M A N I T O B A

THE PUBLIC UTILITIES BOARD ACT

Order No. 40/11

March 30, 2011

Before: Graham Lane, C.A., Chairman
Robert Mayer, Q.C., Vice-Chair

INTERIM RATES FOR MANITOBA HYDRO
EFFECTIVE APRIL 1, 2011

1.0 Executive Summary

By this Order, the Public Utilities Board (Board), which heard submissions on March 9, 2011 from Manitoba Hydro (MH or Hydro) and Interveners as to whether the Board should approve a further interim electricity rate increase, approves an average 2.0 % interim rate increase, to be effective April 1, 2011.

The increase is to be applied to the energy rate across all customer classes with the exception of Area and Roadway Lighting which will not receive any interim rate increase at this time. As well, in applying this interim rate increase to the Residential Class, MH is to apply the Residential rate increase to eliminate the inversion and then keep the two energy block rates equal.

The Board is satisfied that a further interim rate adjustment is required ahead of an expected fall conclusion of MH's General Rate Application (GRA). This latest interim rate increase is expected to increase MH's annual revenue by approximately $22 million, while the interim increase implemented April 1, 2010 is estimated to have increased MH's annual revenue by approximately $33 million. Combined, the two interim rate increases should increase MH's annual revenue for the Utility's 2011/12 fiscal year by approximately $55 million.

The evidence before the Board, as of March 9, 2011, provides *prima facie* support for the granting of an interim rate increase as of April 1, 2011, although the increase approved herein is of 2.0%, that less than the 2.9% sought by MH.

From the evidence adduced to date, there is a reasonable basis for being concerned that MH's projected string of 3.5% annual rate increases (from 2012 through, to and including, 2021), and the interim increases granted in this General Rate Application (which collectively accumulate to an approximate 45% rate increase for consumers between 2011 and 2021) may, when finalized, be insufficient in light of MH's major capital development plans (which includes the construction of Wuskwatim, Keeyask and Conawapa Generating Stations and Bipole III transmission line). However, the GRA hearing is far from over, with much more evidence and testimony to be heard and considered.

The Board concludes, also on an interim basis, that MH's current ratepayers should share in the risks surrounding MH's major development plans with future generations of ratepayers, with the sharing of the risks to take place through higher rates to the current generation of ratepayers.

The Board's major concerns revolve around the Utility's Preferred Development Plan for MH's self described "decade of investment". The Plan, which includes the completion of Wuskwatim and the construction of Bipole III, Keeyask Generating Station and Conawapa Generating Station, was conceived some time ago.

However, since MH formulated its Preferred Development Plan, MH's future domestic load forecasts have been significantly reduced (pushing back the date new generation is required to meet domestic demand); the term sheets entered into by MH and its American counterparties have yet to be converted into firm contracts; short-term and spot export sales prices have fallen dramatically (to 2.3 cents per kilowatt on average for the past two years); and, there is a risk that if the present development plan is implemented sharper rate increases may be required of the Utility's Manitoba consumers than MH currently projects.

Following the conclusion of the GRA hearing, the Board intends to finalize all of its interim rate decisions related to MH; parties are aware that rates set on an interim basis may be confirmed or varied.

2.0 Background

On December 1, 2009 MH filed a GRA seeking 'across-the-board' 2.9% rate increases to be effective both on April 1, 2010 and April 1, 2011. On December 10 and 22, 2009 and March 12, 2010, the Board held Pre-hearing Conferences (PHC) to identify Interveners for participation in the GRA public process; whether and how to incorporate a review of MH's risks and risk management into the GRA process; and, to establish a timetable for the orderly exchange of evidence (to lead up to public hearings that, eventually, began in January 2011).

The Board granted Intervener status to Consumers' Association of Canada (Manitoba) Inc. and Manitoba Society of Seniors (CAC/MSOS); Manitoba Industrial Power Users Group (MIPUG); Manitoba Keewatinowi Okimakanak, Inc. (MKO); Resource Conservation Manitoba and Time to Respect Earth's Ecosystems (RCM/TREE); City of Winnipeg (City); and, Southern Chiefs Organization (SCO), collectively referred to as the "Interveners".

While the Board rejected an Application for intervener status from a former consultant to MH (the 'New York Consultant'/'NYC'), who made serious allegations of mismanagement and risk involving the Utility, the Board provided a role for the NYC. NYC's public document (setting out the NYC's allegations) was distributed to Interveners, placed on the public record and responded to by KPMG in a review engaged by MH.

At the PHCs in December 2009, when various timetables were discussed, it became clear that there was no agreement on the timetable that would facilitate the potential for final April 1, 2010 rate adjustments, should any be ordered by the Board.

Subsequently, the Board accepted a recommendation by RCM/TREE, supported by MH, that MH's rate increase request for April 1, 2010 be considered on an interim basis, pending finalization subsequent to the completion of the GRA process.

Accordingly, the Board held an Interim Rate Consideration Hearing on January 19, 2010, where the Board heard submissions from MH and Interveners as to whether interim rate adjustments should be made effective April 1, 2010, pending completion of the GRA hearing process. The Board subsequently granted interim rate increases effective April 1, 2010.

The Board also determined in 2010 that the oral evidentiary public hearing (a major component of the GRA proceeding) would consider, among other issues, MH's risks and risk management; revenue requirement; the cost of service study (a comparison of assigned revenues and costs employed in the consideration of whether rates are fair and reasonable); and, MH's general rate design.

The initial plan was for the hearing to begin in the summer of 2010, with a conclusion expected for the fall of that year. However, as a result of a number of events and factors, the major factor being the extensive range and complex nature of the issues to be considered, the oral hearing did not begin until early January 2011, and is now not anticipated to conclude (with a final GRA order) until the fall of this year, 2011.

With the revised expectation that the GRA would not conclude until long after April 1, 2011, and noting that MH has projected a rate increase which the Utility has factored into its long-term plans, the Board sought submissions from Interveners and MH with respect to possibly approving a further interim rate adjustment, that to take effect April 1, 2011. Submissions were received from MH and Interveners on March 9, 2011.

3.0 Intervener Positions

CAC/MSOS opposed interim rate increases effective April 1, 2011.

This Intervener submitted that in considering the setting an interim rate, the Board should consider regulatory precedent for the fixing of “just and reasonable” rates, citing CRTC v. Bell Canada [1989] 1 S.C.R.1722 paragraph 57, which states:

> *"….The very purpose of interim rates is to allay the prospect of financial instability which can be caused by the duration of proceedings before a regulatory tribunal. In fact in this case the respondent asked for and was granted interim rate increases on the basis of serious apprehended financial difficulties. The added flexibility provided by the power to make interim orders is meant to foster financial stability throughout the regulatory proceeding. The power to revisit the period during which interim rates were in force is a necessary corollary of this power without which interim orders made in emergency situations may cause irreparable harm and subvert the fundamental purpose of ensuring that rates are just and reasonable.”*

CAC/MSOS noted that the underlying purpose of interim rates, always in the context of just and reasonable rates, is to foster financial stability for a utility throughout a regulatory process, so as to protect the utility against serious apprehended financial difficulties that could flow from an extended duration of a regulatory process.

Holding that there was no serious apprehended financial difficulty in the case of MH, CAC/MSOS opposed an April 1, 2011 interim rate increase while acknowledging that the Board has the regulatory discretion to grant an interim rate increase.

CAC/MSOS held that such discretion should only be exercised in circumstances where current rates are not just and reasonable, and recommended that in deliberating on whether to set interim rates the Board consider criteria based both upon case law and the Board's decision in Order 18/10:

- First, has the Board concluded that a lengthy delay in the regulatory proceeding is likely to take place?
- Secondly, has the tribunal reached the conclusion that there is an unusual financial need such that either a rate increase is necessary to allay the prospect of financial instability or address serious apprehended financial difficulties, which can be caused by the duration of the proceeding?; and
- Third, has the Corporation established a prima facie basis that the proposed interim rate is just and reasonable?

CAC/MSOS opined that MH’s current financial condition is much improved from the Utility’s prior forecasts, noting that MH’s GRA is based on the financial forecasts of IFF-09-1, which indicated that MH would need an additional $33 million of revenue from domestic customers in 2010/11 and a cumulative additional $69 million for 2011/12. CAC/MSOS observed that MH's actual net income for 2009/10 was $39 million higher than MH's projection in its IFF-09 forecast.

In addition, CAC/MSOS noted that MH's updated forecasts for 2010/11 and 2011/12 (represented in the projections of IFF10) reflect an anticipated material improvement in MH's expectations for both net income and retained earnings for the two years (with retained earnings now projected to be $93 million higher than that forecast in IFF 09).

CAC/MSOS suggested that even if the 2.9% increase for April 1, 2011 sought by MH was not implemented, MH would still be materially better off (as measured by the level of projected retained earnings) as at March 31, 2012 than the Utility had originally forecast. Accordingly, CAC/MSOS submitted that MH's materially improved financial results neither support a conclusion of a state of financial instability nor that of a serious apprehended financial difficulty (to arise from a delay of the Board approving another rate increase for the Utility following the close of evidence).

CAC/MSOS further noted that MH's OM&A expenditures have risen materially over the years, and suggested that there was insufficient evidence to suggest effective cost management by the Utility. For CAC/MSOS, Hydro's improved financial position arises from rate increases and subpar forecasting.

CAC/MSOS also submitted that it would be premature for the Board, by approving an interim rate increase as of April 1, 2011, to partially pre-fund the Utility's Preferred Development Plan (particularly until there is greater certainty that the Utility's plan will unfold as planned). For CAC/MSOS, based on the record of the proceeding to-date, it is still unclear whether the export sales term sheets will become firm contracts, and even whether the construction of Keeyask Generating Station will prove to be an appropriate action and proceed.

CAC/MSOS underlined its view of uncertainty associated with MH's Preferred Development Plan, listing three concerns drawn from the evidence of Mr. Rose of ICF (a witness engaged by the Utility), those being (a) natural gas prices and forecast prices are significantly (38-49%) lower than was the case in 2009 when the IFF-O9 was developed; (b) forecasts of the value of carbon emission allowances (expected by MH to assist the pricing of its exports) have been significantly downgraded -- both in terms of the time frame within the value would be established and as to the likely magnitude of the assumed positive effect for Hydro's export pricing (the forecast carbon value now 40% to 60% lower than previously forecast); and, (c) the number of anticipated coal plant retirements in the MISO area -- MH's export market, are now expected to be fewer than before.

CAC/MSOS observed that there is a significant amount of evidence yet to be provided in the hearing, including from the Independent Experts engaged by the Board and from Intervener witnesses.

CAC/MSOS, having fundamental issues with MH's GRA and holding that their issues have yet been fully tested, opined that it would be imprudent for the Board to make a directional judgment at this time, ahead of evidence yet to come. CAC/MSOS also contended that MH had failed to comply with Directive 4 of Board Order 32/09, which directed that an overall analysis of the risks faced by MH be carried out. CAC/MSOS noted that KPMG's study did not provide the comprehensive risk analysis requested by the Board.

CAC/MSOS further held that there would be a material risk that MH would draw the wrong inference from another interim rate approval, and that the granting of a 2.9% interim rate increase could be interpreted by the Utility as the Board approving its scenarios (as set out in IFF09 and IFF10), which incorporate its Preferred Development Plan, even though MH failed to comply with Directive 4 of Order 32/09.

CAC/MSOS also submitted that the sought interim rate increase should not be granted because Manitoba consumers are vulnerable, facing economic and employment uncertainty, citing that electricity and other cost increases are increasing pressure on household budgets, while wage settlements have not kept pace with inflation. CAC/MSOS further observed that MH's rate increases over the last seven years have exceeded the general rate of inflation, and suggested that the flow of rate increases should be "slowed".

CAC/MSOS concluded that the Board rejecting or moderating MH's proposed 2.9% interim rate increase would provide welcome relief to vulnerable consumers, and provide an opportunity for a more "sober" consideration of the issues, while sending a "message" to MH that it is not enough to rely on subpar forecasts and domestic rate increases to meet the Utility's projected future financial obligations.

4.0 MIPUG

MIPUG joined CAC/MSOS in opposing the granting of interim rate increases as of April 1, 2011.

MIPUG noted that while, in support of its interim rate request, MH had cited BC Hydro's high rate increases proposals, MH had not "featured" Hydro-Quebec's action of requesting a zero percent increase at this time.

MIPUG stated that the Board has, to-date, only heard "one side of the story" and opined that a balanced view of the Utility's circumstances have yet to be presented, with, to this point in the proceeding, only Hydro's view and Hydro's evidence tested, and that only somewhat tested as cross-examination of Hydro's panel by Interveners has yet to occur. MIPUG also noted that none of the Interveners have had the opportunity of having their witnesses testify.

With respect to KPMG's risk review (KPMG's panel of witnesses was cross-examined by both the Board and Interveners), MIPUG noted that the review failed to quantify MH's risks (as sought by the Board in Order 32/09) and submitted that further rate increases should be halted until such time that there is sufficient evidence on the quantum and probability of MH's risks.

Also, MIPUG noted that the Board may be missing critical information that may reside in alternative IFF scenarios not provided by MH, and that identification and examination of alternative scenarios are required before a further interim rate increase is approved.

Noting the Board's reluctance for retroactive rate changes, MIPUG also submitted that the establishing of an across the board interim rate increase could create continued inequity for some classes - especially those with Revenue to Cost Ratios outside the Zone of Reasonableness.

MIPUG also submitted that a “special test” has to be met in considering whether to establish interim rates, and referenced *The Public Utilities Board Act,* particularly Sections 44, 27 and 48, the latter which states:

> *"The Board shall not make an order involving any outlay, loss, or deprivation to any owner of a public utility, or to any person without due notice and full opportunity to all parties concerned to produce evidence, and be heard at a public hearing of the Board, except in the case of urgency…"*

MIPUG also cited court cases that it submitted supported is position that an interim rate increase should not be granted. In particular, MIPUG relied on a Bell Canada case (also cited by CAC/MSOS), and set out the criteria used by the CRTC in considering interim rate adjustments, that being:

> *“The Commission considers that, as a rule, general rate increases should only be granted following the full public process contemplated by Part III of its Telecommunications Rules of Procedure. In the absence of such a process, general rate increases should not in the Commission’s view be granted, even on an interim basis, except where special circumstances can be demonstrated. Such circumstances would include lengthy delays in dealing with an application that could result in a serious deterioration in the financial condition of an applicant absent a general interim increase.”*

MIPUG also referred to an Alberta Utilities Commission (AUC) decision dealing with interim rates. MIPUG reported that in AUC Order 2002-115, the Commission set out the factors to be considered in evaluating the merits of a proposed interim rate increase:

> *"These factors can be grouped into two categories, those that relate to the quantum of, and need for, the rate increase and those that relate to more general public interest considerations."*

The quantum and need factors cited by AUC, as reported by MIPUG, included: (a) that the identified revenue deficiency should be probable and material; (b) a response to the question of whether the interim increase was required to either preserve the financial integrity of the applicant or to avoid financial hardship for the applicant; (c) a response to the question whether the applicant could continue safe utility operations without the interim adjustment; and, (d) recognition that contentious costs could be excluded from the revenue requirement to be met.

MIPUG suggested that if all or a portion of the suggested rate increase appears appropriate after consideration of the above listed factors, the Board must then assess certain general public interest factors to see if a rate increase is justified, including the following: (a) whether Interim rates would promote rate stability and ease rate shock; (b) whether interim rate adjustments would help maintain intergenerational equity; (c) whether an interim rate increase was required to provide appropriate price signals to consumers; (d) whether deferring costs from being taken into account in determining revenue requirements should be considered to avoid interim rate increases; and, (e) whether, if an interim rate increase is to be approved, it is appropriate to do so on an across-the-board basis.

MIPUG suggested that the above considerations could be given different weighting depending on the specific circumstances, and held that in applying the above factors by MIPUG, MH does not meet the requirements for an interim rate increase.

MIPUG noted the following factors as not supporting MH having an urgent need for an interim rate increase: (a) MH's forecast electricity operations net income for 2010/11 and 2011/12 have increased from the $78 million and $87 million set out in IFF–09 to $149 million and $125 million in IFF-10; (b) MH's forecast electricity operations retained earnings for 2010/11 and 2001/12 has increased from the $2.261 billion and $2.331 billion forecast in IFF–09 to $2.354 billion and $2,279 billion in IFF-10; (c) MH's quarterly report for the three months ending December 31, 2010 indicates that export revenues for the first nine months of 2010 /11 were higher in both absolute dollar terms and average revenue per unit sold compared to the first nine months of 2009/10; (d) MH's IFF–10 forecast has short-term and long-term debt rates lower than that forecast in IFF–09; and, (e) MH's indicates water levels and water storage through December 2010 is both higher than was the case 2009, and well above average.

With respect to "Public Interest" factors, MIPUG noted that domestic consumers have been subject to a series of rate increases exceeding inflation over the past several years and, for MIPUG, current economic conditions considered from a public interest perspective suggest that ratepayers should not be burdened with an additional interim rate increase.

5.0 RCM/TREE

In addition to its oral submission of March 9, 2011, RCM/TREE provided a written submission supporting MH's request for an interim rate increase. This Intervener maintained that the Board has the legal jurisdiction and wide discretion, derived from statute, to make interim rate adjustments based on the facts before it.

RCM/TREE urged that a long-term view on rates be adopted, and advocated steady annual rate increases be implemented. The Intervener noted that MH's annual export revenues and net income levels are volatile because of water flows and varying export prices, and, by taking a long-term view, rate increases would not be a "start/stop" process based on the "fortunes" of the previous year.

RCM/TREE envisions regular incremental increases, this to smooth the impact of meeting the higher capital costs of such new generation that is required for Manitoba growth. RCM/TREE submits that "skipping" an annual rate increase would not only deprive MH of needed additional income (during the Utility's "decade of investment"), but result in negative revenue impacts into the future by setting a lower baseline for future rate increases.

RCM/TREE also perceives MH's risks as asymmetrical, with the downside of revenue expectations during adverse conditions being more severe than variations to the positive side during favourable conditions, and recommended that rates be sufficient to allow for MH to create and maintain sufficient retained earnings to withstand future negative events.

RCM/TREE noted that its witnesses have yet to testify, and anticipated that one of its witnesses would make recommendations related to rate design. RCM/TREE suggested that the Board approve an interim increase now and adjust rate design and address cost allocation issues with the final Order. For RCM/TREE, if an interim rate increase were granted but the final Order failed to address cost of service and rate design issues, the result would perpetuate what the Intervener holds to be a suboptimal rate design.

With respect to any future Energy Intensive Industry Rate proposal (on two occasions, MH has submitted an application only to later withdraw it), RCM/TREE requested that it be included in the consultation process.

6.0 SCO

SCO submitted a written brief that requested that in any revision of rates, the quantum of the increase be set aside and earmarked for all Manitoba First Nations. The purpose of such segregation and designation of funds would be, in SCO's view, to offset any compensation required to be paid to First Nations as a result of the "negligent operations" of MH's projects and facilities. Any rate increase should, in SCO's view, be set-aside until an environmental assessment on MH's projects takes place and is concluded.

7.0 MH's SUBMISSIONS

MH requested the Board approve an 'across all rate classes' interim rate increase of 2.9%, with the exception of the Area and Roadway Lighting class, effective April 1, 2011. For MH, the implications of a later implementation date would be that MH would either forego needed revenue or that a higher future rate increase will be required. For the Utility, any delay in the implementation of the sought-after rate increase will result in more pressure driving up the magnitude of a future rate increase.

MH noted that its proposal was modest compared to a recent application made by BC Hydro, which applied for a rate increase of 9.73% for each of the next three years (a cumulative increase of over 32% for fiscal years 2012 to 2014). MH stated that its long-term rate strategy involves regular and modest incremental rate increases; with the Utility holding that a 2.9% rate increase as of April 1, 2011 would be consistent with that goal. MH advised that it is mindful of the interest of its ratepayers and promotes gradualism in its rate applications.

MH submits that Intervener suggestions that MH must first demonstrate urgency or a serious apprehension of financial difficulties as a prerequisite for an interim rate increase are erroneous. MH maintained that there is nothing in legislation requiring a state of urgency or requiring MH to be in financial difficulty for the Board to approve an interim rate increase, noting that the Board has never accepted such a premise.

Term Sheets

With respect to the Utility's term sheets [with Minnesota Power (MP) and Wisconsin Public Service, (WPS)]; MH stated negotiations are continuing with significant progress taking place. MH held that both American customers remain strongly committed to proceeding with the proposed transactions and that a major factor delaying completion of the negotiations is defining required American transmission facilities, their associated costs, and the allocation of such costs.

MH indicated that transmission discussions have been undertaken with the CapX Group (Minnesota transmission-owning utilities), and, at the request of CapX, the new Manitoba-US major interconnection was identified in the fall of 2010 for inclusion in MISO's transmission expansion plan as a major regional transmission project (with the goal of it becoming an approved project in the 2012 MISO transmission expansion plan – if approved the cost of the transmission is to be "socialized", i.e. shared by all utilities within the MISO region).

MH reported that MISO filed (having received approval from FERC in December 2010) a modification of the MISO Transmission Tariff to include multi-valued projects (MVPs) that allow for cost regionalization of major regional transmission projects. If the MH transmission interconnection is approved as a MVP in the 2012 MISO transmission expansion plan, MH reported that would allow MP and WPS to conclude contract negotiations with MH such as to meet the revised and now current in-service dates for new MH generation.

Risk

In response to Interveners' claims that MH did not comply with risk related directives of Board Order 32/09, and with respect to assertions of Interveners that the KPMG report did not address Order 32/09, MH noted that there were very unique circumstances surrounding the commissioning of the KPMG report, and, that to suggest that the Board has not been provided with the “full picture” of the risks faced by the Corporation is, from MH’s perspective, inaccurate.

MH reported that it has filed its full corporate risk management report, which identifies all of the major risks faced by the Corporation, and the ICF report. MH further cited the fact that the Board commissioned Independent Experts to produce a risk related report, with a wide scope. MH also noted that in addition, extensive interrogatories (IRs) have been filed and responded to, related to risk.

Load Forecast

MH observed (citing the economic downturn) that there have been significant reductions in its forecasts of the future load of industrial customers, claiming that the forecast reductions in industrial load will be significantly offset by expected increases in the remaining domestic load, in particular with respect to residential loads.

MH also stated that the forecast industrial load growth reductions, indicated to be in the order of a fifteen year delay in reaching previously forecast future loads, would have little impact on forecast future domestic revenues because of the differences in unit prices within the different customer rate classes (the average industrial rate is about 3.7¢/kW.h, the residential rate is close to 7¢/kW.h).

Energy Intensive Rate Application

MH stated that the economic downturn also drove it’s decision to defer filing a new application for an Energy Intensive Industrial Rate (EIIR) – the concept of EIIR is that large additional loads from industrial customers, billed now at an average rate of below 4 cents a kW.h, could result in “lost” incremental revenues as that same power could be sold on export to American counterparties at higher prices. (With the average export price now below 4 cents and with short-term or spot export sales as low as 1 cent, the premise behind the EIIR was challenged.)

MH reported having met with MIPUG and individual large customers on topics related to new industrial rates for new or additional loads. MH stated that numerous meetings were held throughout the spring, summer, and fall of 2010, culminating in a November 2, 2010 workshop presentation to which all MIPUG members were invited.

MH reported that a further workshop is planned for March 16, 2011, and this meeting would broaden consultation to include remaining customers served at voltages between 30 kV and 100 kV. MH further advised that its future consultations would include RCM/TREE, CAC/MSOS and the government.

Upon completion of stakeholder consultation, MH indicated it plans to file a new EIIR Application with Board.

OM&A

MH stated that there are various “uncontrollable” business cost drivers that have contributed to the Utility’s OM&A expense increases that, the Corporation acknowledges, have exceeded the rate of inflation.

These “higher than inflation” expenses include increased maintenance costs due to aging infrastructure, higher environmental and regulatory requirements, costs related to customer additions and new facilities, higher pension costs (the result of investment fund performance and low interest rates), higher material and commodity prices, and higher employee costs (due to additional resource requirements and competitive wage pressures).

MH indicated it had taken steps to constrain the rate of increase in OM&A costs, including a hiring freeze (excepting for trainees and specific key personnel hires), limiting out-of-province travel and other measures. MH advised that the measures taken had been effective in reducing the year-over-year change in OM&A expenses in 2010/11, when compared to 2009/10. For the ten-month period ended December 31, 2010, MH reported that its restraint measures had avoided $16 million in costs.

International Financial Reporting Standards (IFRS)

MH stated that the forecasts of IFF-10 reflect the most likely impacts of the expected and required conversion to IFRS accounting standards. The likely required changes include a reduction to capitalizing overheads (with a corresponding increase to operating costs) and an expected “write-off” to retained earnings of amounts previously capitalized or deferred (the latter including Demand Side Management (‘DSM’), energy efficiency expenditures) but no longer allowed such treatment.

The adoption of IFRS will, according to MH, result in changes to the timing of the recognition of certain costs in MH's current operating accounts, and MH indicated that some mechanism may be required to defer recognition of these costs for rate setting purposes. In this regard, MH indicated that it would provide the PUB with alternatives to consider.

Debt to Equity Ratio

MH believes that its debt to equity ratio and the 25% equity ratio target continue to be important financial metrics to be considered in rate setting, particularly given planned future capital expenditures.

MH responded to questions raised by the Board as to whether Accumulated Other Comprehensive Income (AOCI) and Contributions In Aid of Construction (CIAC) should continue to be included in the determination of equity for use in calculating the debt to equity ratio.

MH stated that in as much as AOCI is a component of equity, in accordance with Generally Accepted Accounting Principles (GAAP), it is appropriate to include the balance as part of equity and as a component in the debt-equity calculation, noting that AOCI primarily reflects unrealized gains or losses associated with the translation of MH's U.S. dollar (United States currency, USD) debt. MH asserted that the translation of the USD denominated debt into Canadian dollar equivalents at each balance sheet date is important, and the result is the best indication of what that debt represents in Canadian currency at that point in time. (MH’s exports sales to American counterparties are priced in USD, and if and as the Canadian dollar appreciates relative to the American dollar, the value of the exports in Canadian dollars decreases, offsetting over time currency gains that have and or may arise with respect to USD debt.)

MH further noted that rating agencies Standard & Poors and Moody’s both accept AOCI as a component of equity for use in debt to equity calculations, and that, as well, both BC Hydro and Hydro Quebec include AOCI in their debt to equity determinations.

MH asserted that Contributions in Aid of Construction (CIAC) should continue to be included as an element of equity, to be taken into account in the determination of the debt to equity ratio, as it represents non-refundable contributions provided by customers towards service extension costs (CIAC amounts are non-refundable, are amortized into income at the same rate as the corresponding assets are depreciated, and do not represent liabilities of the Corporation.).

For MH, since the equity ratio measures the portion of the Corporation's assets that are not funded by debt, the inclusion of CIAC in equity conforms with the purpose of the equity ratio calculation.

Nonetheless, MH advised that the debt to equity ratio at January 31, 2011 was 74/26, and that if AOCI were excluded from that calculation the ratio would change to 76/24, and, if CIAC was also excluded, the ratio would change to 78/22.

Pensions

With respect to the pension deficit (pension obligations less pension assets), MH stated that its pension fund investments have recovered since the economic and market downturn of 2008/09, and that the impact of the negative returns on pension investments in that fiscal year have been partially offset by positive returns since. As of March 31, 2010, MH reported an overall deficit obligation deficit of $89 million, and that it expected the deficit to decrease further by March 31, 2011.

MH further stated that the Civil Service Superannuation Board has considered seeking increases to both employer and employee pension contributions, but that no changes have yet been made by government.

MH further indicated that the International Accounting Standards Board (IASB) has issued an exposure draft, which, if approved, will require all pension gains or losses to be recorded directly into AOCI. As a result of the current level of deferred actuarial losses on the pension plan, the application of these accounting changes will have, according to MH, a relatively small negative impact on the Utility's debt to equity ratio in the short-term, with the effects expected to be fully offset in future periods due to either improved asset values, higher interest rates and/or future amortization of losses.

Upside vs. Downside Risk

With respect to the Board's questions as to: (a) whether there is appropriate sharing of risks between this generation and future generations of electricity ratepayers?; (b) is MH speculating (the word was not employed in a negative sense) on behalf of current ratepayers with the outcomes to be realized by future generations of ratepayers?; (c) as to how symmetrical the Utility's downside risk is in comparison to its upside risk?; and, (d) is it possible that higher rate increases may be required than forecasted in the future?

MH stated that answers to these questions are complex, and that the future is far from certain. That said, for the Utility to do nothing is not an option. For Hydro, the nature of its business demands that decisions be made far in advance of new supply requirements coming on-stream, this in order to provide for the continuance of the supply of energy needed to meet the requirements of the Province.

MH advised that it has been informed by the Minister Responsible for MH that it is the Government's intention to assign responsibility to an independent body to carry out a Needs and Justification assessment of MH's proposed major new generation projects, which, presumably, would include a review of alternate development approaches. MH indicated that it is confident that this upcoming review process will address any and all questions related to the “upside and downside” risks of development.

Forecasting

With respect to concerns raised by CAC/MSOS related to MH’s forecasts, MH acknowledged they are just that – forecasts, and that forecasts represent a view of the future based on “known” information. MH advised it cannot control conditions that will actually occur and which will cause variations to forecasts.

For MH, the one thing known with certainty is that actual results will be different from forecast.

MH’s Conclusion

MH concluded its submission by repeating its request for an interim rate increase of 2.9% across all customer classes with the exception of Area and Roadway Lighting, to take effect April 1, 2011,

8.0 Board Findings

The Board acknowledges that the GRA hearing is far from over and that important new evidence and witness testimony is yet to come. As well, the Board further acknowledges that Interveners have yet to have the opportunity to cross-examine the MH panel or the witnesses that they, and the Board, have engaged. Finally, the Board acknowledges that its preference is to have concluded a GRA proceeding before approving rate changes.

This hearing is unique in the Board’s regulatory history, and not only with respect to interim grid rate Orders awaiting finalization, along with an interim diesel rate decision, but also with respect to the complexities of the issues; the importance of the potential outcomes for ratepayers, the Utility and the Province; and, as well, this proceeding’s length, scope, cost and public profile.

MH filed its GRA December 1, 2009, and in the normal course of events the hearing would have taken place and been concluded with a final rate order issued well before the summer of 2010.

Circumstances resulted in a lengthy delay in the commencement of the oral hearing, and while the importance of the matters before the Board have also contributed to the lengthy process, the facts are that MH has indicated plans to spend in the range of $20 billion in a “decade of investment”, a plan that requires a need for massive new borrowings and, as it would appear, a decade of higher than inflation rate increases. MH projects that during the decade of investment it will seek annual rate increases of 3.5% each year, accumulating in the range of 45% in the ‘decade of investment’.

CAC/MSOS is correct in noting that from 2004 on, MH’s rates have increased by considerably more than the rate of inflation. However, it is also useful to take into account that before 2004, MH rates, other than industrial rates which actually fell, remained frozen for approximately a decade. It is also useful to note that since 2004, the Utility has had to confront a drought, which led to a loss in one fiscal year in excess of $400 million, a credit crisis and major global recession (which contributed to a reduction in demand and a fall in export prices), and with what some observers have portrayed as a “game changer”- new production techniques that have led to major new reserves of natural gas and plunging and now low natural gas prices (which has also contributed to lower export prices).

It has not been an uneventful decade for MH, and it would seem the next decade will be as equally challenging. MH plans a “decade of investment” and, ahead of new Manitoba domestic demand, the construction of major new generation and transmission assets to support the entering into major new export sales contracts with American counterparties, contracts yet to be finalized and which will involve both commitments and risks.

In the end, the results of MH’s actions are of considerable significance to not only Manitoba and the Utility’s customers, but to the overall Manitoba economy. If the new investments planned by MH do not generate the export revenues MH’s expects, or if the costs of its planned investments exceed their current forecasts and are not able to be fully recovered by the now forecast domestic rates and export sales revenue then domestic rates will have to rise higher, and perhaps faster, than the levels now predicted by MH.

Contract and construction risks are not the only risks faced by MH. Already long identified by the Board and the Utility are risks including equipment failure, drought, currency fluctuations, interest and finance cost increases, market disruptions, load forecast variances, etc. etc.

For MH to be able to borrow at reasonable financial terms, the billions of dollars required to complete MH's plans for its decade of investment (billions of dollars to be guaranteed by the Province – MH borrowings may, if as projected, represent 50% or more of the Province's overall debt), lenders have to be confident with the Utility's plans and have assurances with respect to the future balances to arise out of Utility revenues and expenditures. So, the state of the capital structure of the Utility, now and into the future, is a very important matter.

While the GRA hearing is not over, with much evidence, testimony, cross-examination and final argument yet to come, the Board is cognizant of aspects of the Utility's financial circumstances and indications as to the revenue requirements for the future.

The Board has had regulatory responsibilities related to MH for many years, and is familiar with its practices, plans, forecasts and, to a significant yet limited degree, risks. In response to Interveners' views as to the ability of the Board to approve an interim rate increase and that approving an across-the-board interim increase could disadvantage certain classes, the Board finds:

a) that it has the necessary jurisdiction – urgency is not a required condition; and

b) the Board's comments in previous rate orders, which have advised that cost attribution is but one factor in the Board's determination of just and reasonable rates, stand.

Unlike the circumstances of the April 1, 2010 interim rate increase, the GRA is now well underway and while considerable evidence remains to be provided and tested, sufficient evidence is already on the record to justify the Board's consideration of granting another interim rate increase. MH has filed an extensive GRA (including its latest published annual report and financial forecasts), and thousands of interrogatories have been posed and responded to (involving MH, the Board, Interveners and expert witnesses).

As well, MH's witnesses from two consultancies engaged by MH (ICF and KPMG), have submitted briefs, testified and been cross-examined, and while Board Counsel had yet to complete the cross-examination of MH's panel of internal witnesses as at the date submissions were received on the question of an interim rate increase (and ahead of Interveners cross-examining the MH witness panel), a panel that includes MH's Senior Vice President and Chief Financial Officer, a considerable portion of the Board's cross-examination had been undertaken by March 9, 2011.

As to the evidence of witnesses engaged by Interveners and the Independent Experts engaged by the Board, reports have been filed, although the witnesses have yet to testify and be cross-examined.

Accordingly, having considered filings and submissions to and including March 9, 2011, the Board finds that the evidence received and considered to-date, supplemented by the submissions of the parties provided on March 9, 2011, provide *prima facie* justification for an interim 2.0% average rate increase, effective April 1, 2011.

The increase is to be applied to the energy portion across all rate classes, exempting the Area and Roadway Lighting class. MH is to apply the Residential rate increase to the first energy block rate, to eliminate the inversion and then keep the two energy block rates equal, effective April 1, 2011.

With respect to Area and Roadway Lighting (ARL), while the Board will again exempt the class from an interim rate increase to be applied to other classes of customers, it puts the ARL class on notice that further exemptions are far from assured. The Board will careful assess the revenue to cost ratio and other factors that apply to rate setting in determining the relative positioning of the ARL class' rates.

With respect to Residential rates, when the inverted rate was established, circumstances were different than what they are now. Natural gas prices were very high, so high that there was a risk that property owners would consider switching their heating source from natural gas to electricity and MH has yet to reflect consideration of home heating loads in its rate design.

There are rate design issues still to be considered with possible revision in the Board's final GRA Order.

In the remainder of the GRA Hearing and in its deliberations following closing argument, the Board will reassess its view on inverted rates for residential properties, particularly for those where gas heat is not an option.

With respect to rate differentiation between classes and overall rate design matters, MH's plans for massive capital spending and the Utility's projections of a series of annual rate increases of 3.5% extending over a decade, allows the Board ample opportunity to adjust the rates of individual customer classes if it deems such adjustments are necessary.

A major component of this GRA is the identification and review of risks faced by MH, and how such risks should be reflected in consumer rates, and in what quantum and time. MH has testified that while current circumstances and results are important, the Utility's long-term prospects, with its planned new generating stations expected to have service lives of up to one hundred years, need to be taken into account.

MH's major capital expenditure development plans include the completion of Wuskwatim Generating Station (which, although originally forecast to cost $900 million, is now expected to cost $1.6 billion), the construction of Bipole III (MH indicates the proposed new transmission line and converter stations are required for reliability purposes – though also required if major new generating stations are built), and the construction of Keeyask Generating Station and then Conawapa Generating Station. MH's current long-term financial projections involve the expenditure in excess of $17 billion, to be funded by debt and projected accumulated net income.

If MH's major capital plan is implemented, the Utility's assets and loans will more than double over the period of approximately ten years. The major new assets to be constructed, three generating stations (the first, Wuskwatim, to be in service by the end of fiscal 2011/12) and Bipole III, will come at costs very much higher than the cost of generation stations and transmission facilities built in decades past.

With the construction of these assets, the cost per kWh of overall sold electricity will rise significantly, with the marginal cost being a multiple of the historical and present average cost.

MH's comparatively low rates for Manitoba consumers (the comparison being other Canadian and American electric utilities) are founded in large part on the relatively low undepreciated capital costs of the Utility's pre-2010 generation and transmission assets, for which annual amortization costs are very low and the original loans have either been fully paid off or considerably paid down, resulting in relatively low finance expenses. The last major generation station to come into service was Limestone, basically twenty years ago.

Another factor providing for low rates is MH's ongoing deferral and capitalization of expenditures incurred related to its construction development plans. Every year, approximately 1/3rd of MH's OM&A expenditures are capitalized or deferred, meaning these expenditures are neither considered current period costs nor taken into account in rate setting.

To avoid future deficits, the evidence suggests that if the Utility's present capital expenditure development plan is implemented, both domestic rates and export sales prices will have to rise significantly. As developments are completed and new assets put into service, expenditures previously capitalized or deferred, including those carried within Construction Work in Progress on the Utility's Balance Sheet, begin being recorded in the annual income statements as 'costs'. These costs include amortization of "capital" costs as well as the financial costs (interest and the Province's guarantee fee) and any operating costs associated with operating the then in-service asset.

A component of MH's currently projected future rate increases relate to the expectation of ongoing general economic price inflation, the other major component being the inclusion in annual "booked" costs, the costs noted above (again: amortization, financial and operating associated with new generation and transmission assets after they come into service).

Another issue that plays, or may play, a significant role in the forecast of future rate increases is the Utility's debt to equity ratio, a financial test considered to be important by lenders, the Utility, the Board and Interveners. For a considerable period of time, the accepted target for the ratio is 75% debt to 25% equity. As developments proceed and expenditures are incurred, whether expensed in the period or deferred or capitalized, debt generally increases, placing downward pressure on the equity ratio. While it has been generally accepted that the target ratio is unlikely to be maintained through a development phase, when major expenditures are being incurred but the asset or assets being constructed are not yet in service and are, for the time period of development, non-performing assets, the target and the Utility's present actual ratio is still considered important and plays a role in rate setting.

The Board notes that circumstances have changed significantly, not only since the Utility's capital expenditure plans were formed as represented in IFF-09 and prior IFFs, but since MH filed its GRA and since the April 1, 2010 interim rate increase was implemented.

The changed circumstances include:

a) An increased awareness of the causes of and implications of "much" lower than expected natural gas prices (the implementation of new production methods has allowed for the economic extraction of natural gas from shale deposits, and the gas in the deposits discovered to-date has dramatically increased North American reserves -- with this new supply source, the market price of natural gas has disconnected from its historical relationship to the price of oil and fallen to levels not seen for a decade or more);

b) Much reduced prices and bountiful supplies of natural gas has reduced the marginal cost of production of electricity from natural gas. With MH's major

American export customers employing gas generation to meet peak demand, and, more recently, also base demand, the low natural gas prices are also driving down the prices MH has been receiving from its American export counterparties for non-firm short-term and spot export sales;

c) As indicated, MH's short-term and spot sales prices of electricity to American counterparties have fallen sharply, bringing the average price received for exported electricity to below 4 cents per kWh (short-term and spot sales have come at a price as low as 1 cent per kWh. and MH is unable to provide assurances that prices will "recover" in the near future);

d) With firm (contracted) export sales, at average prices less than 6 cents per kWh, remaining at volumes well within the capacity of MH's current hydro-electric generation, MH has confirmed that Wuskwatim's initial generation, which will come at an "all-in" price of 10 cents per kWh is unlikely to recover, at least initially, more than 3 cents per kWh. In short, Wuskwatim's initial generation is expected to produce losses rather than to contribute to net income;

e) As suggested from the Wuskwatim experience, the estimated construction costs for MH's planned major new assets (Bipole III's cost estimates are the subject of discussion, if not controversy, while the forecasts for the construction costs of Keeyask and Conawapa have increased substantially), affecting the price required by MH to make profitable export sales from or through the use of these new generating and transmission assets;

f) It would appear that the cost of Bipole III, mandated by the government to be constructed on the west side of the Province, has risen considerably from the initial estimate of $2.2 Billion -- the Board understands that a large component of the anticipated increase in cost has to do with the required converter stations);

g) The Canadian dollar has strengthened against the American dollar, while this development reduced the cost of historical debt financed in U.S. dollars, and resulted in major “unrealized gains” on foreign exchange for MH with respect to U.S. denominated debt outstanding, it also has negative implications for the Canadian dollar value of exports to the United States, as those exports are priced in American dollars;

h) Political developments in the United States, and the decision of the Canadian government to follow “carbon” developments in America, has reduced the probability and/or quantum of a “carbon premium’ being placed on MH’s exports of “clean” hydro-electric electricity to the United States (again, if a carbon premium does come about, it is likely to come at a lower value and later date for that premium, than previously anticipated);

i) The risk of inflation is increasing, globally, including in Canada, and with inflation one would expect, eventually, higher interest rates;

j) Delays in the conversion of MH’s term sheets with Minnesota Power and Wisconsin Public Service into binding contracts, leading to the “in service” date of Keeyask and Conawapa being delayed a year – the in-service date for Bipole III was previously set back five years, it is now expected to be in service in MH’s 2017/18 fiscal year;

k) The Board has approved new interim rates for four isolated northern communities provided electricity by means of diesel generation, and, in doing so, has directed the absorption in MH's general accounts of the accumulated deficit on past diesel generation operations; indicated an intention to reduce the "tail block" rate for service to the communities over the next several years; and recommended that the grid be extended to the communities; and

l) The recession followed by a major pulp and paper company's closure, the announced closures of one mining company's smelter, and the announced planned closure of another smelter and a refiner in Northern Manitoba have contributed to reduced domestic load forecasts, resulting in delays in the requirement for Keeyask and/or Conawapa in service dates for domestic load requirements. MH has advised that it has already spent $400 million on its Keeyask Generation Station project, which is carried on the Utility's balance sheet as an asset – within the category 'construction work in progress', and that Hydro's ongoing present level of expenditures on its overall major development plans approximate $1 million a day, with that level of daily expenditure expected to rise considerably as the plans mature and further work is undertaken.

All of these expenditures are classified as "assets" (generally construction in progress) on the Utility's balance sheet, and the value of those assets going forward depends on the conversion of MH's term sheets with American counterparties into firm contracts containing adequate volumes, profitable pricing and other significant terms; a favourable outcome at an expected Needs and Justification Review (yet to be conducted), and the development of transmission in the United States, funded by either MH's American counterparties or the utilities of the region acting in concert.

While MH has indicated that economic conditions have improved in both Manitoba and in the MISO market overall, it has also reported, as indicated above, that a) its domestic load forecasts for future years have been scaled back, b) MH has withdrawn its application for Energy Intensive Industry Rates (EIIR), though the Utility has indicated continued consultations with industrial customers and a plan to make a new application at some point in the future, c) the term sheets entered into with MH's major American counterparties have been extended (MH has testified that negotiations are "going well" and the Utility anticipates the conditions required for successful sales will be met), and, d) that the Utility's projected "in service" dates for the two major generation projects, Keeyask and Conawapa, have been delayed a year.

Furthermore, and as indicated above, the Utility's forecasts for the costs of what it portrays as its "decade of investment" have increased significantly, with new higher cost forecasts for Keeyask and Conawapa and serious outstanding questions as to the expected cost of Bipole III (MH's current forecast for the construction of Bipole III is $2.2 billion, though other "unofficial" estimates, yet to be tested and/or confirmed by external experts engaged by MH, have ranged to $4.1 billion).

Until the GRA unfolds further, the Board sees MH's current GRA filings and evidence in a similar light to the Utility's prior interim rate request and Board Order 18/10 (which provided for a 2.9% interim rate increase, 2.8% when the exemption of Area and Roadway Lighting is taken into account, as of April 1, 2010): that is, replete with issues and concerns with numerous risk factors.

These risk factors include drought; changes in accounting standards, IFRS; illiquid equity – MH's balance sheet includes intangible assets, deferred and capitalized costs that may be subject to adjustment or expensing under IFRS; extensive capital plans – with rising cost estimates; decreased short-term and spot export sales prices; term sheets that are subject to renegotiation, to mention but a few.

The Board is not, at least yet, comfortable with either the Utility's methodology of determining its debt:equity ratio, which is one of the cornerstones of MH's alleged financial strength, or that the established target of 75:25 is adequate when the plans made would, if implemented, more than double the Utility's assets and debt obligations.

The Board notes that the present and forecast debt:equity ratio, agreed by MH as being important to credit rating agencies and lenders, also involves the inclusion of Accumulated Other Comprehensive Income (formed by unrealized gains on foreign exchange – debt outstanding in American currency). Those "gains" may well be "offset" by reduced export sales, as export prices are also in U.S. dollars.

Furthermore, MH has testified that if intangible assets, rate regulated assets and contributions in aid of construction were deducted from its equity, its debt:equity ratio would increase from the present 75:25 to approximately 80:20.

As well, the Board has concerns with the present circumstances of the term sheets; the ongoing spending of a million dollars a day based on the premise adequate firm export contracts will be developed; and whether intergenerational equity is represented in current rates, where current ratepayers are, in a sense, engaged in plans that involve risk, with the "cost" of those risks deferred to another generation of ratepayers.

With respect to the funds spent to-date and ongoing spending on the planned Keeyask generating station, those funds will be eventually "recovered" only if Keeyask is built and the export contracts that provide for its "advancement" (of its in service date) are adequate to avoid period losses. That said, the evidence to-date suggests that if built Keeyask may be expected to generate $500 million per year in costs but, as its entire output will, at first, expect to be exported, as domestic load growth is not expected to require Keeyask for well past its expected in service date, export sales revenue may develop only $300 million per year for at least the initial years, leaving $200 million to be met by domestic revenues.

A similar situation appears to apply to Conawapa, where the currently expected annual cost, once it is in service, is $700 million while MH currently forecasts only $550 million of revenue, leaving a further $150 million of annual deficit in the initial years to be, presumably, covered by domestic revenue.

As to Bipole III, dependent upon what the final cost to construct is, these costs will also need to be recovered from additional revenue. If the cost ends up in the range of $2 billion, the annual initial additional costs to be absorbed by additional revenue appears to be in the range of $200 million; if the cost is in the order of $4 billion, then the annual cost in the initial years will be in the $400 million range.

Clearly, the long anticipated “Needs and Justification” review is required. Neither a date for that review has yet been set, nor an agency assigned to undertake that responsibility.

Such a review may require the commitment of MH’s American export counterparties to new firm contracts and the building of new transmission in the United States to connect to MH’s transmission at the border – the cost of the new American transmission may be $2 billion.

Again, the Board is concerned with meeting the need for intergenerational equity, with MH taking risks on behalf of current ratepayers that could contribute to higher rates (in comparison with inflation) rather than lower rates for future generations.

The Board is of the view that other development plans need to be considered as well as MH's present preferred development plan. While MH has assured the Board that its Preferred Development Plan will be implemented only if it proves out to be economically feasible, and that other development plans have been considered – such as building Conawapa but not Keeyask, or deferring both projects and constructing a combined cycle natural gas generation station in southern Manitoba – such alternative scenarios have not been fully tested.

One of the yardsticks by which various development scenarios should be tested is the implications for domestic rates. It is possible that MH's preferred development approach will not prove out to be the most optimal approach for its domestic customers; many of them lower income and many of them using electricity to heat their homes.

Looking out a decade, the Board notes that MH's forecasts assume 3.5% annual rate increases, commencing with April 2012, those projected increases being approximately twice the expected rate of inflation.

Based on the evidence before the Board at this stage in the Hearing, the Board is not "comfortable" or confident that MH's estimated series of annual 3.5% rate increases, although basically twice the rate of inflation, would recover the costs and meet the Utility's revenue requirements into the future, if the present development plan is implemented.

In the very short-term, MH has advised that it does not expect to achieve its most recent forecast net income for fiscal 2011, despite continuing good water conditions (above average), the shortfall largely attributable to lower than expected export sales prices for MH's short term and spot export market sales. In closing, while the Board appreciates that MH's revenues and expenses have not yet been fully tested, and that the GRA process, now underway, will afford the Board and Interveners the full opportunity to do so, there is more than enough evidence and "concern" to justify a further 2.0% interim increase. To avoid this interim increase would only increase the risk that a larger rate increase will be required after the hearing is concluded, providing the risk of rate shock for consumers.

As to the delays in concluding this hearing, the timing of the GRA process has been significantly extended from the usual duration of past experience, primarily due to the increased attention now being paid to MH's risks, that the result of a whistleblower's allegations and the resultant Board's review of MH's risk and risk management issues.

The concerns of the Board with respect to MH's risks go back at least to 2004, and have last been fully enumerated in a number of Orders, including Orders 32/09 and 116/08. Despite the Board's focus on risks and directions to MH to file independent reports reviewing and quantifying its risks, MH has moved slowly, initially withholding risk reports received from their former NYC consultant, and failing to undertake the full risk review sought by the Board through MH's engagement of KPMG.

The extended timelines of the ongoing GRA is not an effort to deliberately delay 'just and reasonable rate increases'. The extended timeline is necessary to ensure all issues are properly explored, thereby, it is hoped, protecting the public interest in the long-term.

When the most important "commercial" asset of the Province, MH, is planning to, largely through debt (that debt to be guaranteed by the Province and likely represent more than 50% of the overall debt of the Province), engage in a "decade of investment" involving commitments to export customers that, in themselves, involve risk, setting rates so as to achieve just and reasonable rates for not only this generation of customers but also the ones that will follow is very important.

The Board considers it highly likely that public hearings will carry over at least into the summer of 2011, thereby delaying a final decision, not only with respect to the interim rates that took effect April 1, 2010 but also the further rate increases sought by MH for April 1, 2011.

Even without having the benefit of the full GRA, the Board does not accept the premise that ratepayers would be better off with delaying a further "relatively modest" (compared to future forecasts) increase on April 1 of this year.

This Board has repeatedly indicated that the financial health of the Utility is a factor to be considered in the Board's deliberations as to setting rates that are in the public interest. To the credit of all Interveners, they too value and support rates to sustain a financially solid Utility.

While the GRA is far from completed, the Board has sufficient information to see the increasing significance and importance of domestic (Manitoba) revenue, and the Utility's reliance on rate increases to support annual net income results and its overall capital structure.

That said, the interests of consumers are another factor that the Board must, and does, take into consideration in assessing the public interest. The economic conditions of the past year, and now, consist of trying times and challenges for consumers. That weighs heavy on the mind of the Board, which still awaits evidence in this hearing on measures and viable options towards addressing the particular payment and energy efficiency problems of lower income consumers.

While financial challenges lie ahead for MH, with its ambitious capital plans, those challenges and issues need to be reviewed taking into account the long-term and such a review has yet to be held. Yet, and despite prior Board Directives, MH has not pursued the required review of its capital plans and export intentions, all of which impact domestic rates. At this point in time, the Board is not confident that MH's preferred and forecast capital expenditure plans for the "decade of investment" represent the approach most likely to ensure the lowest rates possible for domestic Manitoba customers.

And, if the further interim rate increase to be granted as of April 1, 2011 was to be deferred until the conclusion of the GRA, the rate increase required to recover the additional revenues would mathematically need to be higher to recover the additional revenues in the remaining months of MH's fiscal year 2011/12. The Board has previously stated its disapproval of "retroactive" rates or rate riders.

By this interim rate approval, the Board is protecting the short-term financial status of MH with the maintenance of adequate retained earnings. Examining MH's financial forecasts clearly disclose that domestic rate increases are required to keep MH producing annual net income results, without those regular increases, the forecasts suggests a string of annual deficits, even before the coming into service of major new generation and transmission assets, that with further rate implications.

After hearing all of the evidence and submissions in the GRA, the Parties to the hearing and ratepayers generally may be assured that if the Board concludes that the facts do not justify the imposition of the rate increases provided on an interim basis, the Board will adjust rates downward in the final GRA Order. Any amount collected found to be in excess of the rate in the final Order may be refunded/credited back to domestic customers, this to ensure consumers are protected in the longer term.

Interim increases to rates do not bind the Board, in any way, in making its final GRA rulings and directives. MH still bears the onus in its GRA to show that interim rate increases are just and reasonable.

The Board expects all Interveners to collectively explore and test fully all rate increase issues through the remainder of the GRA, together with all cost of service and rate design issues. The interim rate adjustments are to have no prejudicial affect on the ability of Interveners to argue, at the conclusion of the GRA hearing, that the rate increases and/or rate design, quite different from that awarded, ought to be approved by the Board in its final rate Order(s).

MH is to file Rate Schedules to conform with the directions of this Order.

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 at www.pub.gov.mb.ca.

9.0 IT IS THEREFORE ORDERED THAT:

1. Manitoba Hydro's request for a 2.9% average rate increase, for all domestic customer classes (except Area and Roadway Lighting) served by MH, effective April 1, 2011, BE AND IS HEREBY DENIED;
2. Manitoba Hydro is to implement a 2.0% average and interim rate increase for all domestic customer classes (except Area and Roadway Lighting) through an increase to the energy portion of consumer rates, and, with respect to Residential rates, the rate increase is to be applied to the first energy block rate to eliminate the inversion and, then, keep the two energy blocks equal;
3. Manitoba Hydro is to provide the Public Utilities Board with revised interim Rate Schedules for all electricity consumed on and after April 1, 2011, together with Proof of Revenues, prepared in accordance with the directives in this Order;
4. This Order shall remain interim until confirmed, varied or otherwise dealt with by further Order of the Board.

THE PUBLIC UTILITIES BOARD

"GRAHAM LANE, CA"
Chairman

"HOLLIS SINGH"
Secretary

Certified a true copy of Order No. 40/11 issued by The Public Utilities Board

Secretary