Manitoba Hydro and Interim Rates: An Unhealthy Addiction

Submission of CAC Manitoba & Winnipeg Harvest
(The Consumer Coalition)

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Part 1 - Overview - An Unhealthy Addiction

The regulatory record since 2010 suggests Manitoba Hydro is developing an unhealthy addiction to interim rate increases to the detriment of Manitoba consumers. On November 15, 2015, Hydro filed its eighth interim rate application in the last seven fiscal years.[1]

The evidence filed in support of the interim application raises profound questions about:

- the reliability of the Crown monopoly's forecasts given a close to $1 Billion positive shift in its projected fortunes over the next decade
- the credibility of IFF15 given Hydro's failure to incorporate express regulatory directives which would reduce expense costs by more than $500 Million over the next decade

The Consumers Association of Canada (Manitoba Branch) and Winnipeg Harvest (the Consumer Coalition) are troubled by Hydro's temerity in seeking a more than $60 Million interim rate increase based on a forecast which essentially defies the regulatory accounting direction of the PUB. IFF15 cannot be relied upon on a *prima facie* basis for interim rate setting purposes.[2]

At a more pragmatic level, the record of this proceeding begs the question of whether Hydro's inflexible adulation of 3.95% annual rate increases is just and reasonable. In light of recent financial circumstances, there can be no allegation of financial urgency. The projection of an additional $700 million in finance expense savings over the next decade surely constitutes both a repudiation of Hydro's case theory from the 2015/16 GRA and a material and positive change in circumstances from IFF14.

The rate setting alternatives explored by the PUB in the interim rate process coupled with enduring “forecasting cushions” strongly suggest there are lower rate impact options available which would better protect Manitoba consumers while providing sustainable protection against adverse events such as lengthy droughts.

Since the great recession of 2007/08, Manitoba ratepayers have already been battered by double the rate of inflation rate increases[3] driven to a significant degree by Hydro's multi-billion dollar errors in forecasting export revenues[4] and capital costs.[5] Approval of a 3.95% interim rate increase would exacerbate the pressure on many Manitoban households and constitute a cumulative rate increase of more than 36% since 2008/09.[6]

Unfortunately, the tools to assist Manitoba consumers in managing the consequences of Hydro's errors are limited. While DSM should be a primary means of ratepayer protection, the NFAT process confirmed that Hydro's DSM portfolio has underperformed compared to North American good practice.[7]

1 See Appendix A

2 For this purposes of its submissions in this proceeding, the Consumer Coalition will employ the standard for the determination of interim rates articulated by the PUB in *Order 49/14* where the Board held that i) the standard of proof is on a *prima facie* basis ii) the legal question is whether it would be just and reasonable to grant interim rates iii) urgency is not a necessary precondition for an interim rate increase but it is appropriate to consider current financial circumstances in light of recent financial results, p. 16 and 17. Please see Appendix D.

3 See Appendix B, Table 1

4 2015/16 & 2016/17 GRA, Coalition I-24 a) and Interim Application, Attachment 16

5 2015/16 & 2016/17 GRA, PUB I-17 c)

6 Appendix B, Table 1

7 PUB, Final NFAT Report, page 22

Manitoba consumers cannot be confident that robust energy efficiency options will be there for them when they need it.

The DSM budget continue to be underspent. Affordable energy efforts are still evolving. The future of energy efficiency initiatives whether delivered by Manitoba Hydro or some allegedly independent subsidiary is clouded by legislative and administrative uncertainty. The prospects for meaningful Bill Assistance are uncertain and even in the best case scenario months away.

Given Hydro's ongoing challenges with its export market gamble,[8] the best protection for Manitoba consumers is a robust regulatory process including an oral public hearing process. Rate signals are the most important and only universal tool to protect ratepayers and to incent efficient and transparent corporate behaviour.

An interim rate process is no forum in which to test the questionable *bona fides* of IFF15.
The Consumer Coalition recommends that the interim rate tool be employed as an exception rather than the norm and primarily in special or urgent circumstances.

Interim rates enable Manitoba Hydro to delay rigorous scrutiny under oath. They create budgeting uncertainty for consumers. The interim rate process allows for the entrenchment of a regulatory *status quo* that tends to favour the Crown monopoly and is difficult to overturn. It enables the imposition of significant rate increases without rigorous "before the fact" regulatory review.

While the Consumer Coalition acknowledges the disruptive effect of the NFAT in 2014, eight interim rate applications in seven fiscal years suggest that Hydro's regulatory house is not in order.

In the respectful view of the Consumer Coalition, Manitoba Hydro's addiction to interim rate processes should not be enabled in the current instant. A strong message should be sent to Manitoba Hydro to revisit its regulatory and forecasting processes while pursuing all available options to robustly protect Manitoba consumers from unsustainable rate pressures.

Part 2 - Outline of the Submission and Supporting Materials

This submission presents a high level summary of the analysis of the Consumer Coalition. It is supported by four Appendices:

- Appendix A provides a table setting out the Coalition's understanding of the interim processes initiated by Manitoba Hydro since 2010. It offers a basis for the conclusion that Manitoba Hydro has an unhealthy addiction to interim rate applications

- Appendix B documents the significant rate pressures Hydro consumers have endured since the great recession. It provides a recent summary of export revenue and capital expenditure forecast errors in support of the Coalition's contention that double the rate of inflation rate increases have been driven to a significant degree by Hydro's multi-billion dollar errors in forecasting export revenues and capital costs

8 The Consumers Coalition acknowledges that it will take many years to fully understand the failures and successes of Hydro's export market risk taking over the past decade. However, there can be no doubt that to date, much lower than expected export prices and much higher than planned capital expenditure forecasts have placed significant pressures on Manitoba ratepayers.

- Appendix C offers a detailed 29 page critical analysis of the record of this proceeding. It examines the credibility of IFF15 and considers alternatives to Hydro's rate proposal

- Appendix D presents a brief analytic summary of the legal standard employed by the Consumer Coalition in assessing this application. It also seeks clarification from the Board in terms of whether and how s. 48 of *The Public Utilities Board Act* is to be employed in assessing interim rate applications

The remainder of this submission highlights the key conclusions from Appendix C. It provides the recommendations of the Consumers Coalition with regard to factual findings as well as the ultimate interim rate decision.

Part 3 - The Billion Dollar Bounce Constitutes a Material Change in Circumstances

Just five months before the interim rate application was filed, Manitoba Hydro was before the PUB seeking a $60 million rate increase. Central to Hydro's case theory was the allegation that it was facing a sea of red ink between 2019 and 2024. Witnesses for Hydro testified under oath that it was projecting a loss of more than $900 million over that six year period.[9] Hydro was dismissive of allegations by the Consumer Coalition that the credibility of the current financial forecast was undermined by "a prevailing trend to overestimate interest rates."[10]

However, IFF15 confirms the Consumer Coalition's hypothesis that IFF14 was inflated by a massive overstatement of finance expense. It portrays a materially different story of the next ten years than the one offered in IFF14. The central driver of this material change in forecasts is a $757 million downward revision in finance expense out to 2025.[11]

Just a few months ago, the Consumer Coalition asserted that it:

> *has no confidence in the current financial forecast which it believes embeds a financial cushion.*[12]

Despite its other limitations, IFF15 confirms the existence of an ongoing credibility gap related to finance expense. It highlights the need for a robust review of Hydro forecasts and financials rather than the light handed interim rate approach.

IFF15 presents a more than $900 million positive swing between 2019 and 2024 effectively eliminating the alleged losses. For the 10 year outlook period of 2016-2025, it shows an accumulation of annual net income that is almost $ 1 billion higher than IFF14[13].

9 *And if you add up the losses that – if you look at the columns between 2019 and 2024 and you add up the losses that are of 90 million, 160 million, 8 178 million, 206 million, 187 million, and 124 million, those are losses of $901 million in the last six (6) years of -- of this particular ten (10) year part of the forecast.* (Mr. Rainkie, June 13, 2015, p. 3785). IFF14 shows net income losses for 2019 to 2024 of $90 M, $116 M, $178 M, $206 M, $197 M and $124 M for a total of $911 See also *Board Order 73/15*, *Manitoba Hydro announced that successive increases of 3.95% are indicated until 2031. Despite those rate increases, the utility still projects losses from 2019 to 2025 (the total to exceed $980 million) and deterioration in its financial condition*, p. 4. *The current IFF14 forecasts operating losses commencing in 2019 and totaling $980 million over eight years, p. 19*

10 *Order 73/15*, page 48 and 49.

11 See Figure 14 from the Interim Application, page 2

12 *Order 73/15, p. 19*

13 $975 M, Interim Application, page 24

By 2025 under IFF15 as compared to IFF14, long term debt is lower[14] and retained earnings are higher.[15] Overall, this results in a higher equity ratio of 13% in IFF15 versus 10% in IFF14.

While there is ample reason to conclude that IFF15 materially overstates the expenses of Hydro by failing to integrate PUB regulatory accounting determinations, the IFF does offer greater comfort in terms of Hydro's ability during a time of high capital expenditure to absorb the costs of a $1.6 billion five year drought.[16]

Part 4 - The Defiant IFF Conceals as Much as it Reveals

While IFF15 reveals the finance expense overstatement embedded in IFF14, it effectively conceals the effect of *Board Order 73/15* on critical regulatory accounting questions. Put simply, the financial forecast presented in IFF15 appears to be in direct defiance of PUB directives that:

- Manitoba Hydro "continue to utilize the existing Average Service Life (ASL) method for rate setting"[17]

- remaining administrative costs (over and above the $36 M previously approved by the PUB) "continue to be capitalized as per existing practices"[18]

Hydro's defiance has profound adverse effect on the credibility of IFF15 over both the current and test year as well as over the next decade. The Crown monopoly's refusal to respect the direction of the PUB with regard to overhead capitalization and depreciation reduces net income by almost $100 M in 2015/16 and 2016/17.[19] Over the next decade, the defiant IFF inflates expenses by more than half a billion dollars.[20]

Hydro's failure to integrate the Board's regulatory accounting directives from *Order 73/15* effectively amounts to a "back door" attempt to review and vary that order. But Manitoba Hydro has not brought a motion to review and vary *Order 73/15*.

Absent either a motion to review and vary *Order 73/15* or a general rate application in which the merits of the regulatory accounting determinations of the PUB can be expressly challenged, the rate setting process is bound by the Board's prior determinations.

An interim rate application is no process in which to rehash the merits of an express Board directive.

Given the absence of a motion to vary *Order 73/15* and the failure by Hydro to incorporate express Board directives which would have a meaningful effect on its projections, *IFF15* cannot be relied upon for interim rate setting purposes. It does not offer a *prima facie* platform on which the Board can rest

14 $22.7 B versus $23.4 B

15 $2.9 B versus $1.9 B

16 MIPUG I-12 a) suggests the cost of5 year drought running from 2017/18 to 2021/22 is $1.6 Billion and the cost of a 7 year drought running from 2017/18 to 2021/22 is 2.3 Billion.

17 Interim Application, Attachment 1, page 53

18 Interim Application, Attachment 1, page 53

19 From comparing the expenses forecast in IFF15 with the results of Interim Application, Attachment 46, Scenario 11

20 See Coalition 1-28 b) and 1-29

an interim rate determination.

Part 5 – an Information Gap Relating to Sustaining Capital Expenditures

The reliability of IFF15 is also undermined by the failure of Hydro to provide a robust capital asset analysis in support of its projected sustaining capital expenditures in 2016/17 and over the next decade.

Over the past eight years, the Consumer Coalition has alleged an ongoing failure by Manitoba Hydro to manage its day to day or sustaining capital expenditures in a reasonable and prudent manner consistent with North American good practice. It has decried the failure of Hydro to provide a robust explanation of the health of its assets and of its asset management plan.

The PUB sought to address Hydro's asset management shortcomings in *Orders 116/08*, *73/13* and *49/14*.[21]

But eight years after *Order 116/08*, a material information gap remains. Hydro's ongoing challenges related to the "pacing and prioritization" of sustaining capital expenditures were identified by the Coalition and MIPUG in the most recent GRA.[22]

In *Order 73/15*, the Board accepted the reality of a sustaining capital "information gap" for the period beyond the 2015/16 test year. It indicated that this information shortfall should be addressed in advance of the next General Rate Application:

> *To bridge what the Board considers to be an **information gap**, the Board expects Manitoba Hydro to file, by October 31,2015, updated Terms of Reference and schedules for an Asset Condition Assessment. **The schedules should contemplate completion of the Assessment in advance of the next GRA.*** (bolding added)[23]

The PUB has expressly identified an "information gap" going to the prudence and reasonableness of sustaining capital expenditures in 2016/17 and beyond. Hydro has not provided an asset condition assessment and management plan which can support the sustaining capital expenditures which are portrayed in IFF15.

The Board's finding of an "information gap" relating to sustaining capital expenditures has not been overturned. This reinforces the reality that IFF15 is not a reliable platform on which to make a *prima facie* finding of whether the proposed interim rate increase is "just and reasonable."

Part 6 – a 3.95% Interim Rate Increase is Not Supported by the Current Record

There are compelling reasons not to rely upon IFF15 for the purposes of setting an interim rate.

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21 See for example, *Order 49/14*, p. 18. *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.*

22 *Order 73/15, p. 19, The Coalition also believes that higher rate increases should not be considered until the planning and prioritization of sustaining capital spendingis refined. The Coalition expressed concerns with the quality of information used in determining the level of sustaining capital spending.*

23 *Order 73/15*, p. 68

Despite the obvious shortcomings in the evidence and process, there is a key narrative that emerges from the interim rate application record:

- there is an implicit concession that the long term outlook for the Corporation has significantly improved driven to a large degree by lower finance expense costs
- while the short term outlook of the Corporation for 2015/16 and 2016/17 appears to have worsened based on IFF15, a more scrupulous examination of the record dictates a different conclusion

Caveats in Comparing IFF14 and IFF15

In comparing IFF15 to IFF14, it is important to note three key factors which should inform the analysis.

First, IFF15 assumes a shorter duration of 3.95% rate increases and assumes a quicker achievement of the 75/25 debt/equity target than contemplated in IFF14 or the NFAT.[24]

Second, IFF15 does not comply with the Board's regulatory accounting directives with a close to $100 million impact on expenses over 2015/16 and 2016/17 and a more than $500 million impact on expenses over the next decade.[25]

Finally, it is important to recall that IFF15 income statements for 2015/16 and 2016/17 will be dampened by the re-direction of $55 million in additional revenues to the Bipole III deferral account. This was not contemplated in IFF14.

2014/15 Results

In terms of net income, the actual results for 2014/15 are not materially different from forecast. They would have been favourable relative to forecast save for the new purchase power agreement between Manitoba Hydro and WPLP.

However, finance expense would have been lower and net income higher if borrowing undertaken for the year had been aligned with the changed investing requirements and cash from operating activities.[26] If such re-alignment had occurred, it is likely that the equity ratio for 2014/15 would have been higher (as opposed to lower) than forecast.

24 In IFF14, the assumption was that rates would increase by 3.95% until 2030/31 and then by 2% per annum in the years to follow. The result would be a 75/25 debt equity ratio by 2033/34. IFF15 assumes a 3.95% rate increases through to 2028/29 followed by 2% per annum increases resulting in a 75/25 debt/equity ratio by 2031/32.

25 Hydro acknowledges that in *Order 73/15* the PUB indicated that it would not accept the additional $20 M in overhead costs (over and above the initial $36 M identified by Manitoba Hydro) that was being expensed due to the implementation of IFRS. However, IFF15, does not reflect the direction of the PUB. Coalition I-29 indicates that the impact of not following the Board's direction leads to overall increases in expenses of $19 M in 2015/16 and $18 M in 2016/17 – after the impact on depreciation is netted out. Over the 10 year period, this would reduce O&A expense by $200 M and have the net effect of an overall reduction in expenses of $155 M, after allowing for the amortization of the "capitalized" amounts. In Order 73/15 the PUB directed Manitoba Hydro to continue to use the existing Average Service Life (ASL) methodology for calculating depreciation rates for rate setting purposes. However, IFF15 was prepared using the Equal Life Group method. In interrogatory responses PUB I-52 a-c) and Coalition I-28 b), Manitoba Hydro has indicated that that the impact of using ASL (and amortizing the difference between ASL and ELG) would be to reduce depreciation expense by $30 M in 2015/16 and by $31 M in 2016/17. Manitoba Hydro has indicated that using ASL over the 2015/16 to 2024/25 period would decrease depreciation and amortization charges by $371 M, even after allowing the amortization of difference.

26 During 2014/15 Manitoba Hydro issued more debt than was required to finance ongoing activities (e.g. capital expenditures). PUB I-30 explains that this was due to two factors:A decision to borrow additional funds now when rates were exceptionally "low" – given such funds would be required in the near term to fund ongoing activities.

Finally, at year-end 2014/15, Manitoba Hydro was ahead of schedule with regard to its planned staff reductions, which should have a favourable impact on the 2015/16 results. The fact that not all of the reduction in Other O, M and A Costs was due to accelerated staff reductions suggests there may be opportunities to maintain this reduction going forward.[27]

<u>Conclusions Relating to the Current and Test Year Forecast</u>

Taking IFF15 at face value, there is an apparent deterioration in Manitoba Hydro's financial situation over 2015/16 and 2016/17.

However, the following considerations must be considered when comparing the net income results:

- While the impacts have not been quantified, it is reasonable to assume that both O&A costs and interest costs in 2015/16 will be less than forecast. However, export prices are also expected to be lower

- Manitoba Hydro's decision to follow IFRS as opposed to PUB direction with respect to overhead capitalization and depreciation reduces net income over 2015/16 and 2106/17 by almost $100 million. Following the Board's directives would have reduced the net income shortfall between the two IFFs from $132 million to roughly $34 million[28]

- In addition, $55 million of the difference in net income reported in IFF5 is due to higher accruals to the BP III account

Recognizing Hydro's failure to follow PUB direction relating to overhead capitalization and depreciation and the difference resulting from higher accruals to the BP III account, it is reasonable to conclude from an operating perspective that the current income forecast in IFF15 for 2015/16 and 2016/17 is more favourable than that in IFF14.

Similarly, when considering the increase in debt levels it is important to note that the main reasons for the higher debt are:

- The advancement of spending that was originally planned to occur in 2017/18 and 2018/19, and

- The plan to increase Manitoba Hydro's liquidity position which is expected to reduce costs over the long term.

It would appear that the factors leading to any alleged deterioration in Hydro's financial position are short-term in nature and not indicative of any long term deterioration in the Corporation's financial position relative to IFF14.

Indeed, the opposite is likely the case as, under the Board's directed approach to regulatory accounting, retained earnings (including BP III deferral account accruals) will be higher than

27 Coalition 1- 14 a)

28 From comparing IFF14 with the results of Interim Application, Attachment 1, Scenario 1

forecast in IFF14 and interest rates (even lower than those forecast in IFF15) are now expected.

Conclusions for the Longer Term

Over the longer term Manitoba Hydro's financial outlook is improved significantly in IFF15 relative to IFF14. This can be seen from the improvement in the equity ratio outlook between the two IFFs.

This improvement occurs despite the fact that in IFF15 the 3.95% annual rate increases are only maintained through to 2028/29. In IFF14, they were maintained through to 2030/31. The improvement in the longer term outlook beyond 2024/25 occurs even though the cumulative rate increases through to 2034/35 are lower.

More fundamentally, IFF15 does not reflect the impact of following the Board's directions with respect to the capitalization of overheads and continuing use of the ASL methodology for depreciation. Attachment 28 sets out the forecast financial results if these two directives are followed and show that in 2024/25:

- Retained Earnings have increased to \$3.4 B (as compared to \$2.9 B in IFF15), and

- The equity ratio has increased to 15% (from 13% in IFF15)

The target equity ratio of 25% is attained in 2030/31 as opposed to 2031/32.

In its discussion of the results which would flow from following the Board's regulatory accounting directives, Manitoba Hydro raises concerns regarding inter-generational equity[29] relying upon comments by the BC Auditor General regarding BC Hydro's use of deferral accounts for rate smoothing purposes.[30]

These submissions are not appropriate in the context of an interim rate application. Hydro could have challenged the Board's determination through a review and vary motion. It chose not to. Hydro cannot seek to escape robust regulatory scrutiny by delaying an oral public process then employ a much less robust process to challenge the essence of a prior regulatory accounting decision by the PUB.

Finally, while it now appears that export price will be lower than forecast it also appears that interest rates will be lower as well. It is not clear what the net effect of these two factors will be.

Despite this uncertainty, the IFF15 results and the further scenarios provided in Attachment 28 beg the question of whether or not a steady pattern of 3.95% annual rate increases called for by Manitoba Hydro for more than the next ten years is required.

29 Attachment 28, pages 2-3

30 This argument would appear to be tautological given that Hydro's concern is predicated on the view that ELG is the appropriated depreciation methodology and that the \$20 M in O&A is more appropriately expensed each year from an inter-generational perspective. In the case of depreciation, both ELG and ASL recover the costs of the assets in-service. If ASL is deemed by the PUB to be the appropriate depreciation method then the use of deferral/regulatory accounts will contribute to inter-generational equity.

Part 7 - The Alternative Rate Increase Scenarios Presented by Hydro are not Credible

In its Application,[31] Manitoba Hydro examined the implication of adopting annual rate increases of 2% or 2.5% over the period 2016/17 to 2024/25.

However, there are at least two issues with Manitoba Hydro's analysis. The first is that there is a significant distance between 2.5% and 3.95% annual rate increases. But Manitoba Hydro did not explore any of this "middle ground". The second is that the analysis was based on IFF15 which was not based on the Board's directives with respect to depreciation methodology or overhead capitalization.

Part 8 – the PUB Alternative Rate Increase Scenarios are Instructive

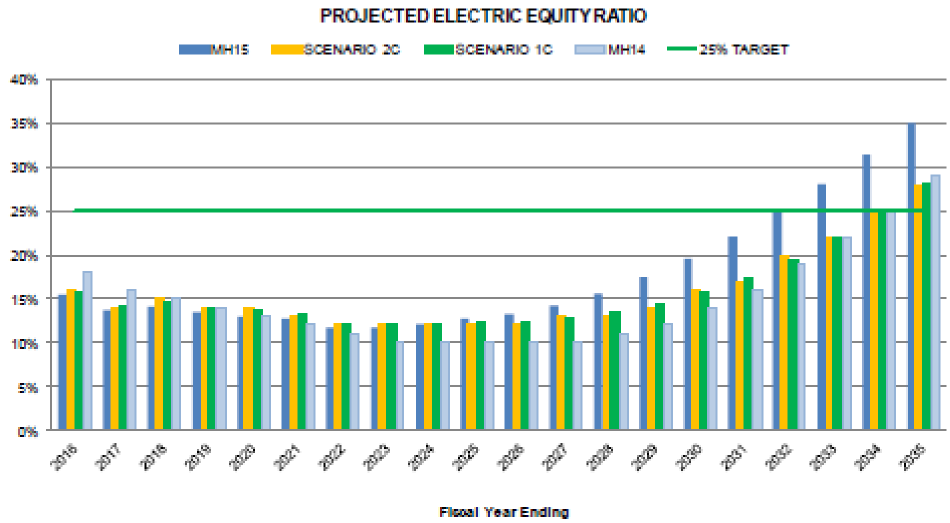
Hydro's inflexible adulation of annual 3.95% rate increases is undermined by the alternative analysis undertaken by the PUB.

Following the initial filing, PUB staff requested a scenario based on meeting the 25% equity ratio target by 2033/34 (the same year as in IFF14) and using the Board's directed accounting for depreciation and overheads. The results[32] indicated that:

- A sustained rate increase of 3.36% would be required to achieve the desired results
- The equity ratio would only dip to a low of 12% (as opposed to the 10% in IFF15), and
- Retained earnings would dip to a low of \$2.8 billion in 2022/23 and 2023/24 (as compared to a low of \$2.7 billion in IFF15)

The long term outlook for the equity ratio based on this scenario versus IFF15 is set out in the following chart:[33]

31 Page 36
32 Attachment 46, Scenario 1
33 PUB I-4 c)



PUB I-5 – Based on Board's Accounting Direction

The PUB also requested variations on Attachment 46 where rate increases of 0%, 2%, 3% and 5% were implemented in 2016/17 with an average annual rate increase determined through to 2033/34 in order to yield the target equity ratio for that year. The rate increase results are summarized in the table below:[34]

ANNUAL RATE INCREASES TO ACHIEVE 25% EQUITY RATIO BY 2033/34 BASED ON IFF15 AND PUB'DIRECTIVES RE: DEPRECIATION AND OVERHEADS	
2016/17	**2017/18 -> 2033/34**
3.36%	3.36%
0%	3.78%
2%	3.53%
3%	3.41%
5%	3.16%

These results demonstrate that annual 3.95% rate increases are not required.

Part 9 – Recommended Findings Based on the Record

In reviewing the record of this proceeding, the Coalition has come to the following conclusions which it would ask the PUB to adopt.

Recommended Finding 1 - Based on its review of the record, there is no "urgent" need for the 3.95% interim rate increase requested by Manitoba Hydro.

- Using the values from IFF15, a rate increase of slightly more than 2% would be sufficient to

34 The Coalition notes that under the 0%/3.78% scenario, the minimum equity ratio for the period is 11%.This value increases to 12% for the 2%/3.53%; 3%/3.41% and 3.36%/3.36% scenarios and is 13% for the 5%/3.16% scenario.

ensure projected net income for 2016/17 is greater than zero[35]

- Using the accounting approach directed by the PUB in 73/15, a 0% rate increase in 2016/17 would still result in positive net income for 2016/17[36]

- Using the values from IFF15, a 2% rate increase in 2016/17 followed by rate increases similar to those proposed in IFF15 would yield longer term financial results (in terms of equity ratio) that are similar to IFF14 (i.e. achievement of target ratio by 2033/34 – same as IFF14 - and a minimum equity ratio of 11% higher than the 10% minimum in IFF14)[37]

- Employing the accounting approach directed by the PUB, a 0% rate increase in 2016/17 would require subsequent increases of 3.78% per annum in order to achieve the target equity ratio in 2033/34 (and the minimum equity ratio would again be 11%)

Recommended Finding 2 - To the extent that issues of long term rate stability and rate smoothing are viewed as relevant considerations when considering requests for interim rate approval, it is clear that even under IFF15 an increase of less than 3.95% in 2016/17 and equivalent thereafter through to 2030/31 would result in achieving the target equity ratio prior to 2033/34 – the year that the ratio was projected to be achieved in IFF14[38].

Under the accounting approach directed by the PUB, steady rate increases of 3.36% per annum to 2033/34 would result in achieving the target equity ratio in 2033/34 – the same year as IFF14.

Recommended Finding 3 – Given the interim nature of this proceeding, it's appropriate to rely upon the Board’s directed accounting for depreciation and overheads. Absent a motion to review and vary this direction or a full GRA, it is not appropriate to reconsider the Board's directives which were fully canvased in the proceedings leading to *Order 73/15*.

Recommended Finding 4 - IFF15 cannot be relied upon on a *prima facie* basis for interim rate setting purposes due to its failure to employ Board directed accounting for depreciation and overheads

Part 10 – Other Considerations of the Coalition

Apart from the record of this proceeding, the ultimate recommendations of the Consumer Coalition are also driven by the sense that Manitoba consumers are being forced to bare the consequence of questionable decisions and forecasts by the Corporation. This reality is compounded by the fact that consumers lack the tools to adequately protect themselves against Hydro's self inflicted injuries.

<u>the Self Inflicted injuries of Manitoba Hydro</u>

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35 Based on IFF15 a 3.95% increase produces $61 M in additional revenue and a net income for 2016/17 of $29 M. As a result, each 1% rate increase produces over $15 M in additional revenues.

36 Attachment 28, page 5

37 PUB -5 bvi (2%)

38 IFF15 only calls for increases of 3.95% through to 2028/29 (as opposed to 2030/31 in IFF14) and still achieves the target equity ratio two years earlier

Just four years ago, in *Order 5/12*, the PUB warned that Hydro's:[39]

> *view of fiscal responsibility is skewed by blind adherence to a future major capital plan that has not been fully tested before an independent tribunal considering the "Needs For And Alternatives To" such a major capital expenditure plan (NFAAT).*

In *Order 73/15*, the Board noted the impact of successive years of poor export price estimates on the business case for Hydro's major new capital investments:[40]

> *The Board is concerned that successive Manitoba Hydro export price forecasts have been revised downward and* ***consistently overestimate*** *actual results. That trend continues since, according to IFF14, Manitoba Hydro expects a further price decline which will* ***negatively impact the business case*** *for Manitoba Hydro's new investments in generation and transmission. (bolding added)*

Whether limited by "blind adherence" to grandiose expansion plans or not, Manitoba Hydro has struggled in coming to dramatic changes in the marketplace.

Appendix B to this submission, highlights the multi-billion dollar forecasting challenges that have underpinned Hydro's estimates of both export prices and capital program costs over the past decade. It also documents double the pace of inflation rate increase which can be directly tied to Hydro's forecasting challenges.

Will Manitoba Consumers Have Adequate Tools to Protect Themselves?

Manitoba consumers have a right to question whether Hydro and the Province have stepped up to the plate in protecting consumers.

While DSM should be a primary means of ratepayer protection, the NFAT process confirmed that Hydro's DSM portfolio has underperformed compared to North American good practice.[41]

Affordable energy efforts are still evolving.[42] DSM budgets continue to be underspent.[43] The future of energy efficiency initiatives whether delivered by Manitoba Hydro or some allegedly independent subsidiary is clouded by legislative and administrative uncertainty.

Manitoba consumers cannot be confident that robust energy efficiency options will be there for them when they need it.

In terms of Bill Assistance, there is no certainty in terms of the ultimate outcome. Hydro has raised jurisdictional concerns. While it has initiated a collaborative process to examine options, the PUB has observed that:

39 Page 26.

40 *Order 73/15*, p. 87.

41 PUB, Final NFAT Report, page 22

42 See the comments of the Coalition, MMF and MKO as documented in *Order 73/15, page 77*

43 For 2014/15 see *Order 73/15*, page 9. The Coalition has no doubt that planning efforts are being hampered by uncertainty relating to who will delivery energy efficiency services in the future

> the collaborative process should not be limited to the consideration of special lower income rates. From a policy perspective, there may well be better solutions that have not been proposed to date. Furthermore, the optimal solution may well involve a portfolio of measures rather than a single measure. However, the idea of lower income rates should not be discarded upfront due to jurisdictional concerns.[44]

In a best case scenario, any robust policy solutions are unlikely to be presented for many months. The composition of the Hydro and PUB Boards that many months into the future is unclear. Even if a robust policy solution is arrived at, Manitoba ratepayers cannot be confident it will be implented.

Given Hydro's ongoing challenges with its export market gamble,[45] the best protection for Manitoba consumers is a robust regulatory process including an oral public hearing process. Rate signals are the most important and only universal tool to protect ratepayers and to incent efficient and transparent corporate behaviour.

Part 10 - Recommended Order

In making its final recommendation, the Consumer Coalition was guided by fundamental concerns that:

- there is substantial reason to question the forecasting veracity of Manitoba Hydro especially with regard to finance expense and export revenues
- interim rates are overused and unfair to ratepayers
- *IFF15* does not reflect the Board's directives relating to regulatory accounting for depreciation and overheads
- the "information gap" relating to the test year and future year sustaining capital expenditures has still not been addressed despite persistent requests by the PUB dating back to 2008
- uncertainty related to energy efficiency and Bill Assistance programming provides little confidence that Manitoba consumers will have adequate tools to mitigate adverse rate impacts in the current fiscal year

The Consumers Coalition also has taken note that material reductions in finance expense projections have left Hydro better able to weather adverse events such as lengthy droughts.

The Coalition recognizes that there is no financial urgency. Using the accounting approach directed by the PUB in *Order 73/15*, even a 0% rate increase in 2016/17 would still result in positive net income for 2016/17[46]

While the Consumer Coalition is aware of the arguments in favour of rate smoothing advanced in *Order 73/15*, it does not consider them persuasive in the interim rate context. This is especially the case given that employing the accounting approach directed by the PUB, a 0% rate increase in 2016/17

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44 Order 73/15, p. 28

45 The Consumers Coalition acknowledges that it will take many years to fully understand the failures and successes of Hydro's export market risk taking over the past decade. However, there can be no doubt that to date, much lower than expected export prices and much higher than planned capital expenditure forecasts have placed significant pressures on Manitoba ratepayers.

46 Attachment 28, page 5

would require subsequent increases of less than 3.8% per annum[47] in order to achieve the target equity ratio in 2033/34 and still achieve a minimum equity ratio above that contemplated in IFF14.[48]

Given these reasons, the Consumer Coalition would ask the PUB to issue an Order:

- rejecting the interim rate application of Manitoba Hydro's, and
- give direction aimed at curing Hydro's addiction to interim rate processes

Part 11 – Conclusion

Manitoba consumers have high expectations of Manitoba Hydro. They expect the Crown monopoly to:

- to facilitate orderly rate setting that provides consumers with a reasonable opportunity to be heard
- provide financial statements that properly reflect Board directives and communicate the impact of Board directives to all Manitobans
- produce forecasts that are reasonably reflective of true financial position of the Corporation
- to respond in a responsible and timely manner to Board Directives aimed at enhancing prudent and reasonable management practices
- manage Hydro in a prudent and reasonable manner that inspires confidence in ratepayers
- take reasonable actions to mitigate the impacts of Corporate decisions and errors upon all consumers including the most vulnerable consumers

These expectations have not been met in IFF14, IFF15 or the interim rate application. Rather than allocating scarce public resources to an interim rate increase process, the energies of Manitoba Hydro, could have been better directed to:

- correcting Hydro's systemic forecasting challenges;
- ensuring the ongoing dialogue relating to energy efficiency and low income affordability is meaningful;
- facilitating a timely and robust COSS review, and
- preparing for a General Rate Application

The Consumers Coalition urges the PUB to reject Manitoba Hydro's interim rate application. Manitoba Hydro's addiction to interim rate processes should not be enabled in the current instant. A strong message should be sent to Manitoba Hydro of the need to revisit its regulatory and forecasting processes while pursuing all available options to robustly protect Manitoba consumers from unsustainable rate pressures.

47 3.78%

48 11%

Appendix A

An Interim Rate Addiction?

Fiscal Year	Interim Rate Order	Result
2010/11	*Order 18/10*	2.9% after being varied in Order 5/12 confirmed in *Order 43/13*
2011/12	*Order 40/11*	2.0% confirmed *Order 43/13*
2011/12	*Order 99/11*	0% confirmed *Order 5/12*
2012/13	*Order 32/12*	2.0% confirmed *Order 43/13*
2012/13	*Order 116/12*	2.4% confirmed *Order 43/13*
2013/14	No I0 sought	N/A
2014/15	*Order 49/14*	2.75 confirmed *Order 51/14*
2015/16*	*Order 17/15*	No interim application entertained
2016/17	Pending	Proposed 3.95%

*Confirming January 27, 2015 letter

2015/16 GRA Appendix 11.9 Financial Information MFR 3

APPENDIX B

RATE INCREASES SINCE THE GREAT RECESSION AND

EXPORT PRICE &CAPITAL COST FORECAST VARIATIONS

TABLE #1

MANITOBA HYDRO RATE INCREASES vs. INFLATION

YEAR	RATE INCREASE		INFLATION		Notes
	Annual	Cumul	Annual	Cumul.	
2008/09	5.00%	5.00%	2.20%	2.20%	(1)
2009/10	2.90%	8.04%	0.60%	2.81%	(1)
2010/11	2.90%	11.18%	1.00%	3.84%	(1)
2011/12	2.00%	13.40%	2.80%	6.75%	(1)
2012/13	4.45%	18.45%	1.60%	8.46%	(1) & (2)
2013/14	3.50%	22.59%	2.40%	11.06%	(1)
2014/15	2.75%	25.96%	1.50%	12.73%	(1)
2015/16	3.95%	30.94%	1.20%	14.08%	(1)
2016/17	3.95%	36.11%	2.20%	16.59%	(3)

NOTES:
1) Approved
2) Rate Increase compound effect of 2% in April and 2.4% in September
3) Proposed

SOURCES:
Last GRA, Appendix 11.9
Current Application, Attachment 22 - Actual Inflaction to 2014/15, Forecast Thereafter

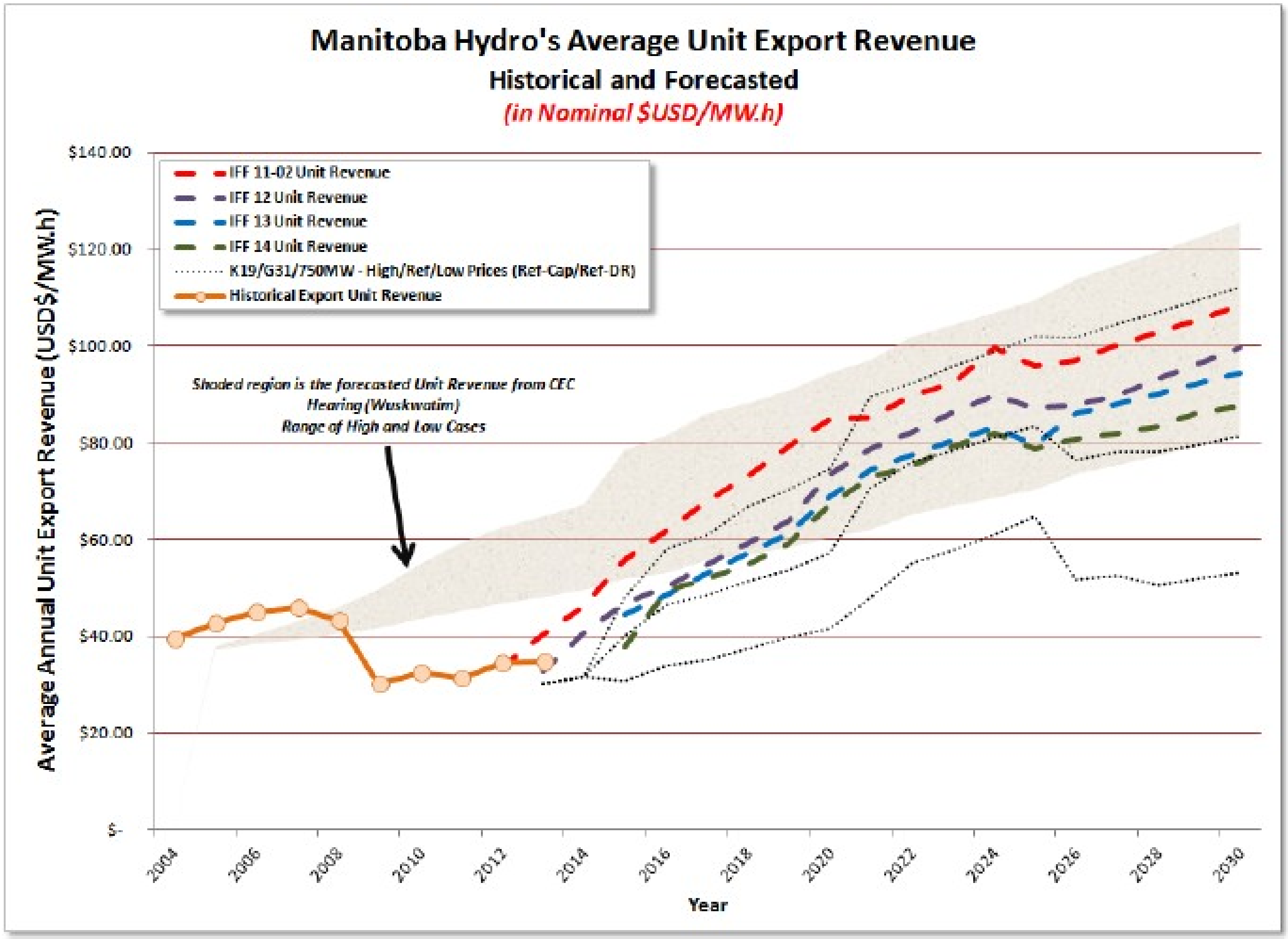
TABLE #2

Progression of Project Costs in $ M												
	CEF-03	CEF-04	CEF-05	CEF-06	CEF-07	CEF-08	CEF-09	CEF-10	CEF-11-2	CEF-12	CEF-13	CEF-14
Wuskwatim G.S.		846	935	1,094	1,275	1,275	1,275	1,275	1,375	1,449	1,449	1,449
Wuskwatim Transmission		199	200	257	320	316	316	291	298	323	320	320*
Wuskwatim Total Project	988	1,045	1,135	1,351	1,595	1,591	1,591	1,566	1,673	1,771	1,768	1,768
Herblet Lake Transmission	57	55	54	54	95	93	93	75	75	77	76	76*
Bipole III	360(E)	388(E)	1,880	1,880	2,248	2,248	2,248	3,280	3,280	3,280	3,280	4,653
Riel C.S.	96	101	103	103	105	268	268	268	268	268	330	330
Kelsey G.S.	121	121	166	166	184	190	190	302	302	302	302	340
Kettle G.S.		61	61	61	61	76	76	166	166	166	166	192
Pointe du Bois Spillway							318	398	398	560	560	575
Pointe du Bois Trans.					83	86	86	86	86	86	114	114
Pointe du Bois Rebuild	421	288	692	834	818	818		1,538	1,538	1,538	1,538	1,852
Slave Falls G.S.				179	192	198	198	223	230	230	126	126
Conawapa G.S.		4,050	4,516	4,978	4,978	4,978	6,325	7,771	7,771	10,192	10,492	397
Keeyask G.S.						3,700	4,592	5,637	5,637	6,220	6,220	6,496
500 KV Dorsey U.S. Border						205	205	205	205	205	350	350
Total	2,043	7,154	9,742	10,957	11,954	16,042	17,781	23,081	23,302	26,665	27,091	19,038

*Wuskwatim Transmission and Herblet Lake Transmission Projects are in-service and have no further capital spending. These projects were removed from CEF14 but included in this table for completeness.

Source: 2015/16 & 2016/17 GRA, PUB I-17 c)

<u>**TABLE #3**</u>



Source: Manitoba Hydro's 2015/16 & 2016/17 GRA, Coalition I-24 h)

Appendix C

OVERVIEW OF MANITOBA HYDRO'S APPLICATION FOR

INTERIM RATES EFFECTIVE APRIL 1, 2016

CURRENT FINANCIAL STATUS AND OUTLOOK

BACKGROUND

- On January 16, 2015, Manitoba Hydro sought approval of an across-the-board increase of 3.95% effective April 1, 2015. The crown monopoly also asked the Public Utilities Board (PUB) to approve an additional 3.95% rate increase effective April 1, 2016[1].

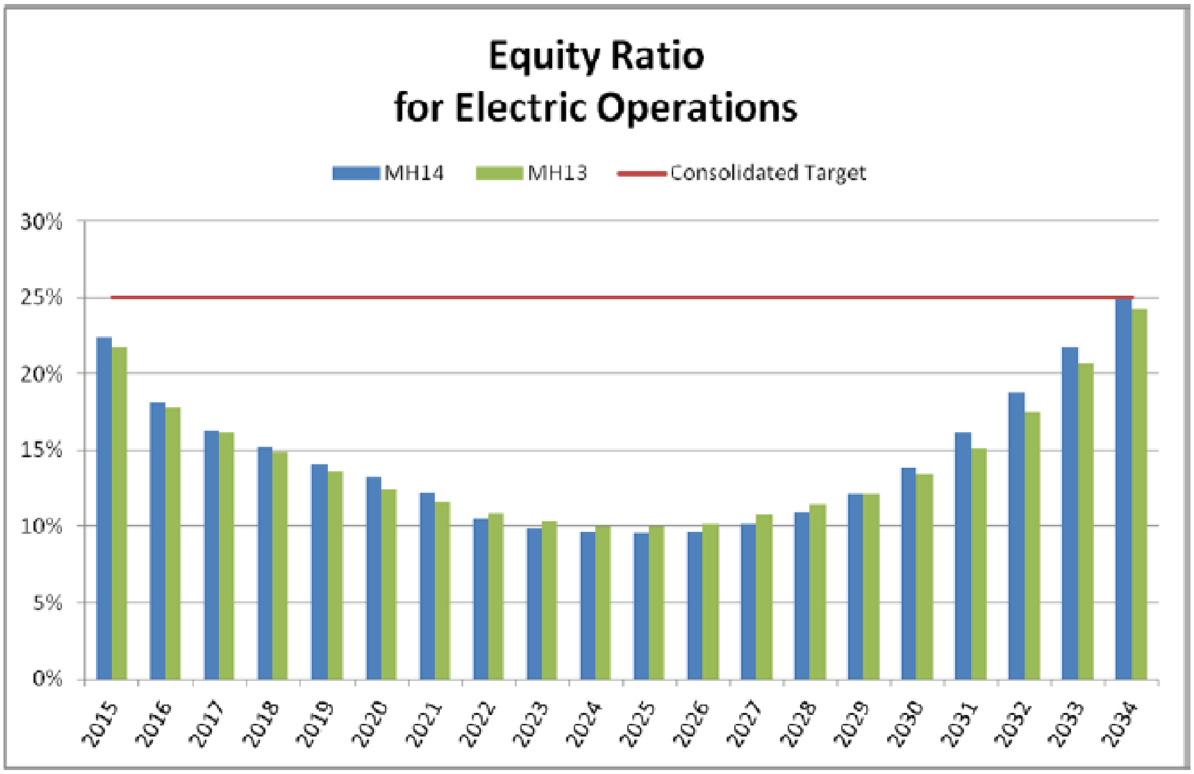
- From Hydro's perspective, the key reasons for the requested increases included[2]:
    - the deterioration in export market prices and a resulting decline in net export revenues[3].
    - planned extensive capital investments over the next 10 years which would be funded primarily through debt financing.
    - the projected deterioration in Manitoba Hydro's financial strength that would occur without future rate increases leading to increased borrowing costs and the risk of rate instability.
    - the resulting requirement for steady rate increases through this period.

- The financial forecast provided with the Application (IFF14) portrayed double the rate of inflation annual rate increases of 3.95% to 2030/31 followed by 2% per annum in the years to follow. Hydro expected the equity ratio for electric operations to decline to 10% by 2022/23 but recover to over 25% by 2033/34. In Hydro's view, the projected deterioration in the equity ratio was the minimum acceptable financial operating level[4].

- This analysis is illustrated graphically in Figure 3.4 taken from the January 2015 application:

1 2015/16 & 2016/17 GRA, Tab 1, page 1
2 2015/16 & 2016/17 GRA, Tab 2, pages 3-4 and Tab 3, pages 1-2
3 Ibid, Tab 2, page 26. Historically, net export revenues made a significant contribution to overall revenues enabling lower rates for domestic customers.
4 Ibid, Tab 3, page 13

Figure 3.4 Projected Equity Ratio



- During the course of the proceeding, the PUB advised Manitoba Hydro that it would not consider new rates for April 1, 2016[5]. It eventually approved a rate increase of 3.95% effective August 1, 2015, but directed 2.15% of the increase to be placed in the previously established deferral account to mitigate rate increases when the Bipole III Project came into service in 2018/19[6].

- In making its Order, the PUB:

    - expressly denied "Manitoba Hydro's request to calculate depreciation expense using the Equal Life Group (ELG) method and required Manitoba Hydro to continue to utilize the existing Average Service Life (ASL) method for rate setting"[7], and

    - rejected the higher level of OM&A costs requested by Hydro and indicated that the remaining administrative costs would "continue to be capitalized as per existing practices"[8].

5 Order 73/15, page 5
6 Order 73/15, page 3
7 Order 73/15, pages 8/9
8 Order 73/15, pages 35/36. It confirmed as indicated at the last GRA that $36 million of additional costs could be expensed.

CURRENT INTERIM RATE APPLICATION

- On November 15, 2015, Manitoba Hydro filed a "supplemental filing"[9] to the 2015/16 & 2016/17 GRA. It sought an interim rate increase of 3.95% effective April 1, 2016[10].

- Hydro's reasons for the requested increase were consistent with those outlined in its 2015/16 & 2016/17 GRA including[11]:
  - an upcoming period of extensive capital investment,
  - continued downward pressure on electricity prices in the export market with a need to increase domestic prices to compensate, and
  - the need to maintain financial ratios at acceptable levels in order to promote rate stability.

- To support its Application, Hydro filed its actual financial results for 2014/15 and an updated financial outlook (IFF15).

- In the next sections, the Consumers Coalition compares the 2014/15 actual financial results and current outlook with the forecasts provided during the last GRA.

Caveats in comparing IFF14 and IFF15

- However, in comparing the forecasts it is important to note a key distinction in the assumptions underlying the two IFFS:

  - In IFF14, the assumption was that rates would increase by 3.95% until 2030/31 and then by 2% per annum in the years to follow. The result would be a 75/25 debt equity ratio by 2033/34.
  - IFF15 assumes a 3.95% rate increases through to 2028/29 followed by 2% per annum increases resulting in a 75/25 debt/equity ratio by 2031/32.

- In addition, it is important to note that IFF15 does not comply with the Board's directive that:

  - Manitoba Hydro "continue to utilize the existing Average Service Life (ASL) method for rate setting"
  - remaining administrative costs "continue to be capitalized as per existing practices"

- Finally, it is important to recall that the income statements for 2015/16 and 2016/17 portrayed in IFF15 will be dampened by the direction of additional revenues to the Bipole III deferral account. This was not contemplated in IFF14.

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9 This will be referred to as the "Interim Application".
10 Interim Application, page 3
11 Interim Application, pages -4

ACTUAL 2014/15 FINANCIAL RESULTS (vs. GRA FORECAST)

Income Statement

- Actual electric operations for 2014/15 net income is $95 M versus the $102 M forecast at the time of the GRA. A comparison of the actual versus forecast Statements of Income is set out below[12].

Figure 11. 2014/15 Actual Financial Results from Electric Operations

MANITOBA HYDRO
STATEMENT OF INCOME
For the Year Ended March 31, 2015
(In Millions of Dollars)

	ACTUAL	FORECAST	FAVOURABLE/ (UNFAVOURABLE) VARIANCE
Revenues			
General consumers	$1,424	$1,407	$18
Extraprovincial	400	409	(9)
Other	18	15	3
	1,843	1,831	12
Expenses			
Operating and administrative	480	486	5
Finance expense	495	495	-
Depreciation and amortization	403	405	1
Water rentals and assessments	125	124	-
Fuel and power purchased	146	134	(12)
Capital and other taxes	100	99	(1)
Other Expenses	2	2	-
Corporate allocations	9	9	-
	1,760	1,754	(5)
Net income before non-controlling interest	83	77	7
Net loss attributable to non-controlling interest	11	25	(14)
Net Income	$95	$102	($7)

* Please note, Manitoba Hydro's financial results for the 2014/15 year are presented under Canadian Generally Accepted Accounting Principles.

Revenue – Domestic

- The Application indicates that domestic revenues are higher primarily due to higher residential usage than forecast[13].

12 Interim Application, page 17
13 Interim Application, page 18

- The 2015 Load Forecast[14] provides further details indicating that weather adjusted sales to both Residential and General Service Mass Markets were higher than forecast but that sales to the Top Consumers (i.e. large industrial customers) were lower.

Revenue – Export

- The Application notes that export revenue were slightly lower than forecast primarily due to an outage of the 500 kV line which limited exports to the US[15].
- However, Coalition I-7 b) indicates that overall export volumes were higher than forecast (10,010 GWh vs. 9,985 GWh). It would appear that the lower sales to the US were offset by higher volumes to other Canadian provinces[16].
- Also, Coalition I-7 b) indicates the average overall export price in 2014/15 was higher than forecast ($37.82/MWh v. $37.23/MWh) - primarily due to a lower actual Canadian exchange rate versus forecast. Similarly, a comparison of the forecast sales revenues[17] to US and Canada to actuals[18] for 2014/15 show that in both cases the actual values are higher before adjustments for transmission and environment charges.
- While there still some inconsistencies in the revenues amount reported in the Application and IR response, it would appear that the lower export revenues are attributable to differences in non-energy related export revenues as opposed to lower volumes or prices in 2014/15.

Expenses – Operating and Administration

- Actual reported O&A for 2014/15 is $5 M less than forecast.
- A detailed comparison of the forecast vs. actual O&A for 2014/15 can be found in the response to Coalition I-24 a). The following table summarizes the key aspects.

14 Attachment 25, page 10
15 Interim Application, page 18
16 Compare Interim Application Attachment 16 with last GRA, Attachment 11.19.
17 2015/16 & 2016/17 GRA, Attachment 11.19
18 Interim Application, Attachment 16

2014/15 Operating and Administrative Expense ($ M)		
Cost Element	**Forecast**	**Actual**
Wages and Salaries	502.7	493.3
Overtime	61.7	69.5
Benefits	160.6	164.7
Total (Labour & Benefits)	725.0	727.6
Less – Charges to Capital	256.6	257.5
Labour & Benefits to Opns.	468.4	470.1
Other Costs – Total	199.8	192.9
Less Other Costs to Capital	33.3	33.4
Other Costs to Operations	166.4	159.5
Total Labour, Benefits and Other Costs to Operations	634.8	629.6
Less Capitalized Labour	289.9	290.9
Less Capitalized O/Hs	81.3	81.7
Less Charge to Centra	67.8	67.5
Electric O&A Costs	485.8	480.5

- Actual total Labour costs are lower than forecast. This is consistent with MH being ahead of schedule on its planned staff reductions[19]. However, this is more than offset by higher than forecast benefits costs resulting in actual total labour and benefits being higher than forecast.

- Other (non-labour and benefit) costs are lower than forecast which contributes to the lower overall actual results[20]. The fact that not all of the reduction in Other Costs is due to the accelerated staff reductions,[21] suggests there may be opportunities to maintain elements of this reduction on a going forward basis.

19 PUB I-21 a)
20 Coalition I-14 a)
21 Coalition I-14 a)

Expense – Finance

- Finance expense is unchanged. While borrowing was higher, interest rates on debt issued were lower.

- The USD/CAD exchange rate was higher on an actual basis than forecast and as a result, the interest expense associated with the conversion of USD interest payments to CAD was higher than forecast. However, the revaluation of USD bank balances into CAD within the Interest Income and Other category more than offset the currency conversion of USD interest expense during 2014/15.[22].

- It is noted that during 2014/15 Manitoba Hydro issued more debt than was required to finance ongoing activities (e.g. capital expenditures). PUB I-30 explains that this was due to two factors:

    - a decision to borrow additional funds now when rates were exceptionally "low" – recognizing these funds would be required in the near term to fund ongoing activities, and
    - a decision to increase Hydro's cash position (i.e. liquidity).

- Manitoba Hydro claims that borrowing additional funds when rates are at an all-time low will benefit ratepayers over the long term as interest expense will be lower for the entire term of the debt (e.g. 30 years)[23]. It also asserts that improving liquidity by advanced borrowing will reduce overall interest costs over the long term[24]. Even, so it does have a negative impact on MH's financial position in the short term[25].

Expense – Depreciation & Amortization

- Depreciation and amortization is slightly less than forecast.

Expense – Fuel & Purchased Power

- Fuel and Purchased Power expense is $12 M higher than forecast. This is primarily due to higher power purchases and merchant purchases offset somewhat by lower thermal fuel costs and transmission charges[26].

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22 Coalition I-11 ad
23 Coalition I-10 c)-d)
24 Coalition I-21 a)-c)
25 Manitoba Hydro was asked to quantify the impact for 2014/15 but did not provide a response (Coalition I-10 c) –d). Coalition I-21 a)-c) shows that while approach used by MH reduces costs in the medium to long term it also shows that cost increase in the near term.
26 Coalition I-8 a) and 2015/16 and 2016/17 GRA, Schedule 5.1.8

Net Loss – Attributable to Non-Controlling Interest

- The $14 M increase in net loss over forecast is the result of the revised power purchase agreement between Manitoba Hydro and WPLP resulting from implementation of the Wuskwatim PDA Supplement #2[27].

Capital Spending

- Actual capital spending for 2014/15 was less than forecast ($1,934 M vs. $2,023 M)[28].
- The under spending occurred in all three major areas: Sustaining ($12 M), DSM ($19 M) and Major G&T ($58 M). In terms of Major G&T projects, the key areas of lower spending were[29]:
    - Keeyask (due to resource constraints related to BP III scheduling)
    - BP III (due to delays in construction)
    - Conawapa (delays in activities related to wind-down).

Balance Sheet

- The actual borrowings for 2014/15 were up even though cash from operating activities was up and investing needs were lower than forecast – giving rise to a $600 M increase in year-end cash versus forecast[30]. (See early discussion under Finance expense.)
- Overall, long term debt levels are higher (see previous comment regarding borrowing under Expense-Finance) and retained earnings are lower than forecast (due to lower than forecast net income for 2014/15), this results in the equity ratio for Electric Operations being 21% as opposed to the 22% forecast in IFF14[31].
- It should be noted that this reduction in the equity ratio would likely not have occurred had the borrowings be maintained in line with the investment requirements.

General Conclusions – 2014/15

- The actual results for 2014/15 (in terms of net income) are not materially different from forecast. Indeed, they would have been favourable relative to forecast save for the new purchase power agreement between Manitoba Hydro and WPLP.

27 Interim Application, page 18
28 Coalition I-2 a)
29 Coalition I-2 c)
30 Coalition I-10 a) versus IFF-14, page 40 and PUB I-2 a) & b)
31 Coalition I-5 a)

- However, finance expense would have been lower still and net income higher if borrowing undertaken for the year had been aligned with the changed in investing requirements and cash from operating activities. If such re-alignment had occurred it is likely that the equity ratio for 2014/15 would have been higher (as opposed to lower) than forecast.

- Finally, at year-end 2014/15, Manitoba Hydro was ahead of schedule with regard to its planned staff reductions, which should have a favourable impact on the 2015/16 results.

FORECAST 2015/16 AND 2016/17 RESULTS (IFF14 vs. IFF15)

Income Statement

- The current IFF15 forecast indicates that the cumulative net income for 2015/16 & 2016/17 will be $132 M less than forecast in IFF14. A comparison of the income statements is set out below[32]:

Comparison of Electrical Operations MH15 to MH14
Increase/(Decrease)
(millions of $)

	2016			2017		
	MH15	MH14	Variance	MH15	MH14	Variance
General Consumers at projected rates	1 463	1 479	(16)	1 551	1 544	6
Extraprovincial	395	434	(39)	406	450	(44)
Other	29	14	15	28	14	14
Total Revenues	1 887	1 928	(40)	1 985	2 008	(23)
Operating and Administrative	542	542	-	552	552	-
Finance Expense	566	510	56	588	548	41
Depreciation and Amortization	410	401	10	426	422	3
Water Rentals and Assessments	126	123	3	116	112	3
Fuel and Power Purchased	120	130	(10)	151	191	(40)
Capital and Other Taxes	107	107	-	122	121	2
Corporate Allocation	8	8	-	8	8	-
Other Expenses	2	2	-	2	2	-
	1 882	1 824	58	1 965	1 956	9
Non-controlling Interest	10	12	(3)	9	8	1
Net Income	15	115	(101)	29	59	(31)

Domestic Revenues

- Manitoba Hydro notes the reduction in 2015/16 revenues in IFF15 is due to the delay in the implementation of the 2015/16 rate increase to August 2015 ($16 M) along with the

32 Interim Application, page 24

fact that a portion ($22 M) of the increase was directed to the BP III deferral account. These impacts are offset by a higher load forecast for residential and mass market customers ($22 M)[33].

- Manitoba Hydro similarly notes the increase in forecast domestic revenues for 2016/17 is due to higher load forecasts for residential and mass market customers ($39 M) offset, again, by an additional $33 M accruing to the BP III account[34].

- In terms of the load forecast, the basic load forecast (prior to DSM) is higher in IFF15 and the impact of DSM is lower than in IFF14[35] – both contributing to higher domestic volumes in 2015/16 and 2016/17 in IFF15.

- It should be noted that for purposes of calculating Manitoba Hydro's equity ratio, the amounts directed to the BP III deferral account ($55 M in total over the two years) is treated as equity[36].

Export Revenues

- Export Revenues are lower by $83 M over the two year period. However, $25 M of this is due to a change in reporting practices for transmission credits which has no impact on Net Income because the offset is picked up under Fuel and Purchased Power[37].

- The reduction in total export revenues is due entirely to lower forecast export prices which are offset somewhat by changes in forecast foreign exchange rates and export volumes[38].

- The response to PUB I-13 a) shows the material reduction in average US export prices (in US$) between IFF14 and IFF15 in 2015/16 (from 3.95 to 3.18 cents/kWh) and 2016/17 (from 5.26 to 4.12 cents/kWh).

- In its Interrogatory responses, Manitoba Hydro notes that it has seen a further decline in MISO opportunity prices since the forecast was prepared and now expects export prices to be lower still[39].

Other Revenue

- Other Revenue shows an increase of $29 M in total over the two years. However, this is all accounted for by the change in reporting of: i) amortization of customer contributions and ii) billing surcharge recoveries[40].

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33 Interim Application, page 24
34 Interim Application, page 24
35 Coalition I-15 a)
36 Coalition I-25 b)
37 Coalition I-23 c)
38 Interim Application, page 25 and Coalition I-16 c)- d)
39 PUB I-14 c)
40 Coalition I-18 a)

Expenses – Operating and Administrative

- The O&A forecasts for the two years are unchanged as between IFF14 and IFF15.

  Planned Staff Reductions

- The response to PUB I-21 indicates that Manitoba Hydro is ahead of schedule with respect to staffing reductions. This has reduced overall 2015/16 costs by $5.7 **M** as of December 31, 2015. PUB I-25 indicates that as of December 31, 2015 overall Electric Operations O&A costs are $8 M less than forecast for the same period. However, Manitoba Hydro claims[41] that it is "premature" to adjust the overall forecast results for 2015/16.

  IFRS

- Hydro acknowledges that the PUB indicated[42] it would not accept the additional $20 M in overhead costs (over and above the initial $36 M identified by Manitoba Hydro) that was being expensed due to the implementation of IFRS. However, IFF15 does not reflect the direction of the PUB.

- Coalition I-29 indicates that the impact of not following the Board's direction leads to overall increases in expenses of $19 M in 2015/16 and $18 M in 2016/17 – after the impact on depreciation is netted out.

Expenses – Finance Expense

- Over the two year period, Finance Expense is $97 M higher in IFF15 (versus IFF14). This is attributed to the impacts of foreign exchange and lower capitalized interest credits, offset somewhat by lower interest payments[43].

  Interest Rate Forecasts

- The interest rate forecast used by Manitoba Hydro in IFF15 is based on an update prepared in October 2015[44]. PUB I-28 provides an updated forecast using more recent sources which indicates that current forecasts for 2015/16 are now calling for even lower long term debt rates (3.95% vs. 4.05%) and for 2016/17 are now calling for lower rates for both short-term (1.45% vs. 1.55%) and long-term (4.15% vs. 4.35%) debt. (Note: These lower rates are after allowing for Manitoba Hydro's assumed increase in the spread between Canada bond yields and its borrowing rate – see PUB I-12 b-c)

- The result it that interest expense for 2015/16 and 2016/17 is now likely to be lower than

41 PUB I-21
42 Page 35
43 Interim Application, page 26
44 Interim Application, Attachment 1, page 3

forecast in IFF15, all other factors unchanged.

Expenses – Depreciation and Amortization

- Depreciation and amortization for the two years increases by $13 M of IFF14. This increase is entirely due to the change in reporting with respect to the amortization of customer contributions which increases the depreciation expense for the two years by $21 M[45].

- Without this change in reporting practice, the overall expense would have been lower. This reduction can be traced to both lower amortizations for DSM and Electric Assets[46], due to lower in-service values for both over the two-year period[47].

IFRS

- In Order 73/15 the PUB directed Manitoba Hydro to continue to use the existing Average Service Life (ASL) methodology for calculating depreciation rates for rate setting purposes. However, IFF15 was prepared using the Equal Life Group method[48].

- In interrogatory responses Manitoba Hydro has indicated that that the impact of using ASL (and amortizing the difference between ASL and ELG) would be to reduce depreciation expense by $30 M in 2015/16 and by $31 M in 2016/17[49].

Expense – Fuel & Purchased Power

- Fuel & Purchased Power expense for the two years is lower in IFF15 (versus IFF14) by $50 M. The revised reporting practices for transmission charges account for $25 M of the reduction while lower volumes and market prices account for the balance which is offset to some extent by changes in foreign exchange forecasts[50].

Capital Spending

- Capital spending for 2015/16 and 2016/17 is higher in IFF15 than IFF14[51].

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45 Coalition I-22 a)
46 Coalition I-22 a)
47 Coalition I-3 a-d)
48 Interim Application, Attachment 1, page 53
49 PUB I-52 a-c) and Coalition I-28 b)
50 Coalition I-23 a)
51 Coalition I-1

Capital Spending (in millions of dollars)	MH15 Sustaining Capital	MH15 DSM	MH15 New Generation & Transmission	MH14 Sustaining Capital	MH14 DSM	MH14 New Generation & Transmission	MH15 Less MH14 Sustaining Capital	MH15 Less MH14 DSM	MH15 Less MH14 New Generation & Transmission
2015*	559	33	1 342	571	52	1 400	(12)	(19)	(58)
2016	577	62	1 951	577	59	1 855	-	3	96
2017	610	58	2 688	610	77	2 387	-	(19)	302

- The higher level of capital spending in 2015/16 and 2016/17 is in part to catch-up for on the under spending in 2014/15. It also reflects the advancement of expenditures on BP III and Keeyask previously planned for 2017/18 and 2018/19[52]. Reasons for the advancement are provided in Coalition I-1 c).

CAPITAL EXPENDITURE FORECAST (CEF15 less CEF14)

(in millions of dollars)

	2015 Under-expenditure	2016	2017	2018	2019
Major New Generation & Transmission					
Keeyask - Generation	(72)	142	150	(125)	(92)
Bipole III - Transmission Line	(75)	87	114	(134)	11
Bipole III - Converter Stations	(19)	67	115	(135)	(15)
Target Adjustment (Cost Flow)		(165)	(21)	58	(15)
Other		(31)	(75)	134	40
MAJOR NEW GENERATION & TRANSMISSION TOTAL (Excluded DSM)		**96**	**302**	**(217)**	**(71)**

Balance Sheet

- As of the end of 2016/17, the overall level of long term debt is higher and retained earnings are lower in IFF15 (than IFF14) leading to a lower equity ratio of 14% versus 16%.

- Three factors contributing to the higher long term debt are:

    - Higher total capital spending over the 2014/15 - 2016/17 period in IFF 15 as discussed above.
    - Lower net income levels, even after allowing for higher contributions to the BP III deferral account.
    - Advanced borrowing to improve Manitoba Hydro's liquidity.

52 Coalition I-1 d)

Conclusions 2015/16 and 2016/17 revised forecast:

- Taking IFF15 at face value, there is an apparent deterioration in Manitoba Hydro's financial situation over these two years as suggested by the decline in the equity ratio for 2016/17 from 16% in IFF14 to 14% in IFF15. Lower net income over the period leads to lower retained earnings and higher long term debt.
- However, the following considerations must be taken into account when comparing the results regarding net income:
  - While the impacts have not been quantified it is reasonable to assume that both O&A costs and interest costs in 2015/16 will be less than forecast. However, export prices (and therefore revenues) are also expected to be lower.
  - Manitoba Hydro's decision to follow IFRS as opposed to the PUB's direction with respect to overhead capitalization and depreciation reduces net income in over the two year 2015/16 and 2106/17 by almost $100 M. Following the Board's directives would have reduced the net income shortfall between the two IFFs from $132 M to roughly $34 M[53].
  - In addition, $55 M of the $132 M difference in net income reported in IFF5 vs. IFF14 for the two years is due to higher accruals to the BP III account.
  - Recognizing Hydro's failure to follow PUB direction relating to overhead capitalization and depreciation and the difference resulting from higher accruals to the BP III account, it is reasonable to conclude that from an operating perspective that the current income forecast in IFF15 for 2015/16 and 2016/17 is more favourable than that in IFF14.
- Similarly, when considering the increase in debt levels it is important to note that the main reasons for the higher debt are:
  - The advancement of spending that was originally planned to occur in 2017/18 and 2018/19, and
  - The plan to increase Manitoba Hydro liquidity position which, in turn, is expected to reduce costs over the long term.
- Taken in this context, it would appear that the factors leading to the deterioration are short-term in nature and not indicative of any long term deterioration in the Corporation's financial position relative to IFF14.
- Indeed the opposite is may be the case as, under the Board's directed approach to regulatory accounting, retained earnings (including BP III deferral account accruals) will be higher than forecast in IFF14 and interest rates (even lower than those forecast in IFF15) are now expected. However, offsetting these positives are indications that export prices may be lower than those used in the forecast.

53 From comparing IFF14 with the results of Interim Application, Attachment 1, Scenario 1

FORECAST TEN YEAR RESULTS (IFF15 vs. IFF14)

Income Statement

- Over the 10 year period 2016-2025 IFF15 is showing an accumulation of annual net income that is almost $ 1 Billion higher than IFF14 ($975 M)[54].

Figure 14. Comparison of Electric Operations MH15 vs. MH14

Comparison of Electrical Operations MH15 to MH14
Increase/(Decrease)
(millions of $)

	2016			2017			2016-2025		
	MH15	MH14	Variance	MH15	MH14	Variance	MH15	MH14	Variance
General Consumers at projected rates	1 463	1 479	(16)	1 551	1 544	6	18 560	18 634	(73)
Extraprovincial	395	434	(39)	406	450	(44)	7 010	7 036	(26)
Other	29	14	15	28	14	14	565	151	415
Total Revenues	1 887	1 928	(40)	1 985	2 008	(23)	26 136	25 820	316
Operating and Administrative	542	542	-	552	552	-	5 909	5 909	-
Finance Expense	566	510	56	588	548	41	9 075	9 832	(757)
Depreciation and Amortization	410	401	10	426	422	3	6 184	5 849	335
Water Rentals and Assessments	126	123	3	116	112	3	1 230	1 222	8
Fuel and Power Purchased	120	130	(10)	151	191	(40)	1 940	2 235	(295)
Capital and Other Taxes	107	107	-	122	121	2	1 446	1 417	29
Corporate Allocation	8	8	-	8	8	-	82	82	-
Other Expenses	2	2	-	2	2	-	24	26	(2)
	1 882	1 824	58	1 965	1 956	9	25 891	26 571	(680)
Non-controlling Interest	10	12	(3)	9	8	1	15	37	(22)
Net Income	15	115	(101)	29	59	(31)	260	(714)	975

- Contrary to IFF14, the net income is now positive in eight as opposed to just four of the eleven years up to 2024/25. .

						NET INCOME ($ M)							
ELECTRIC OPERATIONS		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
IFF-14		$102	$115	$59	$64	-$90	-$116	-$178	-$206	-$187	-$124	-$53	-$614
IFF-15		$95	$15	$29	$63	-$41	$21	-$13	$6	-$4	$56	$129	$356
Notes:	For IFF15 Net Income 2015 is the actual result - per Application												$970

Domestic Revenues

- Over the ten year period between 2016 and 2025, general consumer revenues are $73 M lower in IFF15 than IFF14.

- Coalition I-15 a) presents a chart setting out the change in the load forecast between IFF14 and IFF15.

54 Interim Application, page 24

	GCR Volumes before Forecast DSM Savings (GW.h)			DSM Savings (GW.h)			GCR Volumes After Forecast DSM Savings (GW.h)		
	IFF15	IFF14 *	Diff	IFF15	IFF14 *	Diff	IFF15	IFF14**	Diff
2016	22 785	22 739	46	(192)	(281)	88	22 593	22 458	134
2017	23 433	23 001	432	(365)	(543)	178	23 068	22 459	610
2018	23 729	23 670	60	(759)	(789)	30	22 971	22 881	89
2019	24 046	24 112	(67)	(1 096)	(1 102)	6	22 949	23 010	(61)
2020	24 175	24 639	(464)	(1 470)	(1 388)	(82)	22 705	23 251	(546)
2021	24 941	24 935	6	(1 723)	(1 616)	(107)	23 218	23 319	(101)
2022	25 270	25 247	23	(1 981)	(1 788)	(193)	23 289	23 459	(170)
2023	25 632	25 552	80	(2 129)	(1 888)	(240)	23 503	23 664	(161)
2024	25 978	25 854	124	(2 268)	(1 985)	(283)	23 710	23 869	(159)
2025	26 338	26 157	181	(2 398)	(2 057)	(341)	23 940	24 100	(160)

* *To allow for comparisons, DSM savings of 152 GW.h attributable to programs implemented in 2014/15 have been reflected in the volumes for IFF14 for the years 2015/16 to 2024/25.*

** *Unchanged from IFF14 Net Load Forecast*

- The IFF15 load forecast before DSM is higher in all years except 2018/19 and 2019/20. The IFF15 forecast is lower in these years due to an assumed delay in a pipeline project[55]. The generally higher growth overall is attributable to the residential sector and an increase in the customer forecast[56].

- DSM savings in IFF15 are assumed to be less in the early years. However, this is more than offset by more aggressive DSM in the later years. As a result, after DSM load in the later years is less under IFF15.

- As set out in the table from Coalition I-15 a), overall the lower revenue in later years (from the lower net load forecast) under IFF15 partially offsets the higher revenues in the earlier years. Higher accruals to the BP III account in IFF15 also offset the higher revenue of the the earlier years[57].

55 Interim Application, Attachment 25, page 14
56 Ibid, page 12
57 Coalition I-15 a)

	Total GCR Revenues ($ millions)			BPIII Deferral Account ($ millions)		
	IFF15	IFF14	Diff	IFF15	IFF14	Diff
2016	$ 1 517	$ 1 512	$ 5	$ 54	$ 32	$ 22
2017	$ 1 617	$ 1 578	$ 39	$ 67	$ 34	$ 33
2018	$ 1 678	$ 1 665	$ 12	$ 69	$ 36	$ 34
2019	$ 1 743	$ 1 740	$ 2	$ 21	$ 11	$ 10
2020	$ 1 800	$ 1 822	$ (22)	$ -	$ -	$ -
2021	$ 1 901	$ 1 900	$ 1	$ -	$ -	$ -
2022	$ 1 981	$ 1 985	$ (4)	$ -	$ -	$ -
2023	$ 2 076	$ 2 080	$ (4)	$ -	$ -	$ -
2024	$ 2 176	$ 2 179	$ (3)	$ -	$ -	$ -
2025	$ 2 282	$ 2 285	$ (3)	$ -	$ -	$ -

Export Revenues

- Total export revenues over the 10 year period are reported to be $26 lower in IFF15 (as compared to IFF14)[58]. This $26 M reduction is more than accounted for by the change in reporting of Transmission credits[59].

- After allowing for the impact of transmission credits, the increase in export revenues in IFF15 (over IFF14) is attributable to the projected weakening of the Canadian dollar and lower Manitoba loads in the later part of the period which allow for increased export sales. These positive effects are offset to some extent by lower forecast export prices[60].

- The table below provides a comparison of the average revenue from US exports (in US$)[61]. Export prices are considerably lower in IFF15 at the start of the 10-year period but the gap closes over the period.

58 Interim Application, page 24
59 Coalition I-23 c)
60 Interim Rate Application, page 25
61 PUB I-13 a)

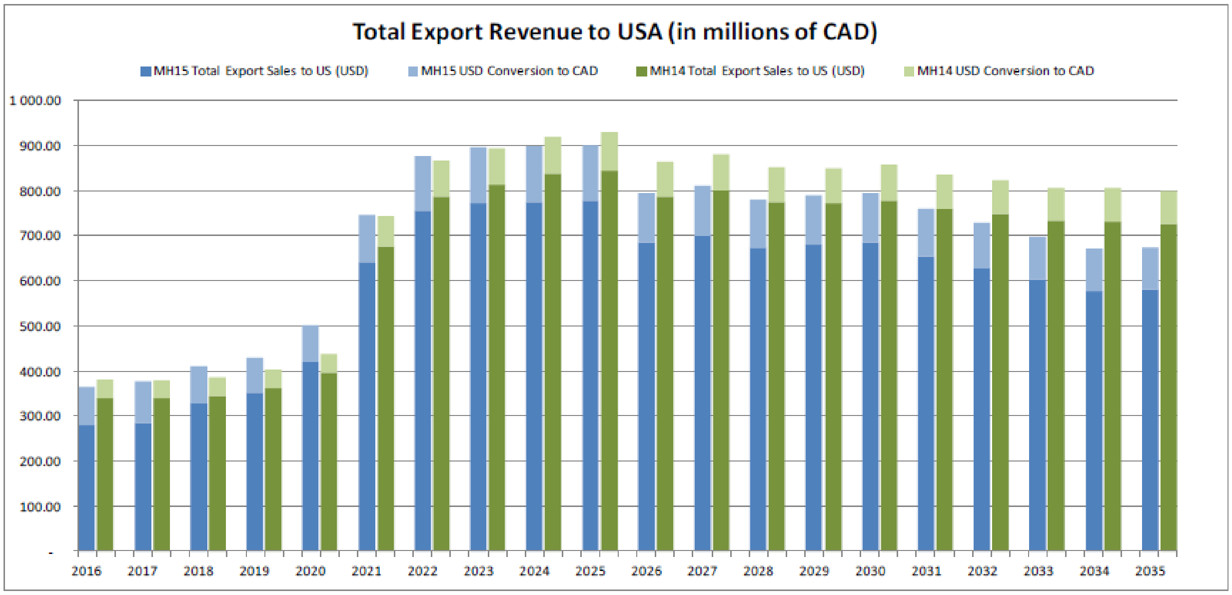
TOTAL EXPORT SALES TO USA

	MH15			MH14		
Fiscal Yr Ending	Revenue (in millions of US$) *	Volumes (in GW.h)	Average Unit Revenue* (₵/kW.h)	Revenue (in millions of US$) *	Volumes (in GW.h)	Average Unit Revenue* (₵/kW.h)
2016	279.728	8785	3.18	339.315	8596	3.95
2017	285.334	6929	4.12	338.845	6444	5.26
2018	326.903	6183	5.29	344.922	6192	5.57
2019	352.370	6268	5.62	360.483	6143	5.87
2020	420.563	6855	6.13	395.906	6289	6.30
2021	641.716	9136	7.02	674.258	9464	7.12
2022	753.846	9986	7.55	787.390	10232	7.70
2023	772.038	9870	7.82	811.774	10207	7.95
2024	774.375	9622	8.05	836.562	10017	8.35
2025	776.267	9398	8.26	843.835	9789	8.62
2026	684.839	8835	7.75	785.900	9462	8.31
2027	699.060	8835	7.91	799.939	9410	8.50
2028	672.082	8389	8.01	773.832	8960	8.64
2029	679.622	8221	8.27	772.402	8780	8.80
2030	685.014	8031	8.53	777.860	8559	9.09
2031	654.605	7533	8.69	759.116	8200	9.26
2032	627.993	7010	8.96	748.639	7870	9.51
2033	601.820	6533	9.21	732.199	7501	9.76
2034	577.477	6109	9.45	731.650	7258	10.08
2035	580.359	5997	9.68	725.450	6971	10.41

* Excluding Net Transmission Charges

- The following graphic shows the combined effect of the change in export prices in US $ and the change in the exchange rates used between IFF14 and IFF15 on the total export revenues in each case[62].

62 PUB I-13 b)



- As noted earlier, Manitoba Hydro is now expecting MISO prices to be lower than forecast[63]. There is no indication as to how long prices are now expected to be lower or by how much but it appears likely the overall export revenues for the period will be less than forecast in IFF15.

Other Revenues

- Over the 10 year period, Other Revenues in IFF15 are $415 M higher. Virtually all of the difference is due to changes between the two IFFs in the way amortization of customer contributions; billing surcharge recoveries and amortization of the BPIII deferral account are reported[64].

Expenses – Operating and Administrative (O&A)

- Over the period there is no change in the O&A cost forecasts as between IFF14 and IFF15[65].

IFRS

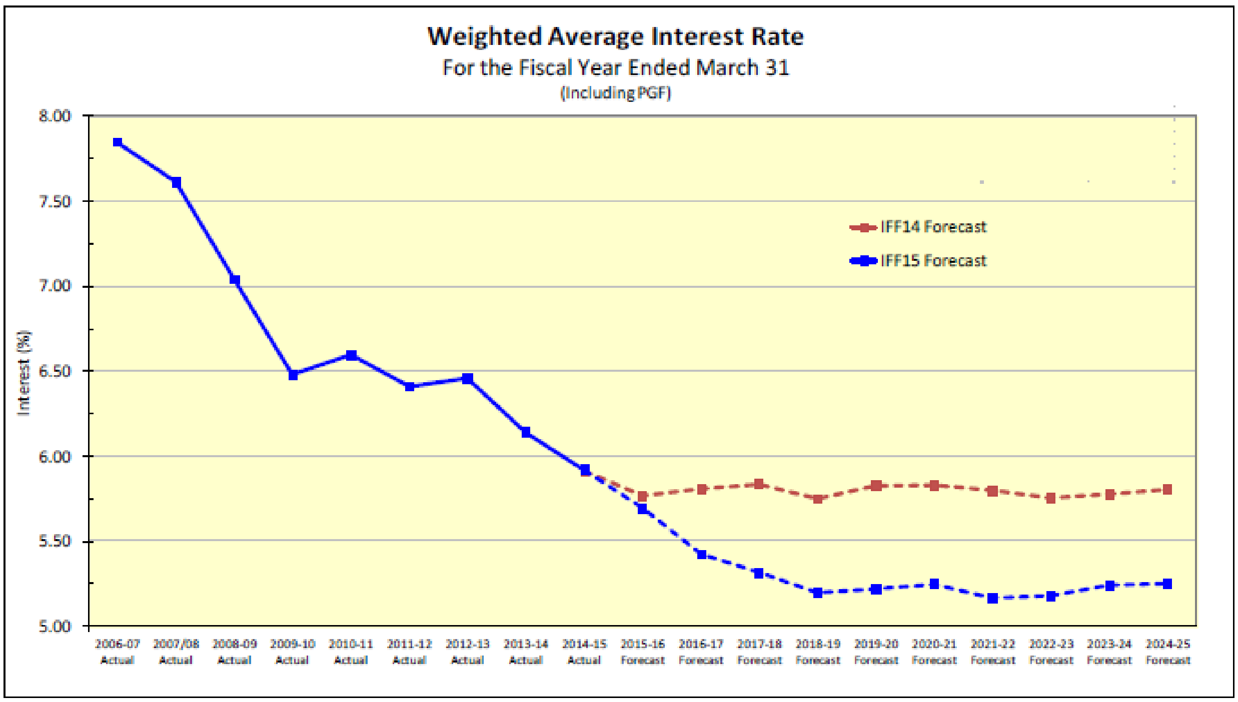
- As noted previously, in preparing IFF15, Manitoba Hydro did not follow the Board's direction regarding the capitalization of the additional $20 M in overheads[66]. Over the 10 year period, this would reduce O&A expense by $200 M and have the net effect of an

63 PUB I-14 c)
64 Coalition I-18 a)
65 MIPUG I-14 b)
66 Interim Application, Attachment 1, page 53

overall reduction in expenses of $154 M[67], after allowing for the amortization of the "capitalized" amounts.

<u>Expenses – Finance Expense</u>

- Over the 10-year period Manitoba Hydro is forecasting that Finance Expenses will be $757 M lower in IFF15 as compared to IFF14. This is due to the lower forecast interest rates in IFF15 (vs. IFF14). The following graph shows the change in the average cost of debt as between IFF14 and IFF15[68].



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Actual	7.85	7.61	7.04	6.48	6.60	6.41	6.46	6.14	5.92										
IFF14									5.91	5.77	5.81	5.83	5.75	5.82	5.83	5.80	5.75	5.77	5.80
IFF15										5.69	5.42	5.32	5.20	5.22	5.25	5.17	5.18	5.24	5.25

- As noted previously, Manitoba Hydro has provided a more recent interest rate forecast which now expects interest rates to be lower still. While there is also a reduction in forecasted rates over the long term, it is not as great as what was seen for 2015/16 and 2016/17[69]. However, the sensitivity analysis provided by Manitoba Hydro in IFF15 indicates that even a 0.1% reduction in rates could increase retained earnings by $88 M by 2024/25[70].

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67 Coalition I-29
68 PUB I-29
69 PUB -28
70 Interim Application, Attachment 1, page 27

IFF 2015 - (Fall 2015 Update)				January 2016			
Canada 10 Yr+ Bond Yield	Spread	Guarantee Fee	MH Cdn Long Term Rate	Canada 10 Yr+ Bond Yield	Spread	Guarantee Fee	MH Cdn Long Term Rate
2.15%	0.90%	1.00%	4.05%	1.90%	1.00%	1.00%	3.95%
2.45%	0.90%	1.00%	4.35%	2.20%	0.95%	1.00%	4.15%
3.00%	0.80%	1.00%	4.80%	2.80%	0.80%	1.00%	4.60%
3.60%	0.80%	1.00%	5.40%	3.75%	0.80%	1.00%	5.60%
3.70%	0.80%	1.00%	5.50%	3.90%	0.80%	1.00%	5.70%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%
3.80%	0.80%	1.00%	5.60%	3.70%	0.80%	1.00%	5.50%

Expenses – Depreciation and Amortization

- The total depreciation and amortization charges for the 2016/17 to 2024/25 period increase by $335 M in IFF15 (over IFF14)[71]. However, $289 M of this is due to the change in reporting of: i) the amortization of customer contributions and ii) the BP III deferral account amortization[72]. Also, contributing to this increase are higher levels of amortization for DSM in the latter years[73] of the forecast as well as the new Manitoba-Saskatchewan Transmission project[74].

IFRS

- As noted previously, IFF15 was prepared[75] using the ELG methodology for calculating deprecation as opposed to the ASL methodology that the PUB had directed be used.

- Manitoba Hydro has indicated that using ASL over the 2015/16 to 2024/25 period would decrease depreciation and amortization charges by $371 M[76], even after allowing the amortization of the difference.

71 Interim Application, page 24
72 Coalition I-22 a)
73 Coalition I-22 a)
74 Manitoba Hydro has declined to provide details regarding the impact of the Manitoba-Saskatchewan Transmission Project (Coalition I-31 c). However the Project costs $57 M and comes into service in June 2021 (CEF15, page 16)
75 Interim Application, Attachment 1, page 53
76 Coalition I-28 b)

Expenses – Fuel and Power Purchased

- Over the 2015/16 to 2024/25 period total Fuel and Power Purchased expense is lower in IFF15 (versus IFF14) by $295 M.

- This is due to a reduction in both volumes and market prices as well as the reporting change for transmission credits/charges, offset to some extent by change in foreign exchange assumptions[77].

Fuel & Power Purchased - Comparison MH15 vs MH14
(in millions of dollars)

	Variance due to:					
Fiscal Yr Ending	Price	Volume	Removal of Interco. Trans.	Other	FX	Total
2016	1	(10)	(12)	4	6	(10)
2017	(25)	(11)	(13)	(2)	11	(40)
2018	(7)	(2)	(13)	(8)	10	(20)
2019	(6)	(7)	(13)	(8)	7	(27)
2020	(5)	(10)	(13)	(9)	6	(31)
2021	(5)	(6)	(13)	(9)	6	(28)
2022	(6)	(5)	(13)	(18)	7	(35)
2023	(6)	(6)	(13)	(12)	7	(30)
2024	(10)	(9)	(14)	(12)	7	(37)
2025	(10)	(9)	(14)	(9)	7	(36)

Capital Spending

- Total capital spending over the 2015/16 to 2024/25 period is $320 M more than in IFF14 as shown below[78].

77 Coalition I-23 c)
78 Coalition I-1

Capital Spending (in millions of dollars)	MH15			MH14			MH15 Less MH14		
	Sustaining Capital	DSM	New Generation & Transmission	Sustaining Capital	DSM	New Generation & Transmission	Sustaining Capital	DSM	New Generation & Transmission
2015*	559	33	1 342	571	52	1 400	(12)	(19)	(58)
2016	577	62	1 951	577	59	1 855	-	3	96
2017	610	58	2 688	610	77	2 387	-	(19)	302
2018	547	99	2 277	547	84	2 494	-	15	(217)
2019	547	95	1 366	547	94	1 437	-	1	(71)
2020	548	90	805	548	78	806	-	12	(1)
2021	573	92	368	573	73	354	-	20	15
2022	555	97	228	555	61	135	-	36	93
2023	563	72	79	563	50	67	-	22	12
2024	571	67	42	571	50	60	-	18	(19)
2025	621	71	38	621	48	60	-	23	(22)

*Amounts listed under MH15 for Fiscal year 2015 represent actual expenditures.

- Of this, $132 M is due to increased spending on DSM, while some of the key changes to New Generation and Transmission project costs are summarized below[79].

Figure 30. Summary of Electric Operations Project Cost Increases (Decreases) in CEF15

Summary of Electric CEF15 Project Increases/(Decreases)

	Total Projected Cost	10 Year Increase (Decrease)
	($ Millions)	
*Electric Demand Side Management	NA	132
Steinbach Area 230-66kV Capacity Enhance	85	85
Bipole III - Transmission Line	1 655	78
Keeyask - Generation	6 496	76
Manitoba-Saskatchewan Transmission Project	57	57
Gillam Redevelopment and Expansion Program (GREP)	266	33
Bipole III - Collector Lines	260	24
Bipole III - Converter Stations	2 675	23
Pointe du Bois Spillway Replacement	595	15
Conawapa - Generation	405	15
Wuskwatim - Generation	1 449	10
Single Cycle Gas Turbines & Thermal Transmission	NA	-
Pointe du Bois Powerhouse Rebuild	NA	-
Pine Falls Units 1-4 Major Overhauls	90	(52)
Target Adjustment (Cost Flow)	NA	(154)
Other System Upgrades	NA	(21)
		320

79 Interim Application, page 50

- It should be noted that the chart sets out changes in the planned spending for the period 2015/16 to 2024/25 and increases in this period do not necessarily mean the total project costs, but rather a change in timing (including catch up on underspending in 2014/15). The following chart sets out the changes in total project costs in IFF15 versus IFF14[80].

Figure 31. Change in Total Project Costs for Major Generation & Transmission in CEF15

	Total Project Costs CEF15	Change in total project cost relative to CEF14	Revisions:
Wuskwatim - Generation	1 448.6	-	
Keeyask - Generation	6 496.1	-	
Grand Rapids Hatchery Upgrade & Expansion	23.5	-	
Conawapa - Generation	404.7	7.7	Estimate reflects an increase in capitalized interest to align with the revised timing of the review of the project business case and anticipated additional First Nation costs.
Kelsey Improvements & Upgrades	338.8	(1.5)	Project decrease reflects a revised schedule, refined construction contracts and updated interest, escalation, activity and overhead rates.
Kettle Improvements & Upgrades	190.9	(0.6)	Project decrease reflects a revised schedule, finalization of construction contracts and updated interest, escalation, activity and overhead rates.
Pointe du Bois Spillway Replacement	594.8	20.0	Project increase is the result of schedule delays in execution of work in late 2014, projected contractor performance in 2015 and resolution of claims, potential increase to the future re-vegetation work and site restoration in 2016. The budget also includes higher interest costs as a result of the schedule delay and cost increases.
Pointe du Bois - Transmission	118.1	3.8	Project increase reflects higher contractor pricing on transformer deluge system and fence replacement as well as higher labor costs on the Stafford Station rebuild.
Gillam Redevelopment and Expansion Program (GREP)	266.5	-	
Bipole III - Transmission Line	1 655.4	-	
Bipole III - Converter Stations	2 675.1	-	
Bipole III - Collector Lines	260.2	-	
Bipole III - Community Development Initiative	62.0	-	
Riel 230/500kV Station	319.9	(10.0)	Project decrease reflects a reduction for unused contingency, removal of escalation and lower capitalized interest.
Manitoba-Minnesota Transmission Project	353.6	3.3	Project increase reflects a refinement of estimates for licensing and environmental approvals.
Manitoba-Saskatchewan Transmission Project	57.0	57.0	New project

Balance Sheet

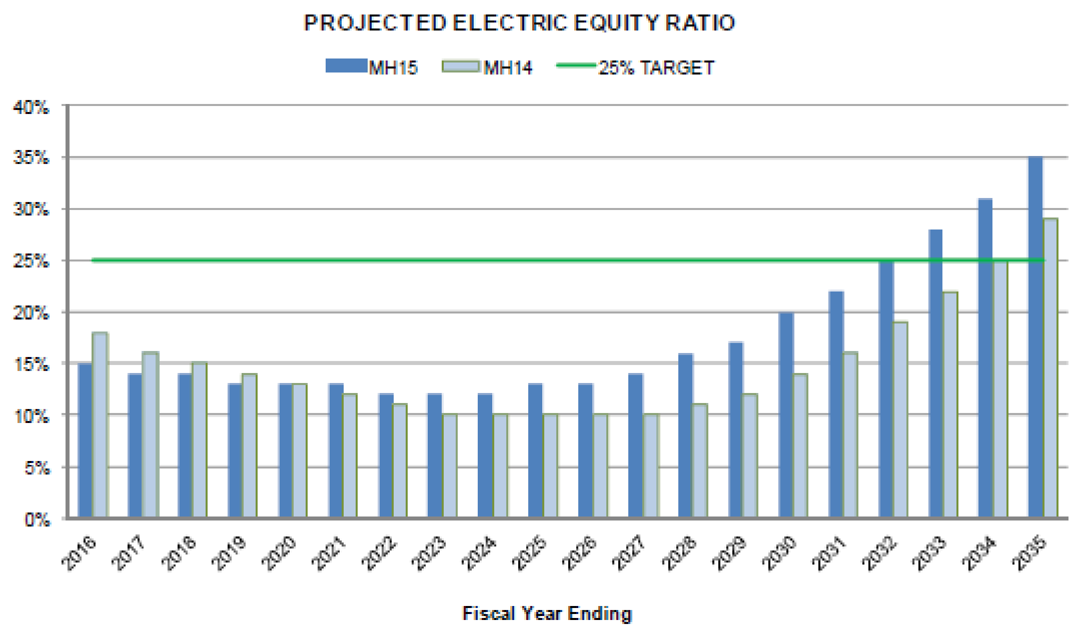
- As of 2025, forecast Total Assets in IFF15[81] are higher than in IFF14[82] ($29.3 B versus $27.9 B). Long Term Debt is lower ($22.7 B versus $23.4 B) and Retained Earnings are higher ($2.9 B versus $1.9 B). Overall, this results in a higher equity ratio of 13% versus

80 Interim Application, page 51
81 Interim Application, Attachment 1, page 43
82 2015/16 & 2016/17 GRA, Appendix 11.12

10%.

- The change in financial outlook also changes the pattern of projected equity ratios for the entire period and beyond as illustrated in the following figure[83]. As can be seen, the lower IFF15 equity ratios noted earlier for 2015/16 and 2016/17 disappear by 2019/20 and progressively improve (relative to IFF14) thereafter. This is primarily due to the lower projected interest rates and resulting finance charges[84].

Figure 17. Projected Electric Equity Ratio MH15 vs. MH14



<u>Conclusions for the longer term</u>

- Over the longer term Manitoba Hydro's financial outlook is improved significantly in IFF15 relative to IFF14. This can be seen from the improvement in the equity ratio outlook at between the two IFFs.

- This improvement occurs despite the fact that in IFF15 the 3.95% annual rate increases are only maintained through to 2028/29. In IFF14, they were maintained through to 2030/31. So the improvement in the longer term outlook beyond 2024/25 occurs even though the cumulative rate increases through to 2034/35 are lower.

- Just as fundamentally, this outlook does not reflect the impact of following the Board's directions with respect to the capitalization of overheads and continuing use of the ASL methodology for depreciation. Attachment 28 sets out the forecast financial results if

83 Interim Application, page 33
84 Interim Application, page 34

these two directives are followed and show that in 2024/25:

- Retained Earnings have increased to $3.4 B (as compared to $2.9 B in IFF15), and
- The equity ratio has increased to 15% (from 14% in IFF15).

The target equity ratio of 25% is attained in 2030/31 as opposed to 2031/32.

- In its discussion of the results from following the Board's directives Manitoba Hydro raises concerns regarding inter-generational equity that it views are triggered by the growth in regulated assets[85]. Manitoba Hydro goes on to quote the BC Auditor General's comments regarding BC Hydro's use of deferral accounts for rate smoothing purposes. Hydro's concern is predicated on the view that ELG is the appropriated depreciation methodology and that the $20 M in O&A is more appropriately expensed each year from an inter-generational perspective.
- These are issues that are a matter for debate and for robust regulatory deliberations which the PUB already has already initiated. In the case of depreciation, both ELG and ASL recover the costs of the assets in-service. If ASL is deemed by the PUB to be the appropriate depreciation method then the use of deferral/regulatory accounts will contribute to inter-generational equity.
- Finally, while it now appears that export price will be lower than forecast it also appears that interest rates will be lower as well. It is not clear what the net effect of these two factors will be.
- Despite this uncertainty, the IFF15 results and the further scenarios provided in Attachment 28 beg the question of whether or not a steady pattern of 3.95% annual rate increases called for by Manitoba Hydro for more than the next ten years is required.

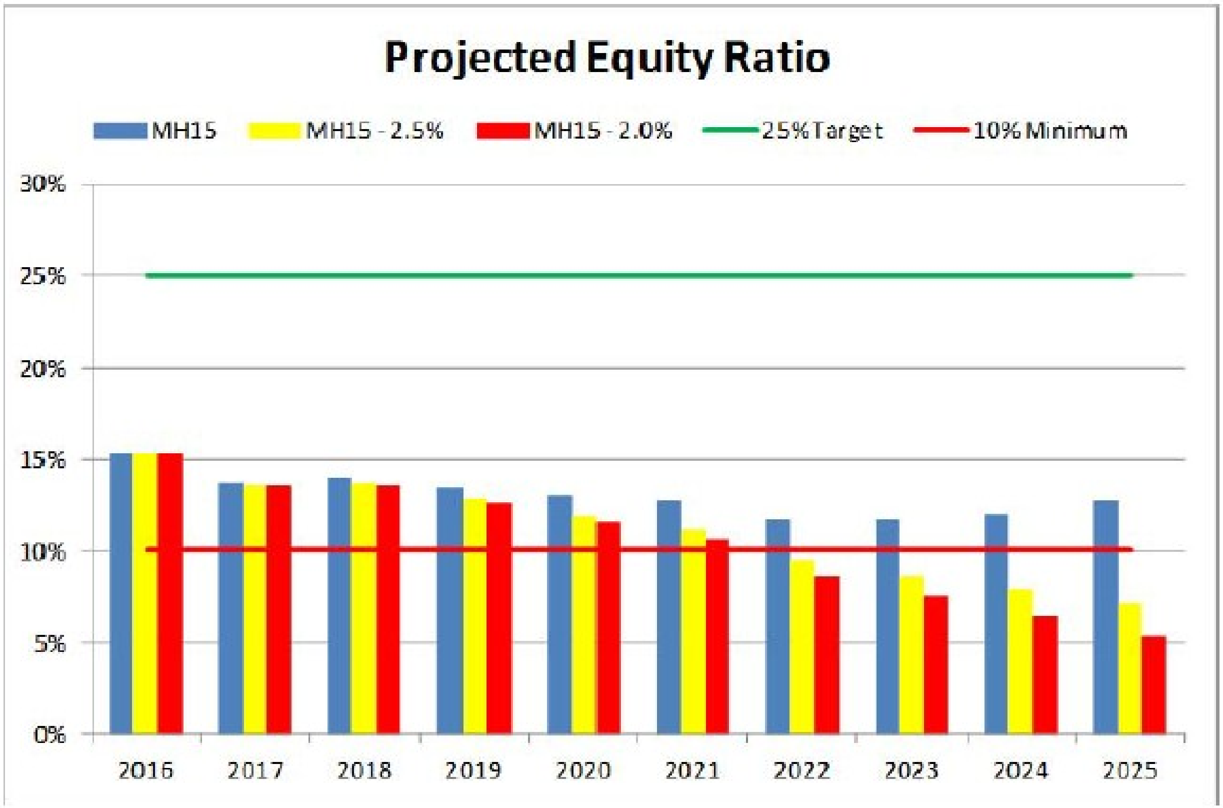
ALTERNATIVE RATE INCREASE SCENARIOS

Interim Rate Application

- In its Application[86] Manitoba Hydro examined the implication of adopting annual rate increases of 2% or 2.5% over the period 2016/17 to 2024/25. The analysis concluded that both rate increase "scenarios" would produce unacceptable financial results over the period as indicated by the following chart[87] and that the proposed indicative rate increases of 3.95% continue to be the minimum necessary[88].

85 Attachment 28, pages 2-3
86 Page 36
87 Interim Application, page 39
88 Ibid, page 42

Figure 22. Projected Equity Ratio under Varying Rate Increase Assumptions



- However there are at least two issues with Manitoba Hydro's analysis. The first is that there is a significant difference between 2.5% and 3.95% annual rate increases and Manitoba Hydro did not explore any of this "middle ground". The second is that the analysis was based on IFF15 which, as already noted, was not based on the Board's directives with respect to depreciation methodology or overhead capitalization.

<u>Other Alternative Scenarios</u>

- Following the initial filing and during the IR process various alternative scenarios were requested and provided by Manitoba Hydro.

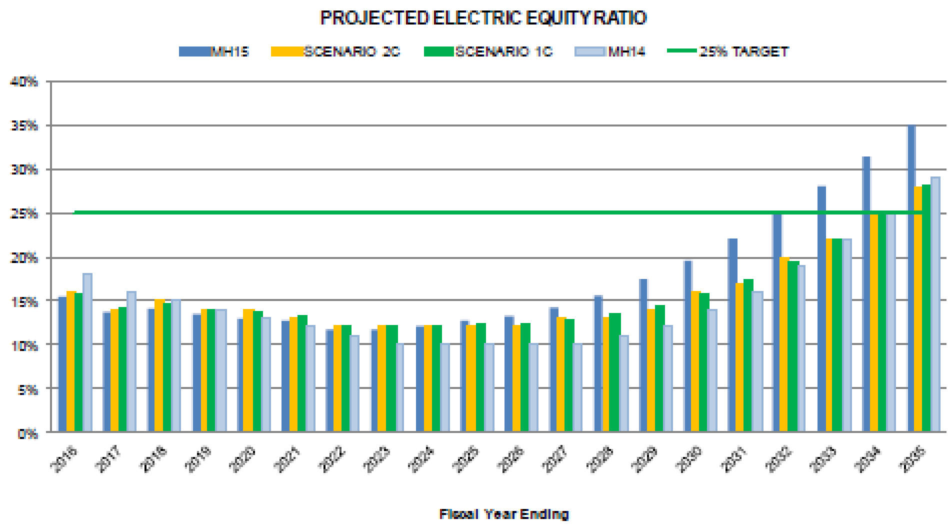
  Attachment 46

- Following the initial filing, the PUB Staff requested a scenario based on meeting the 25% equity ratio target by 2033/34 (the same year as in IFF14) and using the Board's directed accounting for depreciation and overheads. The results[89] indicated that:
  - A sustained rate increase of 3.36% would be required to achieve the desired

89 Attachment 46, Scenario 1

results,
- The equity ratio would only dip to a low of 12% (as opposed to the 10% in IFF15), and
- Retained earnings would dip to a low of $2.8 B in 2022/23 and 2023/24 (as compared to a low of $2.7 B in IFF15)

- The long term outlook for the equity ratio based on this scenario versus IFF15 is set out in the following chart[90]:



PUB I-5 – Based on Board's Accounting Direction

- Requested variations on Attachment 46 where rate increases of 0%, 2%, 3% and 5% were implemented in 2016/17 and then the average annual rate increase determined through to 2033/34 that would yield the target equity ratio in that year. The rate increase results are summarized in the following table:

ANNUAL RATE INCREASES TO ACHIEVE 25% EQUITY RATIO BY 2033/34 BASED ON IFF15 AND PUB's DIRECTIVES RE: DEPRECIATION AND OVERHEADS	
2016/17	**2017/18 -> 2033/34**
3.36%	3.36%
0%	3.78%
2%	3.53%
3%	3.41%
5%	3.16%

- It should also be noted that under the 0%/3.78% scenario the minimum equity ratio for the period is 11%. This value increases to 12% for the 2%/3.53%; 3%/3.41% and 3.36%/3.36% scenarios and is 13% for the 5%/3.16% scenario.

90 PUB I-4 c)

PUB I-5 – Based on IFF15

- The same interrogatory asked for variations of IFF15 where the rate increases were 0% and 2% in 2016/17 followed by Manitoba Hydro's proposed rate increases thereafter. The following Table summarizes the results and also includes the results from IFF15 and IFF14 for comparison.

RATE INCREASE PATTERN	MINIMUM EQUITY RATIO	YEAR 25% EQUITY ACHIEVED
2016/17 – 0% / IFF15 thereafter	9%	2034/35
2016/17 – 2% / IFF15 thereafter	11%	2033/34
IFF15 throughout	12%	2031/32
IFF14[91]	10%	2033/34

MIPUG I-13

- Asked for a scenario based on IFF15 but using 2% rate increases through to 2018/19 and then 3.95% thereafter. Under this scenario:
    - The target 25% equity ratio is achieved in 2034/35, and
    - The minimum equity ratio falls to 8%.

<u>Conclusions</u>

- There is no "urgent" need for the 3.95% interim rate increase requested by Manitoba Hydro.
    - Using the values from IFF15, a rate increase of slightly more than 2% would be sufficient to ensure projected net income for 2016/17 is greater than zero[92]. However, using the accounting approach directed by the PUB in 73/15 a 0% rate increase in 2016/17 would still result in positive net income for 2016/17[93].
    - Using the values from IFF15, a 2% rate increase in 2016/17 followed by rate increases similar to those proposed in IFF15 would yield longer term financial results (in terms of equity ratio) that are similar to IFF14 (i.e. achievement of target ratio by 2033/34 – same as IFF14 - and a minimum equity ratio of 11% - higher than the 10% minimum in IFF14). Furthermore, using the accounting approach directed by the PUB a 0% rate increase in 2016/17 would only require subsequent increases of 3.78%/annum in order to achieve the target equity ratio in 2033/34 (and the minimum equity ratio would again be 11%).

- To the extent issues of long term rate stability and rate smoothing are viewed as relevant

91 2015/16 & 2016/17 GRA, Appendix 11.12

92 Based on IFF15 a 3.95% increase produces $61 M in additional revenue and a net income for 2016/17 of $29 M. As a result, each 1% rate increase produces over $`15 M in additional revenues.

93 PUB I-5 b) ii) – Scenario 1 (d)

considerations when considering requests for an interim rate approval, it is clear that even under IFF15 an increase of less than 3.95% in 2016/17 and equivalent thereafter through to 2030/31 (same as used in IFF14) would result in achieving the target equity ratio prior to 2033/34 – the year that the ratio was projected to be achieved in IFF14[94]. Furthermore, under the accounting approach directed by the PUB steady rate increases of 3.36% per annum to 2033/34 would result in achieving the target equity ratio in 2033/34 – the same year as IFF14.

94 IFF15 only calls for increases of 3.95% through to 2028/29 (as opposed to 2030/31 in IFF14) and still achieves the target equity ratio two years earlier.

Appendix D
The Legal Standard for Just and Reasonable Interim Rates

It is well accepted that the legal criteria for setting rates is driven by the "just and reasonable" standard as articulated in s. 77 of *The Public Utilities Board Act (*PUB Act*)* as well as s. 27(3) of *The Crown Corporation Public Review and Accountability Act*. This standard is confirmed in *Order 5/12*, p. 27 as well as *Order 98/14*, p. 28.

On its face, the Board's jurisdiction in making an interim order is quite broad. Section 47(2) of *The PUB Act* provides that:

> 47(2) The board may, instead of making an order final in the first instance, make an interim order and reserve further directions, either for an adjourned hearing of the matter, or for further application.

However, s. 48 of *The PUB Act* states that:

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

In prior proceedings, some Intervenors have argued that s. 48 operates to limit the power of the Board to issue an interim rate unless a full opportunity to present evidence has been offered. They have suggested that unless there is a finding of urgency or similar special circumstances, no interim Order resulting in an outlay, loss or deprivation (ie a rate increase) can be issued absent due notice and a full opportunity to all parties to produce evidence and be heard at a public hearing.

The PUB has rejected this assertion most notably in *Order 49/14* where it found that:

- the standard of proof is on a *prima facie* basis
- the legal question is whether it would be just and reasonable to grant interim rates
- urgency is not a necessary precondition for an interim rate increase but it is appropriate to consider current financial circumstances in light of recent financial results[1]

For this purposes of its submissions in this proceeding, the Consumer Coalition will employ the standard for the determination of interim rates articulated by the PUB in *Order 49/14*.[2] However, in reviewing both *Order 49/14* and *Order 40/11*, the Coalition has not observed a substantive explanation of whether the PUB considers section 48 to be relevant to interim rate determinations.

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1 Order 49/14, pages 16 and 17. See also *Order 40/11*, p. 11.

2 The application of 49/14 criteria should not be taken as a concession in future interim applications that s. 48 does not apply to interim rate decisions.

All consumers would benefit from an explanation of whether and how s. 48 applies to interim rate applications. In issuing its Order with regard to the interim rate application, the Consumers Coalition would ask the PUB to consider whether an explanation of whether and how section 48 of *The PUB Act* applies to interim rate determinations.