered: in the interests of rate stability and progression, an inflationary type of increase on the order of 2% may be merited. Alternatively, at maximum, an interim increase based on a specified percentage (less than the full 100%) of the lowest cost development plans as reviewed in the NFAT proceedings should be considered. This conclusion is based on the following reasons:

1) **Lack of Testing for 2014/15 Test Year:** In PUB/MH I-4a Manitoba Hydro indicates that it will file a GRA in the fall of 2014. At this time rate increases will be sought for fiscal years 2015/16 and 2016/17. With the IFRS, depreciation, DSM and Cost of Service rate issues left outstanding until then and with the 2014/15 year being mostly concluded by the time of a GRA rate hearing (likely occurring early in 2015), it seems unlikely that the 2014/15 test year will be the major focus at that time. The prospective years 2015/16 and 2016/17 will be the focus of the review. The proposed rate increase of 3.95% for 2014/15 is based on the financial forecast for IFF-13. There are many factors to be considered in this forecast that should be properly tested before a full 3.95% rate increase is assigned, including:

[1] In particular, MIPUG has previously noted that there are impediments to implementing interim rates in Manitoba arising from sections 44(1), 47(2), and 48 of the Manitoba *Public Utilities Board Act.*

a. IFF-13 assumes the approval of Hydro's Preferred Development Plan, including the Keeyask and Conawapa generating stations, and a 750MW US Interconnection. These projects have yet to be approved. Rate increases based on presuming their approval and sanction are premature. Evidence filed in the Needs For and Alternatives To (NFAT) proceeding provides a number of alternative scenarios that provide rate increase assumptions that vary from the 3.95% level, as part of alternative but credible development plans.

b. Further, the NFAT increases for the alternative plans are consistently calculated with the assumption that a failure to fully commit to a hydro resource today requires immediate and full amortization of the project costs. This assumption is inconsistent with what Hydro would likely put into regulatory practice[2]. For example, as per the updated financial statements[3], Plan 5 with base DSM has a 3.65% rate increase through 2031/32[4] but only as a result of requiring existing Conawapa planning cost balances to be written off in full over this period. More problematic, it is assumed that the Conawapa balances are flowed to income on a consistent annual amortization that adversely affects net income year after year. More appropriately, if Plan 5 is the only approval that is provided out of the NFAT proceeding, either (a) Conawapa would remain a planning project on Hydro's account (i.e., not be written off) or (b) would be terminated and the balances assessed for the amount of enduring value contained therein; the amounts not deemed to provide enduring value would likely be written off in 1 year. In short, the NFAT rate increase scenarios are just that – comparative scenarios, and there are factors why the increases shown in Exhibit 104-12-2 may in fact be higher than is properly required.

c. From the original filing of the NFAT business case, the lowest increases required were part of the All Gas plan, with even annual rate increases projected at 3.43%[5] (assuming Plan 4, which includes Keeyask, Gas and a 250MW US Interconnection is unattainable). It is noted that the cumulative rate increase sought over the next twenty years in the updated financial statements for Plan 1 has decreased from the original August NFAT filing from 83.50% to 80.13%[6], which results in an even annual rate increase of 3.32%[7].

[2] As discussed in the NFAT Hearing during cross-examination of Mr. Darren Rainkie by Mr. Antoine Hacault, March 21, 2014, transcript pages 3412 – 3417. Available online: http://www.pub.gov.mb.ca/nfat/pdf/hearing/march_21_2014.pdf

[3] MH-104-12-4 from the NFAT proceedings

[4] While MH-104-12-2 from the NFAT proceedings states 3.63% for projected even annual rate increases it does not include 2013/14, which is assumed to be 3.95%. To properly smooth across all years including 2013/14 the rate increases to 3.65%

[5] Appendix 11.4: Pro Forma Financial Statements Volume I, from Manitoba Hydro's NFAT Business Case Filing, page 1, September 2013. Available online: http://www.hydro.mb.ca/projects/development_plan/bc_documents/appendix_11_4_pro_forma_financial_statements_volume_1_of_2.pdf

[6] The cumulative rate increase of 83.50% for the years encompassing 2014/15 to 2031/32 in the initial NFAT Pro Forma Financial Statements in the ref-ref-ref scenario compared to 80.13% from 2014/15 to 2031/32 in the Updated NFAT Financial Statements in the ref-ref-ref scenario with base level DSM filed as MH-104-12-1.

[7] While MH-104-12-2 from the NFAT proceedings states 3.29% for projected even annual rate increases it does not include 2013/14, which is assumed to be 3.95%. To properly smooth across all years including 2013/14 the rate increases to 3.32%

i. Also note that this All Gas rate increase includes the depreciation of Keeyask and Conawapa sunk costs, which as noted above (a) would not occur in actuality in the event these plans are still being studied, and (b) if it occurred would not be expected to occur as an equal $88 million cost[8] driving losses in many years; it would likely occur as a one-time write off driving a reduction in retained earnings without subsequent Net Income impacts.

d. Changes to accounting procedures due to the transition to IFRS in 2015/16 have not been fully vetted. As referenced in MIPUG/MH I-1c Manitoba Hydro will be adopting the interim standard to continue to recognize rate-regulated accounts for financial reporting in select areas (e.g., DSM), which could decrease costs in the short-term. However, no recognition is provided for other potentially beneficial rate-regulated options, such as maintaining the current Average Service Life (ASL) depreciation method while eliminating the annual provision for Net Salvage as soon as possible 2014/15. This change alone would benefit the 2014/15 fiscal year by $62 million for net salvage, and further benefit future IFF years by $37 million[9] for retention of ASL (compared to the projected conversion to the more aggressive Equal Life Group (ELG) method) and provide larger dollar value impacts as Keeyask comes into service (in the event Keeyask is pursued). This item remains the subject of an outstanding directive from the Board which has yet to receive a response[10].

e. Operating and Maintenance expense, including salaries and wages information in 2014/15 is hard to test because Hydro states in PUB/MH I-16a that the annual detailed operating budget for fiscal 2014/15 is currently underway and divisional EFT information is not available at this time. While Hydro has plans to contain OM&A cost increases to 1% starting in 2015/16 there is no provided cost containment details for the 2014/15 fiscal year.

f. As confirmed in MIPUG/MH I-2c capital taxes related to spending on new major capital projects is not capitalized. Defined in PUB/MH I-153b in the NFAT proceedings, Capital taxes are applied at an annual rate of 0.5% to all of the capital invested by Manitoba in the province, where “capital” can be generally defined as the total debt and retained earnings for the corporation. PUB/MH I-17a shows $2,883 million[11] of Construction in Progress costs for projects not yet in service ($1,862 million associated with Keeyask and Conawapa, projects not yet approved, as well as substantial amounts for Bipole III which is not yet in service). This equates to $14.4 million to be paid to the Provincial Government in capital taxes related to construction work in progress in 2014/15 that is not serving customers. Further consideration is needed as to whether this is a valid and identifiable incremental component of the costs of new capital projects (entirely consistent with capitalized interest) and not included in rates for the current years, until these projects come into service, if they are approved.

[8] MIPUG/MH I-003c from the NFAT proceedings

[9] IFF-13, page 7.

[10] MIPUG/MH-I-1(d).

[11] $1,461 million for Keeyask, $401 million for Conawapa and $1,021 million for BiPole III

2) **Lack of Urgency:** The interim rate increase is proposed to occur months in advance of a proper and full review of Hydro's GRA, which according to PUB/MH I-4a will occur in the fall of 2014. This Application will seek final approval of 2014/15 rates and rate increases for fiscal years 2015/16 and 2016/17. Based on expected river inflows and initial reservoir and lake level elevations carried forward from the 2013/14 forecast, Hydro is forecasting a net loss for 2014/15 of $1 million without a rate increase. It is noted that the proposed rate increase is not for the purpose of maintaining a 75:25 debt-to-equity target as the ratio is close to this level without the rate increase at a time when the retained earnings are at an all-time high. Additionally present water conditions are above average for the time of year. Based on Hydro's forecasts there is a reasonable expectation for stable or potentially even increased revenues. Regardless of the requested increase, the capital coverage ratio (the ability of internal cash flow to finance normal capital spending) remains at or above 1.0, which indicates the Corporation remains cash positive on an operating basis, and is solely borrowing for major new capital projects. In short, absent the proposed rate increase, Hydro is projecting a very slight loss, does not forecast a net cash shortage, and the main reason for failing to project a positive net income is due to the payment of capital taxes on work in progress projects, including Keeyask and Conawapa that have not been approved for construction.

Interim rates are a challenging but sometimes necessary tool; however, given that they lead to rates being charged that have not been fully or fairly tested in a proper and open public forum, they should be used only in limited circumstances where there is a real case of financial urgency, or a net benefit to customers.

In combination, the above facts underlie the MIPUG submission that Hydro should not be granted the full requested interim rate of 3.95% for fiscal 2014/15.

BACKGROUND AND IMPLICATIONS OF PROPOSED RATE INCREASE

Manitoba Hydro has applied for rate increases every year since 2004 except for 2007, often first as interim rates, filed very close to the implementation date with little time for a process for intervenors to test the application. Rates have consistently been applied across-the-board, not according to customer class costs. This translates to over 40% in rate increases in the past decade including the applied for 3.95% for 2014/15 as seen in Table 1 below:

Table 1: Manitoba Rate Increases 2004 - 2014

Effective Date	Rate Increase Approved	Cumulative Rate Increase	PUB Order Granted
August 1, 2004	5.00%	5.00%	101/04 Final
April 1, 2005	2.25%	7.36%	101/04 Conditionally; 34/05 Final
March 1, 2007	2.25%	9.78%	20/07 Interim; 90/08 Final
July 1, 2008	5.00%	15.27%	90/08 Final; Further Directions in Order 116/08
April 1, 2009	2.90%	18.61%	116/08 Conditionally; 32/09 Varied and Final

April 1, 2010	2.90%	22.05%	18/10 Interim; 1.9% Approved in 5/12 Final; 1% approved in 43/13 Final
April 1, 2011	2.00%	24.49%	40/11 Interim; 5/12 Final
April 1, 2012	2.00%	26.98%	32/12 Interim; 43/13 Final
September 1, 2012	2.50%	30.15%	116/12 Interim; 43/13 Final
May 1, 2013	3.50%	34.71%	43/13 Final
April 1, 2014	3.95%	40.03%	Applied for, not approved

For most, if not all, of this time GS customers in the 30-100kV class and the >100kV class have consistently paid over 100% of their costs (often closer to 110%) based on cost of service studies filed by Hydro and tested at public hearings. At a time when electricity price changes were low or negative for much of North America, this history of rate increases has translated to cost pressures and uncertainty for ratepayers. Interim rates can also lead to Manitoba Hydro charging customers more than what is ultimately granted on a final basis. This has occurred over the course of the past decade, especially in the Cost of Service component for Industrial customers. Ultimately, in past examples including the “1% roll-back” rate originally from 2010, these over charges are often approved as final retroactively.

With rate increases forecast consistently for the next 20 years by Manitoba Hydro it is imperative that the need for each increase is thoroughly detailed and proven by Hydro, with whom the onus falls. For interim rate increases specifically, the additional component of urgency needs to be established.

SUMMARY AND RECOMMENDATIONS

In summary, MIPUG notes the following with respect to the consideration of interim rates for Manitoba Hydro effective April 1, 2014:

1. The interim rate increase sought by Manitoba Hydro are based on resource plans, forecasts and accounting practices that have not been properly tested or updated.

2. Hydro has not provided information that justifies a full interim rate increase at this time. MIPUG believes that Manitoba Hydro has yet to provide sufficient and detailed evidence regarding IFF13. This is especially true in light of the amount of costs in 2014/15 associated with projects that have not been approved.

3. There is no basis in evidence to conclude Manitoba Hydro has an urgent need for interim rate relief, or in the alternative, that there are special circumstances to make such an award as Manitoba Hydro projects a stable debt-to-equity ratio, positive interest coverage and is forecasting a very slight negative net income for the year at a time when retained earnings are at an all-time high.

Therefore, MIPUG submits that the Board should not award Manitoba Hydro the requested 3.95% at this time. In the alternative, if the PUB is inclined to provide an award of rates to Hydro, it should be based on either a) an expected inflationary adjustment on the order of 2% or b) the alternative approach noted above, which would start with the 3.32% rate increase linked to the lowest cost Development

Plans, further constrained to 75% of this level, or 2.49%. If this increase is likely to be effective June 1 given procedural timing, a 2.49% would lead to net annual recoveries to Hydro (based on 63% of the requested level, for 10 months) of approximately 50-55% of the revenue sought, or a reduction of approximately $27 million from IFF-13 (in the event the interim rate remains at the 2.49% level through year-end 2014/15). A 2.49% increase retains a forecast positive net income (particularly given present water levels) and the $27 million reduction from IFF13 is in the range of possible contentious items that may be subject to revision at the upcoming GRA, for example exclusion of capital tax on projects in service ($14.4 million) or the potential elimination of net salvage for 2014/15 and adoption of ASL depreciation in future years ($64 million for one year, followed by $37 million in years after 2014/15).