M A N I T O B A	**Order No. 49/14**
THE PUBLIC UTILITIES BOARD ACT	**May 6, 2014**

Before: Régis Gosselin, B és Arts, M.B.A., C.G.A., Chair
Marilyn Kapitany, B.Sc. (Hons), M.Sc., Member,
Larry Soldier, Member

INTERIM ORDER IN RESPECT OF MANITOBA HYDRO'S APPLICATION FOR INTERIM ELECTRICITY RATES EFFECTIVE MAY 1, 2014

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1.0 Executive Summary

By this Order, the Public Utilities Board (Board) denies Manitoba Hydro's Application for an interim electricity rate increase of 3.95% to all customer classes to be effective April 1, 2014. However, the Board approves an interim rate increase for all customer classes, effective May 1, 2014 of 2.00%, to approximate the annual rate of inflation, plus a further 0.75% interim rate increase, with the revenues from the 0.75% rate increase to flow into the existing Deferral Account established in Board Order 43/13 to assist with the payment of in-service costs of the Bipole III transmission project.

According to Manitoba Hydro, the energy future for the Province of Manitoba will require significant annual rate increases to support new electricity generation, regardless of the generation option selected. Manitoba Hydro's 3.95% interim rate request is consistent with the Preferred Development Plan that the Utility is advancing in the 'Needs For and Alternatives To' (NFAT) Review Hearing that is currently before the Board in a separate regulatory proceeding. Stakeholders and the Board are currently considering the many issues and decisions that will result from that NFAT Review. The issues and decisions that result from the NFAT Review will have impacts on the rate levels that are set in future General Rate Applications for Manitoba Hydro. It would be premature to reach any conclusions as to outcome and rate impacts flowing from the NFAT Review as those matters will be the subject of future General Rate Applications that Manitoba Hydro must bring before the Board.

However, on a *prima facie* basis, (and subject to the interim rate increase being varied or finalized in the next General Rate Application to be filed in the fall of 2014) the Board is satisfied that an interim rate increase is required by Manitoba Hydro for the costs of maintaining and replacing aging infrastructure such that it continues to provide safe and reliable service. The Board also notes that Manitoba Hydro's prices for electricity exports have continued to decline, resulting in less revenue to offset the requirement for domestic rate increases.

By this Order, the Board further disagrees with Manitoba Hydro's proposal to file a three-year General Rate Application in the fall of 2014, and instead directs Manitoba Hydro to file a fully comprehensive two-year General Rate Application for electric operations, to cover the 2014/15 and 2015/16 fiscal years. Manitoba Hydro's fiscal years run from April 1 to March 31.

2.0 Manitoba Hydro's Application for Interim Rates

Overview

On March 7, 2014, the Manitoba Hydro-Electric Board (Manitoba Hydro or the Corporation) applied to The Public Utilities Board (Board), for an interim electricity rate increase to all customer classes of 3.95% effective April 1, 2014, sufficient to generate additional revenue of approximately $56 million in 2014/15.

The Board established a written hearing process, with one round of written Information Requests posed to, and answered by Manitoba Hydro, followed by written submissions of all Parties. Four interveners, namely the Consumers' Association of Canada (CAC), the Green Action Centre (GAC), the Manitoba Industrial Power Users Group (MIPUG) and the Manitoba Keewatinowi Okimakanak (MKO) issued Information Requests and made written submissions.

Manitoba Hydro's Application for interim rates parallels the Corporation's Integrated Financial Forecast IFF-13, which projected annual rate increases of 3.95% over the next 20-year time period. Manitoba Hydro based its 3.95% Interim Rate Application on five principal reasons:

1. To avoid the potential for incurring financial losses on its electric operations;
2. To limit the extent to which financial ratios are projected to deteriorate;
3. To compensate for the fact that export prices continue to be significantly less than those experienced prior to the 2009/10 fiscal year;
4. To recognize that Manitoba Hydro's infrastructure is aging and that increased costs are necessary to maintain infrastructure in a safe and reliable manner; and
5. To provide customers with rate stability and predictability and to avoid the need for higher rates in the future.

Projected Income With and Without a Rate Increase

For the fiscal year 2014/15, Manitoba Hydro is forecasting, in IFF13, a net income of $55 million from electric operations after an assumed 3.95% rate increase, effective April 1, 2014. Manitoba Hydro indicates that if the rate increase is not granted, the Corporation could lose $1 million in 2014/15.

Overall net income, accumulated to the year 2032, is forecast to be $2.6 billion lower than the net income forecast in IFF-12, for the following reasons:

- The updated IFF-13 shows a deterioration in the financial figures presented in IFF-12, partially resulting from domestic revenues decreasing by $1.2 billion by 2031. Manitoba Hydro has primarily attributed this change to a reduced domestic (Manitoba) load forecast that projects load growth at 1.5% rather than 1.6%.

- Operating expenses are forecast to be $50 million lower in 2014/15 than forecast in in IFF-12 and $611 million lower through 2032. This reduction appears based on Manitoba Hydro limiting the growth in OM&A expenditures to 1% commencing in 2015/16 and continuing at that level through 2020/21.

- Finance expense is projected to increase by $1.4 billion to 2032 due to higher projected interest rates and an increase of $2.7 billion in debt financing between IFF-12 and IFF-13.

- Depreciation and amortization expenses are forecast to increase by $514 million by 2032 due to increased capital spending and Manitoba Hydro's proposed adoption of the Equal Life Group method of depreciation.

However, due in large part to a colder than normal winter and current favourable water levels, Manitoba Hydro's most recent projected revenues from electric operations for the 2013/14 year are significantly higher than those projected in IFF-12.

Specifically, IFF-12 projected net income of $60 million for the 2013/14 fiscal year, while IFF-13 has increased this projection to $116 million, an increase of $55 million over the course of a single year. This amount approximates the projected $56 million revenue increase for the 2014/15 year, sought in Manitoba Hydro's Interim Rate Application that is the subject of this Order. Actual financial statements for the 2013/14 fiscal year, which ended March 31, 2014, have not yet been filed with the Board as they are being finalized by Manitoba Hydro.

Manitoba Hydro projects Operation, Maintenance & Administration (OM&A) costs of $485 million in 2013/14 and $494 million in 2014/15. In the first nine months of 2013/14, OM&A expenses appear to have increased by 4.9%. The largest increases are attributed to Building & Property Services, Employee Benefits (due to an actuarial re-evaluation of pension and employee benefit obligations) and Consulting and Professional Fees. Growth in these areas was partially offset by reductions in the category of Customer & Public Relations, Sponsored Memberships, and Research & Development. The single largest expenditure category in Manitoba Hydro's OM&A is Wages & Benefits, representing approximately 79% of OM&A.

For the period of 2015/16 to 2020/21, Manitoba Hydro expects to limit OM&A costs to one percent per year, targeting approximately $600 million in total savings over that time span.

In the short term, Manitoba Hydro is forecasting finance expense to reduce slightly, from $452 million in 2012/13, to $437 million in 2013/14. However, in the long term, Manitoba Hydro is projecting cumulative finance expense to be $1.4 billion higher by 2032 due to increased forecast debt levels. Specifically, between IFF-12 and IFF-13, Manitoba Hydro has revised its assumed level of long-term debt upwards by $2.7 billion.

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Financial Ratios

Manitoba Hydro monitors three self-imposed financial targets, namely:

- A debt-to-equity ratio of 75:25;
- An interest cost coverage ratio of greater than 1:20; and
- A capital cost coverage ratio of greater than 1.20.

In IFF-13, Manitoba Hydro predicts a debt-to-equity ratio of 76:24 for 2013/14. With the planned spending on its Preferred Development Plan (which includes the Keeyask and Conawapa Generating Stations), Manitoba Hydro expects the ratio to deteriorate to 90:10 by 2022/23, and not recover to the 75:25 target level until 2033/34.

The ‘interest cost coverage’ ratio indicates Manitoba Hydro’s ability to meet interest payment obligations with the net income generated by the Corporation. IFF-13 projects an interest cost coverage ratio of 1.22 for 2013/14. At this time, Manitoba Hydro expects the level to deteriorate to less than 1.0 by 2019, remain at 1.0 for two years, and then gradually return to the target level by 2028.

The capital cost coverage ratio indicates the ability to use internally generated cash flows to finance base capital expenditures. A level of 1.0 means that all base capital expenditures can be met without incurring new debt. IFF-13 predicts a capital cost coverage ratio of 1.06 in 2013/14. Manitoba Hydro predicts that the level will be less than 1.0 by 2014/15, and return to the target level by 2016/17.

Changes in Export Revenue Projections

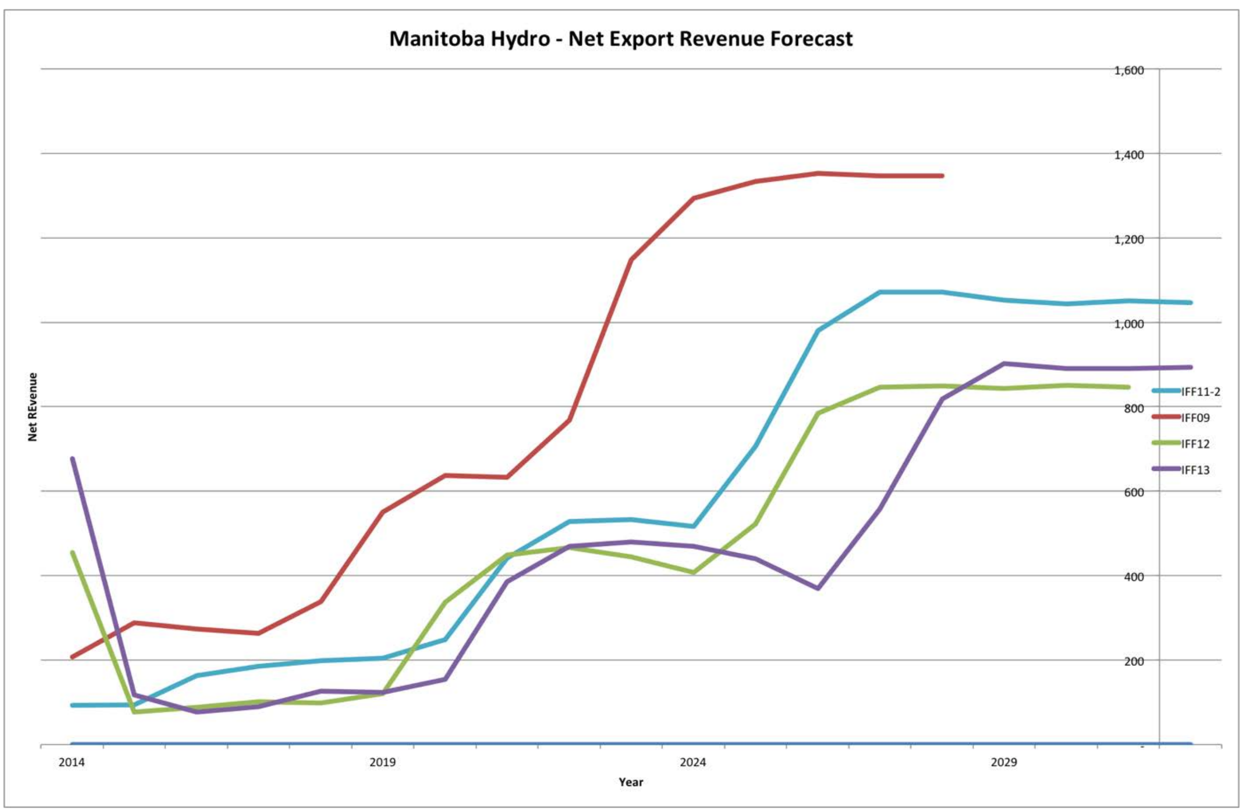
Since IFF-09 in 2009, Manitoba Hydro has repeatedly revised its export revenue projections downward. Specifically:

- For the short-term, in IFF-09, Manitoba Hydro projected gross export revenues of $615 million in 2013/14 and $590 million in 2014/15. Gross export revenue is now forecast in IFF13 to be only $408 million in 2013/14 and $383 million in 2014/15.

- For the long-term, IFF-09 projected annual export revenues to exceed $1 billion by 2020. This has now been revised downwards to $848 million.

Figure 1 illustrates the downward projections in Manitoba Hydro's export revenue forecast.

Figure 1 - Manitoba Hydro Export $ Revenue Forecast



Planned Capital Expenditures

Manitoba Hydro forecasts expenses for annual "base capital" expenditures to maintain and repair existing infrastructure, and for "major new generation and transmission" projects. Manitoba Hydro filed an updated 2013 Capital Expenditure Forecast(CEF-13) setting out Manitoba Hydro's planned 20-year capital spending. Compared to the prior forecast in CEF-12, Manitoba Hydro revised its planned expenditures on major generation and transmission projects over a 19-year timeframe upwards by $1.1 billion, and its base capital expenditures downwards by $122 million. However, from 2015 until 2018, Manitoba Hydro is now expecting a significant increase in base capital expenditure compared to the prior forecast.

The increased budget for major new generation and transmission is due to the one year deferral of the Conawapa Generating Station (now in 2026/27), the re-instatement of Electric and Gas demand side management costs in the capital forecast and the update of a number of project cost estimates. The revised in-service costs for Keeyask General Station have increased from $6.2 billion to $6.5 billion and the in-service costs for Conawapa Generating Station have increased from $10.4 billion to $10.7 billion.

The Board and Manitoba Hydro are currently engaged in a Needs For and Alternatives To (NFAT) Review into Manitoba Hydro's Preferred Development Plan, which, among other things, involves the planned construction of two new generating stations and a 750 MW U.S. transmission line. Manitoba Hydro's Preferred Development Plan, as filed August 2013, assumed annual rate increases of 3.95% over a 20-year period. However, even other alternative plans assume significant rate increases over the same timeframe.

Manitoba Hydro notes that all Canadian electric utilities are facing significant cost pressures. MH's current IFF13-1 reflects Manitoba Hydro incurring material operating losses in 2017/18 through 2021/22 which total over $245 million. The losses are attributable, in part, to the in-service revenue requirements related to Bipole III (in 2018/19) and Keeyask G.S. Rate increases to avoid these forecast financial losses would appear to require rate increases in excess of 4% per year over the next several years. These and other forecasts, and the assumptions on which they are based, will be the subject of further review and testing at the next General Rate Application.

Next General Rate Application

Manitoba Hydro indicates that it is planning to file a three-year General Rate Application in the fall of 2014.

3.0 Intervener Submissions

Consumers' Association of Canada (Manitoba) Inc. (CAC)

The Consumers' Association of Canada (Manitoba) Inc. (CAC) opposes Manitoba Hydro's requested rate increase and considers it to be materially inflated in light of evidence that Manitoba Hydro could meet its 2014/15 financial targets without any rate increase. CAC submits that an interim rate increase should be limited to the rate of inflation. It states that Integrated Financial Forecast IFF-13 shows a forecast net income for electric operations of $116 million, which compares to only $78 million the previous year. CAC further cites several factors to suggest that actual net income for the 2013/14 fiscal year will likely be higher than projected in IFF-13.

CAC submits that Manitoba Hydro has not implemented cost control measures that would limit Operation, Maintenance & Administration (OM&A) expenditure growth to 1% per year, and only plans to do so starting in 2015/16. In CAC's view, implementing such cost constraint measures now would decrease projected OM&A costs in 2014/15 by $5 million.

CAC further states that there are several outstanding directives from Board Order 43/13 relating to the transition to International Financial Reporting Standards (IFRS), and that Manitoba Hydro has not yet performed an Asset Condition Assessment for its Generation and Transmission units.

In CAC's view, Manitoba Hydro is basing its request for a 3.95% rate increase on its planned implementation of the Preferred Development Plan, which has been challenged in the current NFAT review and may no longer be the best option.

Lastly, CAC expresses concern about Manitoba Hydro's stated intention to file a three-year General Rate Application in the fall, and suggests that any application should be limited to two years at most.

Green Action Centre (GAC)

The Green Action Centre (GAC) supports Manitoba Hydro's application, noting that capital costs for Manitoba Hydro's Preferred Development Plan have increased significantly over earlier projections. GAC further states that the costs of ongoing maintenance and the renovation of aging assets will be a reality for Manitoba Hydro in the current period as well as the future, and that an interim rate increase is required to ensure adequate resources for the safety and reliability of Manitoba Hydro's infrastructure. In GAC's view, rate increases above the rate of inflation will be required to keep Manitoba Hydro's financial status healthy or, at minimum, prevent a deterioration of the Corporation's debt-to-equity ratio over the next 15 years.

GAC further recommends that the Board should consider setting rates based on longer-term trends rather than short-term conditions, due to the inherent variability in such short-term conditions.

Manitoba Industrial Power Users Group (MIPUG)

The Manitoba Industrial Power Users Group (MIPUG) opposes Manitoba Hydro's request, and instead suggests two alternate approaches: (1) an inflationary rate increase of 2.0%, or (2) an interim increase based on the lowest-cost development plan reviewed in the NFAT. Specifically, MIPUG suggests that any interim rate increase be capped at 75% of the 3.32% even annual rate increases projected for Manitoba Hydro's All-Gas Plan, leading to an increase of 2.45%.

According to MIPUG, the proposed 3.95% rate increase is based on IFF-13, which not only includes projects that have yet to be approved, but also assumes that if the projects do not proceed, the costs incurred must be fully amortized immediately, which is inconsistent with regulatory practice.

MIPUG further states that changes to accounting procedures to comply with Integrated Financial Reporting Standards (IFRS) have not yet been fully vetted, and that if

Manitoba Hydro adopts the IFRS interim standard, rate-regulated assets will continue to be recognized. MIPUG further states that retaining the Average Service Life methodology of depreciation while eliminating the annual provision for Net Salvage would result in a $62 million benefit for the 2014/15 fiscal year, while benefiting future years by $37 million.

MIPUG further states that Manitoba Hydro has not provided cost containment details of Operating and Maintenance expenses, and that Manitoba Hydro should consider whether capital taxes relating to spending on new major projects should be capitalized, meaning they would not need to be included in rates until the respective new projects come into service.

MIPUG submits that there is a lack of urgency, as Manitoba Hydro's debt-to-equity level is close to the Corporation's 75:25 target, its capital coverage ratio remains at or above 1.0, and absent the rate increase, Manitoba Hydro is projecting only a very slight loss and does not forecast a cash shortage.

Manitoba Keewatinowi Okimakanak Inc. (MKO)

Manitoba Keewatinowi Okimakanak Inc. (MKO) submits that ideally, there should be no rate increase for Hydro-affected customers in the MKO First Nations, including customers in the four Diesel communities. Although MKO does not specifically object to the proposed rate increase, it recommends that the Board condition the current and any future rate increases on Demand-Side Management programs being made universally available and being provided to First Nations customers on a turnkey basis. MKO further seeks a direction from the Board to Manitoba Hydro requiring Manitoba Hydro to regularly report on the availability and penetration of low-income Demand-Side Management programs in the MKO communities.

MKO further submits that the Board should require Manitoba Hydro to provide rate mitigation measures, specifically the following:

1. The creation of a new class of Hydro-affected customers residing on the waterways utilized by Manitoba Hydro;

2. Specific sharing of net export revenues and a removal of mitigation costs for Hydro-affected customers;

3. An “equivalent to gas” rate for electric heat, as no MKO First Nation is connected to a natural gas distribution system, making it impossible for them to save money by switching to natural gas; and

4. An allocation of net export revenue to the Diesel communities, to be applied to the revenue requirement in the Diesel communities.

Lastly, MKO submits that any interim rate awarded in this proceeding should be subject to a rollback or refund to one or more customer classes based on sharing of net export revenues proposed by MKO.

With respect to Manitoba Hydro’s proposal to submit a three-year general rate application in the fall of 2014, MKO recommends that such application do not apply to rates beyond March 31, 2016.

4.0 Board Findings

Test for Granting Interim Rates

The Board notes that Manitoba Hydro plans to file a General Rate Application in the fall of 2014, which Application would likely be heard in a public hearing in the spring of 2015. Accordingly, a General Rate Application would likely only be decided towards the end of the Corporation's 2014/15 fiscal year. Interim rate orders are intended to relieve Manitoba Hydro from the deleterious effects caused by the length of a regular regulatory proceeding. The questions to be determined by this Board are whether it would be just and reasonable to grant interim rates, and whether Manitoba Hydro would suffer a deleterious effect in the absence of an interim rate increase. For the reasons set out below, the Board considers it to be in the public interest to approve an interim rate increase, albeit at a level lower than requested by Manitoba Hydro.

Manitoba Hydro's Financial Position

According to Manitoba Hydro, the energy future in Manitoba will require significant annual rate increases regardless of which source of additional new generation is pursued, and regardless of which decision will be reached in the NFAT Review currently underway. All possible development plans presented in the NFAT Review require rate increases. As such, the Board and Manitoba Hydro customers cannot assume that in the absence of the Preferred Development Plan being approved, rate increases can be avoided. This requires the Board to take into account the need for rate stability and the avoidance of rate shock.

The Board notes that Manitoba Hydro's Interim Application for a 3.95% rate increase is consistent with the Preferred Development Plan that involves the construction of both Keeyask and Conawapa Generating Stations. The outcome of the NFAT Review will be known prior to the filing of Manitoba Hydro's next General Rate Application, and a full

General Rate Application is needed to examine the magnitude of additional rate increases.

Nonetheless, the Board is satisfied on a *prima facie* basis, that an interim rate increase is required. Reliability of Manitoba Hydro's infrastructure is paramount, and the Board accepts that investments in the maintenance and replacement of existing infrastructure is required.

Electricity export price forecasts have decreased over successive forecasts, resulting in less projected export revenue to help offset the requirement for domestic rate increases.

The Wuskwatim Generating Station is now 'in service' and has resulted in an additional domestic revenue requirement to be carried by domestic customers as those additional costs are not paid from export revenues.

Lastly, and despite the Board's comments in Order 43/13 with respect to the need for Manitoba Hydro to contain OM&A costs, those OM&A expenses are projected to increase above the rate of inflation in 2014/15.

The Board agrees with Manitoba Hydro's rebuttal submission that urgency is not a necessary precondition for an interim rate increase. However, it is appropriate to consider Manitoba Hydro's current financial condition in light of favourable recent financial results and the fact that a General Rate Application will be filed this Fall. The Board has determined that an interim rate increase of 2.00%, approximating the annual rate of inflation, is sufficient at this time to meet the needs of Manitoba Hydro. Whether or not an additional rate increase is required is an issue to be left to the General Rate Application, by which time actual financial results for the 2013/14 fiscal year will also be available.

Bipole III Deferral Account

The Board notes that Manitoba Hydro is continuing to spend money for the construction of the Bipole III transmission project which is estimated to cost approximately $3.2

billon. Once Bipole III will come into service (in 2018) it will affect Manitoba Hydro's Operating Statement. In Board Order 43/13, the Board determined that Bipole III will require additional annual revenue requirements of approximately $300 million when put into service, and which yearly amounts will have to be recovered in domestic customers' rates. As part of the last General Rate Application, the Board in Order 43/13, required Manitoba Hydro to establish a deferral account into which the proceeds of a 1.5% rate increase were to be deposited to defray a portion of the rate impacts of Bipole III. This deferral account continues to be active, and the Board remains concerned with the revenue requirement impact that Bipole III will have. Accordingly, in addition to the 2.00% interim rate increase approved above, the Board will approve an additional 0.75% interim rate increase to existing rates, the proceeds of which are to be collected in the Bipole III deferral account established in Order 43/13.

Depreciation & Amortization

As noted by CAC, Manitoba Hydro has not yet filed an Asset Condition Assessment that would provide additional clarity regarding expected depreciation and amortization expenses in the future. Directive 7 of Order 43/13 required Manitoba Hydro to file an Asset Condition Assessment no later than the filing of the Corporation's next depreciation study.

OM&A Increases

The Board has expressed concern with the growth of OM&A expense in prior Orders and remains concerned with Manitoba Hydro's increases in OM&A spending to date, as stated in Order 43/13. Manitoba Hydro's most recently filed financial information shows that since Order 43/13 was issued, OM&A costs have continued to escalate. While Manitoba Hydro has stated that it targets below-inflation growth in OM&A expenses of 1.0%/yr in 2015/16 and expects OM&A expense to grow by only 1.3% in 2014/15, the Board notes that to date, Manitoba Hydro has not been able to achieve below-inflation growth in the past several years. The Board will review Manitoba Hydro's plans for OM&A cost containment at the next General Rate Application.

The Next General Rate Application

The Board shares the concerns of CAC and MIPUG with respect to Manitoba Hydro's plan to file a three-year General Rate Application in the fall of 2014. Manitoba Hydro is undergoing a period of significant and fairly rapid change, especially in light of its plan for substantial ongoing capital investments. The Board notes that it would be extremely reluctant to approve rates for a three-year timeframe in such a period of volatility and will direct that Manitoba Hydro file its next General Rate Application, for electric operations, for the 2014/15 and 2015/16 fiscal years.

Manitoba Hydro's request to implement new LED rates for the Area and Roadway Lighting class, will await further information and review at the General Rate Application.

5.0 IT IS THEREFORE ORDERED THAT:

1. Manitoba Hydro's Application for a 3.95% interim rate increase to all rate classes effective April 1, 2014 **BE AND HEREBY IS DENIED**.

2. The following interim rate increases to all Manitoba Hydro customer classes **BE AND HEREBY ARE APPROVED** effective May 1, 2014:

   (a) A 2.00% rate increase to existing rates to flow to Manitoba Hydro's general revenues; plus

   (b) A 0.75% rate increase to existing rates for all customer classes, with the revenues generated being placed into the Bipole III Deferral Account established in Order 43/13, to be dealt with at the next General Rate Application.

   (c) Manitoba Hydro file revised Rate Schedules, Proofs of Revenue and Customer Bill Impact Schedules;

   (d) The above rate increases will remain interim and are subject to being varied by the Board at the next General Rate Application;

3. Manitoba Hydro file a fully comprehensive two-year General Rate Application for electric operations, for the 2014/15 and 2015/16 fiscal years.

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.

THE PUBLIC UTILITIES BOARD

"Régis Gosselin, B ès Arts, MBA, CGA"
Chair

"Kurt Simonsen, P. Eng."
Associate Secretary

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