

**MANITOBA** ) Order No. 1/10  
 )  
**THE PUBLIC UTILITIES BOARD ACT** ) January 5, 2010

BEFORE: Graham F.J. Lane, C.A., Chairman  
Robert Mayer, Q.C., Vice-Chair  
Dr. Kathi Avery Kinew, Member

**ELECTRICITY RATES**  
**(FOUR COMMUNITIES, DIESEL GENERATION)**

## Report on Status

### **1. Background**

Four First Nation communities in Manitoba are not connected to Manitoba Hydro's (MH or the Utility) extensive transmission grid, and receive electricity from locally generated diesel generation in Northern Manitoba. These communities, with a collective population of approximately 2,000, are:

- Barrenlands First Nation (also referred to Brochet);
- Northlands *Denesuline* First Nation (also referred to as Lac Brochet);
- Sayisi *Dene* First Nation (also referred to as Tadoule Lake); and
- Shamattawa First Nation (also referred to as Shamattawa).

These four communities are also referred to as the "Diesel Zone".

Because these four communities are not connected to Manitoba Hydro's grid, these communities do not pay rates based on costs to serve grid-connected customers. Rather, the cost to serve the Diesel Zone customers are to be born by the Diesel Zone customers, with some historically accepted cross subsidization by grid-connected customers.

The Public Utilities Board (Board) called a one-day hearing to consider the appropriateness of, and possible revisions to, current rates charged by MH to customers in the four communities of the Diesel Zone.

Although the last two Board Orders related to the Diesel Zone were made on a "interim *ex-parte* basis", primarily due to details regarding the Tentative Settlement Agreement being subject to a confidentiality agreement, the November 16, 2009 hearing included representatives of MH, Consumers'

Association of Canada (Manitoba), Manitoba Society of Seniors, Indian and Northern Affairs Canada (INAC) and the four diesel communities - as represented by MKO (Manitoba Keewatinowi Okimakanak).

MH indicated it was not seeking any rate changes at the current time, but that it was the intention of the Utility to review its position with respect to diesel rates at the January 21, 2010 meeting of the Manitoba Hydro Electric Board (MHEB). Then, depending on the decision of the MHEB, a rate application may thereafter be filed with this Board.

No intervener recommended rate adjustments at this time.

## **2. Rate Issues and the 'Tentative Settlement Agreement'**

The rate history since 2004, and the rate impacts of a 'Tentative Settlement Agreement' from 2004, that to this day remains unexecuted, is documented in Board Orders 17/04; 46/04; 159/04; and most recently, 176/06.

### **a. Pre 2004 Accumulated Deficit: \$16.9 M.**

The history contained in those Orders disclose that in the years prior to 2004, and because MH's Diesel Zone rates were not kept current with Diesel Zone costs, a \$16.9 million accumulated deficit arose.

The Tentative Settlement Agreement provided payment of that deficit, plus interest, from an allocation of Net Export Revenues, calculated using the same methodology as the Net Export Revenue credit for grid connected customer classes. However, MH now advises that any un-recovered balances as of April 2014 will be forgone, as the Net Export Credit is to then be directed to reduce consumer rates in the Diesel Zone.

As a \$14.2 million balance exists on the deficit as at March 31, 2009, it now appears unlikely that the full remaining balance will be recovered.

From an accounting perspective (i.e. MH's audited financial statements), MH has not set up a Diesel Zone deficit "accounts receivable" account. Instead, as early as 2005, MH 'expensed' the-then accumulated deficit in its accounts, thus reducing its net income for that fiscal year by \$13.5 million on account of the Diesel Zone deficit.

By such accounting transactions, effectively the deficit has been transferred to grid customers.

b. Pre-2004 Unpaid Surcharge on First Nations Government Accounts: \$3.2 million

The pre-2004 unpaid surcharge on First Nations Government accounts of \$3.2 million has been paid in full, in expectation that the Tentative Settlement Agreement will be finalized.

However, an additional \$1.5 million of unpaid surcharges on First Nations Government Accounts was not charged to the customer during the settlement negotiations. That amount has, therefore, already been deducted from a prior year's net income of the Utility. Again, because of the accounting treatment, the \$1.5 million of the unpaid surcharges was also, in effect, charged to grid-connected customers.

c. Undepreciated Capital Costs: \$28.8 million

The Tentative Settlement Agreement seeks to remove expenses related to major capital costs from the rates structure, by having such capital costs funded outside the rate setting process.

Of the \$28.8 million of MH's Diesel Zone un-depreciated capital costs, as existing in 2004, 69% (or \$19.9 million) has been paid by the four Diesel Zone communities, this through INAC-sourced funding. A further 10% (or \$2.9 million) of the-then un-depreciated capital costs was paid by Government customers.

The remaining 21% (or \$6.05 million) of un-depreciated capital costs was borne by MH, that by reducing a prior year's net income. This is another instance of transferring the expense to the account of the grid-connected customers.

**3. Post 2004 Deficits on Operations: \$20.0 million**

The cumulative deficit on Diesel Zone operations from April 1, 2004 – March 31, 2010 is now forecast to be \$20 million. This \$20 million represents the full difference between customers' revenues and costs incurred by MH to provide diesel electricity service to the four communities in the Diesel Zone.

A considerable portion of the \$20 million accumulated deficit was not expected by MH to be recovered through consumer rates in the Diesel Zone. Specifically \$6.8 million of interest expense and depreciation expense on 21% of the capital investment in place at March 31, 2004 has been, or will be, charged through to grid customers (as a reduction in the Utility's net income and retained earnings).

In addition, MH's grid customers subsidize operating costs by adjusting Residential General Service Revenue Requirements by revenue to cost coverage factors of 82% and 89% respectively. These subsidies are forecast at a cumulative amount of \$4.9 million as of March 31, 2010.

After the above adjustments are made, there is a net \$8.3 million of projected cumulative deficit on operations that MH has not included in rates, from April 1, 2004 – March 31, 2010. While that \$8.3 million deficit may exist for MH's Diesel Cost of Service calculation purposes, all of the \$8.3 million has been or will be charged against overall annual net income and retained earnings.

#### **4. Post 2004 Capital Cost Deficit; \$7.4 M**

From 2005 to March 31, 2009, MH anticipated that capital expenditures of \$8.5 million would be made by the Utility for the Diesel Zone.

After subtracting the contribution received for the generation upgrade at Tadoule Lake, there is a net \$7.4 million still owing to MH. While MH has commitments that the amount it has already expended on capital will be repaid by the responsible parties, the time it is taking for payments to be made appears inexcusable, particularly in light of MH's forecast of additional Diesel Zone capital expenditures of another \$16.45 million in the years ahead.

#### **5. Rates**

##### **a. Residential and General Service**

The 530 Residential accounts and the 114 General Service accounts in the Diesel Zone are charged grid-equivalent rates for the first 2,000 kW.h of monthly electricity consumption.

It is worthwhile to note that electrical service to Residential customers in the Diesel Zone is limited to 60 amps. That level of service permits the use of all household appliances (including computers), with the noted exception of an electric furnace or baseboard heaters for space heat.

MH's diesel generated electricity is not to be used for electric space heat, as it is a grossly inefficient use of energy. By relative example, burning diesel fuel (or 'fuel oil') in a furnace may be 70% energy efficient, whereas burning diesel fuel in a generator and using the electricity that is generated for space heat is only 30% energy efficient.

However, because some electric heaters are sold in the four communities, MH suspects some of the Residential customers consuming more than 2,000 kW.h of electricity per month are doing so due to their use of electricity for space heat. Most residential customers in the Diesel Zone communities use less than 2000 kWh/mo.

Consumption by Residential and General Service customers in excess of 2,000 kW.h per month is billed at a Full Cost rate, reflective of the higher costs, compared to the grid, of Northern diesel generated electricity service.

The current Full Cost rate is 41.27 cents/kW.h as approved in Board Order 176/06. Using the same methodology, but updating the rates to reflect costs with current data, the new Full Cost rate would be 63.15 cents/kW.h.

b. Government Rate

There are 44 Federal Government accounts (which includes approximately 29 First Nations Educations accounts), plus another 21 Provincial Government accounts in the Diesel Zone.

Government customers are charged the Full Cost rate plus a Surcharge or Premium to recover most of the subsidy provided on the first 2,000 kW.h of monthly energy to Residential and General Service customers.

The Board last approved a Government rate, in Order 176/06, of 41.47cents/kW.h plus the 97.09 cents/kW.h Surcharge/Premium totalling 103.36 cents per kW.h. Using the same methodology as in prior rate settings, (where 20% of the accumulated annual deficits was recovered in new rates and updating the calculations with current data) the Surcharge/Premium would be 173.01cents/ kW.h bringing the total Government rate to 236.03 cents/ kW.h.

It needs to be noted that calculating new rates using the old methodology would still leave an un-recovered deficit of 80% of the \$8.3 M accumulated variable operating cost deficit.

**6. Board Findings**

In prior Orders, the Board encouraged MH to provide the Board with current updates and rate applications, all in a stated effort to ensure the Diesel Zone did not find itself in a repeat in the 2004 financial situation, a situation which was then-referred to by one Intervener as essentially “a collaborative but dysfunctional effort” by the parties.



While Manitoba Hydro maintains the Diesel Zone situation is “not a mess”, all parties acknowledge that frustration exists in finding the Diesel Zone in its current financial state. There is enough blame to be shouldered by all Parties, but the Board recognizes the interests of the residents in the Diesel Zone, and of Manitoba Hydro, are not advanced by the pointing of fingers and accusations of fault.

What will be constructive is a demonstrated desire, backed up by tangible results, of all parties to improve what the Board finds to be an unacceptable situation.

a. Financial Overview – 2004 and prior

From the information provided to the Board at its one day hearing, held on November 16, 2009, of the 2004 total of approximately \$50.4 million of then-accumulated deficit, unpaid surcharges and un-depreciated capital costs, Manitoba Hydro has written-off \$24.45 million against corporate net income and retained earnings.

Manitoba Hydro acknowledges its financial treatment of these monies effectively transfers that obligation to grid-connected customers.

<b>2004 Item (millions of dollars)</b>	<b>Grid</b>	<b>INAC/FNs</b>	<b>Other Gov</b>
16.9 m Deficit	16.9	-	-
3.2 m surcharge	-	3.2	-
1.5 m surcharge	1.5	-	-
28.8 m UCC	\$ 6.05	\$19.9	\$2.9
<b>\$50.4</b>	<b>\$24.45</b>	<b>\$23.1</b>	<b>\$2.9</b>

b. Financial Overview – 2005 – 2010

From a financial prospective since 2004, Manitoba Hydro's rates in the Diesel Zone have not been kept current and do not recover the costs incurred to provide diesel generated electricity service. By fiscal year end March 31, 2010, Manitoba Hydro projects it will again be in a \$27.4 million dollar deficit position as a result of Diesel Zone electricity operations.

<b>Post 2005 Item</b>	<b>Grid</b>	<b>INAC/FNS</b>	<b>Other Gov</b>
Interest & Depreciation on 21% of capital Expenses	\$6.8m	-	-
RCC Subsidy	\$4.9m	-	-
Variable Operating Cost deficit	\$8.3m	-	-
Capital Costs (not yet repaid by other parties)	\$7.4m	-	-
	<b>\$27.4m</b>		

The post-2005 deficit contains amounts for interest and depreciation with respect to the 21% of capital costs not associated with First Nations customers, and represent an explicit subsidy. The remaining \$15.7 million is expected by Manitoba Hydro to be, in effect, re-paid (recovered from) by other parties.

The Board has been advised that in January 2009, when, reportedly, MHEB last reviewed the state of affairs in the Diesel Zone, a decision was reached whereby Manitoba Hydro would not seek to keep rates current, as MHEB was reluctant to impose any additional rate increases on the diesel communities at that time. There seems to have been a reluctance to act in advance of assurance of increased INAC funding to assist First Nations paying increased rates. Rather, MHEB directed the Utilities' management to attempt to engage the Government of Canada in a dialogue on the Diesel Zone issues.

That strategy has clearly failed as Manitoba Hydro also advises the PUB that nothing substantive has been accomplished to-date to alleviate the high impact of very high diesel-generated electricity operating costs in the Diesel Zone.

Manitoba Hydro has further indicated that MHEB will again review the Diesel Zone issues on January 21, 2010, when MHEB next meets.

Should MHEB authorize Manitoba Hydro management to file an Application for revised rates, it was suggested that such a rate application could be rolled into the current Manitoba Hydro General Rate Application (GRA) process, which is now underway with this Board.

**7. No rate adjustment at this time; Awaiting MHEB's January 21, 2010 meeting**

Manitoba Hydro has undertaken to notify this Board and GRA participants, forthwith following the upcoming January 2010 meeting of MHEB, as to Manitoba Hydro's intentions.

The Board will await that report before determining whether any adjustments are to be made to current rates in the Diesel Zone.

Even if no rate application is forthcoming following MHEB's January 2010 meeting, this Board reserves its ability to reconsider the rate issue and/or to include the issue of Diesel Rate in the GRA for further investigation and discussion.

## **8. MHEB Decisions & Reasons, January 2010**

This Board will be very interested in the decisions and reasons flowing from MHEB's upcoming January 2010 meeting. As matters now stand, by any measure the rates in the Diesel Zone appear to require immediate corrective attention.

It is important to note that by this Order there are no changes being made to grid or grid-equivalent rates, thus the accumulated deficit associated with Diesel Zone service continues to increase.

Because both Residential and General Service customers in the Diesel Zone are provided grid equivalent rates for the first 2000 kW.h of monthly electricity consumption, even if MHEB seeks rate changes for the Diesel Zone, the rates and utility bills for over 90% of the customers will not be affected by any rate increases that this Board may subsequently direct. However, Residential customers will be directly impacted by any higher prices that may be charged for food, transportation, etc. resulting from higher electricity rates to other classes of customers.

For example, if the "Full Cost" rate is sought and approved as the base rate for Government accounts, (and for Residential and General Service customers consuming in excess of 2000 kW.h per month), that base rate will be increased to 63.15 cents per kW.h. The Government Surcharge/Premium, calculated using the same methodology as in prior applications, would then be increased to 173.11 cents per kW.h, making the total Government rate 236.3 cents per kW.h.

Even if the above-indicated new rates are sought and approved, 80% of the projected accumulated \$8.3 million operating deficit since 2005 would remain unrecovered.

This Board questions whether Manitoba Hydro's practice of only recovering 20% of the accumulated deficit in new rates is appropriate, in an era where Manitoba Hydro does not seek to keep Diesel Zone rates current on an annual basis.

### **Government Rate only increased**

MHEB may consider a different approach, focusing only on the 44 Federal Government accounts, which include approximately 29 First Nations Education accounts (in prior proceedings, the First Nations Education accounts have been referred to as "fully funded" by INAC; this assumption is now in question as a result of the recent submissions by INAC and MKO.

Increasing only "federal government accounts" would, presumably, result in a funding adjustment by INAC to ensure the First Nation Education accounts will be paid in full without First Nations having to reduce other expenditures that are also funded by INAC. MH is to provide written confirmation of this assumption to the Board and all GRA participants.

A reality in the Diesel Zone, given the extremely high rates for "government accounts" is dependence on support from INAC. It is the Board's understanding that INAC provides full funding support of First Nations Education Accounts. Because of the deficit that has developed and continues to accrue with respect to diesel service, the rates for this class of customer, when revised, would, presumably, once again rely on INAC for increased support.

Until this Board has a better understanding of the make-up and situation of General Service and Residential customers, particularly as to related funding, this Board will make no rate increase now for these customer classes, for consumption in excess of 2000 kW.h per month.

This Board expects to gain additional information from MH and MKO through the GRA process currently under way.

## **9. Funding by INAC**

The attendance by legal counsel for INAC at the Board's recent one-day hearing assisted the Board in gaining a better understanding of the Federal Government's perception of the relationship between INAC and First Nation Communities in the Diesel Zone.

INAC states it is neither directly a user of diesel-generated electricity nor a customer of Manitoba Hydro in the Diesel Zone. Moreover, INAC states it is a Federal entity operating pursuant to Federal Legislation, and is "a", and not "the only", funder of First Nations. It is also worthy of note that INAC advised the Board that a provincial entity, such as the Board, does not have any jurisdiction regarding a federal entity.

That said, the level of funding – specifically for electricity services in the Diesel Zone - is of utmost interest to the Board, and is information that this Board needs to be provided in an open and transparent way to ensure this Board's Orders are in the public interest.

That First Nation Education accounts are "fully funded" in the Diesel Zone is clearly in the public interest, as that contributes to a sustainable education environment for all students in the four communities.

That raises the question as to the level of INAC funding for other First Nations Residential and General Services accounts. Diesel-generated electricity is an essential service in Northern Manitoba, even though it is not to be used for space heat.

For that reason, it is with surprise that this Board has only now learned of long-standing litigation between the four Diesel Zone communities and INAC over the level of funding for electricity services prior to 2004. As the litigation appears dormant, perhaps the issue of the funding level post 2005 has been rectified. Transparency, including the specifics of current and expected funding levels, is needed to ensure this Board's mandate for rate setting is in the public interest.

All Parties would best immediately demonstrate that First Nations will be adequately funded for essential services, and that First Nations, with the assistance of INAC, are addressing their financial obligations for such essential services.

If a residential customer in the Diesel Zone had to pay a Full Cost rate of 63.15 cents per kW.h for 2000 kW.h of electricity per month for all 12 months of the year, that customer would pay approximately \$15,000 per year, this in startling comparison to a grid customer, who would only pay approximately \$1,400 per year.

Through express or implied subsidies, Government, and also grid customers, are tangibly demonstrating their support of the residents of the communities in the Diesel Zone.

The Board has recently sought, through subpoena, the most current pronouncement of the relationship between INAC and First Nations in the Diesel Zone.

When received, this Board will review this relationship, and deliberate on what needs to be done with respect to the issue of essential electricity service to Diesel Zone communities. Needing a more in-depth understanding of INAC funding levels, now and in the future, this Board intends to consider this matter further through the GRA process now under way. It may further assist the Board should INAC apply to intervene in the GRA hearing.

#### **10. Safety Issues**

Leaving aside the financial issues, and, as well, energy efficiency issues, the use of electric baseboard or space heaters in the Diesel Zone is seen as a safety issue by the Board.

More needs to be done by both Manitoba Hydro and the First Nations and their identified organizations to ensure any use of space heaters is curtailed. Perhaps the policy allowance of 2000 kW.h per month at grid rates is too generous and too tempting for Diesel Zone customers, such that they use their electricity for dangerous space heating.

Manitoba Hydro and the First Nations and their identified organizations are to bring solutions to the safety issue back before this Board as part of the upcoming GRA process.



## **11. Energy Efficiency – Building Envelope Improvements**

The Board has been told, and expects to be told, in the upcoming GRA, of all the programs available for grid connected customers to lower their energy bills by making their homes and buildings more energy efficient.

This Board sees the immediate improvement of the energy efficiency of houses and buildings in the Diesel Zone as a necessary step to improve living conditions and safety conditions in the communities. Such a program will not only reduce the funding needed for electricity bills, but may also create employment opportunities. This Board understands that INAC is responsible for housing and capital infrastructure in all First Nations. It would therefore seem valuable to MH initiatives and planning, that the Utility works with INAC and the four First Nations of the Diesel Zone.

This Board expects Manitoba Hydro to detail all steps taken to accomplish those ends in the forthcoming GRA process. Such steps will, obviously, only be successful if the First Nations and INAC are or become fully involved.

## **12. Alternative Energy Options**

Manitoba Hydro has and is exploring alternative energy options for the Diesel Zone. Landlines would cost at least \$225 million, and may not be more reliable than the existing diesel generators.

That said, this Board understands that Manitoba Hydro is in discussion with the Federal Government over cost sharing of a \$70 million landline into the Shamattawa community under the Federal Green Infrastructure Fund.

The Board needs more information from Manitoba Hydro as to consumption levels, safety issues (both positive and negative), and any other issues that may have arisen when landlines were most recently installed into nine other communities that were formerly considered part of the Diesel Zone. That information should also be provided as part of the GRA process.

Previously, this Board required MH to meet with the four First Nations and involve them in designing and considering options for future energy delivery and use. This Board looks forward to receiving MH's full report in this GRA, and, also, to hearing from the four First Nations as to their level of involvement and experience.

Board decisions may be appealed in accordance with the provisions of Section 58 of *The Public Utilities Board Act*, or reviewed in accordance with section 36 of the Board's Rules of Practice and Procedure (Rules). The Board's Rules may be viewed on the Board's website, [www.pub.gov.mb.ca](http://www.pub.gov.mb.ca).

**13. IT IS HEREBY ORDERED THAT:**

1. Manitoba Hydro forthwith notify the Board and GRA participants, after its Board of Director's meeting of January 21, 2010 as to the intentions of Manitoba Hydro for a Rate Application for the Diesel Zone;
2. Manitoba Hydro shall provide written responses to the additional formation requested by the Board in this Order, and those responses are to be filed on or before January 26, 2010, and also be provided to interveners of Record in Manitoba Hydro's 2010/11 and 2011/2012 General Rate Application.
3. This Order shall remain an interim Order of the Board until finalized or varied through a subsequent Order of this Board.

THE PUBLIC UTILITIES BOARD

"GRAHAM F.J. LANE, C.A."  
Chairman

"H. M. SINGH"  
Acting Secretary

Certified a true copy of Order No. 1/10  
issued by The Public Utilities Board

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Acting Secretary