MANITOBA	**Board Order 17/04**
THE PUBLIC UTILITIES BOARD ACT	
THE MANITOBA HYDRO ACT	
THE CROWN CORPORATIONS PUBLIC REVIEW AND ACCOUNTABILITY ACT	**February 6, 2004**

Before: G. D. Forrest, Chairman
R. Mayer, Q.C., Vice-Chair
Dr. K. Avery Kinew, Member

AN APPLICATION BY MANITOBA HYDRO FOR AN ORDER APPROVING AN INCREASE IN ELECTRIC RATES IN REMOTE COMMUNITIES SERVED BY DIESEL GENERATION

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Executive Summary

By letter dated December 2, 2002, Manitoba Hydro ("Hydro") applied to The Public Utilities Board ("the Board") to increase certain rates for electric service applying to the remote communities of Brochet, Lac Brochet, Shamattawa and Tadoule Lake, which are served by diesel generation.

Hydro's Application includes the following requests:

1. No change to the existing rates for Residential customers whose electricity consumption is less than 2,000 kW.h per month.

2. No change to the existing rates for General Service customers whose electricity consumption is less than 2,000 kW.h per month.

3. For consumption in excess of 2,000 kW.h per month by Residential customers, a rate increase from 5.16¢ per kW.h to 79.1¢ per kW.h which is the estimated full cost of providing service.

4. For consumption in excess of 2,000 kW.h per month, but less than 3,000 kW.h per month by General Service customers, a rate increase from 5.55¢ per kW.h to 79.1¢ per kW.h.

5. For consumption in excess of 3,000 kW.h per month by General Service customers, a rate increase from 35.9¢ per kW.h to 79.1¢ per kW.h.

6. For all consumption by Government accounts, a full cost rate increase from 35.9¢ per kW.h to 79.1¢ per kW.h, and an increase in the Surcharge per kW.h from 44.8¢ to $1.22.

Hydro's Application was prepared on a basis generally consistent with previous diesel rate applications with the exception of the following changes:

1. Residential customers who previously had access to unlimited consumption at grid rates will now have access to grid rates for all consumption up to 2,000 kW.h per month.

2. General Service customers that currently have access to grid rates for consumption up to 3,000 kW.h per month will now have access to grid rates for all consumption up to 2,000 kW.h per month.

3. The calculation of the Government Surcharge has been updated to reflect current Revenue to Cost Coverage of 90% for Residential customers and 99% for General Service customers.

4. The Application proposes that all First Nations accounts, regardless of the source and level of funding, be subject to the Government rate, including the Surcharge.

Previous diesel cost of service studies have included prior year deficits or surpluses in the determination of the rates. The cost of service study in this Application includes only the costs forecast to be incurred to provide service during the fiscal year ending March 31, 2004. The requested rate increases do not address the sizeable deficits incurred during past years to provide service to the remote diesel communities. This deficit was forecast to be approximately $18 million by March 31, 2004, excluding interest charges. Hydro has stated in their Application that any attempt to recover the total accumulated deficit in current rates would exacerbate a situation where major rate increases are already being sought.

In November 2000, Manitoba Keewatinook Ininew Okimowin (“MKO”) informed Hydro that it believed that First Nations administrative facilities and other services provided by the First Nations to their members should not be billed the Government Surcharge. Hydro agreed to redirect current billings for the difference between Government and General Service rates to the Government of Canada (“Canada”), apparently without prior consultation or agreement with Canada, and began doing so effective November 1, 2000. Canada rejected the direct billings, claiming they have already funded the First Nations for the cost of electricity. Since November 2000, when Hydro commenced billing Canada directly, the accumulated unpaid Government Surcharge on First Nations accounts has reached approximately $2.8 million not including interest, and is growing at a rate of approximately $80,000 per month based on current, approved rates.

The Board remains extremely sensitive to the rising costs of living in Northern Manitoba and the customers' ability to pay. However, the Board also has a duty and responsibility to Hydro and to the large population of Hydro grid customers to set rates for diesel communities that are just and reasonable. This Order indicates the Board's view that the ability to pay issue is one that lies outside of the regulatory arena, and lies more appropriately within the Provincial and Federal Social Policy area.

The Board agreed with the positions put forward by some Intervenors that the existing Government Surcharge system may no longer be appropriate on a go forward basis. In the Board's view, the current rate model may not be sustainable in the longer term. Therefore, an alternative funding model must be developed for the future that recovers excess costs from responsible parties, perhaps in an agreed to non-tariff arrangement such as capital and/or operating cost contributions or other funding arrangements.

The key driver used by MKO in developing their recommendations to the Board is the rate design used by other utilities in remote communities in Canada. MKO argued that comparability between utilities is a key rate design criteria. The Board did not accept this argument, stating that each utility is different, with different cost structures and different operating policies. In addition, utilities operate under different Provincial and Federal jurisdictions and funding models. Although the Board heard evidence regarding various rate design options in other remote communities, the Board heard limited evidence regarding the specific physical differences between the various communities and regarding funding differences, Federal and Provincial government subsidies, and other factors. The Board therefore did not at this time agree with the argument put forward by

MKO that rates for diesel service in remote communities in Manitoba should be consistent with rates in remote communities in other jurisdictions.

The Board agrees with the submission of Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors Inc. ("CAC/MSOS") in their closing arguments that there is no quick and easy solution to the pressing issues at hand. In the Board's view, one of the pressing issues at hand is the need for an immediate and substantial rate adjustment. However, the Board finds itself in a position where it cannot approve final rates at this time. Therefore, the Board approved Hydro's Application on an interim basis only, to be effective April 1, 2004, subject to certain adjustments and conditions.

In this Order, the Board directed that the interim period between the date of this Order and April 1, 2004, the effective date of the interim rate change, be used by Hydro, Canada and other interested parties to resolve the significant outstanding issues discussed in this Order, as well as any other related issues. Any proposed resolution of the matters, to the extent they affect rates, will be subject to Board approval. Hydro is to advise the Board by no later than April 1, 2004 regarding the outcome of the resolution process and the effect, if any, on the interim rates approved by this Order. In the event that agreement amongst the parties and resolution of the above matters is not achieved by April 1, 2004, the Board will consider other alternatives to expedite resolution of these important issues, including a stated case to the Court of Appeal, in an attempt to resolve the issues and confirm or otherwise amend the interim rates by no later than September 30, 2004.

The Board heard evidence from both CAC/MSOS and MKO regarding rate design and efficiency issues, including rate block structures, appropriate rate signals, and the efficiency of adopting progressively more expensive rates. While some of these concepts may have merit, there is insufficient evidence on the record to support any change to the rate design currently in effect at this time. The Board therefore approved, on an interim basis, the rates and rate block structure as applied for by Hydro, with one exception as noted in this Order. However, the Board directed Hydro to consider some of the arguments put forward by the Intervenors regarding rate design issues for remote communities, and report back to the Board by no later than June 1, 2004 regarding the merits or otherwise of changing the existing rate structure for customers in remote communities.

Hydro provided limited evidence in support of its request to modify the Application of the Government Surcharge to apply to all non-residential First Nation accounts regardless of funding sources. This proposed change would have a significant effect on approximately 30 accounts that are currently billed as General Service customers. Based on the limited evidence on this important issue, the Board was not convinced that the requested change is appropriate at this time. In addition, the Board believes that it is important to remain totally consistent with established rate design principles regarding diesel communities pending resolution of the issues discussed previously. Therefore, the Board denied Hydro's requested change in billing the Government full cost rate and Surcharge to all non-residential First Nations accounts.

Hydro was directed to immediately file with the Board, for interim approval, a revised schedule of rates to be effective April 1, 2004 that reflects the revised Surcharge and Government Rate. This Order also directed Hydro to provide a status report to the Board by no later than September 30, 2004 regarding a number of other matters discussed in the Order.

1.0 Appearances

R. Peters	Counsel for The Manitoba Public Utilities Board ("the Board")
P. Ramage D. Bedford	Counsel for Manitoba Hydro Electric Board ("Hydro")
B. Williams	Counsel for Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors ("CAC/MSOS")
M. Anderson	Representing Manitoba Keewatinook Ininew Okimowin ("MKO")
R. Smith, Q.C.	Counsel for Indian and Northern Affairs Canada ("INAC")

2.0 Witnesses for Hydro

V. Warden	Chief Financial Officer, Vice-President, Finance and Administration
R. Weins	Division Manager, Rates and Regulatory Affairs
C. Thomas	Cost of Service Supervisor, Rates and Policies Department
R. Cox	Manager, Retail Sales

3.0 Intervenors of Record

Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors Inc.

Manitoba Keewatinook Ininew Okimowin

Indian and Northern Affairs Canada

4.0 Witness for MKO

D. Hildebrand	Principal, Optimum Energy Management Inc. ("OEMI") (now Stantec Consulting)

5.0 Presenters

R. Markham	Director of Store Planning and Facility Services, North West Company
T. Hood	Maintenance Manager, North West Company
P. Brown	General Manager of Sales and Operations, Northern Stores Interior Division
G. Cattani	Secretary Treasurer, Frontier School Division
H. Arnold	Building and Facilities Manager, Frontier School Division
I. Bussidor	Chief, Sayisi Dene First Nation, Tadoule Lake
F. Flett	Manitoba Regional Chief, Assembly of First Nations
J. Hyslop	Chief, Northlands First Nations, Lac Brochet
D. Whitebird	Grand Chief, Assembly of Manitoba Chiefs
S. Garrioch	Grand Chief, MKO

6.0 Background

Hydro's Application indicates that in the mid 1960's, the Government of Canada, through INAC, approached Hydro to provide electricity to remote First Nations communities in Northern Manitoba. The terms of service under which electricity was provided were documented in various agreements between Hydro and Canada which stipulated that Hydro would construct, operate and maintain the diesel generating stations and distribution facilities required to serve these communities. Canada, in turn, was obliged to pay a capital contribution toward the cost of supplying services to the individual consumers, schools, teacherages, water and sewer stations, and the cost of any additional facilities required to provide the electric power and energy supplied.

In 1977, an amending agreement was entered into whereby the parties agreed that the rates for Residential customers would be as set forth in the Residential Diesel Electric Service Tariff, and the rates for non-residential customers would be as set forth in the General Service Diesel Electric Service Tariff. Tariffs were published from time to time by Hydro. The Board, however, did not regulate Hydro rates until the late 1980's.

Hydro's Application states that various agreements provide that funding for diesel facilities will be provided by Canada. These agreements also set rates for local consumers, for whom Canada had responsibility, which rates were the same as those for a similar service category on Hydro's integrated grid system. This arrangement meant that the rate was partially subsidized by Hydro, to the extent that operating costs exceeded the rate, and by Canada, through capital contributions to support service to the customers in remote communities. To control the amount of subsidization, a limit was placed on the size of the service facilities, which were restricted to 15 amp, three wire, 240 volt service.

During the 1960's and 1970's, the number of diesel communities expanded rapidly. At one point, more than 30 communities were receiving diesel electric service from Hydro.

By 1984 many of those communities had been connected to Hydro's interconnected transmission grid, and 17 communities remained on diesel service. It was expected that by 1990 there would only be six communities remaining to be served by diesel generated electricity, once Hydro had completed the construction of the North Central Project. The terms of agreements with Canada in respect of service to the remaining diesel communities were generally similar, although not necessarily identical, to those contained in earlier agreements. In some cases Canada had previously owned diesel facilities and contributed them. In other situations, the rates were set to reflect the interest and amortization costs of the facilities, as well as the operating, maintenance and fuel costs that were incurred on an ongoing basis.

Generally, the Government of Canada only became involved in diesel communities where the community came under Government of Canada responsibility. In those communities, an overriding principle was that the diesel facilities were to be self-supporting as a consequence of Canada's commitments to Hydro. Over time, costs escalated for several reasons including extraordinary maintenance costs for the diesel plant, the replacement of diesel plants at the end of their useful lives, and increased costs due to additional plant capacities required over subsequent years to serve the growth in electrical consumption. Sales rates charged to local consumers continued to be based on rates charged to similar customers served from the grid, and by 1982, the accumulated shortfall of revenues relative to costs had reached $3.4 million.

To address the growing deficit, a proposal to apply a Government Surcharge to Federal and Provincial accounts was recommended in March 1984. The Surcharge was initially intended to recover the escalating fuel costs and to allow Hydro to realize a Revenue to Cost Coverage ("RCC") in the diesel communities similar to that in rural Manitoba. In May 1984, Hydro formally advised all Federal and Provincial departments and agencies that the Surcharge would be applied effective July 1, 1984. From that time, these accounts have paid the Surcharge, which varied from year to year depending on the actual costs of providing diesel service in each community. The Surcharge also allowed Canada to avoid the need to make periodic large capital contributions, at times when it may have been difficult for Canada to budget for those contributions.

In 1987, INAC advised Hydro that, in keeping with the goal of First Nations' self government, commencing April 1, 1987, INAC energy accounts would be transferred to the First Nations. Payments of the bills would then be the responsibility of the First Nations, which would receive funding from INAC. Hydro then implemented a policy which stated that the Surcharge would normally be applied to accounts of Federal and Provincial governments, their agencies, Crown Corporations and to existing and new accounts historically associated with these customers regardless of current responsibility for payment of those accounts. Apart from a few administrative difficulties, the Surcharge operated fairly smoothly and was paid to Hydro by the billed entities from its inception in 1984 through to November 2000.

Beginning in 1991, Hydro upgraded facilities in the diesel communities not expected to be connected to the grid by the North Central Project. Enhanced service was provided to Brochet in 1991, Lac Brochet in 1992, and Tadoule Lake and Shamattawa in 1994. The intent of the upgrades was to support enhanced service capability from 15 amps to 60 amps for those customers served at grid rates. Along with enhanced service came increased costs. Between 1995 and 1997, nine of the 13 remaining remote communities were connected to the main grid as part of the North Central Project, and were incorporated into what was then Hydro's Rate Zone 3.

Today Hydro provides diesel service to the four remaining remote northern communities of Shamattawa, Tadoule Lake, Brochet and Lac Brochet. Hydro serves a total of approximately 800 customers in these communities with a total population of approximately 2,000 people. Most customers are Residential, but there are also General Service, Federal and Provincial government customers and First Nations accounts. Total sales to all customers are forecast to be 12.1 million kW.h in fiscal year 2003/04. For rate administration purposes, these communities are collectively referred to as the Diesel Zone.

Since the current Diesel Full Cost rates were approved by the Board in 1993, several significant changes have occurred in the delivery of services to remote diesel communities. These changes, while improving service, have also resulted in significant increases in the cost to serve these communities. The most important of these changes was the connection of the nine communities to the central grid, representing approximately 80% of the usage of the 13 remote communities. The remaining four communities are smaller and more remote, and are therefore more costly to serve per kW.h. In addition, much of the Government Surcharge volume was lost with the connection of the nine communities to the grid. The high cost to serve is further exacerbated by the fact that over half of all consumption, and three quarters of all customer bills, in the remaining four communities are Residential customers who currently receive energy at equivalent-to-grid rates, which are considerably lower than the cost of service. Significant capital upgrades in the remaining four communities have also been undertaken to enhance service capability to 60 amps. These upgrades have further contributed to the increasing cost of providing service. Since the majority of Residential and General Service customers are billed at grid equivalent rates, the ever increasing gap between cost of service and grid rate revenue must be recovered by way of the Surcharge.

The following table highlights the cost to provide diesel electric service in the four communities, as well as consumption over selected years since the last diesel rate hearing before the Board in 1993.

Manitoba Hydro
Diesel Rate Zone
Cost and Consumption Comparison
Brochet, Lac Brochet, Shamattawa, Tadoule Lake

	1994*	1996	1999	2000	2002	2004*
Electrical Consumption (kW.h)	4,823,500	6,746,967	7,562,778	8,876,740	10,250,870	12,055,937
Gross Investment	$16,419,436	$16,671,847	$20,738,066	$ 27,595,308	$29,589,147	$ 39,486,580
Net Interest Expense	$ 667,507	$ 1,022,177	$ 1,074,430	$ 1,423,017	$ 1,649,691	$ 2,258,540
Net Depreciation Expense	547,394	579,890	893,461	1,131,305	1,322,640	1,813,462
Operating Cost (maintenance and fuel oil)	1,454,133	1,662,912	2,932,858	2,972,378	2,895,914	4,709,485
Other Costs Including Distribution and Capital Tax Allocation	110,629	180,652	366,512	500,636	438,651	755,371
Total Cost to Serve	$ 2,779,663	$ 3,445,631	$ 5,267,261	$ 6,027,336	$ 6,306,896	$ 9,536,858
Cost/kW.h	$ 0.576	$ 0.511	$ 0.696	$ 0.679	$ 0.615	$ 0.791

*1994 and 2004 are forecasts. Other years are actual costs.

7.0 Hydro's Application

By letter dated December 2, 2002, Hydro applied to the Board to increase certain rates for electric service applying to the remote communities of Brochet, Lac Brochet, Shamattawa and Tadoule Lake, which are served by diesel generation.

The Application, as amended in Exhibit MH #10, includes the following requests:

1. For Residential customers in diesel communities whose electricity consumption is less than 2,000 kW.h per month, no change to the existing basic monthly charge of $6.25, no change to the charge for the first 175 kW.h per month of 5.78¢, and no change to the charge for the next 1,825 kW.h per month of 5.16¢ per kW.h.
2. For General Service customers in diesel communities whose electricity consumption is less than 2,000 kW.h per month, no change to the existing basic monthly charge of $14.90, no change to the charge for the first 1,090 kW.h per month of 6.13¢, and no change to the charge for the next 910 kW.h of 5.55¢.
3. For consumption in excess of 2,000 kW.h per month by Residential customers, a rate increase from 5.16¢ per kW.h to 79.1¢ per kW.h which is the estimated full cost of providing diesel electric service.
4. For consumption in excess of 2,000 kW.h per month, but less than 3,000 kW.h per month by General Service customers, a rate increase from 5.55¢ per kW.h to 79.1¢ per kW.h.
5. For consumption in excess of 3,000 kW.h per month by General Service customers, a rate increase from 35.9¢ per kW.h to 79.1¢ per kW.h.
6. For all consumption by Government accounts, no change to the basic monthly charge of $18.05, a full cost rate increase from 35.9¢ per kW.h to 79.1¢ per kW.h, and an increase in the Surcharge per kW.h from 44.8¢ to $1.22.

The Application by Hydro for increased rates was prepared on a basis generally consistent with previous diesel rate applications with the exception of the following changes:

1. Residential customers who previously had access to unlimited consumption at grid rates will now have access to grid rates for all consumption up to 2,000 kW.h per month. Any monthly consumption in excess of that volume will be billed at the full cost rate of 79.1¢ per kW.h.

2. General Service customers that currently have access to grid rates for consumption up to 3,000 kW.h per month will now have access to grid rates for all consumption up to 2,000 kW.h per month. Any monthly consumption in excess of that volume will be billed at the full cost rate of 79.1¢ per kW.h.

3. The calculation of the Government Surcharge, previously calculated to include a Hydro subsidy determined in relation to the RCC of 85% applied to both Residential and General Service accounts, has been updated to reflect current RCC ratios of 90% for Residential customers and 99% for General Service customers.

4. In previous applications, Hydro calculated the Government Surcharge based on consumption by all accounts of Federal and Provincial departments, agencies, and Crown Corporations, including First Nations accounts funded by the Government of Canada. The current Application proposes that all First Nations accounts, regardless of the source and level of funding, be subject to the Government rate, including the Surcharge.

5. Previous Cost of Service studies have included past surplus and deficits in the determination of rates. The full cost and Surcharge portion of the diesel rates currently in effect were implemented November 1, 1993. Since that time, there

have been significant increases in costs to serve the remote communities served by diesel generation, including investments to upgrade generation facilities. As a result, a deficit has accumulated, estimated to be approximately $18 million by March 31, 2004. The current rate Application does not include any provision to recover any portion of the significant accumulated deficit.

The initial timetable for hearing this Application included a public hearing in Thompson Manitoba, and the provision for presentations in the communities affected by this Application. Subsequently, on the agreement of all interested parties, the timetable was revised, and the location of the public hearing was changed to Winnipeg, Manitoba. A public hearing was held in Winnipeg, Manitoba from January 6, 2004 to January 9, 2004. Final arguments were heard in Winnipeg on January 22, 2004.

8.0 Accumulated Deficit

Previous Diesel Cost of Service Studies have included prior year deficits or surpluses in the determination of the rates. The cost of service study in this Application includes only the costs forecast to be incurred to provide service during the fiscal year ending March 31, 2004. The requested rate increases do not address the sizeable deficit accumulated over past years to provide service to the Diesel Zone. This deficit was forecast to be approximately $12.6 million at March 31, 2003, and approximately $18 million by March 31, 2004, excluding interest charges. The accumulated deficit is the result of current billed rates falling far short of actual incurred costs, commencing in 1999/2000. From that point the deficit has been accumulating rapidly. Total costs for the year ending March 31, 2004 are forecast to exceed total revenue at existing rates by approximately $5.8 million.

Hydro has stated in their Application that any attempt to recover the total accumulated deficit in current rates would exacerbate a situation where major rate increases are already being sought. Hydro continues to review options to deal with this accumulated deficit and has undertaken to inform the Board of any proposal to be made as a result of that review.

The accumulated deficit does not include any portion of the billed but unpaid Surcharges since November 2000 in the amount of approximately $2.8 million, which Hydro continues to bill to INAC.

9.0 Unpaid Government Surchage

In 1987, INAC advised that, in keeping with the goal of First Nations' self government, commencing April 1, 1987, INAC energy accounts would be transferred to the First Nations. Payments of the bills would be the responsibility of the First Nations, which would receive funding from INAC. Hydro then implemented a policy which stated that the Surcharge would normally be applied to all accounts of Federal and Provincial governments, agencies, Crown Corporations, and First Nations accounts which were funded by Canada.

In November 2000, MKO informed Hydro that it believed that First Nations administrative facilities and other services provided by the First Nations to their members should not be billed the Government Surcharge. Hydro agreed to redirect current billings for the difference between Government and General Service rates to INAC, apparently without prior consultation or agreement with INAC, and began doing so effective November 1, 2000. INAC rejected the direct billings, claiming they have already funded the First Nations for the cost of electricity. Since November 2000, when Hydro commenced billing INAC directly, the accumulated unpaid Government Surcharge has reached approximately $2.8 million not including interest, and is growing at a rate of approximately $80,000 per month based on current, approved rates.

10.0 Presenter Positions

10.1 The North West Company

Mr. R. Markham provided some background on The North West Company, and outlined the potential impact of the proposed rate increase on the company and its customers. North West Company is headquartered in Manitoba where it operates a distribution centre and operates 30 stores, including stores in the four affected communities.
Mr. Markham's presentation reviewed some of the costs implications of operating in the North, and focused on the impact of the proposed rate increase on those costs. His presentation covered five specific areas including (1) background on who and what The North West Company is; (2) information on costs of doing specific segments of business in the North; (3) information on what steps The North West Company has taken to understand the high costs of doing business in remote areas, and make the specific business more efficient; (4) provide a measured impact of what the proposed rate increase could mean to customers in the four affected communities; and (5) outline the legacy obligations that The North West Company brings to the North.

Mr. Markham stated that utilities represent the third largest expense of the Company after employee and freight costs and the increase in electricity rates would be borne by residents of the four communities through higher costs. Higher utility costs may require The North West Company to consider other alternatives including generating their own energy, or re-routing some of their energy requirements such as refrigeration.

Mr. Markham's presentation concluded by stating that all companies, governments and citizens living, working and operating in the North have a legacy to uphold and an obligation to improve life in the North. He observed that the people living in the communities affected by the proposed increase are among the financially poorest populations in the country. Because Hydro is a legacy to the people of Manitoba, regardless of where they live, the proposed Hydro rate increase should be applied equally across the Province to the benefit of all Manitobans.

10.2 Frontier School Division

Mr. G. Cattani provided some background on the Frontier School Division, indicating it geographically covers 75% of the Province of Manitoba, has a $75 million operating budget, a $75 million capital budget, and is the second largest school division in Manitoba. Frontier School Division operates 42 schools in 38 communities in Manitoba, and educates approximately 7,000 students. Mr. Catanni stated that half of the Frontier School Division students are provincially funded and the other half are First Nations students. As a consequence, funding and financing the Frontier School Division's operations is a highly complex issue.

Mr. Cattani reviewed the specific funding sources, indicating that because of the sparcity of population, the revenue from the tax levy system makes up approximately 3% of budget, compared to 40% to 50 % in other school divisions. The balance must come from uniform mill rate increases. As a result, people living in areas such as Lake of the Woods, Gypsumville and Grand Rapids will pay increased taxes because of the proposed Hydro rate increases. Mr. Cattani estimated that the proposed Hydro rate increases would result in increased costs in Brochet of approximately $303,000, which equates to $2,000 per student. This increase in turn would result in a 2.4% mill rate increase to all communities in the Frontier School Division, which in Mr. Cattani's view, results in subsidization by property owners who cannot afford the increase, and receive no benefit. One alternative that might be considered by Frontier School Division to offset these large increases is the possibility of generating their own electricity.

Mr. Cattani stated that the subsidy for the increase should come directly from Hydro and affirmed the position of the Frontier School Division which strongly opposed the electric rate increases. He requested the Board to deny the Application, or direct Hydro to come back with a more equitable proposal as to how the requested rate increases could be applied in an affordable fashion. Mr. Catanni concluded that Frontier School Division had a very good working relationship with Hydro in the North, and the purpose of his presentation was to help the Board to understand who will be impacted by the proposed Hydro rate increases.

10.3 Sayisi Dene First Nation – Tadoule Lake

Chief Bussidor strongly urged the Board to reject Hydro's proposal and supported the efforts being made by MKO to ensure an affordable supply of electricity for the community. Chief Bussidor briefly reviewed the history of Tadoule Lake, and stated that an adequate and affordable supply of electricity is essential for the health and well being of the 350 residents of Tadoule Lake, and strongly affects the ability to provide basic community services, including recreational opportunities for youth. Chief Bussidor also reviewed issues related to unresolved land claims, as well as options to provide energy to the community in the future that is in accordance with the Kyoto Protocol.

Chief Bussidor stated that Hydro's wealth must be shared with all Hydro customers, and that it is Hydro's duty and responsibility to provide adequate and affordable electricity to the Sayisi Dene First Nation, and that the cost should be shared by all Hydro customers. Chief Bussidor commented that Hydro development in the North is directly responsible for the grave environmental and other damage to traditional territories suffered by First Nations communities. As a result, the communities have lost revenue that would have been generated from their lands, but have not received any of the revenue generated by the Hydro developments.

10.4 Northlands First Nations - Lac Brochet

Chief Hyslop expressed his views on the responsibilities of both the Federal and Provincial governments to provide services to northern communities. He referred to a treaty signed in 1906 intended to provide equal treatment to the First Nations communities, and ensure they enjoy the same services that other Canadians enjoy. However, northern communities do not enjoy similar services, but must pay very high costs which they cannot afford. Chief Hyslop also stated that the treaty signed in 1906 entitled the First Nations communities to the natural resources of the country.

10.5 Grand Chief D. Whitebird

Grand Chief Dennis Whitebird, representing the Assembly of Manitoba Chiefs and Northern First Nations communities, urged the Board to consider the cost of service in the diesel communities in a different light to ensure the rates are just and reasonable. Grand Chief Whitebird concurred with the recommendations made by MKO.

Grand Chief Whitebird stated that the funding of the communities is inadequate and any sudden increase in electricity rates will affect many cultural, recreational, and social needs in the affected communities. Grand Chief Whitebird stated the Assembly of Manitoba Chiefs does not support Hydro’s proposal and recommended the Board reject the proposal and have Hydro submit a just and reasonable proposal based on the recommendations by First Nations.

Grand Chief Whitebird further recommended the diesel generating stations be dismantled and replaced with more contemporary means of generating hydro power within a short period of time. The Assembly of Manitoba Chiefs would welcome joint hydro development projects between First Nations and Hydro and reiterated that Hydro develop a proposal jointly with First Nations which is affordable and acceptable to the community.

10.6 Grand Chief S. Garrioch

Grand Chief Sydney Garrioch strongly urged the Board reject the Hydro Application for rate increases to the diesel service customers. Grand Chief Garrioch stated an affordable and adequate supply of electricity is an essential element of the basic services and infrastructure necessary to maintain a healthy and growing community.
Grand Chief Garrioch stated Hydro has a central role in shaping the legacy of Manitoba and its communities and it was its responsibility to support community development and well being by providing electricity supplies adequate for the needs of the province.

Grand Chief Garrioch further stated that if the proposed rate increases were approved by the Board, it would place each of the First Nations into severe financial circumstances which would result in the affected communities either being unable to pay their bills or requiring them to scale back or close down many of the community services.
Grand Chief Garrioch stated that it is a treaty issue which could be resolved through the equitable sharing of wealth of Manitoba water resources with all of the First Nations people of Manitoba. Grand Chief Garrioch urged the Board to direct Hydro to develop a new rate proposal that reflects its responsibility to serve, as well as the equitable sharing of Hydro’s export revenue with the First Nations.

11.0 Intervenor Positions

11.1 Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors

CAC/MSOS referred to this file as a "mess" and described it as a "collaborative, if dysfunctional effort" on behalf of the Government of Canada, Hydro and MKO. CAC/MSOS acknowledged that there is no quick and easy solution to the pressing issues. CAC/MSOS believes that there is a clear historic and enduring obligation on the part of Canada, but also acknowledges that there is some responsibility on the existing grid customers. CAC/MSOS observed that the Surcharge mechanism may no longer be appropriate, and further stated that the Surcharge mechanism should not be charged to First Nations customers, because the Surcharge mechanism is intended to seek recovery from the Government of Canada, not the Social Housing or Economic Development budgets of the First Nations communities. CAC/MSOS also observed that because of the gap between the cost to serve and the community's ability to pay, full cost recovery cannot be expected. Therefore, there should be equivalent to grid rates for non-space heating purposes. CAC/MSOS also discussed four guiding principles being: (1) maintaining affordability, (2) recognizing the need for efficiency, (3) protecting grid customers from escalating costs, and (4) keeping rate shock in mind.

CAC/MSOS' final arguments included five specific recommendations to the Board.

The first recommendation was that the first rate block for Residential customers be reduced from 2,000 kW.h per month requested by Hydro to 1,500 kW.h per month. CAC/MSOS argued that the 1,000 kW.h per month rate block suggested by MKO was uncomfortably low, and some residents not using any space heating energy could exceed that level of consumption. CAC/MSOS believes that the 1,500 kW.h per month level is a safer option, and well within the average consumption levels provided by Hydro.

The second recommendation was to have a “protective” or “security blanket” rate block from 1,501 kW.h to 2,000 kW.h per month to protect those customers who may periodically use more than 1,500 kW.h per month for legitimate non-space heating purposes. This warning rate block would send a very specific price signal to the residential consumer that a significant rate increase will be realized once the 2,000 kW.h per month consumption level is exceeded. CAC/MSOS argued that the warning rate block should, to the degree possible, be consistent with the concept of avoiding rate shock.

The third recommendation was that the General Service customer category should have a similar three block monthly limited rate structure, with the first block of 2,000 kW.h, the second block at 2,001 to 3,000 kW.h, and all consumption above 3,000 kW.h at the full cost rate. CAC/MSOS proposed a different first and second rate block for General Service customers because the rate block could not be tied to space heating requirements as clearly as could the Residential group, and the General Service group in the diesel communities are a much more heterogeneous group than the Residential customers.

CAC/MSOS suggested a rate of 5.28¢ for the first rate block which is a blended rate based on the basic monthly charge and the grid rate. CAC/MSOS stated that in future hearings, they may well argue that the basic charge should recover the full cost for purposes of transparency, but are not doing so in this Application because there are enough complicated issues already on the table. The second block for Residential and General Service customers would be at 8¢ per kW.h, which would help mitigate rate shock, but provide an appropriate price signal. The full cost rate applied to the last rate block would be at the 79.1¢ as applied for by Hydro. CAC/MSOS also argued that an inverted rate structure is justifiable and logical, and Hydro should be sending a message to consumers that there is a definite cost to increased consumption.

Based on CAC/MSOS Exhibit #6, the annual revenue shortfall resulting from the proposed rates and rate structure would be approximately $5.5 million, which, in CAC/MSOS' view, should be recovered approximately $3.9 million from the Government Surcharge, and approximately $1.8 million by way of a further subsidy from the existing grid customers. In CAC/MSOS' view, Canada should be responsible in terms of its contribution for the capital costs associated with generation. Therefore, the Surcharge subsidy of $3.9 million is based on generation costs as a percentage of total costs of 43.9% based on Hydro's evidence. CAC/MSOS argued that it would be unfair to expect the grid customers to accept primary responsibility for the subsidy, especially given CAC/MSOS' view of Canada's clear responsibility, as well as the likelihood of general rate increases in the near future. CAC/MSOS estimated that the suggested subsidy of $1.8 million to be provided by existing grid customers could result in rate increases in the range of 0.21%.

CAC/MSOS also suggested that because of the material rate impacts, there should be an extensive communication effort, regardless of which rate alternative is ultimately approved by the Board. CAC/MSOS further commented that because the Surcharge mechanism blurs the distinction between capital and operating costs, future capital expansions should be funded by way of some form of capital contribution, either by way of up front contribution or some arrangement to collect estimated costs over a period of time.

With respect to the significant accumulated deficit, CAC/MSOS commented that it is important to get the current and future costs dealt with in a principled fashion. Whatever the rate approved by the Board, the rate impacts will be significant. If Hydro and other parties could then come to some negotiated settlement regarding the deficit amount, the additional amount could perhaps be phased in over time using a Surcharge or some other mechanism. CAC/MSOS also argued that there is no need for a stated case to the Court of Appeal at this time, to determine the obligation of the Government of Canada, and there is no need to determine whether contracts still exist. The Board's role is to determine if rates for service are just and reasonable, taking into consideration of the Government of Canada's constitutional obligations, its obligations in contracts recognized in the past, its present conduct in the past, and its conduct. CAC/MSOS concluded that asking Canada to pay a contribution is just and reasonable.

11.2 Indian and Northern Affairs Canada

INAC argued that the Board does not have the jurisdiction to make orders against INAC or any other Federal body to force them to pay any of the outstanding First Nations hydro bills. INAC referred to a 1992 decision of the Court of Appeal that determined that the jurisdiction of the Board is limited to the fixing of rates. In INAC's view, the Board must determine whether the amounts of the proposed rates are just and reasonable, but if determining how to recover costs includes considering who should pay those costs, the Board's jurisdiction is exceeded. INAC also argued that billing Canada for any part of the diesel hydro charges, and in particular the Surcharge, is not just and reasonable. INAC also argued that they are not a user, and therefore Hydro is in breach of their own regulations by billing INAC for Surcharges related to hydro power used by First Nations.

INAC argued that the original contracts between Hydro and Canada were replaced by subsequent developments, and that novation has occurred, which involves the making of a new contract. INAC believes that all the old contracts between Canada and Hydro ceased in 1987. INAC argued that at that time, all diesel generated hydro accounts in each of the four communities were transferred to the First Nations as part of a move towards self government. Subsequently, the First Nations paid the accounts, including the Surcharge, for thirteen and one-half years from 1987 to 2000. INAC expressed concern as to how, in November 2000, the President of Hydro could make a unilateral decision to change a billing practice that had been in place for thirteen and one-half years, and begin rendering bills to Canada for a Surcharge that had previously been billed to and paid by the First Nations for so long. INAC urged the Board to find that the current practice of billing the Surcharge to Canada is not just and reasonable. INAC clearly stated that they are not asking the Board to rule whether novation occurred in 1987, because in INAC's view, it is not within the Board's jurisdiction to do so.

INAC acknowledged that the current financial magnitude of the issues between Hydro and Canada was in the range of $25 million to $30 million. Because of the significant amount of money involved, INAC was seeking instructions from "a higher place." As soon as those instructions are received, expected to be within the next four to six weeks, and definitely before the end of March 2004, INAC would be making a proposal to Hydro to submit to a resolution process, providing that Hydro is willing to attempt to negotiate a settlement, and further providing that MKO is invited to participate in the process.

11.3 Manitoba Keewatinook Ininew Okimowin

MKO stated that they represent 30 First Nations in the northern most part of the Province that include 50,000 First Nations members. MKO's argument metaphorically referred to the two problems of the accumulated deficit and the unpaid Surcharge as "wolverines" that are particularly problematic in this proceeding.

MKO stated that its greatest concern is the inability of the First Nations to pay the proposed Government Surcharge, which could result in legal and funding disputes, closure of First Nations facilities and distress amongst First Nations customers.

The key driver used by MKO in developing its recommendations is the rate design used by other utilities in other remote communities. In MKO's view, comparability between utilities is a key rate design criteria, particularly when considering remote service. MKO stated that all jurisdictions in Canada provide electricity service to remote communities below cost.

MKO referred to its proposal and Hydro's as two proposals at the opposite ends of the bookcase, with CAC/MSOS somewhere in the middle. MKO believes its proposal is based on sound rate design principles and comparable to other jurisdictions in Canada where service is provided to remote communities. Hydro's proposal, in MKO's view, is an impractical solution to a contract dispute, and the Board is being asked to take on the role of counselor. MKO recommended that the Board reject Hydro's proposal outright on the grounds it is discriminatory to all Hydro remote customers.

MKO stated that Hydro has a responsibility to serve customers and provide power, adequate for the needs of remote customers, as citizens of the Province of Manitoba. MKO stated that since 1994, a number of changes have taken place that should influence a change in Hydro rates charged to remote communities. These changes include MKO being better informed about the Surcharge in terms of its effect on First Nations accounts, the fact that Hydro's system has been substantially consolidated, the implementation of uniform rates legislation, and the enactment of Bill 55 which provides Hydro the exclusive authority to sell power in Manitoba, including on Indian reserves. In addition, MKO has formally adopted a position that the approved General Service diesel rate government tariff number 60-08 enhanced Federal rate is inapplicable to any First Nations account.

MKO expressed concern with the level of capital costs and the forecast of annual operating costs in remote communities, stating that in their view, there is no direct regulatory oversight on individual capital expenditures, and no competitive pressure to keep costs down. MKO argued that had Hydro been required to seek regulatory approval for prior capital expenditures, many of the issues now being faced would be moot. MKO argued that if underlying costs are not reasonable, then proposed rates that flow from the costs cannot be just and reasonable, and are discriminatory. In general, the high cost to provide service in the communities, and lack of Demand Side Management ("DSM") initiatives, means that costs in the four remote communities will be high into the foreseeable future. MKO further submitted that the costs of the Shamattawa diesel project are excessive and should be discounted when determining just and reasonable rates.

MKO recommended a single cost of service approach for both grid and remote service customers, stating that all Manitoba customers, including customers in remote communities, should be treated with equality. MKO further argued that Manitoba First Nations accounts should not be treated as Government accounts, and there is no longer any precedent in Canada to define First Nations accounts as Government customers and apply the Surcharge. MKO believes that Hydro's proposal to redefine First Nations General Service accounts as Government accounts is nearly unique in Canada and is digressive from the direction taken by other utilities. In other jurisdictions in Canada, utility ratepayers ultimately subsidize the cost of diesel generation. MKO recommended that Hydro provide service to all First Nations accounts, at General Service rates, in accordance with other General Service customers in their communities. MKO also argued that Hydro's billing system is not capable of implementing the proposed rates. MKO submitted that if Hydro's Application was approved, the bills will not get paid, leading to additional contractual and legal disputes.

MKO recommended that the proposed increased rates be rejected and Hydro be directed to re-file an application for rates based on a single cost of service, with remote customers included in the Residential and General Service classes. Diesel generation fixed costs should be classified as transmission costs with the appropriate service extension policy applied, and diesel distribution fixed costs should be classified as system distribution costs. Rates should be designed with a uniform first block, a second incentive block and a tail block equal to the variable cost of fuel. Hydro should also file annual adjustments to diesel rates for Board approval in a public process.

MKO believes that the tariff structure proposed by its witness from OEMI is consistent with other jurisdictions and should be implemented in Manitoba. MKO took the position that remote generation is a substitute for transmission. MKO proposed that the net Hydro remote generation investment should be reclassified as net transmission investment, and Hydro should be directed to adopt a single cost of service approach and allocate diesel revenue shortfalls to all Hydro customers. MKO commented that implicit in this proposed treatment of net investment is that remote customers would share in the benefits of export revenue.

MKO argued that Hydro should adopt OEMI's Residential rate design methodology with three escalating rate blocks, supported by revised forecasts of billing determinants incorporating estimated demand responses to escalating price blocks. Rates should not impose rate shock.

MKO stated that Hydro should adopt OEMI's rate design for non-government General Service including all First Nations accounts, with three escalating rate blocks. Government rates should be identical to General Service rates.

Hydro will need to upgrade their billing system, and should implement a comprehensive energy management program for each of the four communities. Hydro should also prepare an information document that explains the escalating price block rate design, and translate it into local languages.

MKO recommended that the issue of stranded costs be resolved in a process which includes MKO's participation, and a full audit of all diesel fixed and variable costs. Any capital contribution ultimately collected by Hydro from Canada should be collected off-tariff, either as a lump sum or structured payment over time. If the contracts between Hydro and Canada are determined to be valid by whatever process, and Canada is found to be responsible for variable cost shortfalls, the shortfalls should also be collected off-tariff. MKO recommended that the Board issue an interim order which holds any rate changes in abeyance until the dispute resolution is completed.

11.4 Optimum Energy Management Inc. ("OEMI")

Mr. D. Hildebrand, Managing Principal of OEMI, was retained by MKO to review the Hydro Application and provide evidence. Subsequent to filing its evidence, OEMI merged its operations with Stantec Consulting. Mr. Hildebrand, Stantec Consulting and OEMI are collectively referred to as OEMI.

OEMI stated that its evidence provides no legal opinion as to the applicability of the contracts between Hydro and Canada, as well as no legal opinion regarding interpretation of legislation. However, OEMI developed its evidence on the premise and assumption that the contracts between Hydro and Canada are not valid, that the Manitoba Hydro Act places an obligation on Hydro to provide service to remote communities, and that Hydro has authority to provide service to all customers at uniform rates regardless of location.

OEMI stated that Hydro's proposal to charge customers served in remote communities the direct costs of providing generation, rather than an average rate similar to that charged to customers that are connected to the grid, may be unjust and unduly discriminatory. Further, the proposed rate structure may not appropriately recognize Hydro's obligation to serve. OEMI argued that an isolated diesel generation system is simply a cheaper method to serve customers in remote communities as opposed to connecting those customers to the grid. OEMI also argued that there may be an element of discrimination related to customers who were formerly remote not paying any diesel generation stranded costs resulting from their subsequent interconnection to the grid.

OEMI stated that the Government Surcharge which proposes to recover the entire revenue shortfall from accounts that are consuming less than 29% of the energy appears to be discriminatory and violates several criteria of sound rate design.

OEMI provided electricity rate tariffs used in other remote communities in Canada for comparative purposes, and suggested that the rate design criteria used in these other jurisdictions could be used to develop rate structures for the four remote communities.

OEMI recommended that the costs of the stand alone systems should be included in the total revenue requirement of Hydro and all users of the system should pay uniform rates. OEMI also recommended that Hydro consider additional terms and conditions or rate structures to provide incentives to customers served in remote communities to minimize consumption. These options might include energy management initiatives and customer education. Finally, OEMI suggested that the costs incurred by Hydro to rebuild the diesel generation facility at Shamattawa were excessive.

12.0 Hydro Summation

In its closing submission, Hydro noted that existing rates and rate structures were last reviewed by the Board in 1994. At that time, the Board concluded that the diesel rates and rate structure were fair and reasonable. Hydro also noted that MKO argued in favour of the rate structure and Surcharge, at that time, motivated in part by MKO's desire to see the North Central Project proceed, and the incentive provided by the Surcharge for Canada to partially fund the project. Hydro stated that the approach used by Hydro to recover costs in the current Application is substantially similar to the approach and principles used in the 1994 Application.

Hydro stated that because of the high cost, service restrictions to Residential customers have been in place in diesel communities since the earliest days of Hydro's involvement. Hydro argued that the proposed 2,000 kW.h per month cap does not constitute a change in this principle, but simply a modification of how the principle is achieved. Hydro stated that the space heating prohibition has never been easy to enforce, and recent service enhancements in the four communities have further exacerbated this problem. Hydro argued that the proposed 2,000 kW.h per month restriction to Residential customers is clearly in accordance with the accepted principles governing the provision of service in diesel communities, and is a just and reasonable means of discouraging space heating. Hydro further argued that the evidence clearly supports the conclusion that the consumption restriction should easily accommodate all reasonable uses except for space heating, and is generous when compared to other jurisdictions.

With respect to the proposed 2,000 kW.h per month consumption restriction for General Service customers, Hydro argued that part of the intent when enhancing service to remote communities, beginning in 1990, was to have similar restriction on consumption for both Residential and General Service customers. Hydro observed that a subsidy in the range of 73¢ per kW.h was a large subsidy, and to ask for a large subsidy by increasing the consumption cap for General Service customers would be unreasonable to those that are paying the subsidy. Hydro further observed that although sympathetic to the concerns expressed by the Northern Stores, Hydro must also recover its costs.

Hydro noted that they have relied, in good faith, on the Surcharge mechanism to recover costs since 1984, and agreed that it now needs some attention from the principal parties. Hydro expressed encouragement with Canada's potential offer of a process to resolve outstanding issues.

Hydro argued that the requested change in billing the Government Surcharge is required because Hydro staff cannot determine the extent of funding to each First Nations non-residential account with any degree of consistency. According to Hydro, it is likely that all First Nations accounts receive funding from Canada directly or indirectly, and the provision of adequate funding to the First Nations is a matter between the First Nations and Canada.

Hydro stated that it was not practical for Hydro to base rates on a customer's ability to pay, or on a funding formula determined elsewhere. Hydro further stated that billing the Surcharge to all First Nations accounts increases the customer base over which the Surcharge is collected. Hydro observed that no explanation from the Intervenors has been given as to why the taxpayers of the Province of Manitoba or the budgets of other customers such as the RCMP or Health and Welfare Canada should be responsible for subsidizing INAC clients.

With respect to the Shamattawa project, Hydro argued that given the operating conditions of the remote community, there was a need for a permanent facility, capable of meeting the long term growth in a sustainable, safe and reliable manner. Hydro stated that the costs incurred are reasonable and not dissimilar to costs incurred for similar facilities in other Canadian remote communities.

Hydro briefly reviewed the history of diesel service in Manitoba, and stated that costs were incurred in the good faith expectation that they would be recovered. With respect to cost recovery, Hydro stated that they are relying in part on the early contract as part of the historic record, the verbal undertakings of Canada, the participation of Canada in the redevelopment of service in the four diesel communities and in the North Central Project, the assurances given to Hydro by Canada in 1987 when the accounts were transferred for billing purposes, and the constitutional responsibility of Canada for the provision of service to First Nations. Hydro suggested that the Board should place a heavy onus on any party advocating a change in rate structure and principle to demonstrate what has changed, particularly since 1994, to support any advocated change in rate principles from the current rate structure.

Hydro acknowledged that the requested rates represent significant increases, but increases that are justified by the reasonable costs of providing service, and the responsibility of Governments for assuring service in remote communities. Hydro urged the Board to make clear the obligations of the governments to support the provision of service through the Surcharge.

Hydro made several references to Canada's potential offer of a resolution process, and indicated that Hydro would be most willing to participate in any meaningful discussion. Hydro suggested the Board should not to delay the matter pending these discussions, and urged the Board to put rates in place that reflect current costs and put the appropriate incentives in place for when those discussions take place.

13.0 Board Findings

13.1 The Ability to Pay Issue

The Board listened very carefully to the strong position advanced by MKO, and supported by many of the presenters, that Hydro customers in the four effected remote communities cannot afford to pay the rate increases requested by Hydro. The Intervenors most directly affected were quite concerned about increasing the already high costs of living in remote communities, and called for increased subsidies from Hydro.
Two Chiefs of the four First Nations communities affected by this Application stated their concern about the high cost of living in remote communities in the North. In particular, they expressed concern that higher diesel electric rates would increase food costs and all other costs dependent on electricity. Northern Stores stated that increased electricity costs would be borne by their customers through higher food and supply costs. Frontier School Division noted their concerns about the increased mill rates that would result from higher electricity rates. MKO stated that their greatest concern is the inability of the First Nations to pay the proposed Government Surcharge, which could result in legal and funding disputes, closure of First Nations facilities, and distress amongst First Nations customers.

The Board remains extremely sensitive to the rising costs of living in Northern Manitoba, and the ability to pay issue. However, the Board also has a duty and responsibility to Hydro and to the large population of all of Hydro's customers to set rates for diesel communities that are just and reasonable, within the mandate of the Board in applying the principles of rate regulation. It is the Board's view that the ability to pay issue is one that lies outside of the regulatory arena, and lies more appropriately within the Provincial and Federal Social Policy area. Hydro grid customers presently subsidize electricity rates in remote diesel communities to a significant degree. The Board refers to the Governments of Canada and Manitoba the need for improved social policy to address the ability of people living in remote northern communities to pay for essential services. It is not within the mandate of this Board to use utility rates to effect social policy.

13.2 The Sustainability of the Existing Surcharge Mechansim

The Board agrees with the positions put forward by CAC/MSOS, and supported by the witness for MKO, that the existing Surcharge system may no longer be appropriate on a go forward basis. The remaining four diesel communities are somewhat a victim of circumstance, and must bear the indirect and direct costs and consequences of the previous diesel communities being connected to the grid. As a result, the ability to share the Surcharge over a larger customer volume base is lost. The remaining four communities are more remote, more costly to serve, and consist predominately of Residential and General Service customers who receive a substantial amount of electricity service at grid rates, which are significantly less than cost, as long as they do not exceed certain consumption limits. The resulting cost difference must be recovered from a limited and potentially decreasing number of Government accounts. This situation could be further exacerbated if other large customers such as The North West Company and Frontier School Division pursue alternate energy options. In the Board's view, this rate model is not sustainable in the longer term. Therefore, an alternative funding model must be developed for the future that recovers excess costs from responsible parties, perhaps in an agreed to non-tariff arrangement such as capital and/or operating cost contributions or other funding arrangements.

13.3 Comparability of Rates to Other Jurisdictions

The key driver used by MKO in developing their recommendations to the Board is the rate design used by other utilities in remote communities in Canada. MKO argued that comparability between utilities is a key rate design criteria. The Board does not accept this argument. Each utility is different, with different cost structures and different operating policies. In addition, utilities operate under different Provincial and Federal jurisdictions, each with their own unique histories, cost structures, operating regimes and funding arrangements. Each of these aspects must be considered by the various regulators when designing just and reasonable rates. Although the Board heard some evidence regarding various rate design options in other remote communities, the Board heard little, if any, evidence regarding the specific physical differences between the various communities and regarding funding differences, Federal and Provincial government subsidies, and other factors. The Board therefore gives little weight to the argument put forward by MKO that rates for diesel service in remote communities in Manitoba should be consistent with rates in remote communities in other jurisdictions.

13.4 The Need for Rate Relief

The Board agrees with the observations of CAC/MSOS in their closing arguments that there is no quick and easy solution to the pressing issues at hand. The Full Cost and Government Surcharge portion of the diesel zone rates currently in effect were implemented November 1, 1993, and approved by the Board in Order 62/94 dated April 8, 1995. Since that time, there has been a significant increase in the costs to provide service, including significant increases in capital costs related to upgrading generation facilities. In the Board's view, one of the pressing issues at hand is the clear need for an immediate and substantial rate adjustment. However, the Board finds itself in a position where it cannot approve final rates at this time. Therefore, for reasons discussed later in this decision, the Board will approve Hydro's Application on an interim basis, to be effective April 1, 2004, subject to certain adjustments as described below.

13.5 Resolution of Significant Outstanding Matters

Although the need for an immediate rate adjustment is clear, the Board finds itself in a position where it cannot come to a final decision on just and reasonable rates for diesel communities without final resolution and determination of responsibility for a number of related matters, including the funding of the significant accumulated deficit of approximately $18 million, payment of the significant unpaid surcharges of approximately $2.8 million exclusive of accrued interest, future funding of existing capital costs and future operating costs, and funding mechanisms for future capital expenditures when required. Resolution of each of these items could have a significant impact on any final rate decision. However, final resolution of each of these issues is outside of the Board's jurisdiction.

The Board heard from INAC that they were awaiting authority to proceed with discussions with Hydro to resolve some or all of the above matters. In light of these pending negotiations, the Board has further concerns regarding any final decisions in this Order regarding rates that might somehow have an impact on those pending negotiations. All of this is even further complicated by the fact that Hydro, by letter dated January 29, 2004, filed a General Rate Application with the Board, which application may further affect rates in diesel communities.

The Board will therefore direct that the interim period between the date of this Order and April 1, 2004, the effective date of the interim rate change, be used by Hydro, INAC and other interested parties to resolve the significant outstanding issues discussed above, as well as any other related issues. Any resolution of the above matters, to the extent they effect rates, will be subject to Board approval. Hydro will advise the Board by no later than April 1, 2004 regarding the outcome of the resolution process and the effect, if any, on the interim rates approved by this order. In the event that agreement amongst the parties and resolution of the above matters is not achieved by April 1, 2004, the Board will consider other alternatives to expedite resolution of these important issues, including the possibility of a stated case to the Court of Appeal, in an attempt to resolve the issues and confirm or otherwise amend the interim rates by no later than September 30, 2004.

13.6 Rate Design Issues

The Board heard evidence from both CAC/MSOS and MKO regarding rate design and efficiency issues, including rate block structure, appropriate rate signals, and the efficiency of adopting progressively more expensive rates. While some of these concepts may have merit, there is insufficient evidence on the record to support any change to the rate design currently in effect at this time. In addition, pending resolution of many of the matters previously discussed, the Board is reluctant to add any further complications to the process by introducing additional rate design changes at this time. The Board will therefore approve on an interim basis the rates and rate block structure as applied for by Hydro. However, the Board will also direct Hydro to consider some of the arguments put forward by the Intervenors regarding rate design issues for remote communities, and report back to the Board by no later than June 1, 2004 regarding the merits or otherwise of changing the existing rate structure for customers in remote communities.

13.7 Requested Change In Billing Non-Residential First Nations Accounts

Hydro has provided limited evidence in support of its request to modify the Application of the Government Surcharge to apply to all non-residential First Nations accounts regardless of funding sources. This proposed change will have a significant effect on approximately 30 accounts that are currently billed as General Service customers. If the requested change in billing policy was approved, these accounts, in addition to the Government Surcharge, would also be required to pay the full cost rate for all consumption. This would result in a significant increase to their current energy costs. Hydro’s main argument in support of this requested change in billing policy is Hydro’s inability to clearly determine funding sources. Based on the limited evidence on this important issue, the Board is not convinced that the requested change is appropriate at this time. In addition, the Board believes that it is critically important to remain totally consistent with established rate design principles regarding diesel communities pending resolution of the other issues discussed previously. Therefore, the Board will deny Hydro's requested change in billing to the Government full cost rate and Surcharge to non-residential First Nations accounts.

13.8 Other Matters

In the Board's view, it is important that, to the extent possible, the customers in the four remote communities have a good understanding of the cost consequences of alternative energy consumption patterns. The Board notes that Order 62/94 commented that Hydro's DSM programs should be tailored for the diesel communities and should take into account the nature of the resources and consumption of all customers. The Board also notes the undertakings by Hydro during this hearing to attempt to improve the level of customer understanding of efficient energy use, billings rates and meter reading. The Board would encourage Hydro to continue to work with Band councils and residents in the remote communities to enhance the level of communication regarding this particular rate decision, and a higher level of understanding of energy options in the future. In addition, a higher level of DSM initiatives may be possible to further assist in reducing the high cost of energy consumption in these Northern remote communities. The Board would expect that the higher cost of generation in the remote communities would increase the opportunities for existing and special programs to create savings to customers. The Board would also encourage Hydro to make whatever enhancements to the existing billing system are required to appropriately accommodate the seasonal variability of billing cycles to these remote northern communities. The Board will direct Hydro to provide a status report on each of these items by no later than September 30, 2004.

14.0 IT IS THEREFORE ORDERED THAT:

1. The Application by Manitoba Hydro for new electricity rates for the remote communities of Brochet, Lac Brochet, Shamattawa and Tadoule Lake BE AND IS HEREBY APPROVED on an Interim Basis, to be effective April 1, 2004, subject to the following:

   (a) The requested change in application of the Government Surcharge to apply to all Government accounts, including First Nations accounts regardless of the level of funding, BE AND IS HEREBY DENIED. The Government Surcharge shall continue to be applied to Government and First Nations accounts consistent with the practices used immediately prior to the issuance of this Order.

   (b) Hydro shall immediately file with the Board, for interim approval, a revised schedule of rates to be effective April 1, 2004 that reflects the revised Surcharge and Government Rate.

2. In the interim period between the date of this Order and April 1, 2004, Manitoba Hydro shall meet with INAC, MKO and other interested parties in an attempt to achieve a full and final resolution regarding responsibility for the following matters with respect to diesel service in remote communities, which in each case will be subject to approval of the Board:

   (a) The significant accumulated deficit of approximately $18 million.

   (b) The unpaid Surcharge billings of approximately $2.8 million plus accrued interest.

   (c) Future funding responsibilities and mechanisms for existing capital costs.

   (d) Future funding responsibilities and mechanisms for future operating cost deficits.

   (e) Future funding responsibilities and mechanisms for future capital costs as required.

3. Manitoba Hydro shall report to the Board by no later than April 1, 2004 regarding the status of the resolution process, and if appropriate, request the Board approval for the proposed resolution to the matters set out above.

4. Manitoba Hydro shall review the rate structure proposals put forward by MKO and CAC/MSOS, and provide a report to the Board by June 1, 2004 setting out Manitoba Hydro's recommendations for consideration prior to confirmation of the interim rates.

5. In the event that resolution of the matters set out in directive #2 is not completed by Manitoba Hydro, INAC and other interested parties by April 1, 2004, the Board will consider other alternatives and any written submissions by the parties, to expedite the resolution of the matters, including the option of stating a case to the Court of Appeal, with a view to confirming or otherwise dealing with the interim rates by no later than September 30, 2004.

6. Manitoba Hydro work cooperatively, with the four First Nations communities, MKO and other parties, to take action and provide a status report together with a report on their future plans to the Board by no later than September 30, 2004 on the following matters:

   (a) Actions taken by Manitoba Hydro regarding communications with the Chiefs, Councils and residents in each of the four diesel communities regarding the Surcharge, rate block, and other factors that impact energy costs, including number of meetings in each community, translation of meetings and other information material, and other actions and initiatives.

   (b) Actions taken by Manitoba Hydro regarding a public education program with the Chiefs, Councils and residents in each of the four diesel communities regarding Demand Side Management Programs and Energy Management initiatives.

(c) Actions taken by Manitoba Hydro to make enhancements to the existing billing system to appropriately accommodate the seasonal variability of billing cycles in the four diesel communities.

(d) Actions taken by Manitoba Hydro, in consultation with Canada, the First Nations communities, MKO and other parties regarding research and development of alternative energy sources including micro-hydro, wind and other options.

7. This Order shall be in full force and effect until confirmed or otherwise by a subsequent Order of the Board.

THE PUBLIC UTILITIES BOARD

Chairman

Secretary

THE PUBLIC UTILITIES BOARD

"G. D. FORREST"

Chairman

"G. O. BARRON"

Secretary

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Secretary