MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA HYDRO
2004 GENERAL RATE APPLICATION

Before Board Panel:
Graham Lane - Board Chairman
Len Evans - Board Member
Robert Mayer - Board Member

HELD AT:
Public Utilities Board
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APPEARANCES

R.F. Peters	)Board Counsel
Patti Ramage	)Manitoba Hydro
Byron Williams	)CAC/MSOS
Michael Anderson	)Manitoba Kewatinook Ininew Okimowin (MKO)
Peter Miller (NP)	)TREE
Randall McQuaker (NP)	)
Garnet Boyd (NP)	)IBEW 2034
John Osler	)Manitoba Industrial
Patrick Bowman	)Power Users Group
Tamara McCaffery	)
Jurgen Feldschmid	)CCEP

TABLE OF CONTENTS

LIST OF EXHIBITS

--- Upon commencing at 9:12 a.m.

THE CHAIRPERSON: Good morning, everyone. The Hearing is entering its final phase, and to paraphrase Walter Whitman,

> "Oh Captain, Oh Captain, our fearful trip is almost done. Our little group has weather'd every rack, and the outcome is almost at our back. Port is near, I hear the bells."

Hydro's first Application to increase rates since 1997, 1992 for industrial ratepayers, began with the filing of the GRA in January of this year.

Due primarily to changes at the Board, the Hearing was set for June, a delay from what otherwise would have been expected.

The Corporation supported its Application with Panels providing testimony, supporting schedules and responses to Information Requests.

The Intervenors and the Board advisors filed Information Requests and cross-examined Hydro's witnesses. In addition, three (3) of the Intervenors presented expert witnesses and the company.

The other Intervenors filed information requests, and the Board took advantage of their presence to question them on their views of the Application and related matters.

Today the Board will hear final statements, arguments, if you wish.

We will begin with Mr. Peters, for the Board, and then proceed through the list of Intervenors, and close with the Applicant, Manitoba Hydro.

Out of abundance of caution, and acknowledging the particular weight of this year's Application, the Board will accept supplementary written comments from the participants to next Wednesday, and written reply by Manitoba Hydro is due by next Friday.

The concept behind the process is to help the Board reach conclusions in the public interest, so the Board wants to best ensure those participating in the process have and perceive themselves to have had the time to reflect on yesterday's -- yesterday's transcript and provide their best concluding remarks. If providing this grace period for supplementary comments, provides this opportunity, this is to the better.

At the same time, we are mindful of the remarks Ms. Fernandez and Mr. Williams, Mr. Peters and Ms. McCaffrey, and remind all parties that written submissions to follow this sitting, should not take advantage of the opportunity to explore new areas or engage in critiques of the remarks of others today.

While we reach -- while we reach -- when we reach TREE and the RCM argument, we will distribute their written presentation, as Professor Miller was unavailable today, and gain dispensation in advance to file his final written argument. Mr. Peters will place his argument into the transcript.

Thank you for your patience throughout the Proceedings. Mr. Peters...?

MR. BOB PETERS: Good morning, Mr. Chairman, Board Members, ladies and gentlemen. I’m not sure if I can do justice and paraphrase Walt Whitman, but I think what I hear the Board saying is that after hearing the oral evidence of Manitoba Hydro and the Intervenors, and dealing all with the Rate Application by Manitoba -- we’ve now -- Manitoba Hydro we’ve now reached the point n the proceedings where each of the parties to this Application will provide their final arguments and closing submissions.

As Counsel to the Board it is not my role to take a particular position with any of the issues attached to this Application. Rather, as I have done in the past, I will briefly summarize some of the more important issues that may need to be adjudicated by this Panel and identify issues that should be specifically addressed by the interested parties in their respective closing comments.

As you noted, Mr. Chairman, this is the first General Rate Application before the Board since 1996, at which time Board Order 51 of ’96 approved an increase in general consumer revenue of 1.5 percent in 1996 and a further increase of 1.3 percent in 1997.

Other than a provincial wide implementation of uniform rates which primarily affected residential consumers outside the city of Winnipeg and became effective by way of legislation on November 1st of 2001 there have been no further domestic rate changes since that time, other than certain specific special rate matters.

Because of the extended time period since the last Board review of Manitoba Hydro’s matters in 1996, Hydro filed a Status Update Hearing with the Board on November 30th of 2001 and following the hearings, the Board issued Order 7 of ’03.

Subsequently, Hydro requested the Board to review and vary certain directives in that Order and by way of further Order 154 of ’03, the Board detailed their decision with respect to Hydro’s Application to vary and provided Hydro with certain directives.

Hydro’s responses to many of those directives have been considered as part of these proceedings and some of the directives in 154/’03 remain outstanding in the form of reports and other information that is still to be filed with the Board.

Also, in approximately March of this year, the Board approved interim diesel rates to be effective April 1st of 2004 and further directed Hydro and other parties to undertake a process to resolve certain long outstanding disputed issues.

The diesel Cost of Service is not a specific component of this General Rate Application other than Manitoba Hydro proposes the consequential impact of changes in grid rates which will also affect basic diesel rates.

I mention this matter only in respect of the importance of the resolution to the four (4) remote diesel communities that are affected and to note that the Board is awaiting advice from Hydro regarding the outcome of the resolution process.

I’m sure that Manitoba Hydro will summarize the specific details of the General Rate Application in their summation, but in general terms, the Application requests an increase in general consumer revenue of 3 percent effective April 1st, 2004 and a further 2 + percent effective April 1st, 2005.

Hydro has requested that they be permitted to recover the full years’ revenue for the first test year increase, regardless of when the increase becomes effective. In addition, there are rate change differences within customer classes intended to move some customer classes closer to the Zone of Reasonableness and determined by the Cost of Service Study.

Hydro has also requested certain specific rate changes and final approval of a number of ex parte orders issued by the Board since January of 2003.

Some important issues that have been examined during the evidentiary portion of this hearing and issues that may be addressed by interested parties in their closing comments to assist the Board in its deliberations, include the following.

Firstly, should the two (2) year rate increase requested by Hydro be approved and, in exploring that, in particular, given that Hydro is now projecting an operating loss for fiscal 2004 that exceeds 400 million dollars, and the retained earnings have been significantly lower than target levels, are the requested rate increases sufficient or appropriate to maintain the financial integrity of the Corporation?

Secondly, what if any, increase in rates, if approved, should be done on a retroactive basis? That would mean a rate rider or some other mechanism to recover the full amount of the revenue within the fiscal year as requested by the Corporation.

Next, evidence during the hearing suggested that retained earnings should be sufficient to cover risks related to factors such as drought. We have also heard that losses from a five (5) year major drought previously estimated to be 1 billion dollar range, are now estimated n the 2 billion dollar range.

Given that Hydro's current retained earnings is significantly less than that amount, what if any impact should these considerations have on current and future rate increases?

Then there were a number of directives in order 154 of '03 that I mentioned and they dealt with cost of service issues and cost allocation matters. And, in particular, matters around the substantial export revenues to various customer classes.

It also included the possible creation of an export customer class for cost of service purposes. In response to those directives, Hydro fired -- filed the NERA report as part of these proceedings.

Although Hydro has indicated general agreement with many of the recommendations in the NERA report, Hydro has not reflected any of those recommendations in their Cost of Service Study in this Application.

Any comments parties may have with respect to a suggested process, in respect of changes to the Cost of Service Study, would be helpful for the Board.

Then Hydro has also filed cost allocation study, general consistent with the methodologies previously approved by the Board and based on that Cost of Service Study, Hydro has suggested moving certain customer classes closer to the Zone of Reasonableness, by requesting various differential rate changes within specific customer classes, that are different than the overall average requested increase.

What consideration should be given to rate change differentials for individual customer classes, in the current application, based on the current Cost of Service Study, is another matter to be considered.

Then the Board has also heard much evidence regarding Hydro’s financial targets and financial ratios, including debt levels, debt equity targets, interest coverage ratios and capital coverage ratios.

These are likely to be met with comment from the parties, differing in their views as to how quickly Hydro should achieve some of their targets. But, comments that are -- that interested parties may have on this issue, would be helpful to the Board.

Rate design issues including further discussion of the inverted rate structure has been canvassed in this Hearing and further comments that interested parties may have on rate design issues would also be helpful to the

Board.

Other areas in this Proceeding, include matters related to Hydro's DSM program, including the non-utility generation aspects, O&M costs and other expense levels, capitalization of various costs including planning studies, O&M, and DSM, acquisition of Winnipeg Hydro and the realization of synergy benefits, good will purchased in that acquisition of both Centra and Winnipeg Hydro, together with self insurance risks, the costs of purchase power, thermo-generation, hydraulic generation, load forecasts, capital expenditures, debt management strategy and risk management strategy.

The list is lengthy and no doubt many of the interested parties will express their views and recommendations with respect to some of these items.

In closing, Mr. Chairman and Board Members, I'd like to thank Manitoba Hydro for their considerable effort in providing timely responses to information requests and to various undertakings.

I would also like to acknowledge and thank all of the Intervenors for their important participation in the process. And, of course, I want to thank the Board for their attention and patience in this matter, as well.

I will indicate, that at the end of the day, Mr. Chairman, Ms. Ramage and I, have a few housekeeping matters to attend with respect to undertakings and exhibits. And we'll put that on at the end of the day.

Those conclude my remarks. I suggest it would be appropriate for the Board to pull out the outline of procedures and canvass the other interested parties for their closing comments and I do note that while some of the Intervenors are not yet in the Hearing room, they are expected, and I'm sure they just didn't want to be here to hear me speak.

So, I'm sure they're arriving any minute now.

MR. ROBERT MAYER: I can't believe you actually got it in ahead of schedule. They're probably still out in the hallway expecting you to go over the time estimated.

THE CHAIRPERSON: Thank you very much, Mr. Peters.

First up on our roster today, is CCEP, Mr. Feldschmid.

MR. JURGEN FELDSCHMID: Thank you, Mr. Chair, Members of the Panel. We go from quotes from classics of literature to references to American cinema. We started this proceeder -- Proceeding with My Friend, Mr. Williams, making analogy to the film of Perfect Storm.

Yesterday, My -- My Friend Mr. Anderson, raised the remembrance of the film 2001, and talking about some of the computer programs that Hydro uses for water predictions to the computer HAL, with left me with an image in my mind of Mr. Cormie sitting in front of a -- of a terminal saying, open the reservoir gates HAL." and a very calm, computerized voice saying, "I'm sorry Dave, I can't do that.".

Be that as it may, Mr. Chair and Panel, CCEP as you know, represents the interests of small commercial and non-residential rate payers, by and large falling into the general service small classes, both demand and non-demand, and to some degree, general service medium, but certainly our intervention has been focussed mostly on the treatment of those who fall into the general service small demand and non-demand.

CCEP, as I've indicated previously, is Chaired by Mr. Paul Costas, who's the President of Hampton -- Hampton Inn Suites and the two (2) Super 8 Motels here in Winnipeg, and there are other Board Members of the Corporation which have been set out in our Application for Intervention at the beginning of these proceedings.

As we also indicated at the beginning of these proceedings, Mr. Chair, our interest is primarily in the area of cost of service and -- and rate design. We have, of course, had to monitor and have some participation of the rate -- revenue requirement section of these proceedings, but our focus is certainly on -- on the latter.

We have placed our -- our -- our trust in the other Intervenors, such as CAC, and MIPUG to deal with the reven -- revenue requirement issues. And so in -- in keeping with that, my comments on the revenue requirement area will be extremely brief, and I'll deal with it first.

The only area which I -- I wish to bring to the attention of the Board, is -- is some of the concerns that CCEP has, somewhat out of step with current times as perhaps they may be, on the decisions that Hydro has made in the recent past on capital projects, as they may be affected by environmental concerns and environmental regulation.

And, in particular, I draw the Board -- the Board's attention to my cross-examination of the -- of the Hydro Revenue Requirement Panel, at approximately page 618, and following, and particularly in the -- in the area of page 714 and following.

And the -- and the issue is, in particular, the conversion to coal, of the Selkirk Plant from -- from, or not to coal, from coal to gas, and the effect that that has had, particularly in the experience of the -- of the just recently ending drought, of having to turn to imports and thermal generation, and the fact that this conversion to -- to coal, eliminated from hydro system, a significant coal fired thermal capability, in a context where the coal fire --

coal thermal generation would have been the cheapest of the three (3) possible alternatives in -- in the context of a lack of hydro generation that Hydro might have had.

The evidence at page 717, I believe my questions to Mr. Surminski indicate that, for instance, first of all, that Hydro, rather than relying on gas fire thermal generation, will turn to -- has turned to imports in the recent past, because of the -- the cost benefit of doing so.

But beyond even the imports, the evidence on the record shows that coal would have been an even cheaper alternative, and I believe at page 717, line 4, Mr. Surminski indicates that, on an annual basis, there was a negative impact approximately, using very round numbers, I appreciate, but just to give some -- some mag -- some order of magnitude to it, of some $25 million.

And the concern that CCEP has is that we continue to remain unsatisfied, and I appreciate that in terms of the -- the conversion of the Selkirk Plant that's somewhat water under the bridge, or -- or water through the spillway.

But we -- we nevertheless are concerned that Hydro use more rigour in making these types of determinations. In our view, the -- the conversion to gas and the elimination of coal thermal generation, though well intended, did add to the negative financial impact on

Manitoba Hydro, in the context of the -- of the recent drought.

And dealing with the -- the -- trying to get at the issues as to the decision making process behind that conversion, not only during this process, but also going back to the 2002 Update, we still are somewhat at sea, in terms of understanding the full extent of Hydro's reasoning, whether it was being pushed by considerations of good corporate citizenry, being pushed by anticipated regulation, or -- or existing regulation, we still feel that we're somewhat at sea at that, and -- and submit that that suggests that perhaps there was somewhat -- there was somewhat lacking in rigour.

And unfortunately, while the goal of -- of being environmentally more sound is a laudable one, it has bottom-line monetary impacts on Hydro, and therefore its ratepayers. And that's why we -- we bring that issue on the revenue requirement to the attention of the Board and to the attention of Hydro.

That's really the only particular comment I wanted to make -- make in the general area of revenue requirement. I'll move on to my submissions on the -- in the cost of service area.

In the view of CCEP, the cost of service process is -- is certainly in flux, I think as we all recognize, in the previous order of this Board 7/'03. Hydro was directed to undertake a review of cost of service. I think Hydro in -- even without that direction would be thinking seriously about cost of service issues, based on -- on recent changes.

And what I would like to focus on, I think we've all been focussed on through these Proceedings, is the -- is the influence in the place of the allocation of net export revenues, back to the various customer classes, in the context of export revenues that are growing, not only in terms of volumes, but also in terms of the price per -- per unit being received.

And it is CCEP's position that, and we agree substantially with Manitoba Hydro here, that the increase in the volume of exports and -- and the prices received for exports, has had a distorting affect on the cost of service, and it's something that needs to be dealt with.

Manitoba Hydro is dealing with it, we have a very important, I'll call it a discussion paper from NERA, at the request of Hydro, discussing various options, and I think that will be a very important basis for future consideration by Hydro, and this Board and -- and interested parties, as to the directions that we should take in cost of service, particularly with the treatment of the allocation back of net export revenue.

One (1) of the key concerns that -- or one (1) of the key issues that has come to light in -- from the view of CCEP in this Proceeding, is -- and I think certainly on a more personal level, sort of clicks a light on just about this much above my head, to say why it is that Mr. Wiens and company, made the decision in 2002 to attempt to move to a marginal cost basis for -- for analysing and dealing with generation and transmission.

And -- and I think it was to deal with this issue of an inappropriate mix of marginal costs or marginal revenue, if you will, with respect to what's received in -- in export revenues, and then crediting -- crediting -- let me say that again, crediting -- crediting them back to costs that are embedded costs, low embedded costs.

And I direct the Board to my discussion with Mr. Wiens in and around page 1386 where he raises that issue.

And in particular, so if -- if I may -- if I may essentially summarize, as -- as -- as I understand the evidence, you've got this disconnect between marginal costs or marginal revenue with respect to the net export revenue crediting it -- crediting it back against the embedded costs on the costs side, and the -- and the difference between those two (2) amounts or those two (2) rates is essentially an economic rent; an economic rent that is gleaned from a supply and demand, free market -- free export market and is -- is captured by that -- that -- that export revenue.

And that is then taken and allocated, as we know, by the process and the method approved by this Board in Order 7/'03 to the customer classes based on those customer classes usage of the generation and transmission function.

And while the export revenue in terms of volume and perhaps more importantly, in terms of price, was lower in years past, that was not as much of a -- a distortion problem as -- as it is now.

I direct the Board also to my cross-examination of Mr. Bowman appearing on behalf of MIPUG where I was attempting to question him on this same issue in and around page 1939 of marginal costs or marginal revenues being credited against lower embedded costs raised with him the issue of economic rent; he had some responses that I'm not sure get to the crux of the issue.

But they included saying, well we have water rentals and -- and that's intended to capture the economic rent, although as I -- as I questioned him, I think he was clear and I think everyone in -- in this Proceeding understands that there is no study that particularly says the water rentals or other charges of the -- the -- that the Province levies on Hydro are equally matching the economic rent that is derived from the generation of -- of -- of hydro electricity and there -- therefore remains within the net revenue from exports that Hydro receives or credits back to the customer classes; this element of economic rent. And that is the -- the -- the crux of the -- of the distortion that occurs.

So, bottom-line is from the point of view of CCEP that there are -- there is a significant issue with respect to costs. It is creating a distortion. It is for those customers of Hydro that use the highest percentage of generation transmission in their total costs. It -- the situation is resulting in an outcome in -- on current cost method to suggest that these classes are over-contributing revenue in relation to their costs when, in our submission and at this point, I guess something -- somewhere between view, belief and suspicion is that they are not.

Now, the difficulty of course for the Board today is that we have one (1) official cost of service method which the Board set out its Order 7/’03 and Hydro has followed that in terms of doing the full analysis of allocation of costs for -- for this particular Proceeding. We had the NERA report, but as I’ve indicated, that’s really more in the nature of a discussion paper, I think Hydro would agree with that at this stage, raising ideas for consideration for future modifications to the costs that may improve it in the future.

But, what can the Board, Mr. Chairman you and your colleagues do today and in the coming days as you write your decision to deal with this concern that there is some inaccuracy or some distortions within the current cost.

In the submission of CCEP, the alternative that the Board should be relying on, is to look and see what double checks there are, with respect to the outcome of the Cost of Service Study.

And what, sort of, double checks are available. And I would recall to the Board, the issue of looking at revenue to cost ratios, prior to the attribution back of net export revenue.

And I think the best example or illustration of the effect of that is, in Manitoba Hydro Exhibit 58, where the pre-export RCC's have been re-stated on a base of 100 percent. And looking at that, you see -- well first of all, on -- on the most extreme right column, that general service small non-demand, is 104.9 percent. General service small demand is 109.7 percent.

One (1) barely within ZOR, one (1) clearly about ZOR. On the official cost of service methodology. Looking at the check method of pre-export RCC's, general service small non-demand is 112.6 percent, general service small demand, is one hundred and ten point five (110.5).

General service large, in excess of 100 kV, while appearing to be significantly about the ZOR on the -- shall I say official cost of service methodology, on this double check, looks -- appears to be almost exactly at unity.

And so here's an example where we have several classes that appear to be above -- above ZOR. One (1) of them, if we look at a double check, does not appear to be above ZOR. General service small demand, however, and general service small non-demand clearly are continuing to be above ZOR.

A further double check, Mr. Chairman, in our submission is available at Tab 32 of Mr. Peter's Book of Documents, and that's of course the TREE/Manitoba Hydro Round II, 13, response to an information request, implementing the preferred alternatives set out in the NERA report.

And here again, we have an example where, general service small non-demand, general service small demand, are above the ZOR and the most above the ZOR of any of the customer classes, except for area and roadway lighting.

So, now we have another check method that again confirms that general service small demand and general service small non-demand is above the -- the ZOR. In my cross examination of Mr. Bowman, I raised with him this issue of using checks and double checks and so forth.

And I believe one of his responses was, well, it's no -- there's no point in checking with a method that you know to be inferior if there's a superior method available to you.

The point that I would make is that there isn't a superior method available to us right now. There's some problems with our main method right now.

And so therefore, we need to rely on some of these other checks and look at what the results of them are and my suggestion to the Board is that, the results of them reinforce the conclusion that general service small, is clearly over contributing, in terms of the revenue it pays in relation to the cost of serving.

(BRIEF PAUSE)

I would also remind the Board that My Friend , Mr. Williams, has spoken extensively at this Proceeding and has at previous proceedings about the effect of uniform rates on the residential class.

Uniform rates also had a significant impact on general service small, particularly non-demand, such that the issue raised in the expert evidence of Mr. Harper, that the effect of uniform rates is being, sort of, slowly bit by bit, eaten away, by the process of rate making at the PUB away from the intent of the legislation of uniform rates in that people within the city of Winnipeg are coming to the point where they are going to contribute above 100 percent, perhaps even above ZOR if the trend continues.

I would remind the Board, that for general service small non-demand and demand within Zone 1, they have been contributing significantly above ZOR. That that is a reality, that is their current reality.

It's not an issue of will it happen or it's going to happen if we keep going that way. It is happening and has been happening for a substantial period of time for general service customers in Zone 1 and -- and even in Zone 2.

And a quick reference to look at the quantum of those figures can be obtained at Tab 34 of Mr. Peter's Book of Documents which is a copy of PUB/MH-I-38-C.

All of this, Mr. Chairman, to emphasis to the Board that the customer classes which CCEP represents are clearly in need of redress, continue to be in need of redress even after the 1 percent reduction that was obtained by CCEP upon -- on behalf of these rate payers in the 2002 Status Update.

So, we come to the bottom-line. What do we suggest these ratepayers should have in this current situation? We would submit, and recognizing that Hydro already proposes a lower rate increase for this class, but we would submit that the situation in terms of their over-contribution of revenue in relation to their costs continues to be significantly or -- or substantially -- sufficiently serious and pronounced that even in the context of Hydro requiring additional revenue from the domestic customers in the current circumstances, that a rate freeze, that is no increase for general service small non-demand and demand should be contemplated by this Board.

That if -- if CCEP if -- if the Board is asking what does CCEP say that these customers should have; that CCEP -- CCEP's answer is, we think it should be no increase.

In order to appreciate the revenue impacts of that, I would direct the Board to revue Manitoba Hydro Exhibit 59 which sets out not the zero (0) increase scenario but it -- it sets out various other scenarios based on Manitoba Hydro's rebuttal evidence at page 17 of the rebuttal evidence of the impacts -- what -- what sort of rate changes would be required in order to bring general service small demand and general service small non-demand in to the ZOR, to unity within certain periods of time; for instance, within seven (7) years to unity, within five (5) years to unity, within three (3) years to unity, within five (5) years to ZOR.

If, in the alternative, the Board comes to the conclusion that a freeze is -- is not in the overall best interests of rate -- of rate payers and -- and the Hydro system as it were, we would suggest that at the very least an increase in accordance with bringing small demand and small non-demand within unity within seven (7) years should be implemented by the Board.

Now, preferably CCEP would not like to have relief for general service small result in increases for other consumer groups and if My Friends at CAC and MIPUG are successful in convincing the Board that Hydro doesn't need as quite as much revenue increase domestically as it's saying, then there may be such room available to implement these either freeze or a lower increase than what -- what Hydro's proposing for general service small without affecting any other class, at least in terms of a rate increase.

If that is not possible, I think it's pretty clear that there are customer classes within the system that are consistently under contributing, and we would suggest that in the alternative the Court -- the Board may well contemplate a slightly higher increase for that class.

If -- if it finds that the revenue requirement that Hydro is seeking is in fact something that should be granted leaving no room for relief for general service small without increasing another group.

Lastly, let me turn to the issue of rate shock, which I discussed to some extent with Mr. Wiens, at page 1408 of the transcript. Certainly CCEP is concerned about rate shock, particularly in terms of Hydro's proposal to have a short term rider for the balance of this fiscal year, in order to collect all of the revenue that they anticipated, if the -- as if the rate increases had been brought into -- into being, at the beginning of this fiscal year.

This will have the effect, as we've discussed extensively during these Proceedings, of making whatever increases we've got, that much higher percentage, for the balance of this fiscal year. CCEP does not support that approach.

Frankly, CCEP would take the position that Hydro should be granted whatever increases the Board finds are appropriate and they should have the start date in accordance to when that order comes down, and if, as a result, Hydro's collected the higher rates late in the year, and results in a little less revenue, or significantly less -- less revenue, over this year, the position of CCEP frankly, is so be it.

Manitoba Hydro is coming for these increases, primarily because of the effects of the drought. The magnitudes involved with respect to the effect of the drought, really do pale what Hydro is -- is seeking from its domestic customers, $28 million I believe in the first year, in comparison to net income/loss swings of, you know, from somewhere just beneath a 100 million, all the way down to three hundred and fifty (350) or 400 million.

I'm not sure how much difference it makes if we really go into a severe drought in the next year or two (2) again, whether Manitoba Hydro collects $15 million in increased revenue for this year, because they started late, or -- or a full twenty-eight (28).

Certainly though, having to spike the increase for the remainder of the fiscal year, to collect the full amount of revenue, will have an adverse effect on the classes we represent and all ratepayers.

And in addition, I think, as Hydro has said repeatedly, the exercise of rebuilding reserves in the wake of this drought, is a long term issue. There's nothing to say that Hydro would not come back I guess for fiscal '06/'07 and say, we still need to have some additional amounts out of domestic ratepayers, because we're continuing to have difficulty rebuilding the reserves. We need to face the risks that we face.

So, I don't think that the situation is so critical and so desperate, particularly given the magnitude of the rate increase from the domestic customers being sought by Hydro, in relation to all the other things that are going on in its IFF in terms of drought impact and so forth, that the -- the Board must -- should feel that it's in the position that it has to put in a short term rider, so that Hydro gets all the revenue it was hoping to get in this fiscal year, notwithstanding the late start to this process.

Mr. Chairman, and, Members of the Board, those are my comments, subject to any questions. Thank you, very much.

MR. ROBERT MAYER: Mr. Feldschmid, I think I have your position clear; it is you would suggest that because general service small is considerably above the Zone of Reasonableness, they should receive a zero (0) rate increase. You didn't say it, but I'm assuming that the only customer class then, to pick up whatever shortfall the Board feels is required by adopting your position, would fall upon the residential taxpayer, or sorry, the residential ratepayer.

If that is the case, do you really help these -- the general service small in light of the fact that as described, most of those customers are, in fact, as well residential ratepayers generally residing within the Province?

MR. JURGEN FELDSCHMID: Our system is predicated and I - I'm speaking to you, Mr. Mayer, as -- as a fellow Member of the Bar, our system is predicated on -- on an adversarial process. And I'm presuming that if I do my best focusing on what I'm here to do and Mr. Williams does his best, focusing on what he’s here to do, then Mr. Williams will succ -- no, sorry, not that Williams -- Mr. Williams will succeed.

But the best possible result when you have two (2) -- the representatives of the various ratepayer interests doing their best job, before the Board with its overall view of considerations to which -- that the best possible decision will result.

THE CHAIRPERSON: Thank you, very much, Mr. Feldschmid.

Mr. Williams, CAS/MSOS. Before we begin, Mr. Williams, and I certainly don’t want to in any way interfere with the flow of your remarks, would your preference be to have the break now or -- or would you prefer to pick your spot during your comments and have the break then?

Because I realize it’s kind of early to do the break, but on the other hand, I think I’ll leave it up to your discretion.

MR. BYRON WILLIAMS: And I appreciate that, Mr. Chairman. I was going to make the suggestion because I -- I -- I made the error today of buying into the Bob Peter’s principle and Mr. Silver from the Manitoba Society of Seniors was here. And I told him he did not need to be back till at least ten o’clock, because I was confident that Board Counsel would take at -- at least until -- until then.

So, given my false presumption upon that principle, it would be -- I think it would be good for my clients to -- to be here to observe and if -- if we might use our time most efficiently, Mr. Chairman. So, I would suggest a break now.

What -- for the Panel and for other members in the room, if you're wanting to follow along with the argument, the follow up to undertakings binder that -- that CAC/MSOS referred to yesterday would be something helpful to have at hand.

And we've also taken the liberty of summarizing some information from past annual reports; just a one (1) page table that I -- I've given to Mr. Barron over on his desk, but which has not been distributed.

So, it might be a good time to -- to kill two (2) or three (3) birds with one (1) stone.

THE CHAIRPERSON: That's very helpful. And to carry on, on that concept, Mr. Peters, perhaps this is a good time to introduce TREE's final argument into the record?

MR. BOB PETERS: My suggestion, Mr. Chair, with respect, is that procedurally if Mr. Miller and Mr. McQuaker were in the hearing room, they would provide their closing comments at their appointed time which would follow MKO later this afternoon. And I'm sure much turns on -- I didn't speak to Professor Miller but he may not want his comments provided at this time, so others who would normally be behind have a chance to comment on his proposals.

So, I suggest that we could provide it to the Court reporting services and that they could transcribe it in the record when it comes to his time later this afternoon.

But I don’t think much turns on it, whether it’s now or later.

THE CHAIRPERSON: Okay, I’ll defer to review on that. We stand adjourned.

--- Upon recessing at 10:00 a.m.
--- Upon resuming at 10:24 a.m.

THE CHAIRPERSON: Okay, welcome back everyone. Mr. Williams, you’re welcome to begin at any time you wish.

MR. BYRON WILLIAMS: Thank you, and good morning again, Mr. Chairman, Members of the Panel.

A couple of preliminary matters. As I indicated before, you’ll want to have nearby, the Book of References of CAC/MSOS from yesterday, titled, ’Follow Up to Undertakings’.

And also there’s a table which was hopefully distributed over the break, called ’Manitoba Hydro Consolidated Financial Results’.

THE CHAIRPERSON: We should probably give an exhibit number to it.

MR. BYRON WILLIAMS: Fourteen (14).

THE CHAIRPERSON: So be it.

--- EXHIBIT NO. CAC/MSOS 14: Table entitled, Manitoba Hydro Consolidated Financial Results.

MR. BYRON WILLIAMS: I got it in really quick that time.

THE CHAIRPERSON: Subject to check.

MR. BYRON WILLIAMS: Yeah. It’s from the Annual Report.

And, Mr. Chairman, and, Members of the Panel --

THE CHAIRPERSON: Your clients.

MR. BYRON WILLIAMS: Yes. I did -- and I neglected to -- to introduce my clients when Mr. Harper gave his direct evidence, but there -- when Mr. Harper gave his evidence were Mr. Silver from MSOS, Mr. Cruden from MSOS and Ms. Desorcy, and I’m welcoming back today, Mr. Silver, who’s in the middle row, and who’s -- who’s not the Hydro employee in the middle row, who’s a male.

And -- and to his left is Ms. Gloria Desorcy. Mr. Silver is the current Executive Director of the Society of Seniors, and Ms. Desorcy is the current Executive Direct of CAC.

The last thing before I begin, Mr. Chairman, is to express my appreciation to the Board for your ruling yesterday, in terms of written comments of being available on Wednesday. My expectation is that our comments will be brief, but as I worked -- went over the material last night, it occurred to me that there was a couple of areas, which I'll try and red flag in my oral comments, where we're likely to make some additional comment.

And to let the Panel know, and where we're going, I think there's five (5) areas that I'm going to be talking about today. One (1) is the revenue requirement, another one not surprisingly, is cost of service. A third is rate impacts, and fourth is the conclusion, and fifth, and this is pursuant to the PUB rules, I'll speak very briefly to the issue of costs, orally, which is pursuant to those rules.

MR. ROBERT MAYER: Do want to go through that again?

MR. BYRON WILLIAMS: Yes, Mr. Mayer, the five (5) issues are:

1. Revenue requirement.
2. Cost of service.
3. Rate impacts.
4. Some very brief conclusions, and
5. Even briefer comments on costs.

And in terms of the first area, which is -- which is the revenue requirement, Mr. Chairman, if you or your Panel members are looking for some kind of themes that are going to emerge from my argument, I think you're going to hear an awful lot of the words prudence, and balance, and anger, and onus, and also a number of references to the mysterious $11 million.

And I thought, in terms of the revenue requirement, and especially the concept of prudence, a good start for my discussion dates back to the seventh day, the third morning of the Hearing -- the third Monday of the Hearing.

And it relates to an off the mic comment from one (1) of the Panel Members, which went something to the effect of, "Some of us on this side of the table think you should be asking for more". And I think that was directed at Manitoba Hydro. And sadly, it wasn't captured by the transcript, because I was looking for it.

But the thrust of that statement was forever emblazoned upon my rather scarred psyche. And I have to say that initially I was quite shattered by that statement, and I think my clients might have been too. But after I sutured my slashed wrists and I restored my fragile psyche, I recognized that the Panel Member was merely playing devil's advocate.

And once I had persuaded my clients that they shouldn't pack up their bags and -- their regulatory bags and leave, I thought to myself, with sober second and third thought, what a most excellent and what a most prudent question.

With Hydro just coming off losses in the '03/'04 year of $400 million dollars, with their witnesses throwing around unquantified estimates of $2 billion dollars as a consequence of a five (5) year drought, with the current reserves forecast bid the end of '03/'04 in the range of 800 million, wouldn't a prudent person, a prudent consumer, a prudent Panel members ask themselves and ask Hydro the question: Why aren't you asking for more?

So, although I don't always demonstrate it, I like to think of myself as a prudent Counsel and I certainly am confident that I'm representing prudent clients.

And so I think I'm going to start off by answering that question. And I always think that history is an aid when we try and get perspective and balance. And I want to start off -- off by adding some prudent perspective.

By reminding this Panel where Hydro was the last time it faced a significant drought. And I want to take the Panel back in time to the early 1990's, to a time which Mr. Surminski noted at page 346 of the transcript, was the worst drought on record; the '87 to '92 drought.

And it was in the midst of that drought, and that’s not on the table before you, but Mr. Warden noted this at page 83 and 84 of the transcript, was way back in 1989 that the retained earnings of Hydro had sunk to $92 million dollars.

And as you look at this table which is titled ‘Manitoba Hydro Consolidated Financial Results’ and subject to the comments of My Friend Ms. Ramage, is tentatively titled CAC Exhibit 14, you can take a look at where Hydro was back in 1992 at the end of the last drought; a debt ratio of point nine four (.94), retained earnings of $183 million dollars.

And just for the sake of perspective, you can look at where the 2004 forecast has us; a debt ratio which is somewhat lower at zero point eight six (0.86) and retained earnings which are more four (4) times higher, not allowing for inflation at around eight oh five (805).

They’re probably a bit lower than that, once we get the final results for ’03/’04 but in that range.

And that figure of 805 million may not seem quite so handsome when we compare it to the halcyon days prior to the drought. But if we look back over this Exhibit, CAC/MSOS 14 -- hearing no objections from My Friend, I’m getting more confident in its -- I’m just teasing.

When we look over this exhibit and we look at the retained earnings for past years, we see that that eight oh five (805) figure is higher than all the years between 1992 and 1999 and is very comparable, again I'll --leaving aside inflation, to the figure as it stood in the year 2000.

So, when you're looking for perspective and I -- I think it's important in terms of addressing the question of why Hydro shouldn't be asking for more and presumably why this Board shouldn't be granting more, it's important to -- to remember and we -- we've got a sense of the long term perspective of Hydro through this Hearing, that droughts happen. They are -- they're part of the cost of operating the Hydro system and they're planned for.

As Mr. Surminski at page 292 and Mr. Cormie note at page 270 they are planned for in Hydro's export planning and pricing.

Droughts are expected to occur and the likelihood of such events is worked into the export planning and pricing. And again, droughts are planned for when we evaluate and seek to rebuild reserves.

And, Mr. Warden, I thought, made this point quite well at page 83 of the transcript when he noted that Hydro was in a pretty good position, going in to the -- the last drought.

And it's important to recall that they didn't get into that position going into the last drought over night. We build up reserves over time and -- and we -- we build them up, at least in part, to miti -- mitigate the short term financial impacts of droughts.

And Mr. Warden, I thought, expressed this point very well at page 873 and 874 of the transcript when he said that Manitoba Hydro, in -- in terms of the interest coverage target, was willing to accept a temporary decline in Hydro's achievement of that target in times of drought.

And what I drew from that is that was the plan. That's what you planned for, that's why you build up reserves.

Now, if I'm not mistaken, and I'm not going off the transcripts, but I believe yesterday Mr. Warden used the words 'disastrously low', to describe the state of Hydro's reserves.

But I took that statement with a grain of salt. And I think I took it with a grain of salt, because I was kind of anticipating that he was making it with -- expressing it with a bit of concern for the negative impacts at Hydro's disastrous treatment of OM&A costs, was having on its case.

But if you're worried about his comments, you may want to turn to page 83 of the transcript, and you don't have to do it now, but I suggest you look at it, at your leisure, because I think pages 83 to 85, Mr. Warden provides a much more balanced perspective on where Hydro is, was and is going.

And I'm only going to put in the rosy coloured parts, but I'm sure My Friend, Ms. Ramage, will put in the less rosy parts of it.

But he described Hydro as exceptionally well positioned, as one (1) of the leading energy providers in North America. And even with this figure of 805 million, or about there, in terms of reserves, I can guarantee you that when Mr. Brennan and Ms. Wray go in to see the bond writers, they're going to go in with smiling, jovial faces, and say that the long term fundamentals of this Corporation are pretty sound.

I don't want to understate the situation Hydro's in, but I think it's important not to overstate it or to mis-characterize it as being disastrous.

So, my advice to you as a prudent counsel, representing prudent counsel, is to recognize that the system is working pretty much as -- as was intended. Hydro, relative to the past decade, is in a relatively decent position, and a prudent Panel should take that into account.

Now, in terms of prudency, the answers of my clients might be a little different if they thought there was a high likelihood that we were still in the midst of a drought. But we would note -- I would note on behalf of my clients, that Mr. Cormie at page 103 of the transcript, indicated that as a result of the much above normal spring rains, with normal weather conditions, Hydro would achieve the export revenues in its financial forecast.

And I think his -- Mr. Cormie's discussions with both Mr. Peters and Mr. Anderson yesterday, also reinforced that message, not that things are perfect, but that we can have a relatively decent degree of confidence, that we're not still in the midst of a drought. And I think Mr. Peters, at least in his question to Mr. Warden, highlighted that point, when he noted the comments of the President to Manitoba Hydro, in at least recent media release, suggesting that Hydro's results as a result of rain were pretty decent.

Now, I don't want to slight any other Members of the Hydro Panel, but I do enjoy hearing the evidence of Mr. Cormie, mostly because it's so foreign to me. And I thought he gave good advice to this Panel at page 287 of the transcript, because he said it was important not to overreact during the drought -- during the drought. And I think that same measured, balanced response, is exactly what my clients would advise to this Board, as Hydro makes it way out of the drought.

Now, if I haven't persuaded you, if you're still not confident, I want to offer a few more reasons why this Panel should not be looking at any more rate increases.

Another reason is the position of Manitoba Hydro. Manitoba Hydro, projecting at least on the face of IFF-03-01, a net income of $40 million, could have come in and asked for more.

Their judgment was that, well, they had to make some recovery towards their debt equity target, they were not going to rebuild Rome or the debt equity levels in a day, or in a year.

They didn’t have to like their situation, but they considered it was reasonable to live with.

Now, I want to be clear, I would rarely, rarely, rarely advise you to take unsupported recommendations of Hydro, solely on the basis of -- of Hydro’s recommendations. But in this case, Hydro’s judgment is supported by the position of my clients, CAC/MSOS.

And in the last Manitoba Public Insurance General Rate Application, my clients demonstrated that they are more than happy to just say no, if they think a corporation is acting imprudently. In that Application they said and believed that Manitoba Public Insurance was acting imprudently, by budgeting for a deficit.

And notwithstanding the negative short term impact of that upon their Members, they said that the increase granted by the Public Utilities Board should be higher. So, I think my clients have a pretty decent record as prudent clients.

And if you're looking for more support on this point, I'll offer one (1) more. I think you should take some comfort from the advice of Mr. Harper. And I think Mr. Harper has developed a good reputation in Manitoba, both before the Clean Environment Commission, and before this Tribunal or Panel. And you've had a chance to see him, and I think you've had a chance to hear him take positions that he was pretty confident his clients wouldn't be that happy with.

He expressed views as any good expert should, that were his own views, independent of the -- of the desires of his clients.

And sometimes I want to kick him for that, but I think in the long run, taking a long term perspective, that's the right thing to do. And his advice to you was that this was a -- the -- the Manitoba Hydro targeting for net -- net income, in the range of $40 million for '04/'05, was a reasonable response to a -- a negative year, the year before.

And I'm hoping you'll conclude, and this goes to some of my other comments about Mr. Harper's evidence, that of the witnesses you have seen during this Proceeding, Mr. Harper ranks right up there, in terms of his fairness and balance.

I would ask you to keep in mind that word balance, because if you're still looking at that debt equity ratio of Hydro, where it is, the point eight six (.86), and you’re still thinking maybe Hydro should be moving quicker to reduce it, I want to share with you two (2) final reasons why the devil’s advocate, the prudent and balanced person should not be requesting or recommending a greater rate increase.

And these reasons start with a careful consideration of what’s underlying Manitoba Hydro’s debt equity ratio and its current situation, and where it’s likely to be over the next two (2) years. And clearly the drought is one (1) of those factors.

But there’s a couple other things in there that are important as well. And various individuals have tried to explain it in different ways, but I want to give you a couple concrete examples.

We’ve had a lot of discussion in this Hearing about good debt and about bad debt. But even when we look at items like Wuskwatim, and the purchase of Winnipeg Hydro, which, I think that many people, perhaps most people in this room, would argue fit within the definition of good debt.

We have to recognize that these investments are putting pressure on the debt equity level. Individually, items like Wuskwatim, as it rolls out around 2010, may only have an impact on the debt equity level of about 2 percent.

Individually, the purchase of Winnipeg Hydro, starting at 0.5 percent and rolling out to about 2 percent, may not seem to have a big effect on the debt equity ratio, but collectively, these major purchases, these major good debt purchases, I think my clients would accept those words, put a lot of pressure on the debt equity level, currently and out into the future.

And I believe Mr. Harper made this point at page 2066 of the transcript. And if we raise rates in response to a high debt equity level, driven in part by high capital rates, we are raising questions of inter-generational equity.

We are suggesting to Mr. Cruden of MSOS that his rates, perhaps, should be rising a bit to pay for a benefit of a project that he may never enjoy.

And it seems to me again that that's one of the points that Mr. Warden was making to me the other day, at page 876 of the transcript. He said that at times of major capital expansion, Hydro was willing to accept temporary declines in terms of, in this case, its interest coverage rates.

And I think the point he was making was that it would be unfair to ask today's ratepayers to pay for tomorrow's ratepayers' benefits.

So, it's important to consider in terms of these debt equity targets recognizing what's going on in the level of capital.

And similarly my clients would argue that when we look at the current situation, in terms of the debt equity ratio, and in considering how far and how fast rates should rise, and I say this with some trepidation, but we have to keep in mind the special payment to the province, the special dividend.

And I raise the subject with some trepidation because of its obvious political overtones. But I want to be clear of my point, and my clients' point is this. There is no doubt that the special dividend has had a material impact on the debt equity ratio of the Corporation.

Their interrogatory responses on file, being PUB-16-I-16(f) suggests an impact of three (3) to 5.5 percent. Excuse me, I misspoke, three (3) to 4.5 percent as it rolls out over time.

And Mr. Warden acknowledged in his discussion with me that Manitoba Hydro and this was at page 84 of the transcript, Manitoba Hydro was going to have to work harder to rebuild its retained earnings as a result of the special dividend.

So, this Board looks to the appropriate level of rate increase. We would ask you keep in mind that the debt equity and interest coverage ratios you are seeing are more than simply a reflection on the drought. They are a reflection of higher capital expenditures, they are a reflection of the special payment.

In a way, they are both signs, the higher capital expenditures and the special payment, of the fact that the Corporation is and was, as Mr. Warden said at page 85 of the transcript, exceptionally well positioned and in many ways a strong and successful util -- utility.

So I probably talked this point to death, but I'll just conclude by saying it's important not to overreact. Important to be balanced and to remember that the reserves were built up from a terrible base back in 1989 of less than 100 million and some of those reserves were actually built up during the course of a drought.

And our expectation is that they will be built up again, and I'm sure we'll have fights in the future about how high and how fast that target -- that -- the reserves should be.

But when we look at Hydro's application targeting the net income in the range of 40 million for '04/'05, my clients have concluded is a reasonable and valid way to look at slowly replenishing its reserves.

MR. ROBERT MAYER: Before you move on to the next point, could you just clarify something on Exhibit 16 for me? You -- you'd mentioned the length of that drought; when did you say it started?

MR. BYRON WILLIAMS: It's exhibit -- are you referring to Exhibit 14?

MR. ROBERT MAYER: 14, okay. Yes.

MR. BYRON WILLIAMS: I believe I was relying on -- upon Mr. Surminski's evidence and I think his evidence was and he can wink if he -- if I've got it right, but it -- starting in -- at -- in the fiscal year '87 and ending in the fiscal year '92.

MR. ROBERT MAYER: So from '87 to '92? Now, you've started at '92. Do you have the numbers on what the debt equity ratio in retained earnings were at the beginning of that drought?

MR. BYRON WILLIAMS: I don't, Mr. -- Mr. Mayer, but I could -- I did -- I can tell you that in 1989 they were at 92 million. So, I'm not sure where they were going in. I suspect they weren't in the -- that Hydro was over ninety (90) -- 90 percent debt, but you know, I don't have that for sure. I could certainly provide that.

MR. ROBERT MAYER: I appreciate that. Go on, please.

MR. BYRON WILLIAMS: I'm going to turn quite shortly to the question of whether Hydro has met its onus to establish that its proposed rates were appropriate.

But I do want to comment very briefly on one (1) of the numbers that Manitoba Hydro has put on the table, and this again relates to a number my friend, Mr. Surminski through out, his off the cuff estimate of the impact of a --

of a five (5) year drought being $2 billion.

And I want to emphasize that my clients chose not to cross-examine him on this subject, because he quite fairly noted that this was a preliminary estimate. And my clients have been through this before with other utilities such as Manitoba Public Insurance, and based upon that experience, their expectation is that over time, the -- it's corporation's desire to increase their reserves, the -- the dollar figure that they attribute to the risk they face, also seems to rise.

And what my client's position is, is that that $2 billion figure as Mr. Surminski noted, is an estimate, preliminary. And we want to assure the Board that once Hydro has quantified this estimate through a proper risk assessment, we'll be happy to evaluate and test the reasonableness of this number.

And if our experience with Manitoba Public Insurance was any guide, we'll find it a pretty interesting debate.

From the client's perspective, that $2 billion figure at this point in time is not a figure to be feared, nor is it a figure to be trusted. It's a figure to be tested once the appropriate analysis is done.

And that only goes to underscore a point that the witnesses from Inter Group I think had made quite strongly in the course of this Hearing, of the importance of Hydro finalizing that risk assessment, and looking at the probability of risks and how they correlate, whether positively or negatively.

And when that’s done and when we have a chance to test those numbers, I’m pretty confident on behalf of my clients, that we’ll see a reasonable number in terms of a target that we can all aim for and adjust for as time goes on, but we’re not at that stage yet.

Turning now to the question of whether Hydro has satisfied the Board that its proposed revenue requirement designed to earn a net income of 40 million in ’04/’05 and 31 million in ’05/’06 is appropriate. And this is where we begin to enter my world, my world of onuses and anger and the mysterious $11 million that we saw being added and subtracted all over the place yesterday.

And I think it’s important to recall, as Mr. Peters did in his concluding comments yesterday, that the onus in this Hearing, in terms of explaining those numbers is Hydros. It’s their Application, and it’s their integrated financial forecast upon which we rely, as we consider whether the revenue requirement is reasonable.

And so I’d like to turn you to Tab 2 of the follow-up to undertakings of the CAC document from yesterday, which is the projected operating statement for electric operations, and again, that’s from Appendix 4.1, page 32 of the Hydro filing.

And when you look at the columns for 2005 and for 2006, the first question my clients would suggest that you should ask yourself, or when we go beneath the surface of these numbers, do they truly add up.

And the answer, as we heard -- first heard from Mr. Harper two (2) Thursdays ago, is that they don’t. The numbers for ’05 and for ’06, don’t add up, because Hydro -- Manitoba Hydro has double counted at least $11 million in subsidiary OM&A; the mysterious $11 million.

And I’m going to provide you with a brief explanation of how Hydro has double counted this figure. It starts on the other line, the other income line. And Hydro did that when it included net income from subsidiaries of about 1.4 million in ’04/’05 and about eight hundred thousand (800,000) in ’05/’06, and of course to calculate, and I can see you’re yawning already up there, but I have to go through this.

And of course to calculate the net income of subsidiaries, it had to subtract total revenues from the total expense. So that means that total expenses are already accounted for and that’s set out in MIPUG first round number 3 and that’s at Tab 6 of the same book. So, that’s counting the expenses once on the revenue side.

When did it count them twice? Well, when we go down to costs of operations, and for ’04/’05 we see $307 million dollars, and for ’05/’06 we see $309 million dollars.

So, how do I know they’re counting the subsidiaries again? If we flip over one tab, to Exhibit 49 which is Tab 1 of this book, and you go to the extreme right -- two (2) right hand columns, you’ll see that the OM&A with subsidiaries for ’04/’05 is about 307 million and for ’05/’06 is about 309 million but once you’ve deducted those $11 million dollars, you see the true OM&A for electric corporations, at least according to this exhibit which is two hundred and ninety-five point nine (295.9) for ’04/’05 and two hundred and ninety-eight point three (298.3) for ’05/’06.

So, flipping back to Tab 2; if we weren’t double counting the subs, we would expect the figures -- the figure of two hundred and ninety-five point nine (295.9) to replace the three oh seven (307). We would expect the figure of two ninety eight point three (298.3) to replace the three oh nine (309).

So, that’s at least -- excuse me, that’s at least 11 million and subject to undertakings, perhaps more, that’s been double counted and which should be adjusted either by increasing the revenue by at least that amount or reducing the ex -- the operating expenses.

How do I know -- how do we know that this is a right approach? Well, first of all, Mr. Harper told you so, but I'm -- I'm sure that won't be enough. And I think Mr. Warden begrudgingly admitted yesterday that at least Mr. Harper had his math right.

But I think better evidence than Mr. Warden's unwilling admission can be found if you go to Tab 7 and 8 of the -- this same Book of Documents. And if you look at Footnote 4, Manitoba Hydro is telling you exactly how you should perform these calculations.

And basically what Hydro is telling you is that if -- if you're netting out other revenue, then you don't have to include it on the expense side. If you're putting in total revenue, then there has to be corresponding entries on the expense side. And I won't go through the grizzly detail.

So, we think you can be very confident in the suggestion that Hydro has double counted, or at least I thought we could. So, if we're to assume that Manitoba Hydro was accurate in Exhibit 49, Tab 1, and advis -- in advising us that the total OM&A for electrical should be two hundred and ninety-five point nine (295.9) for '04/'05 then that figure in the IFF in Tab 2 should be adjusted by at least 11 million.

But here the mystery deepens. As I understand Mr. Warden's testimony from yesterday, and he's saying that

that’s not the case, and we should not be adding that -- or we should not be deleting that 11 million in OM&A expenses, or adding that addition 11 million in revenues.

And I’ll have to review yesterday’s transcript, but the best way that I can find to paraphrase Mr. Warden is turn you back to Exhibit 49, Tab 1 because what I think Mr. Warden was saying yesterday, when he was talking about top down and bottom up, and he was talking about a top down bottom up gap in terms of OM&A expenses in the Corporation.

And that might be a gap you’d find quite surprising, given the fact if you recall Mr. Warden’s testimony from Day 1 of the hearing at page 89 when he talked about the stringent cost controls and budget -- budgetary controls.

But from what I understand he -- he was saying yesterday, the top down people, I’m assuming those are in management -- senior management, are telling us that the Corporation’s OM&A target for electrical and that’s once subsidiaries are netted out, is 295 million for ’04/’05 and two hundred and ninety-eight (298) for ’05/’06.

And when I asked him yesterday to confirm that Hydro should be evaluated based upon this target in future years, he did so.

Then he went on to explain, I think, that the bottom-up people in the organization, and I'm quoting from my notes, think the electrical OM&A net of subsidiaries, and I underlined that word, should be higher by $11 million; the three-o-seven (307) that is set out for '04/'05 in Tab 2.

And I underlined that word 'net of subsidiaries', because when Mr. Warden told me what his bottom-up people were doing, as compared to the top-down people, I was so astonished, that I asked him to confirm that. And I believe that if you review the transcript, you'll see that he confirmed that position twice; that the bottom-up people, the people whose numbers are presented in Appendix 4.1 page 32, are saying that the OM&A for the electrical operations, net of subsidiaries for '04/'05 should be $11 million higher than the top-down people.

So, to a certain degree, if you're going to accept Mr. Harper's suggestion that there should be at least another $11 million in the income statement, depends whether you put your faith in the top-down people or the bottom-up people.

And I say, I think, because I always thought that Mr. Warden was one (1) of those top-down guys. I've heard him talk about many times, of the Corporation's aggressive target of five hundred and eighty-four dollars ($584) is a cost per customer for '04/'05, which of course is based on the top-down figure of two hundred and ninety-five point nine (295.9) for OM&A, that aggressive target, and that's set out in Exhibit 49.

But I think he told the Peter -- Mr. Peters, the Peter's principle, and the Chairperson, and myself, that when it comes to that IFF at Tab 2, he's sticking with the bottom-up guys, and a figure of three hundred and seven (307) net of subsidiaries.

Subject to review of transcript, this is where I think, and on behalf of my clients I submit, that Mr. Warden's top-down, bottom-up analysis, is hoisted upon its own analytical petard and hoisted upon the fine work of Mr. Harper.

And here's where the mysterious 11 million pops up its head again, because if you will recall, in Mr. Harper's direct evidence, and also in his written evidence, he -- but primarily in his direct evidence, he talked about taking two (2) approaches to analyzing the reasonableness of Manitoba Hydro's revenue requirement.

In his writt -- written evidence, was one (1) of them. And that was based on the written record of the Hearing to date, prior to this Exhibit 49. And I hope you'll reread his evidence, but perhaps the best and simplest explanation of what he did can be found, if you turn to Tab 18 of this same Book of References.

And I didn't go through it yesterday, but here we are today.

And what this is, is the Interrogatory Response to the PUB of MH-I-46.

And that's what Manitoba Hydro was telling us prior to Mr. Harper's written evidence, and that's what Manitoba Hydro was telling us about what would be a reasonable number in projected OM&A expenses for '04/'05, and '05/'06.

And if you look at that figure, lo and behold, there's that $307 million figure again, and the three hundred and nine (309). And there's an OM&A per customer, for the electrical operations of six oh six (606) and six oh seven (607).

Those are exactly or very close to the same figures that those bottom up people are saying should be in Hydro. And when Mr. Harper looked at these numbers in his written evidence, he said these numbers don't make sense. He said that the figure of 307 million in terms of OM&A and its corresponding costs of per customer of six hundred and six (606) were way too high.

If you review his evidence he said that they were at least $10 million too high.

And the Corporation should be more aggressive, and that the OM&A real numbers for the Corporation should be at least $10 million less.

And he also said that the OM&A per customer, should be in the range of the maximum of five hundred and eighty-two (582) per customer, or taken into account Winnipeg Hydro synergies, five hundred and seventy-eight (578) per customer.

And I'm a dreamer, I admit it. And during this Hearing I thought for a brief while that Manitoba Hydro was agreeing with us, because when we go back to Table -- or Exhibit 49, Tab 1, they're adjusted targets in the Hearing slash their OM&A, it looked like they were following Mr. Harper's advice to a 'T', by $11 million and we think thereby implicitly endorsing Mr. Harper's written evidence.

But if that's the case, and if the OM&A net of subsidiaries for electric operations in '04/'05 is $295.9 million, then we go back to the -- the problem, the IFF makes no sense.

And that's why Mr. Harper's second approach was to say the IFF makes no -- no sense, because if that two ninety-five (295) is right, Hydro's double counting.

And as I said before, Mr. Warden, to his credit, has tried to straddle this issue, by explaining this mysterious $11 million as the top-down, bottom-up gap.

But here's his dilemma, if we accept the view of his bottom-up people, that the OM&A costs for electricity, net of subsidiaries should be three hundred and seven (307) for ’04/’05, that evidence is impeached not only by Mr. Harper’s written evidence, but by Manitoba Hydro’s own top-down approach, as set out in Exhibit 49.

And that’s the approach, the Exhibit 49 approach that Mr. Harp -- Mr. Warden told us yesterday, that Hydro’s efforts should be judged by.

The other horn of the dilemma is that if we have set the figure of two ninety-five point nine (295.9) as the appropriate figure for OM&A net of subsidiaries, the top down number we have IFF forecasts that are off by at least $11 million.

So, whether one con -- characterizes it as Mr. Harper did in his written evidence, as an eleven (11) or ten (10) or $11 million OM&A adjustment, at least that, or as $11 million double counting, an adjustment has to be made.

Mr. Chairman, that’s one (1) adjustment, and I’m going to come back to the -- just briefly to the top-down bottom-up people a bit later but I think it’s important to ask ourselves whether, based upon the record of this Proceeding, there are any more adjustments that need to be made to Tab 2; the IFF, the basic operating statement.

And one (1) adjustment that I thought we had agreed upon in this consensus building forum that we’re in, was related to ongoing pension statements, and these savings, these ongoing savings were first identified to me by Mr.

Derksen at page 819 and page 820 of the transcript.

And the actual figure of these ongoing savings, what’s confirmed at pages 832 and 33 of the transcript, as being 5.1 million. And both Mr. Derksen at page 820 of the transcript, and Mr. Warden, at page 837, confirmed that these ongoing savings were not reflected in this number in the IFF.

So, Mr. Harper, in his oral direct evidence, took Mr. Derksen and Mr. Warden’s evidence at its face value, and incorporated it into its oral evidence and conclusions. And he said, you should make an additional $5 million adjustment.

So, you can see, Mr. Chairman, I hope, how we’re getting closer to the $20 million figure that Mr. Harper was speaking of, and I did want to kick him when he used the words "wildest dreams", because Mr. Harper is not a -- a dreamer.

But what he was speaking to, if I may attempt to speak for him was, a pension adjustment in the range of $5 million dollars, the double counting or OM&A padding adjustment of at least $11 million dollars and to the extent that any depreciation was reflected on the expense side, which -- and taxes which should have been netted out, that was where he was coming towards the $20 million dollar figure.

Now in terms of the pension savings, I -- I believe in Mr. Warden's testimony yesterday he adjusted this figure downward from a 5.1 million to about 3.5 million and that's one thing that, on behalf of CAC/MSOS we'll be taking the opportunity to review his comments on that subject and perhaps provide some written comments too about that, on Wednesday, if we see fit.

So, of course, Mr. Harper sees these ongoing savings which are not reflected in the IFF and he thinks that should be incorporated in the net income line, in the Corporation's bottom-line.

But from I gathered, Mr. Warden's testimony was yesterday, he's of the view that those savings, those ongoing savings of somewhere between three point five (3.5) and 5.1 million will also be swallowed up in new expenditures, or to plagiarize Mr. Peter's phrase, usurped.

And here we come, not for the first time, or the last time in this closing argument, to the issue of prudency as it relates to the eating up or usurping or vaporizing of savings or productivity benefits.

And here we come back to the prudency of my clients. Because I'm sure that Ms. Ramage doing her job for her clients, in her closing argument, will be urging this Panel, even if you believe Mr. Williams, even if you believe Mr. Williams' and Mr. Harper's submission that the OM&A

numbers are padded at -- by $11 million dollars, and there's an additional padding of somewhere between three point five (3.5) and 5.1 million dollars in terms of pension savings that are not reflected in the expenses.

Even if you believe that submission, we expect Hydro to submit you should still approve the rate increase as sought notwithstanding that fifteen (15) or $16 million change in net income, or that fifteen (15) or $16 million perhaps more appropriately characterized as padding.

And my clients' response in anticipation of My Friend's argument is in no uncertain terms, we would not recommend doing that, or my clients would not.

And that relates back to their prudency. They'll tell you that they want to see Hydro healthy. They want to see rates as low as possible in accordance with sound business practices, and that's because they accept the principle, and I think I've heard Panel members refer to it as service at cost.

My clients will also tell you in a few minutes that they are prepared to see rate increases from Manitoba Hydro, increases which on average are at, or slightly above, inflation in order to assist for the recovery of the drought.

But Manitoba Hydro's evidence at the start of the hearing was that it was prepared to live with a net income of 40 million dollars as reasonable, as a modest step to recovery.

And my clients want to hold Manitoba Hydro to its word. We of course want them to earn more if they can do it through improved efficiency, through more aggressive marketing of their export products, through expanded DSM. We'll be happy if they earn more, or my clients will be, because we all benefit when they work harder and more efficiently.

But when Hydro comes to you and says, we only need 40 million, and you find out that they've got another 15 million dollars in padding in that budget, we think that it would be -- send the wrong message to Manitoba Hydro to pass through that padding.

Because you'll give them an additional 50 million or 60 million dollar cushion and when you do that, you're simply inviting Manitoba Hydro to see any productivity opportunities that may realize. You're inviting them to simply have them eaten up or usurped. And as prudent consumers, my clients think that's wrong.

There's, in still staying with the IFF, there's one other adjustment that my clients are interested in and considering. And this relates to the additional productivity savings that Mr. Warden identified, again at page 819 of the transcript.

And I tried to refresh the Panel's memory on that point yesterday. And you will recall from my discussions with Mr. Warden yesterday, that the identif -- identification of this roughly, and I underline the word roughly, additional 3 million, flowed from a cross-examination on Exhibit 24, and you don't need to turn to it, but that's at Tab 11 of the same Book of References.

And that was Manitoba Hydro's first crack at explaining that 20 million variation from forecast to actual in 2003/'04. And you'll also recall, both from page 819 of the transcript, and from my discussion with Mr. Warden yesterday, that the initial explanation of that $20 million variance, was a $10.9 million pension saving, a seven (7) time, or $7 million one time only debt restraint, and around $3 million in productivity.

And I may have misspoke, Mr. Chairman, if I said that the pension savings was one time only. I'm not sure if I did or not, but it was, of the ten point nine (10.9), the evidence was that five point one (5.1) was ongoing. So I'm not sure if I misspoke or not, but...

So, based on that evidence from page 819 and based upon the start of my conversation with Mr. Warden yesterday, I was feeling pretty good on behalf of my clients, that there might be an extra 3 million in ongoing productivity, until I had my dis -- discussion with Mr. Warden about Exhibit 64, which explained the way about $10 million of the variance, through subsidiary OM&A, and which seemed to shrink that $20 million savings down to 10.2 million.

And that left, sadly, for my clients, a $10 million savings that, based upon Exhibit 24, we thought had existed, somewhere out there, potentially eaten up or usurped.

Now I say potentially, because as best I can understand from our conversation yesterday, the explanation for this unexplained evaporation of the $10 million in cost savings, relates again to that top-down, bottom-up thing, and as I understand it, most of the bottom-up people who prepared Exhibit 24, think it's 20 million. And most of the top-down people, who prepared Exhibit 64, think it's 10 million.

So again, the answer depends upon whether one agrees with the top-down or bottom-up people. And for consistency's sake's purpose, my clients are likely to agree with the top-down people.

But if we agree with those top-down people, and accept that maybe the $3 million in productivity offered by Manitoba Hydro in Exhibit 24, doesn't exist, then I think we may also have to conclude that that other $7 million in savings, the one-time only savings associated with the drought, don't exist either.

Because of that whole initial $20 million variance established in Exhibit 24 and transcript page 819, the only figure that we confirmed, certainly yesterday, was the $10.9 million pension savings, for ’03/’04. And that more than matches the $10.2 million gap in Exhibit 64.

So, that’s a mystery, that my clients, based upon a careful scrutiny of the record, can’t resolve for this Panel. But it does reinforce my clients’ concern, that if we accept the view of the bottom-up people, that the OM&A should be padded by $11 million we’re merely giving the corporation an opportunity to once again usurp it’s productivity savings.

Now before I leave the area of the IFF Operating Statement, I want to talk very briefly about anger.

MR. ROBERT MAYER: Before you get angry, Mr. Williams, --

MR. BRYON WILLIAMS: Oh, I’m not going to be angry today, Mr. -- Mr. Mayer.

MR. ROBERT MAYER: Before you get angry, you haven’t commented on it, but before you leave this area, did anywhere -- or do you have any recollection because I don’t, in the transcript where Mr. Warden was able to explain how the difference between top-down and bottom-up of $1l million dollars mysteriously came out almost to the penny as the subsidiary deduction on Number 1?

MR. BYRON WILLIAMS: Mr. -- Mr. Mayer, I think in fairness to Mr. Warden, that’s the -- I don’t think he ever put a figure to the top-down/bottom-up. He just mentioned that there was a gap that they were trying to reconcile.

So, if anyone kind of dotted the 'I's' and crossed the 'T' on that statement that was -- that was me.

Before I do leave the area of this IFF operating statement, I do want to talk very briefly about anger and Mr. Warden, in my discussion with you yesterday, I expressed some anger and for that I apologize because I pride myself on being courteous and I believe I failed you in that regard.

MR. ROBERT MAYER: Thank you.

MR. BYRON WILLIAMS: But I -- I guess as an explanation of my anger I can perhaps offer that never in my eleven (11) years of experience before this tribunal or even before the CRTC have I ever seen so many numbers that defy reconciliation.

And in expressing my anger, perhaps I was also expressing the frustration of my gentle friend Mr. Harper who has mastered this record as few people can and still can't make the math work.

And this leads me back to the question of onus and more directly, to the question of OM&A. And I want to start direct -- start directly address -- addressing the issue of OM&A. And I would note that, in theory, here's an area where we have some consensus between Hydro and CAC/MSOS, at least on the point that the Corporation should be maximizing internal efficiencies as a means to moderate rate increases.

And Mr. Warden made this point at five (5) -- page 520 of the transcript when he noted that Hydro should exploit efficiencies before asking for rate increases.

And Mr. Harper, on behalf of CAC/MSOS in his role as objective expert made the same point at page 2223 and he talked about how an improvement in retained earnings could be reached by raising rates, but also by reducing costs.

Where I think the parties disagree and this was highlighted both by Mr. Warden’s comments yesterday and Ms. Fernandez’ cross-examination as well, is whether the Corporation has done enough to maximize efficiency.

And I’m going to, just so I’m clear, characterize what I understand Manitoba Hydro’s position to be:

One (1), that the Intervenors can’t prove that Hydro has been spending inefficiently.

Two (2), that they have plenty of productivity savings, just look at Exhibit 24.

Three (3), when you look at our OM&A overall, it’s risen by only slightly more than the rate of inflation.

And four (4), in terms of OM&A, when you compare Hydro's results over the past five (5) years in terms of growth, to the results of other jurisdictions such as BC or Hydro Quebec, Hydro's doing splendidly.

On behalf of my clients, I'll address each of these allegations in turn, but I think it's important to start out with some understanding of the analytical flaws in Hydro's whole OM&A analysis.

Mr. Chairman, what I'm going to propose is that I'm -- I've got another, perhaps, fifteen (15) to twenty (20) minutes on OM&A and then subject to your direction, I might want to take a very brief -- brief break before turning to cost of service. Or --

THE CHAIRPERSON: Keep it to a fair level of enthusiasm

MR. BYRON WILLIAMS: I could -- this is -- the next section is somewhat tedious, Mr. Chairman, so if you wanted a five (5) minute break now that's just as fine. It works well for -- for me. I've been going for an hour.

THE CHAIRPERSON: I think we'll take you up on that.

--- Upon recessing at 11:24 a.m.
--- Upon resuming at 11:39 a.m.

THE CHAIRPERSON: Mr. Williams, any time you wish to resume.

MR. BYRON WILLIAMS: Thank you, Mr. Chairman. When we were parted so sadly a few minutes ago, where I was getting into some of the specifics of OM&A and anticipating some of Hydro's arguments, and also outlining what my clients considered to be analytical flaws in their -- in their analysis in -- in this Hearing.

And I -- I think an important piece just to start with, and this flows from Ms. Fernandez' cross-examination is, we expect Manitoba Hydro to argue that the Intervenors cannot prove where Manitoba Hydro has been spending inefficiently.

We expect them to argue that they're not going to point to any explicit cost savings. Now, I think that's contradicted to a certain degree by the -- by the record, but in my respectful view and on behalf of my clients, their respectful view, I guess, it's the wrong question and it betrays a fundamental misunderstanding of what we're doing in this Proceeding.

Now Mr. Harper talked about in his oral evidence, there are different ways to test the efficiency of OM&A expenditures, and different ways to hold corporations cost accountable.

He -- I think he listed three (3); the two (2) that I would just note are line by line analysis, as they do in the BCUC, or a different analysis, and including a variety of approaches, including target OM -- targets for OM&A.

And I think it's important going back to Ms. Fernandez' what I assumed was a premise of her question, to note that we are not in a cumbersome line by line analysis Proceeding, in which Hydro would have to demonstrate a potential cost -- it's the -- the reasonableness of its expenditures on a line by line basis.

If we were, Hyro -- Hydro would have to file vastly different and a vastly larger filing, than if we wanted to go that way.

And just for the purposes of argument, we tried to give the Panel a bit of a taste of that, with my cross-examination of Mr. Derksen at page -- starting at page about 777 of the transcript, when we went through the changes in equivalent full times.

And I'm not sure how much knowledge, in terms of the -- that situation the Board garnered, although I'm still wondering how they -- how they had such a sharp increase rates in regulatory affairs.

But I think what -- I hope that discussion demonstrated, is that Panel -- Hydro's Panel did not have an immediate handle on its staffing changes; the handle that one would have expected to have if we were actually going through that cumbersome line by line analysis.

So, that’s not the kind of Proceeding that we’re in. And I think that more importantly, as my discussion with Mr. Warden yesterday, in terms of Exhibits 24 and 64 demonstrated, for Manitoba Hydro between the bottom-up people and the top-down people, we can’t even reconcile a high level variance explanation, and that begs a question of what Hydro would do if we really had to get down to the gory detail.

And you don’t have to do this now, but sometime at your leisure, I’m sure you’ll have lots of leisure over the -- as you make your decision, in the follow-up to the Undertakings at Tab 17, I was feeling mischievous yesterday, so I thought I might go through it, but I chose not to.

There’s a response to CAC/MSOS-I Interrogatory 18, and I won’t dwell in tiresome detail upon it but there you see an explanation of a variance between the ’02/’03 actuals, and the ’03/’04 forecast; a $40 million variance explanation. Sadly what’s not in there is any reference to subsidiaries.

And if you think that my -- Mr. Warden and myself were getting bitter yesterday on Exhibit 24 and Exhibit 64, think of the fun we could have on Exhibit -- or CAC/MSOS-I Interrogatory 18, trying to cram $40 million of variance explanation into a variance that after allowing for subsidiaries, would only be 30 million.

These are only illustrative examples but from my client's perspective, they raise a material level of concern. When the Corporation, which bears the onus to prove its case, can't make its top-down and bottom-up numbers reconcile for the purposes of proving that case.

And these concerns of my client although we resolved some of them through cross-examination extend the Hydro's presentation of OM&A expendi -- expenditures throughout the rec -- record. And I refer you to my transcript discussion with Mr. Ward and Mr. Derksen about page 804 of the transcript and also to CAC/MSOS Exhibit 84 -- or excuse me, number 4. I don't think we're up to 84 yet.

And what that Exhibit demonstrated and that transcript discussion demonstrated was that in the course of this Proceeding, we've seen from Manitoba Hydro, three (3) different definitions of OM&A using the application, the annual reports and the interrogatory responses. And in -- in the two (2) years illustrated in that Exhibit 4 which is not before you right now, Mr. Chairman, there was a correspondingly three (3) different figures for each of the years in question. And from my client's perspective this is a cause for concern.

Another concern that my clients have is Manitoba Hydro's inconsistency and the treatment of OM&A

costs per customer. And this is a starting point for this kind of concern with Hydro’s analytical approach to this -- this point. I refer you to pages 88 and 89 of the transcript. And again, you don’t have to go there.

But at -- at those pages Mr. Warden in his direct evidence suggested that the Intervenors were over emphasizing the target of OM&A costs per customer. He suggested it was a high level indicator and that the real control exerted by Manitoba Hydro was in the budgeting process and the stringent cost controls within that process.

And it should be noted, as Mr. Harper did in his direct oral evidence, that his approach to the -- to OM&A expenditures was somewhat mis-characterized at pages 88 and 89 of the transcript because he adopted a much wider more fulsome approach to this issue. But he did take a hard look at OM&A costs per customer.

But from my client’s perspective the deeper analytical concern relates to Hydro’s suggestion that its regulator should look to its budgeting process for assurance that all is well in the OM&A field. And if Hydro is relaying upon its budgeting procedure to establish the reasonableness of its -- it’s expenditures, from my client’s perspective, this onus has just not been met.

One of the problems when you only rely upon taking confidence from the budgeting procedure is that it’s a qualitative measure and the question begged by Hydro’s suggestion that we look at it’s budgeting process is what figure is it set upon? What figure is the initial budget level set if it’s not set upon some measure as cost per customer?

Just to give an example, we heard at page 801 of the transcript that 1.83 percent productivity was built into the 2003/’04 to offset high wage increases. What figure was used initially to determine this level of productivity as required? And perhaps I’m not being -- making myself clear so I’m going to try it another way.

Hydro spoke of stringent cost controls in its budgeting process. And presumably that was those top-down people asserting some control over the bottom-ups. You can have all the stringent controls in the world but they’re of little use if all the productivity savings achieved are eaten up because the budgets were too generous to begin with.

And from my client’s respectful point of view that’s a refrain we’ve heard far too often in this Proceeding. When asked by Mr. Peters at page 541 of the transcript whether the product savings of Manitoba Hydro had been usurped Mr. Warden, to paraphrase, replied:

"It looks like they’re not there, but they are."

And that I thought was the same answer that

Mr. Warden gave to me, when we were talking about Exhibit 64 yesterday. When I asked him where were the at least $10 million of savings set out in Exhibit 24, and transcript page 819? Where had they disappeared to? And he assured me that they were there, even if you couldn't see them through the top-down analysis.

And our concerns with Hydro's approach to what we consider, on behalf of my clients, is a very important figure of cost per customer, is highlighted because we see it as being inconsistent with what Manitoba Hydro told this Panel in the Status Update Hearing, and that's at pages 1961 and 1962 of the Status Update Transcript.

> "Mr. Warden: We have a budget review process that we're in the midst of right now, all the divisions are putting together their operating budgets, which are to be presented to Executive Committee later in June. This forms part of our integrated financial forecast that goes to the budget in November. So, we'll be scrutinizing those budgets and comparing them on an overall basis to the cost -- to the cost per customer, to make sure that we get down to that level of detail on the budget side."

Excuse me, there wasn't the word detail after level:

> "And then it will be a matter of meeting that, that -- those budgets on the actual costs side."

Now, I put this to Mr. Warden at pages 761 and 762 of this year's transcripts, and he acknowledged that reading the transcript out of context as -- as he suggested I might be doing, would lead one to believe that the cost per customer drives the budget, then he told the Panel that it really wasn't the case.

But he did say, in isolation, it looks like it's driving the budget. And I invited him to read the transcripts from the Status Update, and subject to further cross-examination, to come back and tell us where we were taking him out of context, and to the best of my knowledge he hasn't.

So, still from my client's perspective, Hydro's relaxed emphasis, based upon their comments at pages 88 and 89 of the transcript on the target costs per customers, seems inconsistent with what they were telling us in the last Proceeding and inconsistent from my client's perspective with the direction the Board gave to Manitoba Hydro at page 92 of Board Order 7/'03.

And my final comment on this point, was

yesterday when I heard Mr. Warden talking about the 11 million, and again, I'm using the figure of $11 million -- so when I heard him talking about the gap between top down and bottom up people, and how he was under so much pressure, those comments -- and we'll review it further in the transcript, seemed so inconsistent with the message that we were getting on day one (1) of the Hearing, about strict budgets and stringent cost controls, because based upon again, my notes from yesterday's conversation, it sounds to me like the top-down people are saying aggressively managed to that target of two ninety-six (296) OM&A net of subsidiaries.

But the bottom-up people seem to be interpreting that to say, aggressively managed to the bottom-up target of three oh seven (307).

Now, Hydro -- and I'm moving to my second point in terms of OM&A, their sugg -- what we anticipate to be their suggestion that they have plenty of productivity savings, they're going to tell you that they can demonstrate, based upon the record of this Proceeding, that they have achieved material cost control.

And I guess the easiest response, and I won't belabor it, is to keep going back to the suggestion of Mr. Peters, that these productivity savings appear to be usurped, or the evidence of Mr. Harper, that they appear to be eaten up.

And the best example in the record that we can see, is at pages 527 and pages 522 and 523 of the transcript, Warden -- where Mr. Warden makes the point about how productivity improvements are built into the forecast, but he also concedes it's equally clear that they don't get through the bottom-line and rather that they used to fund new program initiatives.

So, one (1) recommendation my clients are going to offer free to Manitoba Hydro, is in its OM&A presentations, that they should show these productivity savings separately, and then also show the cost increases and new programs that offset these increases, as opposed to just showing the net effect of the two (2).

And this we would think would help the Board in future years, to focus on the key change areas that are putting upwards pressure and costs, and allow the reasonableness of those changes to be tested, so that's something.

So, that's something for the future that we think would assist all parties.

Getting past is -- I've been reluctant to do about the suggestion that these savings have been usurped. I think there's other -- other evidence on the record, that Hydro is not being as aggre -- is not as aggressively managing it's OM&A costs as it should.

And I would suggest you look back to Mr. Harper's written evidence, around page fourteen (14), or his direct evidence at pages two forty five (245) and two forty six (246). And the point he makes there was that the OM&A costs for the test years '05 and '06, are higher than the cost forecasted for the same year at the time of the Status Update. And that's after one adjusts for Winnipeg Hydro pension costs, et cetera.

This suggests that when we look back as compared to the Status Update, that rather than aggressively managing its OM&A costs, they're increasing, relative to that forecast.

So, if we look to where the hydro can demonstrate a bottom-line impact from productivity savings, we can be confident that it's not there. And if we look to the suggestion of whether they've been stretching themselves, as compared to their forecast in the Status Update Hearing, Mr. Harper's evidence is again, that they're not achieving -- that's those stretched targets.

Moving to my third point, I anticipate that My Friend, Ms. Ramage, will say, "even if you can't see it, it's there.". And I think she'll say, "Look at how we've compared to other utilities, not on an absolute basis, because we don't look so good compared to BC Hydro, but look at the percentage change over the last five (5) years.".

And again, Hydro’s first attempt to make this argument, appears at page 89 of the transcript. And at that page, Mr. Warden discussed the issue of OM&A expense over time. And he suggested that Hydro’s calculation was that its costs had increased by 1.9 percent, just below the rate of inflation.

And he suggested, that that compared very favourably when you compared it to what was admittedly, a simplistic look at the annual reports for Hydro Quebec and BC Hydro, which showed that their calculations, their increase over the last five (5) years, was in the range of 6 percent or higher.

As a starting point, Mr. Warden’s comments at page 89, in my clients’ views, should be taken with a few grains of salt. And we attempted to do that at pages -- to offer one grain of salt in which to temper the enthusi -- enthusiasm of his conclusions at page 851 of the transcript, and also through Exhibit 5.

When we took Mr. Warden through a similar calculation, of Manitoba Hydro’s annual reports, not adjusting for Winnipeg Hydro, not adjusting for pension costs, not adjusting for subsidiaries, and when we took the same or similar simplistic approach, to what Mr. Harp -- or Mr. Warden had done to BC Hydro and to Hydro Quebec, as set out in Exhibit 5, you find that the -- the results are -- are much less impressive from Hydro's perspective.

The second grain of salt we would offer in terms of Hydro's calculations, and I think you can best see this by turning to Tab 3 of the -- the book provided, which is Exhibit 50. And you can start on the first page, when we see that first of all that figure of -- that's Tab 3 of the -- of the Book of Undertakings, and it starts of the first page.

When we see that the one point nine (1.9) annual increase in Mr. Warden's direct evidence was, when -- when actually factored out consolidated operations, it was an average of 2.1 percent, a small point.

But if you go to the next page, and if you look at the figure for '03/'04, which shows $283.4 million, you'll recollect, that based upon Mr. Warden's evidence and the bottom-up people's evidence as well, in Exhibit 24, included in there was a six (6) or $7 million one (1) time saving associated with the drought.

We wish that was a true saving; one (1) that was ongoing. But if you exclude that one (1) time only calculation, you start to get a better picture of the actual growth in OM&A for this period, and we're very confident the Board's analysts, if they choose, can do the calculation, that the result won't be 1.9 percent, or the adjusted 2.1

percent, or even 2.5 percent.

Just while we’re on Exhibit 50, one (1) more word of caution, and it’s not a grain of salt, because I don’t think that would be fair. But if you’re going along under the column for the actual increases for 2002/’03, and you see the figure of 0.5 percent, that looks tremendously impressive.

But we’re confident that if you explore that figure for that year, and you’ll find that reference in CAC/MSOS-I-18¬), that much of this apparent reduction in OM&A on the net income line, is due to higher than normal levels of capitalized activity, which increase the OM&A that is capitalized in that year by 5.6 million.

Now, in fairness, that -- I think it pops back into the equation in the next year, so I don't think it would affect the overall number, but that zero point five (0.5) in '02/'03, should be viewed cautiously.

So, based upon that analysis, we think it would be inaccurate to suggest that their OM&A over the last few years is 1.9 percent or 2.1 percent. And we don't think in the apples to oranges comparison, that Hydro has just demonstrated superior performance to other utilities.

The CAC/MSOS Exhibit 5 would provide a more apples to apples comparison, but not a very good comparison. I think it's clouded with too many other factors.

Grain of salt number three (3) is something that I didn't discuss with Hydro in my cross-examination on day -- day four (4) or five (5) of the Hearing, in terms of Mr. Warden's comments at page 88, but it did come up yesterday.

And that came up when I was asking him with reference to their -- their pretty table that they presented yesterday, whether that was an apples to apples comparison.

And I'm not sure -- I think I got a longer answer for that one (1). But I think what he confirmed was that in Hydro's analysis, the subsidiaries and the OM&A associated with them are out, but for Hydro Quebec, and for BC Hydro, the OM&A for subsidiaries are in.

And I think it's important to recall, and we haven't done the calculation, and I'm not sure how valid much -- much of this percentage increase over the last five (5) years is, but a lot of the growth in Manitoba Hydro OM&A in the last few years, if you look, including subsidiaries, has been related to subsidiaries.

So, I think that's something important to keep in mind, and who knows how fair or what would be the better way to do an apples to apples, whether it would be with subsidiaries or without. I don't think I'm in a position to comment on that and I'm not sure Mr. Warden is either.

And I guess the last comment on this -- on

Hydro's allegedly fine perf -- or the last two (2) comments on their performance in the last few years, is imagine what will happen if the bottom-up people get their way. Imagine if the OM&A for '04/'05 is 307 million for electric, net of subsidiaries, instead of two ninety-five (295); imagine how that figure will look.

The last point, and again, I come from a background before the CRTC where there's a lot of performance based regulation, and a lot of productivity based regulation, and it's interesting to me to note that in that -- in that world, companies are expected to come in with increases in costs that are below the rate of inflation, because they're expected to achieve a certain level of productivity that -- that is -- results in an overall increase of less than inflation.

And it seems to me and I'm not speaking as an expert here, but that perhaps we set our sights a little low.

At long last, Mr. Chairman, and Members of the Panel, we're at the end of the revenue requirement section and I can assure you that the cost of service one will go much quicker.

THE CHAIRPERSON: You take your time, Mr. Williams.

MR. BYRON WILLIAMS: Yeah. If I can -- if I can give you any -- any assurances, Mr. Mayer, is that the --

the sheets that I've gone through on my left are much thicker than the sheets that I have yet to go through on my right.

I just want to sum up by providing my client's general recommendations in terms of the revenue requirement. When looking at their recommendation, they start from the principle that the objective should be to ensure a sound financial basis for the Corporation moving forward.

Secondly, to recognize that there's going to be upward pressure on controllable costs and that there are -- is upward pressure from those bottom up people that I keep talking about. And a third objective we would submit for this Panel should be to send a message to Hydro that it is expected to achieve additional bottom-line benefits through cost control or which can be reflected in the bottom-line or as Mr. Warden agreed there should be a reasonable expectation that Manitoba Hydro would first exhaust internal efficiencies before coming to the Boards for a rate increase.

We'd like the Board to recognize based upon our analysis, that Hydro can still achieve its projected net income with a -- a lower rate -- rate increase and a proper reflection of the padding related to pension savings and subsidiary expenses and the IFF.

We hope that the Board will encourage Hydro to improve its bottom-line further through productivity improvements and through greater control of capital expenditures. In my client's submission, and this is based upon the evidence as of yesterday, subject to undertakings, the required rate increase sought should be reduced by at least $15 million.

And that should be composed of at least $11 million associated with the double counting of OM&A, subsidiary expenses and the pension savings of between three point five (3.5) and $5 million, roughly $15 million, and that Hydro should be directed to improve bottom-line beyond that through productivity improvements and cost control and to be able to demonstrate that when it comes before the Panel next.

Issue number 2, cost of service. Mr. Chairman, on this area if you're looking for any themes and they won't be as repetitive as the first section but I think the three (3) themes that will emerge from this argument, on behalf of my clients based upon the record, are a certain degree of agnosticism towards the concept of unity, a recog -- recognition that the market place has changed materially and fundamentally in the last decade and an acknowledgement that the existing cost of service rules are in a state of flux with the uncertainty that is -- flows from that.

Now, as I understand the issue before you, regardless of the amount of the rate increase granted, and I'm presuming there will be some rate increase, that you're receiving -- you're hearing arguments for differential rate increases based upon groups being outside the Zone of Reasonableness with the residential class being around ninety (90) below ZOR and groups like general service large being well above the ZOR based upon the existing approved cost of service, methodology.

And, at least as I understand from the industrials and perhaps from Mr. Feldschmid this morning as well, those classes are arguing for absolute relief from any rate increases on the ground that the existing status quo in terms of the Zone of Reasonableness is fundamentally unfair and unprincipled.

And, Mr. Chairman and Members of the Panel, representing prudent clients who are also principled, I want to take a moment, as a framework for analysis, to observe that when my clients appear in Proceedings before the Public Utilities Board relating to Manitoba Public Insurance, they're -- they take a much more strict perspective, when it relates to cost causality and cost of service and they don't endorse the ZOR in those Proceedings.

I guess one could argue that they do so out of expediency, but my clients do so, and I think when we reflect upon this further, they do so out of a sense of principle. And that principle is that there are fundamental differences in the insurance world, which might suggest we might want to be more religious on the principle of unity, as opposed to the utility world, which would suggest that we might want to be more agnostic on the concept of unity.

My clients look at Hydro differently than MPI as a starting point, because in MPI the joint are relatively small and the primary source of revenue, I think around 80 percent, comes directly from the rates of ratepayers. There’s nothing that even rivals ratepayers rates as a source of an income.

In contrast, when my clients look at Manitoba Hydro on the cost side, they see the joint costs are huge. Generation alone accounts for about 45 percent of the costs of Manitoba Hydro.

And as we’ve heard at the transcript pages 1515 and 1516, when you’re -- one (1) of the reasons my clients are agnostic on the issue of unity, is because when it comes to joint cost, they defied principled analysis. And when you look at what Mr. Bonbright says, and I put this to Mr. Wiens, I think we both agreed that while we were waxing poetic, that he was a wise man, Mr. Bonbright, the problem of joint and common costs makes it impossible to allocate them. At least on a cost basis, the costs attributable to specific classes and units of service.

So, that’s one (1) reason why my clients are more agnostic in this forum than in others. And I think

NERA, at page 19 of its submission, and Mr. Wiens in his discussion with me at page 1520 and 1521 also seem to make the point that the issue of joint costs becomes particularly interesting and complicated when we deal with the issue of hydro electric utilities such as Hydro.

So, I think the starting point, when we talked about the "fair," in quotation marks, allocations of cost of service in the Manitoba Hydro situation, it's to recognize we're not talking about allocating rates that are currently based upon market rates. And the allocation doesn't speak to the actual costs.

What it really is about is a directionally correct allocation of shared costs. And NERA noted this in terms of its discussion, saying that there is no one (1) accepted methodology.

And as Mr. Harper noted at pages 2133, 2134 of the transcript, methodologies change over time. Thirty (30) years ago if we were in this room, we'd be talking about the fixed versus the variable. Now that -- that approach has been given a bit more of a refined approach through load factors, but it's only a directional indicator. And again, that's why my clients in this field are agnostics.

When we turn to the revenue side, again recalling the situation with MPI, we see a very different situation in terms of Manitoba Hydro, and it goes to my second point, that the marketplace has changed fundamentally.

In the old days, as Mr. Harper noted at page 284 of the transcript, domestic revenues were dominant both in value and in volume. And as Mr. Bowman noted from -- for InterGroup at page 1960 of the transcript, export sales were kind of like a salvage operation, to recover at least some value from excess capability or excess capacity.

And both Mr. Bowman, at page 1960 of the transcript, and Mr. Harper, at page 284 noted, that in those days, the average price per kilowatt for export sales was less than the average cost to product it.

And in those days, back in the early '90's, it made some sense to say, let's directly allocate these revenues back to generation transmission, as an offset against cost of production. If they weren't even making their average -- the -- meeting the average cost of production, then it made some sense. And Mr. Harper acknowledged that at page 284 of the transcript.

And I think Mr. Bowman essentially said the same thing at page 1980 -- 1958, when he said in the past, if there'd been an expert class, there would have been no surplus.

But then something happened. In Mr. Bowman's words, at page 1961:

"A heck of a lot of things have changed

since then"

And that’s highlighted at the NERA report at page 58. Volumes have increased; we know that the average price has increased, we know that from the Wuskwatim procedure.

And as Mr. Harper noted at page 2084,

"Average prices for export sales now exceed average costs."

And today, we are building plants and planning, with a greater focus on exports. And Mr. Wiens acknowledged that at pages 1524 and 1525. Today, unlike a decade ago, speaking strictly from an economic -- or a revenue sense, Hydro is better off if they can conserve and -- a kilowatt of hour in Manitoba and sell it to the States.

In fact, that’s how we set our DSM or how we evaluate the effectiveness of our DSM programs.

And in Mr. Harper’s submission, his evidence at page 2085:

"That’s turned the rules of cost causality on their head"

Because now, in using a kilowatt hour in Manitoba, imposes an opportunity cost upon the system.

And I think, and I haven’t given him, perhaps, the credit he deserves, but Mr. Lazar as well acknowledges this, and at pages 1266 of the transcript. He spoke of the additional distortion by the method of calculation and allocation of export credits.

And I think that even My Friends from InterGroup, who perhaps I don't give enough credit to either, both in this Proceeding and the last one, recognize, while they may not endorse it, but that there might be, once you got to the true cost of exports, there might be another way to do things, through an export class. And there might be different ways of allocating export revenues, once you got to that true cost of experts -- exports. I don't really want to talk about the true costs of experts, until my closing on cost.

And things have changed. This Board recognizes it in Board Order 7/'03, when they directed Hydro to look at the creation of an export class.

MR. ROBERT MAYER: Against the recommendation of Mr. Harper and of my MIPUG, if I recall correctly.

MR. BRYON WILLIAMS: And I -- I think we explained that, I hope in our direct evidence. I notice -- noticed you were fairly silent on that point. I had all sorts of excerpts from the transcript explaining what a nuanced opinion Mr. Harper gave in the last Hearing.

But -- and I think Hydro and Euro have both acknowledged a material difference, as well. And I think it's important, when we look to guidance from regulatory precedent, to recognize that there isn't much, not any more, because things have changed materially.

And if we look back to NARUC, the last update, which is in 1992; that was before these material changes. And that's acknowledged by Mr. Bowman in -- at pages 1968 and 69 of the transcript.

And as Mr. Harper said, at page 2125, if you're looking for regulatory precedent in Canada, by -- from major exporters like BC Hydro, Hydro Quebec, it doesn't exist. Because their cost of service updates, in terms of the consideration of export allocation, haven't been done, since I think in the case of both utilities, you can check the transcript, since the early 1990's.

So, they -- if you're looking for regulatory precedent and you're looking at a change, you're it. This is -- this is -- times have changed and I think regulators as years proceed will be struggling to adjust to it.

MR. ROBERT MAYER: Didn't you say that Hydro Quebec was, in fact, legislated and that there was no regulatory intervention in the export allocation, at all?

MR. BRYON WILLIAMS: Yeah, and I -- I think if I'm right, and thank you for that Mr. Mayer, I think the last cost of service in Hydro Quebec was in the 1980's and it's B.C. Hydro that I was speaking to more specifically.

(BRIEF PAUSE)

Mr. Chairman and Members of the Panel, I've spoken to why my clients are unity agnostics, why the marketplace has changed. And I think we can recognize that the existing cost of service rules are in a state of flux.

We're awaiting what flows from the NERA recommendations. The last thing I do want to talk about before I get to my clients -- some implications and conclusions, relates to uniform rates.

And I always quail a little bit, when I bring up this subject. But, I want to emphasize from my client's perspective that it's -- they don't see it as a political question. They see it as a question of fulfilling the legislative intent.

And that's certainly how, Mr. Harper's advice and recommendations have been framed at page 2090. And he interpreted his reading of the legislative record and the status update discussion, as suggesting that there was not an intent to bring in uniform rates through the imposition of intra-class subsidy.

He took it that there was an explic -- explicit intent to do it through export revenues. And he took it that there would be -- that was the intent.

And the implications of that, were that there would be no rate increases for consumers as a result of uniform rates. And certainly many consumers, especially in the former Zone 3 have benefitted tremendously and my clients acknowledge that.

But, the fact is, and Mr. Wiens acknowledges at pages 1421 and 1422 of the transcript, when you look at the degree to which the residential customers are currently below the ZOR, you can take about 2.5 percent -- percentage points and attribute that to uniform rates.

And Hydro agrees, and I think that's at page 1429 of the transcript, that the lower RCC due to the uniform rates, may contribute upward pressure on residential rates.

And I think to their credit, they adverted to the possibility that this might impose an unfair burden on residential customers and I refer you to pages 1232 of the transcript.

And also their argument, even in the status update filing, their final argument pages 3603 and 04. And that, as Mr. Wiens explained, is due to the way that uniform rates are implemented in the Cost of Service Study and that's at page 1436.

And on behalf of my clients, we appreciate the openness to a solution that Hydro has expressed. Mr. Wiens, at page 1438, indicated that the method outlined in the IR to CAC/MSOS was not, in his words, an inappropriate -- was not an inappropriate way to address the problem.

And Mr. Harper has also suggested a couple of ways to deal with it. And those are at pages 2092 and 2093 of the transcript.

And even, My Friend Mr. Lazar, at pages 1266 of the transcript has noted that there may be policy solutions to the situation.

So, where does that contextual discussion leave us? From my client's perspective, in terms of the cost of service, unity as I've said before, is not of such religious consequences.

And though they do acknowledge adherence to the ZOR makes a lot of sense. And especially a lot of sense here, where there's large, joint costs and with the realities of a large Hydro electric utility with the specific characteristics of Manitoba Hydro.

They think, as well, that gradualism makes a lot of sense, especially given the new reality of the marketplace and concerns with the fairness of the current allocation of export costs. And they think that gradualism makes some sense because as everyone's acknowledged the current situation is in a bit of flux. I'm not sure if everyone has acknowledged it but many have.

So, they would conclude and recommend that for the purposes of this Proceeding, the Board not consider unity to be an urgent target but to consider the object of ensuring that all are within ZOR, over a reasonable period of time being five (5) to seven (7) years is a reasonable target.

My clients would also conclude that as the Board tries to deliberate in terms of what's an appropriate rate differential, it should look at:

a) the implication of uniform rates on residential consumers, and

b) the implication as Hydro has suggested of the pre-export cla -- pre-export revenue allocation.

And Mr. Harper endorsed that point of view at pages 281/82, 297 and 2104 of the transcript.

Mr. Harper concluded, and that's in Tab 10 of the -- of the -- his conclusions aren't there but based upon Tab 10 of his materials at the time he filed his evidence --

MR. ROBERT MAYER: This one?

MR. BYRON WILLIAMS: -- not -- not on this one, sorry Mr. Mayer, that when the Panel looks towards a rate differential in terms of the difference from the average rate, that the rate differential proposed by Hydro for residential, one (1) was too high but that a point five (.5) was not unreasonable.

And I can advise the Panel, Mr. Harper made that recommendation with some trepidation because he wasn't sure my clients would endorse it. But my clients do. They see that is -- is part of a gradual move towards not unity because they think that that's a -- a target that's -- that's not particularly urgent or important but to the ZOR; they see that that is reasonable.

My clients have also asked me to say to you that -- and we've had a lot of debate with my clients over the years, when they first started coming to these proceedings they use to come in with positions as bargaining chips, they would advance a position say you know, expecting the Board to come down the middle.

Over the last few years my clients have moved away from that and they've taken, they -- they don't see this as a bargaining chip or bargaining approach. They're offering their advice to this Panel, their bottom-line number from their perspective taking into account the fact that they are prudent consumers.

Over the long term, my clients endorse the evidence and Mr. Harper I think, Mr. Wiens as well, that Hydro and the cost of service approach in terms of the allocation of export revenues needs to have something more neutral, less distorting than the current allocation. My clients accept Mr. Harper's evidence that the export class has some merit to consider but that the devil will be in the details. Hopefully there's no devil in the details.

So, they would recommend to this Panel that it -- it tell Manitoba Hydro to come back with a -- based upon what it -- Manitoba Hydro considers to be favourable or supportable recommendations from NERA with the full Cost of Service Study based upon those recommendations.

Before this Panel I guess there are two (2) proposals in terms of a more efficient, a less distorting way to allocate export revenues; there's the tentative NERA proposal and there's also the proposal of Mr. Laz -- Lazar which I'll characterize as the export credit proposal.

My clients are more sympathetic to the proposal of NERA and they note that Mr. Lazar noted at page 1267 of the transcript that that might be an appropriate approach. And they also note that Mr. Lazar acknowledged generously at page 1270 of the transcript that his approach might be considered more extreme.

And given my client's sense of gradualism, but recognizing the need for change, they think that the NERA approach is one that this Board should look upon more favourably.

Issue number three (3): And this pile to my right is getting very thin, is residential customer impacts. I told you before I was a dreamer, but, I'm going to be a pessimist for just a second.

And I'm going to assume that the Panel accepts

Hydro's request for the rate increase proposed. And I want to point out, on behalf of my clients, that if the rate increases sought by Hydro are brought in, effective August 1st or September 1st, they will result in very significant increases to the average rates for residential consum -- consumers; 5.52 percent, if brought in effective August 1st on average and that's from page 1459 of the transcript, 6.1 percent if brought in September 1st, and that's from page 1462.

For the space heaters amongst us, for the two thousand (2000) kilowatt hour users, the effect for residential customers of a September 1st, increase would be in the range of 6.7 percent. And that's from CAC/MSOS Exhibit number 9.

And my clients do have concerns from a policy perspective with rate increases materially above inflation for Hydro consumers. And they'd note and they noted with interest one of the interrogatories or undertakings requested by the panel in terms of a comparison to Centra increases.

And my clients want to make it clear that they consider this a very different situation from Centra for two (2) reasons:

One (1) is that rates under Centra and I'm not -- I don't have a great deal of experience with that, but, they're much more market based and there's much more competition, or there is the possibility for competition in terms of the provision of natural gas. So, that's one (1) important distinguishing characteristic compared to the regulated rates of Manitoba Hydro; much more heavily regulated, in that way.

Secondly, the other distinction is, recognizing that Hydro rate customers and part -- part of this is due to the credit of the utility and also to its export revenues, have had very stable rates for the past few years.

And rate change of this magnitude, my clients believe, would be much more pronounced when clients or where the customers have been more accust -- accustom to a more heavily regulated, more stable environment. So, it's not the same in their submission as MPI -- as -- as Centra.

Just a couple more points on this subject, Mr. Chairman. My clients are also -- also concerned, in terms of a rate increase, of that magnitude because they think -- they think of rate shock in another way, not in terms of the -- the definition of rate shock, but, also expectations that have been created due to media publicity, which, as Mr. Harper noted at page 2077, spoke of a 3 percent increase.

And even the public notice which, although acknowledge that residential rates would rise, could rise 4.1 percent, didn't explain that the differential block was going to be eliminated in this proposal.

And so, my clients are concerned that people who use a higher kilowatt hour per month, in terms of -- of energy, may be materially affected without notice, whether it's proper in the regulatory sense, I'm not sure, but, it's not proper in terms of the communication sense.

The cumulative effect, if the Hydro revenue requirement and proposals, as my clients understand it, is accepted, would be for those, take into account both the implementation in August or September of '04, and in the subsequent rate increase in April 1st of '05, for those using two thousand (2000) kilowatt hours per month would be close to, in fact, over 8 percent and the average for residential classes would be close to 8 percent. And that's from Mr. Wiens at pages 1477 and 1479. And that's of concern to my clients.

(BRIEF PAUSE)

So, where does that leave us? Where does that leave us in terms of the recommendations of my clients? In his direct, Mr. Harper, spoke to proposing a kind of rate smoothing, taking into account the reduction of $10 million in terms of revenues.

And he suggested, his recommendation were increases of 2.5 percent on September 1st, followed by 2.3 percent on April 1st. And that was based upon a $10 million revenue reduction.

Based upon a $50 million, at least, revenue reduction as recommended by my clients, this would leave Manitoba Hydro in the '04/'05 year requiring 13 million instead of 28 million and for the '05/'06 year requiring 36 million instead of 50 million.

And doing the straight math and I'm giving evidence on this point, but, it's -- you'll give me that liberty on this simple point, would lead to an overall increase of 2.3 percent on September 1st and one point five (1.5) per six (6) -- one point five six (1.56) on April 1st.

Smoothing them out, which my clients would recommend, would yield increases of 2 percent, which they're recommending to you on September 1st, followed by 2.1 percent on April 1st.

That's on average -- incorporated into that, as well, would be the differential rate increase for residentials of an additional 0.5 percent.

Now, my clients did consider given the additional 5 million in -- in savings that they found, compared to Mr. Harper's evidence, whether that instead should be plowed back into, increased net income.

And their conclusion was, no, and for many of the reasons I've outlined previously.

Just a couple of quick points. There's been some discussion of retroactivity in this Proceeding. It's not something my clients normally endorse. Hydro has suggested in the future, it may be a more frequent occurrence.

And that is again, something my clients would caution against. And based upon their experience with Centra Gas, my clients are not really big fans of deferral accounts either.

I was a little surprised by this, but, I take my instructions. They said that in similar situations in the future, you know, an interim increase might be something they would certainly -- might want to consider the merits of, compared to the options of retroactive increases or deferral accounts.

So, that's something from my client's perspective and I don't -- I'm not sure I can elaborate on it a lot, but, I think that's where they come from in terms of -- for the future.

MR. ROBERT MAYER: Did we address the issue of rate rider?

MR. BRYON WILLIAMS: I would have to get instructions because I was not paying that much attention to Mr. Peters, sadly. But, you know, Mr. Mayer, perhaps in my comments on Wednesday, which will be brief, we might speak, just put forward the client's position on that point.

One other point, rate design. And I'll just refer you to my discussion with Mr. Lazar at page 1272 and 1273, in terms of inverted rates. And I think he agreed with me, that if he was in the regulator's shoes, I think he was talking about laced up shoes, he thought the regulator would benefit from the input of Hydro in terms of that subject, as well as the response to it by Intervenors.

And my clients, I think -- think that's the -- they think that there is some merit to the concept. They also expressed some concerns in the Status Update Hearing with that concept and they would want to see, in this case, whether their devil was in the details, or not.

So, they did look forward to receipt of Hydro's report and look forward to providing comments when those come.

Last thing, conclusions and recommendations. And I've shared most of them with you on the course of my argument, but, I just want to highlight four (4) or five (5).

My clients believe that Hydro's revenue requirement should be reduced by at least 15 million. That Hydro should be directed to find additional OM&A efficiencies, productivity savings to be reflected in its bottom-line, that the export revenues should be adjusted to account for proper treatment, or in their view, a proper treatment of uniform rates, as proposed by Mr. Harper.

Fourthly, Manitoba Hydro should be invited to propose changes to the current costs of service methodology, based upon the recommendations from NERA, which it supports.

In terms of the rate differential between the average rate and residential rate, my clients think the 1 percent differential is excessive, given the impact of pre-export allocation and uniform rates, and that there should be only a 0.5 percent differential.

And you've just heard my comments in terms of the rate increase.

In terms of costs, my clients will speak to this in writing, primarily. But I did want to take this opportunity, Mr. Chairman; we did receive a letter, I think, from you in your capacity as new Chair of The Board, talking about the appropriateness of expert fees and legal fees.

And I hope you've seen, during the course of this Hearing, the value that witnesses such as Mr. Harper can provide. When you get our costs application, you'll see a -- an hourly rate for Mr. Harper, which is less than market rates, just as you'll see an hourly rate for me, which are less than market rates, but that are still substantial expenditures.

I hope you'll understand, and the Panel will understand that, we make every effort to keep costs as low as possible, but to attract good people, you have to pay rates that are fairly competitive.

We've already lost Mr. Todd to the other side, to the dark side, to -- to BC Gas and to ICBC, and we're facing increased pressure with all our experts, because we cannot pay rates that compete with the utility's.

But I just put that forward, Mr. Chairman and Panel Members, so that when you see those hourly rates, you won't have too many gasps of horror.

And subject to any questions, those are my comments.

THE CHAIRPERSON: Thank you, very much, Mr. Williams.

Mr. Peters, unless you have any suggestions, we'll adjourn now for lunch, and we will, let me look at my schedule here, we'll return with Ms. McCaffrey and MIPUB closing arguments.

MR. ROBERT MAYER: Just before we do, Mr. Chair; it's not a question for Mr. Williams, because I asked the question, he didn't have the answer. But I will be asking Hydro the same question, referring to CAC/MSOS, I think now we're now really calling it Exhibit 14, on the Manitoba Hydro Consolidated Financial Results.

I will be looking to ask the question: What were the retained earnings and the debt ratio at the beginning of the drought in what I'm now told is 1987, and if anybody could, if that's an easily obtainable number, I'd appreciate it, when it comes time for Hydro's argument.

THE CHAIRPERSON: In mind of the time, and given the fact that there's always some deliberations that goes on while we're on the break, we'll shorten it down and we'll come back at, if no one minds, at about a quarter to 2:00. Would that be okay? An hour from now.

--- Upon recessing at 12:44 p.m.
--- Upon Resuming at 1:52 p.m.

THE CHAIRPERSON: Welcome back everyone. Anytime you're ready to start, Ms. McCaffrey.

MS. ODETTE FERNANDEZ: Mr. Chairman, prior to Ms. McCaffrey beginning her closing, Manitoba Hydro does have two (2) responses to undertakings that they would like to file.

THE CHAIRPERSON: Please.

MS. ODETTE FERNANDEZ: The first one is a response to Undertaking Number 61 which is the inter-company charges dealing with both revenue and expense side of subsidiaries for fiscal 2005 and fiscal 2006. And I believe we're up to Exhibit Number 75.

THE CHAIRPERSON: That sounds fine with me but I don't have -- I don't have it in front of me. That's fine though.

--- EXHIBIT NO MH-75: Response Manitoba Hydro Undertaking No. 61.

THE CHAIRPERSON: It is Friday afternoon, Ms. Fernandez, we're reacting a little slower than normal.

MS. ODETTE FERNANDEZ: That's fine.

THE CHAIRPERSON: What exhibit number did you have for this one?

MS. ODETTE FERNANDEZ: Number seventy-five (75).

THE CHAIRPERSON: Thank you.

MS. ODETTE FERNANDEZ: The second one we have is Manitoba Hydro's response to Undertaking Number 65 which is the Lake Winnipeg in-flow for 2004/05 and I propose Exhibit 66.

THE CHAIRPERSON: Seventy-six (76)?

MS. ODETTE FERNANDEZ: Seventy-six (76), sorry.

THE CHAIRPERSON: You've been playing too much bingo. Okay, that's good. Thank you.

--- EXHIBIT NO. MH-76: Response to Manitoba Hydro Undertaking No. 65.

MS. ODETTE FERNANDEZ: And we're just handing out one more which is Manitoba Hydro's Undertaking Number 63 which is the five (5) year comparison of home heating costs for energy sources that Manitoba Hydro attracts and that would be exhibit 77.

THE CHAIRPERSON: Thank you very much, seventy-seven (77).

--- EXHIBIT NO. MH-77: Response to Manitoba Hydro Undertaking No. 63.

THE CHAIRPERSON: Is that all of them, Ms. Fernandez?

MS. ODETTE FERNANDEZ: That's all of them.

THE CHAIRPERSON: Ms. McCaffrey...?

MS. TAMARA MCCAFFREY: Thank you very much, Mr. Chairman. I have circulated a few pages, I don't know that they need an exhibit number but if they do, I believe we're at Exhibit 12 now for MIPUG. But all these are are transcript excerpts because -- oh, I -- I gave nine (9) copies -- left them for Mr. Barron on his chair.

So, the purpose of doing that is because I'm going to go through my Argument but I'd rather not break up the flow of the argument making repeated references to transcript pages. So, what I have attempted to do this time is summarize essentially the point that I -- that you'll hear me talk about in the Argument with a page reference.

And then if you like you'll have those references available to you if you need to go back and -- and find --

THE CHAIRPERSON: Very helpful.

MS. TAMARA MCCAFFREY: Thank you. To the extent that there may be one or two points made where there isn't a transcript reference, any additional references. I don't think that's the case but it -- it may be the course of the Argument that that arises and references certainly can be provided.

Now, we've had that wonderful quotation from Whitman, from yourself this morning, Mr. Chairman, and we've had references to cinema and unfortunately I'm a tired mother with young kids, so the best I can do is think of the Lion King and the circle of life. And I'd like to just talk a little bit about the role of the regulator, the utility and the consumer in Manitoba, and how they all fit together.

THE CHAIRPERSON: We'd appreciate the advice, thank you.

MS. TAMARA McCAFFREY: Now, operating as a regulated utility, Hydro has a solemn responsibility to its regulator, that is not to be taken lightly. And the regulatory process, similarly has a responsibility to Hydro, to ensure that it receives a fair level of rates in a consistent predictable treatment by the regulator.

Both have a responsibility to domestic customers to ensure that the power that they receive reasonably reflects the -- or the price that they pay for the power they receive reasonably reflects the costs that they impose on the system.

And Mr. Bowman yesterday referred to this as the regulatory compact, which means covenant that -- that exists between these entities.

Of course the Board here is charged with ensuring that the public interest is maintained, and there is considerable flexibility in how it achieves that mandate.

But there’s also important conventions, principles, traditions, objectives and past practice, that are available to guide this Board in carrying out its responsibilities.

Some of these come from legislation of course, some from sister jurisdictions, some from textbooks on monopoly regulation that we’ve heard various experts refer to in this Hearing, some from hard work and wisdom of past members of the Panel, that stretch back at least to the 1980s.

So, we encourage the Board to make the most of this collective well of wisdom that has accumulated over the years.

Regulation in Manitoba; Hydro is somewhat unique compared to the normal model perhaps for regulation of -- of other utilities such as, for example, Centra Gas. And that the Board really only has two (2) levers of control over Hydro, the big one (1) being setting Hydro's rates of course, and the more subtle control exists through the form of recommendations or directives to undertake studies, and to a certain extent moral suasion.

Now, despite this that there is a tradition of strong regulatory oversight by this Board, and that is a factor that MIPUG members, and you heard that from Mr. Turner when he came before you at the beginning of the Hearing, or consistently voiced this as being one (1) of the most important factors to their confidence and Manitoba's Power rates being fair, stable and as low as possible, while of course maintaining the -- a healthy utility.

Now, I just -- I'm giving you some broad overview type comments at the outset, and then I'm going to go through the -- the order of my argument shortly. But at the outset, I want to say that in this Hearing there has been a distressing lack of commitment, MIPUG Members are concerned about, from Manitoba Hydro with respect to responding to directives from the Public Utility Board.

Those recommendations, directives, persuasive nudging, call it what you will, but dating from this Board, back at least to 1996 and then even again through to 2002, we highlight three (3) -- lack of attention to keeping capital costs under control as one (1) example. The failure to address or even take seriously the Board's concern, repeated concern about reducing the absolute levels of debt, and the lack of an earnest commitment to comprehend and weigh the Board's recommendations with respect to the -- the reserve provision amount. Those are three (3) examples.

Outside of meeting the Board's guidance on these matters, Hydro's assertions about the need for higher equity and bigger reserves, have to be taken with a degree of skepticism.

It's not enough to assert the drought could cost 1 billion or even two (2), as a carte blanche that ratepayers should fund the absolute level of reserves, without any consideration of probabilities of those risks existing, and other tools that can come from the types of analysis that the Board requested, but has not been provided.

Mr. Harper referred to this quite accurately as having us all know how long and far the journey is going to be.

Most importantly for this Hearing, we strongly encourage the Board to make the most of -- of both levers that are available to it. There’s a clear and demonstrated need to ensure Hydro is under continued pressure to maintain cost controls and provide considered opinions on a number of subjects and this can be achieved with some additional important recommendations from this Board, but it must be backed up by the Board, maintaining a firm grip on the level of domestic rates, and ensuring a strong regulation continues in this Province.

Collective wisdom from Hearings past found a way to make due in many situations of drought or flood, within a commitment to ensuring that the overall level of rates did not increase faster than inflation in any given year. And we think that’s one (1) piece of wisdom that would be of great value in future, and not ought to be discarded today.

So, having said that, in terms of the framework from where MIPUG is coming from, our recommendations are as follows. Or there are six (6) of them:

1. The overall rate increases for ’04/’05 and ’05/’06 years, be approved at 2.4 percent and 2 percent respectively; that’s the level of inflation.

2. The prospective Cost of Service Study '04, should be accepted.

3. Any relief in the overall level of rates granted, be directed to getting customers that have had rates consistently above the 105 percent revenue cost coverage ratio on the past towards the Zone of Reasonableness, and that specifically means that no increases for the general service large, greater than 100 kilovolt class, general service large thirty (30) to 100 kilovolts, and the general service small demand sub-classes.

4. The Public utility direct that capital spending outside of generation and transmission that's required to provide safe and reliable service, be reduced and stringently controlled in light of the impact that such spending has on rates.

5. Direct that Hydro continue and complete their work on the quantification of the reserve amounts, not retained earnings, the reserve amounts that would be necessary to guard against the major risk it faces, and to develop a proposal for setting such amounts aside in the manner of insurance to ensure that amounts set aside as reserves and not retained earnings, are in fact available when they're actually needed, should risks materialize.

5 (sic). That the Board direct that Hydro consult with customers, regarding development of rate policy,

which affects them.

I'd like to go first through the revenue requirement portion, and then I'm going to follow that with a brief comment on -- on arrow and then cost of service and finally rate design or price signals.

With respect to the revenue requirement, this Board is charged with asking this question: Do Hydro's rates, or that's the rates that they are proposing, fairly reflect their costs of running the Utility and providing safe and reliable service to electricity customers.

Reference is of course Crown Corporation's Accountability Act, Part IV, Section 26, and it deals with rates, the item -- and the items to be taken into account, and of course the Public Utility Act, Section 77.

Hydro's level of revenue must be sufficient to run the utility meeting all of its costs and to provide safe and reliable electrical service for consumers, yet not be so high that the revenues beyond what's reasonably required to do this.

In terms of what revenue is required, and again, you can reference of course Section 40(1) of the Manitoba Hydro Act, Hydro's required to maintain a reasonable level of reserves in order to deal with debt, maintain or replace works to the Corporation and to maintain rate stability in the face of certain calamities. Of course this is prudent, and it protects ratepayers from sudden sharp rate increases, and maintains rate stability over time.

Now, we recognize the impact that the drought has had on Hydro, and that is why MIPUG is -- is recommending that an overall rate increase, not exceeding the level of inflation, but -- but at the levels I stated is appropriate at this time.

But recovery from the drought ought not be borne solely by the ratepayers. We do not agree that Hydro cannot pare back their internal spending in order to respond to this drought.

Both MIPUG and CAC/MSOS experts concluded that a substantial portion of the rate increase is planned to fund cost increases other than those that relate to the drought.

Mr. Harper also agreed that the Board has an important role in ensuring that Manitoba Hydro is operating as efficiently as it can, and you can -- of course you can implement that through the level of rates that you approve.

Mr. Harper also agreed that the build up of reserves following drought should be shared between Hydro and ratepayers and not solely from ratepayers.

We all have to come together in this circle, to share the pain as it were, and everyone has to do their part to respond to adverse circumstances as they arise. With respect to capital spending, $250 million was the level in

1996 at that GRA and the Public Utility Board was concerned about those increases at that time.

What did the Public Utility Board say? They said pare back, cut back. What did Manitoba Hydro do? They increased their capital spending outside of generation and transmission to 350 million by the time of the 2002 Status Update. What happened in 2002? The Public Utility Board said pare back, reduce the long term debt, control your internal expenditures, were not required for safety and reliability.

In 2004 Manitoba Hydro capital spending 380 million and I'm referencing MIPUG Exhibit 6 here and that's outside of spending related to generation and transmission. Now there was some discussion about system supply enhancements but I think when we look at the hundred's of capital expenditure pro -- or capital projects on the forecast we agree and Hydro agrees that, as I see, sort of a minimal amount of that. So, they're not accounting for the increases.

With respect to O&M costs we didn't duplicate the very good and thorough work of Mr. Harper on behalf of CAC/MSOS and Mr. Williams. And some of that work uncovered an additional $11 million that's been double counted with O&M expenses.

Now, the concern here that we have is Mr.

Warden's comments and this reference may not be on my sheets, so it's -- it's at page 2404, that Manitoba Hydro, and I'm not going verbatim here but that Manitoba Hydro will either find a way to spend this money or if they don't, it will be available in retained earnings to benefit ratepayers and to rebuild from the drought.

That's Manitoba Hydro's mantra of course. Greater earnings; good for Manitoba Hydro, good for rate payers because the money's there, we need it, i.e. if a drought arises and it also reduces Manitoba Hydro's interest costs. Now, rate payers may be forgiven for being cynical with respect to this -- this assertion.

Mr. Warden's comments tell us that the money will be there for the drought or ratepayers benefit. Of course, only if not funding insufficient operating cost controls by Manitoba Hydro, MIPUG would assert.

Another basis for the cynicism is that retained earnings cal also be tacked upon government charges and increased capital spending. Manitoba Hydro notes, of course, that increased government charges including water rentals is a risk that they face and they noted that in Exhibit 41, the Risk Management Report at page 10.

Now both Mr. Harper and Mr. Bowman were concerned that rate increases would be largely used to find cost increases at Hydro and not materially aid in recovery from the drought. We have to keep that in mind. Both of these people coming at it from different perspectives, and different roads came to that same conclusion. And nothing in this Hearing has changed that.

Keeping in mind the legislative framework which designates reserves and the rates that are used to allow utilities to build them up. We think that the cynicism about reserves could be assuaged by a direction from this Board that Manitoba Hydro developed credible options for setting aside reserves, again the distinction has to be maintained between reserves and retained earnings.

Setting aside reserves once the risks and relative reserve amounts are quantified. And setting aside those reserves in a manner separate from retained earnings which can, as Mr. Warden indicated, be drawn down whenever the Corporation has costs or losses or special circumstances.

So, setting aside a matter separate from that with its own special rules regarding how they can be drawn down or increased and to bring some credible alternatives back to this Board for review.

The theme here that I tried to develop with respect to the concern of the Public Utility Board historically about ever going capital debt and Manitoba has not and is not taking this concern seriously is important.

I submit that the Public Utility Board’s concern was not because they were anti-growth or that they didn't understand good debt but because there was a recognition that for every dollar spent on capital there are costs, interest, depreciation, not to mention of course buying 25 percent being sought by the Corporation to put into their retained earning. All of this would put upward pressure on rates.

So, MIPUG is concerned with the blurring between the retained earnings, again which can be drawn down whenever the Corp incurred losses, or increased costs and reserve provisions which ought not be treated in the same way. Reserves are not an outdated term; it's not the same thing. And there's a need to ensure that reserves are there, when they're needed.

I believe Mr. Bowman used the term sacrosanct, and you know, I thought, I don't think that's an exaggeration, I think ratepayers want to know that the money that they're putting into the -- the bank account for insurance, is -- is there for those purposes.

With respect to the overall level of rate increases not exceeding the rate of inflation, now the Public Utility Board isn't hamstrung by the past, of course you've got the discretion to impose the rate increases that -- that you're convinced are appropriate. But it's important to recognize that this precedent benchmark exists, and it's a useful guide in terms of stability and predictability of rates over the long term.

Now, there may be a time when increases beyond inflation are required and appropriate, but this isn't it. During the second worst drought on record, between I believe it's '87 to 1992, rates were still kept to the level of inflation and exports weren't what they were now; Hydro continued on. They found a way to live within that.

And again, for reference of the historical rate increase that had been sought, and the rate increases that had been given by the Public Utility Board, there was reference to the Appendix A at page 47 and 48 of MIPUG's evidence, that was filed in this Proceeding, the written evidence.

And speaking of drought, let's get some perspective on the drought. In 1996, the forecast for reserves was about $700 million by about 2004; we're -- we're at that level now.

And in fact, reserves only reached the 700 million mark in the year -- March 31st, 2000, so Manitoba Hydro was actually only back about four (4) years from where they would have been without the drought. And we know that there's some increase in capital spending and other expenses that have contributed to this as well.

And the future, in terms of water levels, are looking brighter, as are exports. The prognosis is that exports are going to continue to be profitable.

Now, indeed, when you take into account Mr. Harper's double counting with respect to the $11 million, and some additional constraint by Hydro, under direction from this Board, it's possible that the two point four (2.4) and the 2 percent series of increases that MIPUG rec -- recommends, would allow for faster progress towards drought recovery, than even what is shown in the IFF-03-01.

Though again, at the end of the day with respect to the overall rate increases being sought, in our view, Hydro can continue to progress towards their financial targets, continue to make progress towards recovery from the drought, with the rate increases that we're recommending. And that would not require -- and I'm going to deal with this more in cost of service, a shortfall to be made up in terms of imposing greater rates for some classes and less rates for others.

Moving to cost of service now, again, the current cost of service study that's been filed in this Hearing is appropriate to this cost based jurisdiction, and ought to be accepted.

Now, export revenues, to the extent that there were any, have been allocated to generation of transmission components to the system, since the time when Manitoba Hydro first began being regulated by this Board in -- in the late ’80s.

This practice is and remains totally consistent with the cost of getting those export sales, and they are the only functions responsible for supplying the power to the export market. They were in the early ’90s when Mr. Harper agreed that that was an appropriate allocation, and they were in the 1994 GRA when the Consumers Association of Canada advocated a different allocation. They were in the 1996 GRA when they did it again.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: I knew my cold was going to catch up to me. And they were in 2002, when Hydro brought it forward, and they are now.

And by bringing these things forward, I’m talking about bringing forward all the other ways of allocating the export revenue.

You know, Mr. Williams, actually, in his wonderful and eloquent argument that he gave this morning, in his customary thorough fashion, made a comment that Mr. Bowman agreed with him that there are other ways of allocating those export -- the net export revenues, and Mr. Bowman only agreed. He said again to Mr. Peters, that there's millions of ways probably, of allocating them, but none is consistent, or has been found to be consistent with cost based principles in this jurisdiction.

So, we can keep looking at different ways to allocate export revenues; that's nothing new to this Board. And I expect it's going to continue to happen in the future, and that's fine.

The Board's rejected them each time, and -- and based on the proposals that were put forward. And just making reference to Board Order 51/'96, page 40 of that Order, the Board has continued to allocate the export revenues to generation and transmission functions, because this is based on the principle of cost responsibility, rather than mere judgment.

MIPUG certainly looks forward to further debate and discussion, if Hydro comes forward with another proposal for export allocation, as there was a lot of discussion in 2002. And if they come forward again with another proposal, we welcome the opportunity to have input and to have a -- have a debate about what the best way to go would be.

But the fact is that -- that we're looking at more dollars coming in from exports, but it doesn't change the logic of these objective and useful regulatory principles of assigning revenues in accordance with the components of the system that give rise to them.

I won't be long on revenue cost coverage ratios, I think to everyone's relief. But let's deal with them briefly. Mr. Wiens, page 1491 of the transcript indicated that there was this notion of fairness within the context of classic rate making.

And he talked about the relationship between rates and costs, and he indicated that there may be other definitions of fairness, but in classic rate making, fairness refers to equal treatment of customers causing equal costs.

We agree with that. And with respect to fairness, we have a couple of points to make. First of all, it's not fair to give a $15 million subsidy to the residential class, as a result of the uniform rate program; getting right to the point.

The uniform rates policy is one (1) that's seen throughout the country. It's a good policy. It's a policy that makes sense. It's not a special deal that needs to be funded by any special subsidy.

It's also not fair to maintain certain customer classes outside the Zone of Reasonableness, consistently over time.

In cost based jurisdictions, what's fair is that customers pay their fair share of the costs.

And Manitoba Hydro's agreed that it's not reasonable to maintain certain customer classes outside the Zone of Reasonableness over time, yet their forecasts show that the stubborn problem of certain classes being above or below the Zone of Reasonableness is not going away any time soon. So, essentially their proposed rate increases fail to solve this problem, even over a twenty-five (25) year period, if we look ahead over the next ten (10) years and take the fifteen (15) behind us.

The industrial sub-classes are paying between a one hundred and thirteen (113) and 114 percent of their costs. This isn't a result of export revenues creating a distortion in revenue cost coverage. And again, a review of MIPUG Exhibit 11, from Manitoba Hydro's rebuttal evidence 2002, bears that out.

We know from that exhibit and from the evidence that we've heard from Mr. Bowman, in particular, that even if the exports had remained the same as in 1996 levels, the GSL greater than 100 kilovolt sub-class would have a revenue cost coverage ratio of one point one (1.1). And because exports increased the revenue cost coverage of this sub-class is one point one three (1.13). There's not a material difference either, with respect to the residential class.

So, even though there was an increase in export revenue that's been significant in terms of the money coming in, we can see the impact of the export revenues on revenue cost coverage themselves, as relatively small.

The gap between revenue cost coverage ratios as the classes exist, as it did before the boom in the export market because certain classes are not paying rates that reflect the costs that they impose on the system. Mr. Wiens agreed when Mr. Feldschmid put it to them in the transcript that the GS largest is -- class is truly over contributing with respect to cost to serve.

MIPUG's position is that this can be addressed by a rate re-balancing without the need to depart from sound regulatory practice. Just before moving on now it's my final area of -- of rate design.

If 95 to 105 percent Zone of Reasonableness is to be a meaningful objective, then Manitoba Hydro's rates should actually reflect their stated goal to move classes to the Zone of Reasonableness in five (5) to seven (7) years.

I com -- I commend you once again to the work done by Mr. Osler and Mr. Bowman, specifically the work that you can find with respect to Table 3.4 and three point five (3.5), Table 3.3; that portion of the evidence when they -- where they review the issue of revenue cost coverage.

Table 3.4 at page 33 in particular reviews the maximum rate increases that would be allowable under a long term Zone of Reasonableness approach; that would be 0 percent for the general service large greater than one hundred (100) kilovolt and the curtailable of the sub classes. And -- and nobody need get upset about that because they're already paying and have been paying for a long time well over their cost in any -- any event.

So, the fact that we're saying that it's not appropriate -- we're not -- we're not recommending a decrease given the change of financial circumstance a result of the drought the way we did in 2002 but it's -- it's not appropriate nor is it necessary to impose a rate increase to this industrial sub class.

And what flows from the -- Mr. Bosler -- Mr. Osler and Mr. Bowman's evidence, also and specifically with respect to Table 3.5 is compared to the 27 million that Manitoba Hydro was looking for in '04/'05, all customer classes could be brought onto the path towards the Zone of Reasonableness if rate increases were $3.7 million less or were lower and that is 2.6 percent overall rate increase or less instead of the 3 percent overall that Hydro's requesting. And again, that 2.4 percent and the 2 percent in each of the two (2) respective years can achieve that.

It achieves stability and predictability because it maintains that benchmark of -- of not -- rates not exceeding the rate of inflation. You don't need to depart from that benchmark at this time. Secondly, it does not materially impact the achievement of financial targets by Manitoba Hydro.

And in fact, that the $11 million, as I've indicated earlier that Mr. Harper found in the O&M area and some capital -- by Manitoba Hydro, as I stated, it's an important point, 2.4 and the 2 percent rate increases allow Manitoba Hydro to actually achieve drought recovery faster than in their IFF-03-01.

Thirdly it moves the customer classes closer to the path of the Zone of Reasonableness which gives meaning to that target of bringing them to the zone within five (5) years. Now, any relief then with respect to an overall increase in rates, with respect to any relief that this Board determines as appropriate, we submit that priority ought to be given to classes that are consistently above the Zone of Reasonableness.

And of course we're here on behalf of the industrial sub class which is -- has remained over the Zone of Reasonableness by any approach under the current cost of service study or any of NERA's approaches and again has been in that state for more than fifteen (15) years.

And rate increases, with respect to any amount, do have a significant impact on industries where the majority or a significant amount of operating costs do relate to electric power. And I remind you of Mr. Turner's submissions on behalf of MIPUG that were quite relative there; a -- a copy of the written submissions that were distributed at that time.

Now, I'd like to move to a final -- well, it's not -- it's the final area in terms of the bulk of my argument, but I do have a couple of points to make with respect to Arrow and DSM as well, it will be brief.

But moving now to Manitoba Hydro's concern about price signals, and this notion that there's a distortion with respect to under pricing the commodity, relative to what they can get for it on the market.

Now, don't be seduced by that logic, because rates in Manitoba are again, set on cost principles. And we would in fact need to change the legislative framework to set rates based on the market.

So, while we have to take the market into account, we're not saying it's irrelevant of course, everybody wants a financially healthy utility, but there's got to be some perspective kept here. All right, that's well and good that you can make good mon -- money on the exports, and that's terrific, but it has to be balanced in terms of what's going on in Manitoba, and the priority to serve domestic customers with power, that reasonably approximate the costs.

Mr. Harper agreed price signals are a rate making issue, and the Public Utility Board has been asking Manitoba Hydro, at least since 1996, to go and consult with customers, in terms of developing comprehensive rate policies, and we would like to see this directive again.

With respect to the new asset retirement obligation accounting standard that's been developed, I just want to make a brief point about that. It was touched on briefly in the evidence, and I can sum up our position quite briefly.

We're reassured from Mr. Warden, that Manitoba Hydro does not intend to take monies that have been set aside for the future removal and site restoration and putting them into retained earnings. This was done in British Columbia, however, at the direction of their auditor; they had to take that money that was set aside and put it into shareholder's equity.

So, while we agree with Hydro, that this isn't appropriate, and we appreciate their assurances, the concern we have of course is that if their auditors or somebody else makes a determination different than that made by Manitoba Hydro, and more in line with what happened in British Columbia, the result could be that ratepayers have essentially -- find themselves ending up paying twice for these costs, the money that they've already put aside, and then they would again have to put it aside again, if -- if the money was moved back into retained earnings.

Therefore, we encourage the Board in its Order to make it clear that in the amounts that are put aside for removal and restoration purposes, whether currently in the thermal generating station, deferred amount or bundled into the accumulated amortization amount on Hydro’s balance sheet, be maintained as liability for the purposes for which they were set aside.

With respect to going back now to sum up our position with respect to rate policy and our recommendation that the Board direct Hydro to have more discussion with customers, with respect to the development of rate policy.

We note Mr. Bowman’s evidence regarding the success and Mr. Osler’s evidence as well, regarding the success of the Curtailable Rates Program and that’s an example where that approach actually has worked particularly well.

I’m not going to spend much time on DSM. The record’s quite -- quite clear, I think, what MIPUG’s position is but we would like to add though that recognizing that Manitoba currently spends money on DSM Programs that are designed to benefit electric ratepayers, there is also evidence that Manitoba Hydro’s DSM Programs are going to become part of efficiency Manitoba.

And it’s important that, in our view, the

Board write an Order that directs that Manitoba Hydro file an updated DSM plan as soon as possible, and to ensure that a review of this plan, as well as a plan dealing with non-utility generation as -- as well, be reviewed in a Hearing by this Board, before the next GRA, to ensure the electric ratepayers are getting the value for the dollars that are built into rates, with respect to these types of programs.

I also note Mr. Bowman's evidence with respect to fuel switching and non-utility generation being areas that aren't being pursued by Hydro in their DSM, that are being pursued in some other jurisdiction, and to which there seems to be potential to develop. And I would urge the Board to -- to recommend that -- that Hydro do that.

Our conclusion, overall, then, is that the overall rate increases be held to the level of inflation. Manitoba Hydro can do with 3 million or more or less, and still progress towards achieving their target and recovering from the drought.

We believe we've established where that relief should go, and we urge you to do that, to -- to follow the recommendations that we're giving to you, in order to make Man -- both the Public Utility Board and Manitoba Hydro's Zone of Reasonableness targets meaningful, truly meaningful.

I again urge you to consider the evidence, the written evidence, filed on behalf of MIPUG, and specifically, pages 29 to 33 in that regard.

And I hasten to add, in response to Mr. Mayer's comment to Mr. Feldschmid this morning, that not imposing rate increases on this particular sub-class, does not mean that there's a shortfall that needs to be made up by the residential class, because, again Manitoba Hydro can do with this -- this amount less. And they can also do their part, and should do their part, by responding to financial downturns by keeping their own house in order with respect to their spending.

Both may be good, but you don't have to have everything all at once, and -- and the timing of growth can -- can be and should be flexible, in order to deal with certain incidents that arise.

Subject to any questions you may have, that completes our submissions on behalf of MIPUG. Thank you.

THE CHAIRPERSON: Thank you Ms. -- Ms. McCaffrey. Mr. Evans has a question.

MR. LEN EVANS: I'm going to get closer. I thank you very much for your presentation. I found many of your remarks very interesting, reasonable, and very informative.

Often you refered to the Consumer Price Index as a benchmark; this should be your guide for rate increases. You mention various numbers; two point four (2.4), two point zero (2.0) and so on.

I'd like to ask you the question: Are you aware of the -- how the Consumer Price Index is made up, and that there are several components of the Consumer Price Index; transportation, clothing, food, energy, your various components? Were you aware of that?

MS. TAMARA MCCAFFREY: Boy, are you asking the wrong person there, Mr. Evans. I'm -- I'm only a lawyer, but my -- my left and right hand, Mr. Osler and Bowman, I expect, have a great deal more knowledge of that, though I haven't discussed that specific issue with them.

MR. LEN EVANS: Well, my point --

MS. TAMARA MCCAFFREY: If there -- there's something you're concerned about that it impacts on that as a benchmark?

MR. LEN EVANS: Well, my concern is about relevance, the relevance of looking at the Consumer Price Index; what's happening to it, and on more specific relative terms, more relevant terms. And that is, what I'm suggesting is, a relevant reference would be the energy component of the Consumer Price Index. And if you and your advisers would look at that, I'm sure you'd be -- you'll find numbers in the double digits.

In fact, I looked at one commodity price index prepared by a Federal agency, which showed that between the year 2002 and the year 2003, the energy price index that they compiled, rose by over 36 percent one year. That includes oil, coal, and natural gas.

Anyway, I'm just suggesting you and others have often referred to the CPI as a relevant benchmark, and it is relevant for a lot of arguments. But also, I think, one should look at the CPI in more detail and this is what I -- that is why I asked you that question.

MS. TAMARA MCCAFFREY: That's a -- that's an interesting suggestion, and as with all comments that come from this Panel, of course our clients will give that some due consideration.

I -- I do note, however, that the reliance on the Consumer Price Index, the inflation rates, were from information that we received from Hydro and a reference can be provided if necessary.

MR. LEN EVANS: Thanks.

THE CHAIRPERSON: Thank you Ms. McCaffrey. We appreciate your comments.

We're moving on now to Mr. Anderson. Are you prepared to begin, Mr. Anderson?

MR. MICHAEL ANDERSON: I am, Mr. Chair, but if I might just have a brief break?

THE CHAIRPERSON: That would be fine.

MR. MICHAEL ANDERSON: My attention span would be much improved if I did. Thank you, Mr. Chair.

--- Upon recessing at 2:39 p.m.
--- Upon resuming at 2:47 p.m.

THE CHAIRPERSON: Mr. Anderson, are you ready to go?

MR. MICHAEL ANDERSON: I am. I'm glad I'm being able to contribute to such a festive atmosphere, Mr. Chair.

(BRIEF PAUSE)

MR. MICHAEL ANDERSON: Thank you very much. On behalf of the Manitoba Keewatinook Ininew Okimovin, I'm pleased to present our closing comments, at least part I of them, in terms of those things that we might add in writing next week.

But it's been a -- a very interesting process, I'd like to thank the Board for its patience in all the work that we've done; it's certainly an assistance to the parties, the Manitoba Hydro for its answers and time that it's spent in preparing documents and materials.

Although -- oh, Mr. Peters is there, I also wanted to also comment -- compliment Mr. Peters and his staff of advisors for the excellent work that they've done in producing material for the -- the record, and assisting in arriving at what we hope is a more complete understanding of the status of the Corporation at the present time, in terms of the rate increase.

In my opening comments I described the MKO organization and what I would repeat from that is that our keen interest in Manitoba Hydro's effective and cost effective operations, certainly the health and stability of the Corporation are very important in that every one of the MKO First Nation citizens who is -- has electric service is a customer of Manitoba Hydro.

And so, while it may seem distant at times in terms of the distance between the Head Office and our communities as I had indicated in my opening comments, there is a direct and immediate contact between many of our communities and Manitoba Hydro on a daily basis, particularly those that live along the developed waterway or are associated with its large scale and heavy transmission -- high voltage transmission facilities.

So, Manitoba Hydro has a remarkable and large, if not looming presence in many of our communities and so we're keenly interested in those things the Corporation does in ensuring that the electricity services that is provided by the Corporation are affordable.

Having said that and following along the general pattern, to some extent of my colleagues, I just wanted to provide some overview from our examinations and from the evidence that we have of the Corporation and to some extent they're thematic and to some extent they're specific in terms of revenue requirement and rate design.

The one thing that really strikes us, in terms of the current application, as a matter of concern giving -- given the very close relationship between ourselves and Manitoba Hydro as I've described, is really what appears to us to be a substantive change in the profitability and operations of the Corporation.

That is to say, if we look at the -- the ten (10) year record that I reviewed at page 94 of the Annual Report to show periods of significant profitability over the last ten (10) years those net revenues -- that net income being generated without the benefit of near term rate increases.

And of course those looking at the policy documents that were filed as part of Manitoba Hydro Exhibit 51 in terms of the rationale for the uniform rates and so on and so forth, it's very clear to us that there was a wide spread perception of significant profitability on the part of the Corporation. Certainly that's they're viewed by the MKO First Nation members, as a corporation with significant net revenues that it’s able to use to do all sorts of things with -- for the benefit of Norther First Nation persons and Manitoba as a general.

That seems to have been shared in terms of the interest in the Province in securing what it describes as a dividend in terms of a transfer of -- of retained earnings. The history of that’s well known.

Retained earning are not necessarily cash. The Corporation can’t cut a cheque for it and so on and so forth and there are borrowing costs that have been involved as well as the transfer of dollars themselves.

But where all that goes to is the change, a very real change in what appears to be the ten (10) year record in the Annual Report to what appears in Mr. Peter’s Book of Documents at Tab 2 which of course is the projected operating statement and IFF -03-1.

What’s really striking to us about this document and of course I -- I went through this in cross-examination of the Manitoba Hydro panel, is that with the exception of the first year, in the test period, the year 2005, the net income of the Corporation is dependent on rate increases from Manitoba customers.

Which is a substantive change between the history of the Corporation generating substantial net revenues in excess of $200 million, absent rate increases and additional contributions from Manitoba Hydro customers to a schedule of steady rate increases in the IFF that in fact support the profitability of the Corporation.

Now this substantive change concerns us greatly. I mean, the object would be looking at the issue in terms of drought, we would think that well, we could recover from that. But a drought is one of those things that happens that we have no control over and so forth.

It might be a bad year for a company that’s primarily hydraulic but we’ll get back to normal. We’ll be back to generating profits again. But that’s not what the IFF says. It appears that the IFF indicates that the historic profitability as outlined in page 94 of the Annual Report, that time is over. It’s a different corporation.

That the good old days are gone. And that’s a deep concern to MKO because of its close relationship and it’s understanding of its relationship with the Corporation. It appears to us that the commentary that’s been made by CAC and MIPUG in particular about getting to the bottomline, about controlling costs of the Corporation are very important concepts for the Corporation and for the Board to consider.

That is it’s clear from the IFF, that not any time between now and 2014, are we expecting the good old days of substantial profitability related to inter -- inter-provincial sales to return, that we’re looking at steady annual rate increases, projected by the Corporation at a minimum of 2 percent a year.

Now, it seems to us that -- that some change in the cost structure of the Corporation is necessary, to place it on a footing that is at least equivalent to the cost structure that existed during those years when it was generating substantial net revenues.

Now, one (1) of the -- the issues that also comes through this is the concept that the IFF of course is -- is created in its -- in the document itself in its first year, on current, known and anticipated water conditions, the second year on median flows, and the following years on weighted average conditions.

But the sum of all of this is that as it's -- as Mr. Cormie indicated in his exchange with Mr. Peters at two seventy (270) to two seventy-two (272), that roughly nine (9) years out of ten (10), we're going to be doing all right. One (1) year might be poor, but on -- out of ten (10) years it all balances out so, that it means that there are no windfall years being fore -- forecast to offset a bad year. What we're looking at is the median, the weighted average of the reality the Corporation projects until 2014.

So, what we see is the Corporation's best guess of the cycle of ups and downs through that entire period of time, without any -- ever returning to substantial net profitability.

We have concerns about this that I'll get into in a bit in terms of how the uniform rate will be addressed, how the RCCs for those customer classes, former customer classes that benefit most from it will be addressed and so on and so forth. But it really seems to me that in order for the Corporation to return to the net profitability that everybody seems to associate with it, that some different approach to its cost and revenue relationships, internally as a corporation, need to be addressed.

MKO First Nations, in summary, Mr. Chair, Members of the Board, are not relishing the thought of annual rate increases as far as we can see into the future, because in particular, the waterways and resources of our communities have been affected by the development of the Corporation, to some extent, largely based on the promise of the type of profits that we've recorded over the last ten (10) years.

I've no comment to make with respect to the partnerships the Corporation's involved in, in terms of business development for projects, those were covered in the other place.

But I indicate that as ratepayers, communities have that concern; that's what the future looks like.

Now, in terms of the need for the rate increase, other than beginning with that sort of observation of the status of the company, it’s of course -- and I’ve referred to it several times in my examination of various parties, at Tab 1, Volume I, at lines 28 to 33, and I’d like to -- to read it again, because it’s important in terms of the context of my comments.

Since 1997, Manitoba Hydro has been able to forego proj -- these projected rate increases, because favourable export revenues made it possible to absorb the increasing costs without rate increases.

In the 2004/’05 -- 2005/’06 test years, due to the unusually severe impacts of the current drought, I emphasize the word current, and I’ll get to that in a moment, Manitoba Hydro is no longer able to achieve its projected revenue requirements, without requesting rate increases.

So, it indicates that its primary reason is -- for the rate increases is to address the current drought, which we realize from the evidence has many dimensions, some of it being hydraulic resources, energy and storage, some of it is costs related to that and so forth.

But the only theme that I -- that emerges from an examination of the evidence to us and putting it into a couple of terms is that to some extent it appears that whether -- was, notwithstanding, that the operations of the Corporation have become substantially more risky, and I couldn’t help when I was making my notes just to call it risky business. And I have a few themes that I'd like to go through, as I go through this.

At -- at page 3 of Tab 7 of Volume I, and set out at PUB-MH-I-30. It provides to me, as a -- and to MKO and by myself as an observer of the Corporation for some period of time, a truly stunning number of a seven thousand eight hundred and nine (7,809) gigawatt shortfall between actual production during the drought, and a long -- and the long term mean.

Now, that's a -- that's an enormous amount of energy. As an order of magnitude, Mr. Cormie, what I recall said, "I'm not sure why you're using those examples, Mr. Anderson", but he helped work with me on them.

If you look at it in comparison to PUB-MH-I-32, it would take a Conawapa twenty point four (20.4) months to generate that much energy at its average plant factor, to fill in that shortfall.

It would take a Wuskwatim six point two (6.2) years to replace the energy that shortfall represents.

So, the -- how this came to be was of great interest to us. How did we get there?

Mr. Cormie, at page 463 to 465, in exchange with Mr. Peters, and again, I thank him for his excellent examinations on these issues, succinctly explains how operating decisions and drought combined, to result in seven thousand and eight hundred and nine (7,809) gigawatt shortfall, which in turn contributed to a loss, as we understand it, between four hundred (400) and $430 million.

I would like to read this remarkable passage completely:

"Mr. Peters: Mr. Cormie, I'm looking at my notes and from what you've told me, and am I correct that Manitoba Hydro reduced its reservoirs prior to the drought setting in, in the summer of 2002 to 2002 to 2003?

Mr. Cormie: During -- during fiscal 2003/'2 and 2003, Manitoba Hydro drew the reservoirs down lower than what we anticipated in our -- in the IFF, in order to help offset some of the reductions in the water supply that occurred in the fall of 2002.

And so that's one (1) -- one (1) way you can, if you have surplus energy and reservoir storage, and that energy is available for economic dispatch. We set our IFF targets in the summer of 2002. The rains that we had assumed would occur in the fall of 2002 didn't occur, so we drew the reservoirs to some extent, to help offset that reduction in water supply, to help the Corporation achieve its financial targets.

But there -- we weren't -- we did not draw them to the point where it would threaten the reliable supply of water in 2003, we drew them to the extent that it was. It was just a financial matter.

But having taken that water out of storage in fiscal 2002 and '03, it was now no longer available to help mitigate the cost of drought. And that was one (1) of the considerations that you -- you take, is that you -- you take that water to market and avoid some thirty (30) -- thirty dollar ($30) purchases, of course in dollars per megawatt hour, only to be faced with the following year, being a sixty dollar ($60) market, and you know, hindsight is 20/20.

But again, when we make that decision, we look at the expected value of the water in storage, and nine (9) years out of ten (10) that water had -- would have much less value than thirty dollars ($30). So, it -- on an expected value basis, it's the right thing to do is to take the water out of storage early, than to leave it. Because if you leave it, you always run the risk of spillage, and the probability of drought is low.

That’s one (1) of the factors we considered when we chose to take water out of storage in the spring in 2002 and ’03, and that replacing it in 2003 and ’04, if any really severe drought conditions, it could be very expensive. But we didn’t know what the water conditions are going to be in the future, so we could only look at the expected value, which considers the possibility of all flow conditions occurring.

Mr. Peters: All right. And you’re right, you didn’t know in advance. But to replace the water that was drawing down on those reservoirs the subsequent year, in 2003/04, I guess the financial records show that did -- that did prove to be costly?

Mr. Cormie: Yes, it did. Yes, yeah."

So, recognizing that 20/20 hindsight is the perfect view, and also recognizing the difficulty of predicting the future, it remains that it’s part of the business of primarily a hydraulic corporation to balance these various elements, and to try to ensure, in fact, that adequate resources are available to not only to provide the domestic requirements, which of course is the primary statutory duty of the Corporation, but as part of that, to ensure that the means by which it is done, does not incur a cost burden on the customers, in such a way that it requires rate increases, adjustments, and financial targets and other burdens.

So, we -- if we look at the, again back to IFF-03-1, in terms of other aspects of the operations of the corporation, the fuel purchase costs that I’d examined on, shows off-peak and on-peak sales and increasing power purchases, which is explained at transcript 1025 and 1026 as being related to generating export revenues through a difference between off-peak and on-peak prices, and using the capability of the system to shape resources to support these activities, if there’s an opportunity that makes -- that is clear.

And this is discussed in greater detail at ten fifty-five (1055) and ten fifty-six (1056) and I’d just like to review that brief transcript reference again. Mr. Cormie said:

"Several factors have contributed to the increase in power purchases. Firstly, Manitoba load continues to grow and so more and more of our hydraulic energy is being consumed in the Province and less is available for sale on the on-peak markets into the United States. But these opportunities still exist in the United States, and so Manitoba Hydro increasingly purchases more and more off-peak power, in order to continue to reap the margins in the on-peak. And that's a result of load growth.

Then the second factor is the on-peak, off-peak differential has grown tremendously over the last ten (10) years. On average, it used to be five dollars ($5.00) a megawatt hour and so there was limited opportunity to buy off-peak power before it became uneconomical to resell it in the on-peak market, with only a five dollar ($5.00) spread between the on and off-peak.

Today, the margin between on and off-peak can be forty (40) or fifty dollars ($50.00) a megawatt hour. And so there's greater opportunities to buy more and more expensive power and to still reap a margin in the on-peak.

And, in so that, that's the reason why there's a forecast to be continuing growth and power purchases".

Now, one of the things we note from the ten (10) year record in the Annual Report, page 94, and the comparison to IFF-03-1, is that instead of power purchases declining over time or appearing to level off, of course, they were incr -- they have increased substantially over those periods of time, in order to seek these kinds of gains.

Now, a concern to MKO is that search as we might through the available record, we can't really see a display of the -- of this activity, that is, power purchases with the intention of doing off-peak and on-peak sales, offset against the revenue, so that we could see what the net result would be over any given period of time. The numbers just aren't here to do it.

Now, there's been numerous questions asked by both Mr. Peters and myself on this matter, but it remains that we can't disaggregate from the evidence that we have, the actual net profitability of this exchange.

And when we're looking at power purchase numbers in excess of $100 million, I think it's very important that we do understand exactly what the net profitability of that activity is, to determine whether, in fact, it imposes a risk on the corporation by buying power for later resale, or not. Because the amounts of money involved in the transactions are substantial.

And of course, looking at records that might be available, such as the NEB records, which I don't intend to comment right now, indicate all purchases. So, again, they don't disaggregate those that are used for on and off-peak exchange.

But there's a substantial amount of funds involved and the net profitability of that operation is not -- not clearly known. We've netted off power purchases and water rentals and so on and so forth, to sort out net interchange revenue, but we don't know what this particular set of transaction deals.

In terms of other aspects of the risky business, and the costs associated with drought and operational decisions, at transcript 268 to 269 on June 15th, Mr. Cormie described, that Manitoba Hydro would prefer to quote:

> "settle financially as a preferable way to address self supply." End quote.

Now, that's been discussed as well, that when the Corporation had an obligation, in terms of a -- an export delivery to a customer in the United States, if it was possible to simply settle with the customer, as distinct from purchasing, reselling, or delivering power, that was preferred.

As -- as far as I can review the record, we do not have a breakdown of the amounts of those settlements, and where they would appear in power purchases, which it appears to be the place in the books that that entry would arise.

So, again we have another size -- potentially a sizable sum imbedded in the power purchase costs that isn't broken out so we can see what those settlements would be. Now, interestingly there has been an exploration of the settlements with Winnipeg Hydro -- with -- with the City of Winnipeg on the DSM delivery.

And there's another group of settlements of the Corporation in terms of promises that it's made through its arrangements with others. But we don't have this one broken down and again we're talking amounts of monies that are hundreds of millions of dollars and we don't know how they're disaggregated.

So, in terms of the risks for the Corporation and its costs getting caught in a low water year on the decisions in prior years. But we -- we can't really see what the cost of these various elements are and we're concerned about that.

Now, also we don’t have the -- to whom them payments were made and related to what contracts, what volumes, what times of year, what are the temporal aspects of the deliveries? We can’t see the pattern of these expenses.

So, it’s taking on faith in affect several hundred million dollars worth of power exchange arrangements both in settlements and purchases that are in addition to the historical pattern of cost.

Again, now, the expectation and understanding is the Corporation’s primarily hydraulic. In a good water year it’s got lots of power, it sells power and doesn’t buy it. It’s not settling with customers. So, these are new costs to the Corporation which may or may not be unique.

Something else that has -- we’ve observed that has contributed although the end of the exchange that I read in its entirety with Mr. Peters shortly following Mr. Peters asking Mr. Cormie about system reliability standards.

Those standards and the changes, what we see as -- perceive as changes in them are described at PUB/MH-1-29(a) in which they -- Manitoba Hydro indicates that in addition to placing greater reliance on its tur -- Brandon Turbines to provide resources for export.

Manitoba Hydro’s has indicated that since 1988 its increased import capability by five hundred (500) megawatts through inter-tie development but that theoretically would provide four thousand (4,000) gigawatt hours of energy supply. So, for the Corporation to rely on its system planning on up to four-thousand (4,000) gigawatt hours of import to our understanding of the long term record is -- is an evolution, it's a change between a higher reliance on purely domestic resources and reliance on external resources.

As was the evidence when the external resources are aware that Manitoba Hydro is in difficulty in respect of its resourcing, it's resource mixed, the price goes up. So, if -- when we get to the point where we're relying on four thousand (4,000) gigawatt hours to provide for supply and firm requirements, it's getting more expensive.

But apparently the system planning, including the entry into contracts, is relying on this external supply to support them at additional cost, at increasing costs. In other words, the more you need this four thousand (4,000) gigawatt hours, the more expensive it gets.

And we seem to have found a collision of all of these in this drought period. Again, it's exposed the company to considerable cost and the customer in turn.

Other aspects of it in terms of this business that's changing of course are, although it wasn't discussed -- it was briefly discussed in the discussions about -- about

MISO.

It’s common knowledge, I would hope, and if it isn’t then the Board will take my comments into whatever light they choose, when FERC Order 888 was through and resulted in the divestiture of transmission systems which is not a strange -- Manitoba Hydro followed in suite and in order to, you know, part -- participate in the export market place.

The objective was to reduce competitive leverage and flatten prices out and make price -- energy more affordable within the overall unified market place. The MISO common dispatch is heading in the same direction. It may benefit Hydro in the long term by increasing prices in a common pool but it’s a price influence that may or may not have additional influence and significance to the Corporation in it’s long term operations.

And we for one (1) would have liked to have heard more about that in terms of the capital plans that they do have before them for additional facilities. But certainly in terms of the -- of the short term markets it’s very clear that Manitoba Hydro is price sensitive.

I mean, it could be -- and I’ll get to the business about what’s water, but the issue is, is that the water being dispatched economically is the critical thing for its profitability. So, any influence external to the

Corporation in the export market that influences price is very important to ratepayers.

In terms of some of the other costs of this drought, of course I reviewed this under -- to some limited extent, but Manitoba Hydro, the observation that -- that has been made is that -- I already made, is that they were under pressure to generate revenues to cover their own bottomline, as well as the impact of the special payment and all the other aspects of it. And in the end, with the transcript reference I had, they were additional cost generated.

One (1) of the other areas that we explored and I was happy for Mr. Cormie’s responses on it, were Exhibits MKO-5 and MKO-9, which indicated that operational decisions led to very sudden changes in water levels that affected some of the MKO First Nations, and in this case I used the First Nations in Split Lake and York Factory in particular.

Through that it was clear that Manitoba Hydro regulates 95 percent of the water flowing through that system, so therefore is Split Lake goes down it’s because Manitoba Hydro regulated it to go to that level; that the natural inflows in the area are not sufficient to overcome the influence of Manitoba Hydro’s regulation.

Although there was a short exchange on it and I don’t intend to address it any further than that here, it was as entered into -- as evidenced by information that was provided, that it had the end effect, knowingly or not, of grounding the York Factory Ferry.

And Exhibit 55, which was sort of I guess a joint undertaking, but the Chair and the Board provided substantial assistance, and it did itemize that some eight hundred thousand dollars ($800,000) in cost were incurred, at least in that immediate local area, as the cost of drought.

Now, we weren't -- I didn't -- we weren't encouraged to explore the other costs. I began to talk about fisheries, et cetera. But I wanted to leave it on the record that we're interested in what other costs may have occurred as a result of this.

We know the customer and the Corporation are facing four hundred (400) to $430 million. There were costs incurred by two (2) small -- one (1) -- you know, two (2) -- two (2) small communities approaching a million dollars; eight hundred (800) -- over eight hundred thousand dollars ($800,000), but we don't have a total accounting of the costs throughout the Manitoba Hydro system.

So, I suspect if we delved deeper, we would find that there were other influences here.

But I -- I leave that to indicate that the -- the Corporation's ability to influence water levels to provide revenues, has an immediate affect on many MKO First

Nations beyond rates, in terms of the direct operations of the company. And those were additional costs that were incurred at that time.

We agree with MIPUG of course that the burden of paying for the cost of drought and recovery should not be entirely borne by ratepayers. And we think that to some extent that this speaks back to the Corporation, in terms of rationalizing its cost in revenue pattern on an overall basis, not only for going back to the IFF -- our observation of IFF-03-1, about a long term prospect to steady rate increases, but in order to try to adjust for this -- this single event that the Corporation didn't -- well, the evidence was is that didn't predict it, and walked into it with decisions that it made in previous years.

(BRIEF PAUSE)

MR. ROBERT MAYER: While you're considering your next question, Mr. Anderson -- or next comment --

MR. MICHAEL ANDERSON: Comment. This is when I get to actually --

MR. ROBERT MAYER: -- I -- you've indicated -- I thought I just heard you say, the costs of the drought or incurred by the drought, shouldn't be borne entirely the ratepayers. In light of the fact that Hydro's a cost based

-- or regulated on a cost based basis, and I return on -- or on the revenue requirement, who do you suggest should bear that cost?

MR. MICHAEL ANDERSON: That's an excellent question and it's one (1) that that whole -- this concept has been in a -- in a rate base rate of return investor owned type situation, theoretically if it could be established that the Corporation made decisions in trying to increase its revenues that ended up catching it, it's theoretical that the regulator could ask the shareholders to take the cost.

Well, in effect, the customers are the shareholders. But there are -- there are substantial expenditures the Corporation makes throughout its service in a variety of categories, whether it's personnel, whether it's capital expenditures, whether it's deferrals of other aspects of its operation, whether it's cost minimization, we concur with CAC that there's more that can be done.

I don't think that any of the Intervenors on this side have said anything other than the Corporation can take a harder look at its operations and sharpen its pencil and dig deeper. I think the cost of this drought, and the significance of it, is such that it -- it provides a particular onus on the Corporation to do so, to the extent that it's possible. And only what -- whatever is left over from that would be considered to be -- required to be contributed by ratepayers.

I -- I have some other comments I want to make about where we get this money, but that's the general theme. It's -- it's the obligation and responsibility of the Corporation in an environment where it's not a rate base rate of return, shareholder eats the cost sort of situation, that it must operate in this way. And that it places the Board itself in the position of imparting a shareholder influence on the operations of the company, to suggest that these types of costs be managed and maintained.

It's the art of regulating a Crown utility in a non-rate based rate of return environment where you're not dealing with used and useful, those sorts of things, as a regulatory standard.

It's an excellent question, and it really is the central core of what to do in this situation. So, there has to be at least a sharing of this between the Corporation and its customers, at a minimum.

Getting to paying for the cost of drought, and getting on through the revenue requirement aspects of it, now that we've made these observations. The term that we've -- that I've indicated that we used is we think of it as, I suppose, in a semi-humorous way, is diving for dollars Part I, and what we mean to say is that the objective of the Intervenor and the customers in reviewing the Application is if we can find $28 million in the first year and fifty-one (51) in the second, there's no rate increases.

So, I mean that's really the standard against when it's -- all the investigation of this, the costs and expenditures are being done. Now, Mr. Williams has gone through a great deal of effort to nail down the elusive $11 million, and the manner in which the subsidiary cost in revenues and net revenues are explained, but that's part of the process, that's the significance.

If the Board can be satisfied that $40 million in revenues, for example, can be obtained in this fiscal year, then no increase should be granted. We're on that -- on the same page as CAC/MSOS on this that the Corporation has set a forecast for itself, it's set a target. If the dollars can be found against the money that the Corporation wishes to raise, $28 million in the first -- first year, then there's no rate increase that should be approved by this Board.

If in the alternative -- so if we're successful in finding all the revenues in both test years, no rate increase should be granted neither.

If in the alternative the Board is satisfied that some of those dollars that are intend -- revenues that are intended to be raised through rate revenues, can be found through efficiencies, or restatements of revenues and expenses and so forth, then the rate increases must be reduced, and that the -- any over recovery or other dollars should not go back to the Corporation, it should go back to the customers. And this way, using Mr. Mayer’s comment, the company and the customers are sharing dealing with the costs of drought.

In terms of testing the revenue requirement, Mr. Williams talked a bit about the kinds of things that would be helpful. The discussion on the differences between the presentation of information from a top-down and bottom-up approach, indicate there’s a need for a level of -- additional levels of detail in materials filed by Hydro, or some level of standard of understanding of what we’re looking for, so that the presentment -- the presentation of numbers is understandable by everyone who’s using them and also so that they’re presented in a way that results in a clear picture being derived from reviewing them.

The inability the -- quantify the costs, for example, also as another example of the simple increases in EFTs, of a hundred and ninety-four (194) in 2004 and two hundred and fifty-three (253) in 2005, is set out at page 17 of Mr. Harper’s evidence, is another example. As well as the forecast -- quantifying the value of the forecast of the reduction in positions, which in Mr. Harper’s footnote were not equivalent to EFT, due to the synergy savings for the acquisition of Hydro.

So, these are substantial sums of money that we can’t identify, in this effort to find $28 million. Or for the Board to consider the advisability of permitting those or -- or encouraging those expenditures.

The significance of inter-provincial sales to corporate net revenues and in turn to customer RCC’s and rate design because those net revenues are being distributed through a allocation process. We just want to have a detailed understanding of inter-provincial sales. That is the overall environment changes in the market place, contracts and agreements in the information filed by Hydro with its federal regulator.

Although this Board does not have a general regulatory authority to approve or deny a specific expenditure, this Board can and as Ms. McCaffrey went through in terms of -- of those things the statute provides for, this Board can express its opinion about certain expenditures or patterns of decisions and expenditures and influence the ability of the Corporation to make the expenditure by approving or denying the level of rates sought by the Corporation.

So if the Corporation is indicating its desiring expenditures of a certain level and the Board on a whole is not comfortable with them, if it reduces the rate increase applied for, the Corporation has to make adjustments. Find the revenue in some other location other than customers.

It is suggested for example that OM&A cost be expressed at least at the level of operating division, setting out salaries, wages, benefits and specific expenses associated with these personnel and their related activities.

These tables should be expressed in actual current year -- actual current year and forecast and a minimum of test year -- of the test year forecast with the variances if any of each line item identified for assistance.

The Board may recall that such information was in fact previously submitted by Manitoba Hydro in proceedings in the early 1990's. I must say that there was also a lot of back and forth about the relevance of them and whether they should be admitted.

But in the end they were included. So we were able to actually go across and look at staffing changes by division. And at least arrive at some level of comfort about their advisability and reasonableness. This approach may appear counter and I had discussed this with my colleague, Mr. Williams, to the move towards performance based standards and factors that -- that serve as a proxy for detail such as OM&A per employee.

However, when the evidence of performance is measured by the percentages of proposed rate increases, additional oversight is warranted.

Well, having said all that, the good news is the drought is over. And I'm pleased to be able to indicate and I was plea -- the discussions that we've had with Mr. Surminski and Mr. Cormie on reservoir activity are -- are very helpful and one of the things I'd just like to summarize is -- is our take on the reading of some of the documents that -- the exhibits we had provided yesterday and just to review all of that.

In MKO-17, we've provided the update to our previous exhibit MKO-14 on water levels within the Manitoba Hydro system and it's important to -- and helpful I think to understand them.

When we look at the first one on page 1 of MKO-17 for example, for Southern Indian Lake, what's important to recognize is in addition to its forecast level being above the long term average, that forecast level is also getting to the top of its operational rule curve established by license.

I mean, the lake isn't going to hold anymore water under its license conditions. It's full. That explains the discharges that you see in the second table at Foot Print Lake which is relatively unusual for this time of year on a historic basic.

But the point is, is that Manitoba Hydro has to move water out of Southern Indian Lake in order to make -- accommodate in-flows from the Churchill River system which we provided of course to you as information in MKO-16.

Now what’s -- what’s of importance about that is Mr. Cormie was right when he said that the important information on the Saskatchewan Watershed Authority forecast was that the Island Falls generating station would be operating slightly below full capacity.

The Island Falls is operated, and this is available on Sask Power’s website if there’s any contention about this, as a run of the river plant. It’s designed that way. So it’s good news that it’s running slightly below its full capacity. The remainder of that forecast if I might summarize it, is that there are -- there are flows in the Churchill River that are not being regulated upstream at the present time. Island Falls is running at near full capacity to pass those flows through it, in order to generate electricity.

As the natural -- as the unregulated flows in the Churchill subside, then they will be able to do releases from White Sand, which is exactly what the forecast says. The net result of that, there’s a lot of water coming from Saskatchewan down the Churchill River into Southern Indian Lake, which Manitoba Hydro has to move out of Southern Indian Lake, and that shows on the flip current lake releases. The good news is, it’s full.

When we go to consider the other major reservoir of the system, and I won’t itemize all of the other inflows, because actually, MKO-18, the advisory for Cross Lake Community, says it all.

All of the watersheds that are feeding Lake Winnipeg, all of them, combined, together, have supplied enough water to Lake Winnipeg, that it’s at the licensed maximum of its operating curve. It’s warning the community that if any more rain comes, we’re going to have to let water out, and the water levels at Sipiwesk Lake might increase two (2) feet precipitously.

So the two major bodies of water that we’ve had evidence on are used as the measurement for water supply for the system, Southern Indian Lake and Lake Winnipeg, are at the top of their operating curves under their license. We can’t get anymore full. The drought is over.

Now, that’s how they are with the present conditions, and of course, time goes on through the year, but Mr. Peters, of course, referred briefly to a -- an article that quoted the President, and I won’t go beyond it to say except that in the Monday, July 5th, 2004 article in the Winnipeg Free Press, it -- the President was quoted as indicating if there’s not a single drop of rain that’s -- that’s gained by the system before freeze-up, they’ll meet its financial targets. So, this is all good news in terms of the immediate issue.

Now, in looking at the graphs that we discussed with Mr. Cormie yesterday in MKO-19 for Steven's Lake Reservoir. The one interesting thing about that, though, is what it does show is the shaping activity the corporation engages in.

When I ask Mr. Cormie, why is this graph, this line, this elevation line, different than the forecast, and different than the longer-term average, the response was that there was a surplus of water relevant to demand.

The corporation's holding onto the water, waiting for better sales opportunities later in time. Right now we're all hoping it's thirty-five (35) degrees celsius down south tomorrow.

But the point is, is that it shows it. So these -- these charts that MKO has filed before the Board, explain the system and how it operates. So now we have a really detailed understanding that we have full reservoirs everywhere, the corporation has let water go down to the last controllable point, which is Stephens Lake, it's storing it and maximizing its revenues.

The one -- the other important thing about this is that at transcript 2377, even with all this water, Mr. Cormie says there's been no spill, there's no intention to spill, and there's no expectation that spill will occur, very important, very good news.

Manitoba Hydro's evidence is that we can expect with such high water, they are presently engaged in careful reservoir management to shape resources into higher value periods and as I've just described in our Exhibits MKO-17 and 19.

So, if we do get better water, with better sales conditions, we'll certainly have revenues. We also understood, after sort of bumping around a bit, on which model runs what, that it's very clear that the HERMES model is simulating the revenue's -- that the -- this very full water condition is able to produce on a virtually, as I understand it, almost a real time basis, daily, if not something less than that. So the corporation is aware of what all this water is going to do.

One of the other things that was very interesting to me and Mr. Peters' discussion on an update of MH-28, is that the first reply was sort of a straight line drawing to -- to eighteen (18) kilowatt hours, and then within seconds, it was updated to nineteen (19) and I can't speculate that -- the point is, is that there's substantial energy resources that are increasing, almost literally as we sit.

Since HERMES has modeled all this, and since we have full pool everywhere, the question really is: When will we see the new numbers? I mean, Mr. Williams and others have been digging for $11 million diligently, but we have reservoirs that are full. This is a hydraulic utility with the resources that it needs to optimize its revenues.

We're using a forecast based on median flows, and coming out of a drought, so it's the forecast itself in the first test years, influenced by that to some extent. When do we see the new numbers?

Internally within the Corporation they exist, but Mr. Warden had explained that there is a specific process within the Board to move new numbers forward. The point is, is that process and our Rate Application and the approval by this Board of the Application itself, those time periods don't line up.

So, the Board is looking at a Rate Application that was based, according to page 1 at Tab 1 on drought, when we have reservoirs at their full roll curves, everywhere. We couldn't possibly get more water in storage.

So, it's a dilemma for the Board, the -- the issue that we would suggest is that prior to proving any increases effective in the first test year at a minimum, the Board should make an interim order requiring the production by Manitoba Hydro of revised revenue forecast, based on Manitoba Hydro's evidence that energy in storage will be used to generate power and not spilled, and based on the fact that we have evidence that the reservoirs are full.

Otherwise, we're looking at passing on $28 million in costs to customers that may not in fact be necessary. And there's a reasonable apprehension that that may be the case.

If the reservoirs weren't full, if the Churchill River was down and low and dry and so on and so forth, that may not be a reasonable expectation, but we know that the reservoirs are full.

And so we make that recommendation to the Board, to put its final order in abeyance until you get better information on the status of its revenue -- Manitoba Hydro's revenue forecasts, in respect of the water that it now has in storage.

Now, turning to the work that Mr. Williams and Mr. Harper have done, and we also appreciate their diligence in going through the record, every dollar's important. And that we have the rule of thumb that $10 million equals the 1 percent of the proposed rate increase. Again, I've just -- we counter point that to the energy that's in storage.

We now have Mr. Williams' comments, the information today, the transcript from yesterday about the elusive $11 million, and Mr. Williams, as I understand it, is comfortable in suggesting to the Board that $15 million should be netted down from the $28 million for the first test year, and rates redesigned accordingly.

I would say notwithstanding anything else that I've said, that we accept the work that Mr. Williams and Mr. Harper have done in that regard, and would suggest that absent additional revenues being available for hydraulic resources, that at a minimum, CAC's recommendations in respect of those amounts be accepted by this Board.

And the variances and the rate increases that are suggested by Mr. Williams, with the assistance of his expert, Mr. Harper, be accepted by the Board.

Now, in respect to financial targets, which really fit into Mr. Williams' larger picture, and to some extent I've sort of hop -- leap scotched or hop frogged over them. One (1) of the things about the financial targets that I am -- I am very pleased that the Board's expressed an interest, Mr. Mayer, in particular in the financial target records between '87 and '92. Because my recollection is, is that they were different targets than those the Corporation is seeking today, that is it's carrying a greater degree of debt relative to its operations.

It's very clear that variability is a feature of hydraulic operation, and that to accept variation in its financial targets to some degree, suits the business. To the -- going back to my discussions, however, about the IFF-03-1, I mean it's clear that that's all smoothed out.

But in any case, on an annualized basis, those are things that differing targets with a Corporation of this size, can be considered and adjusted. And there are -- there was much discussion about the precedents in other jurisdictions, and that to the extent that those jurisdictions have similar operations, that is useful information.

In respect of the $2 billion retained earnings target, we agree that it's an estimate, it's not based on a detailed risk assessment, and it hasn't been able to be tested, and I'm not really sure that should necessarily weigh heavily on us and hang over us as a target the Corporation should make.

Therefore, justifying what appears to be a string -- the beginning of a string of steady rate increases to 2014, we need more information on that.

What happens with the Board, we trust that the Board's information on the financial targets during the previous period of drought will appear in its decision, and look forward to reading how it applies to that particular information.

In terms of basic rate design issues, some of the key areas that we have an interest in of course, are the RCC is the former Zone 2 and 3 residential customers.

Now, we -- MKO agrees with Mr. Harper's evidence in respect of providing some form of recognition, as talked about again in argument by Mr. Williams, for the effect of the uniform rate on RCC coverages.

The -- the possibility that there would be upward pressure, driven by the interest in keeping the RCC's within the Zone of Reasonableness, having them drop as a result of the difference in revenue coverage, arising directly from the uniform rates, seems unreasonable to us.

That is the Provincial Government established a statute, passed a statute, directing the corporation to make changes in its rates, that resulted in changes in the revenue cost coverage for a large number of customers. To have that cycle back through redesigned rates to bring them back into the Zone of Reasonableness, just seems patently unreasonable.

And that one means of addressing it, if the Board is comfortable with it, is to provide a direction that such a credit or some form of acknowledgement be made in the Cost of Service Study.

And in essence, if it's not done in that way and there is a movement to readjust the RCC's to in effect recover the benefit of the uniform rate, it sort of undoes the entire intent of the statute.

In the event that the Board finds itself in a position where issuing a cost of service methodology directive in this regard, we would suggest that the Board requests and obtain a special direction from the Province of Manitoba for this purpose.

That is that the legislation that established the uniform rate, in effect, is incomplete. It ordered -- it directed Manitoba Hydro to establish uniform rates for grid customers, but did not follow it through, by explaining how it was supposed to address the cost effects of this in its cost of service and rate design.

So, it's been set in motion, but to the extent to which the Board finds itself or feels responsible for sorting out the cost of service aspects of that, perhaps it could be done by explaining to -- making a recommendation to Government that it be addressed, so that it's clarified for all parties, that the -- that the benefit, intended benefit by statute of the uniform rate, will not be clawed back through rate design, or minimized or reduced through rate design, and just in order to rationalize improvements in the Board's standards for the Zone of Reasonableness.

In respect of the -- the blending in year 2005 of the rate blocks in the residential general service zones, although I didn't ask this question to Mr. Harper, it appeared that in his response to me that moving toward inverted rates is in fact a direction to be pursued, but when you're dealing with rates that are in fact declining block rates, clearly the flat rate is preferable. It's the lesser of two (2) evils, if I might put it that way.

But MKO, as it indicated in its evidence on diesel rates, does directionally support communicating the cost of service to customers, because we believe that ties together, however, with the suite of demand side management and other initiatives that integrate into an energy services approach.

Affordable energy is crucial to the MKO First Nations, but also so is an understanding of the cost of it and the manageability of those costs.

We see great opportunities actually, in the fact that Manitoba Hydro is now an integrated gas electric utility, because it sees both sides.

That Manitoba Hydro is developing a more direct and intimate understanding of the direct use by its customers of several different sources of fuel, it's always had this information but now it's selling one of them, as well as providing information about them.

And in the MKO region, this -- this integrated approach to energy services of course includes fuel oil, wood and propane. Now, in the cost comparisons that were just filed today, I noted that the approximate cost of fuel wood was not one of the costs that was listed.

But within the MKO region, a partnership on demand side management, from an energy services approach, that is what is the best source of energy supply to provide a certain service, is something that is crucial for us to follow through and -- and to develop.

And so to the extent that the Corporation makes expenditures in this regard to assist MKO customers in reducing their overall expenditures, we would support that.

Now, one of the final areas that I need to address, and because it wasn't touched on in the wildly -- widely ranging transcript of yesterday, and due to our understanding that it would not appear in our written notes, is comments on the proposed diesel rates.

In respect of Manitoba's application to increase rates for the residential and general service customers for the first 2000 kilowatt hours, Manitoba Hydro has asked this Board to approve an automatic pass through of any increase granted to -- for grid residential and general service rates, to those rates applied in the diesel -- to diesel residential and general service customers.

Right off the top I have -- MKO would request that the Board reject Manitoba Hydro's present application to increase diesel rates for the first 2000 kilowatt hours for residential and general service for the following reasons.

Firstly, the approach to the cost of service and the setting of rates for the diesel residential and general service customers, are treated differently from those on the grid. Manitoba Hydro has confirmed in these Proceedings and strongly argued in the previous and recent diesel rate application, that it's Manitoba Hydro's position that the diesel service customers should be treated separately and apart from the grid service for the cost of service and rate setting purposes.

In fact that 94 percent of the cost of service be covered -- recovered through customer rates. That's the distinction between the grid customers who on their former equivalent in Zone 3, are paying something in the order of 65 percent of their cost of service, 55 percent, excuse me.

In accepting Manitoba Hydro's argument that the cost of service and rates to the diesel service should be treated separately from the grid service, this Board, on the alternative, did not accept MKO's argument in fact, that the capital costs of diesel should be subsumed within the overall Hydro system.

That diesel residential and general service customers be treated as Manitoba Hydro customers within the overall Manitoba Hydro system, and reflected in the consolidated Manitoba Hydro Cost of Service Study.

And that as an addition to that, as part of that, we also recommend that inverted rates be applied to reflect and recover the variable cost of service.

So, in fact, MKO recommended -- requested that the diesel customers be included as the whole system, and the Board did not accept that argument.

So again, diesel customers are being treated differently and apart from the grid.

Secondly -- and I make no issue with the Board's decision on that, I just state that that was the exchange.

Secondly, Manitoba Hydro's application is incomplete in respect of the proposed increases in diesel rates, there's no diesel cost of service information or projected operation statement filed as part of the Application, providing supporting rationale for the increases to diesel residential and general service rates.

There is no updated information indicating the effects of the increases that went into effect, as of April 1st, 2004, that went into the original Application, despite being reminded of the effect of the recent Board Order and urged by Board Counsel to file such information as a housekeeping matter, at the conclusion of June 14th, the first day of these Proceedings, the first version of the updated rate proposal in MH-16 was incomplete and had to be revised at a later day.

The bill comparison information, which was filed in the original Application for the diesel service, was not updated until an undertaking was sought by MKO and the Chair to do so.

There's no evidence identifying any changes in costs that would justify increases in the diesel and general service rates.

Again, although Manitoba Hydro has indicated that it's OM&A costs have increased for the grid service, we've had a great deal of discussion about that, there's no evidence indicating what share of these increases in grid service or corporate costs, if any, were incurred by and should properly be allocated to the diesel service.

Cost responsibility is the whole theory of the diesel Cost of Service Study, hence the 94 percent cost recovery of the overall service, but we have no evidence on what portion of the OM&A should be charged to diesel customers.

Manitoba Hydro has not indicated how the increased revenues will be applied to the existing cost of service, and whether or not proposed adjustments to the tail block for residential rates for example, to resid -- the tail block for residential and general service rates, and/or to the surcharge amount for Government rate customers.

We don't know what the -- where the revenues would go. There's no proposal for it.

At transcript 1694 to 1695, Mr. Warden suggests that any over recovery of revenue is to be credited to what was described in the diesel proceeding as the deficit, which as the Chair confirmed, in your questions about interest, is an off tariff non-interest bearing deferral account, not included in the diesel Cost of Service Study.

Manitoba Hydro has presented no baseline in this application against which to measure any over recovery of these revenues in the diesel service.

MR. ROBERT MAYER: Mr. Anderson, you know from the Diesel Hearing, that the diesel rates for the people using under two thousand (2000), they are no relationship whatsoever to the costs. They are tied strictly to the -- the -- the grid customer, because Hydro has chosen to bring them into that rate. I don’t understand your argument at this point.

If you want to go back to costs to the diesel communities, you know that -- what that will do to them.

MR. MICHAEL ANDERSON: What I indicate is that the rate on paper is the same, that’s true. But the difference is, is that the diesel cost of service is set up so that 94 percent of the total cost of services, recovered with the rates that are designed, and so --

MR. ROBERT MAYER: Not for the 2000’ -- not for the first 2000 kilowatt hour customers, not at all, you know that.

MR. MICHAEL ANDERSON: There is a contrib' -- I'm speaking of the -- the over recovery that was referred to in the transcript reference.

MR. ROBERT MAYER: So you don't argue with the fact that -- of the -- any -- that if there's a 3 percent increase for residential customers, that would be passed through?

MR. MICHAEL ANDERSON: Assuming, but you raise it -- you bring me to my next point, and I thank you for that, is that in the transcript reference, there's a reference to over recovery and the application of it. That's all I'm referring to here.

There isn't a reference in the application as to whether or not Manitoba Hydro would increase its contribution to the diesel cost to service, in order to cover the cost of this increase. I'm on your point, Mr. Mayer. I was going to get there. That was my next comment.

So I was referring, one, to the transcript reference on over recovery; my second would be, there's no evidence that they would increase the contribution to the system cost. I'm right with you on that point, and I thank you for it.

And that's what I mean, that there would be an

-- without an additional contribution to the corporation, others in the diesel service would be paying for the first two thousand (2,000). Thank you.

In respect to the brief transcript reference to over recover, there is no basis for the Board to approve an application of any of these revenues to an off-tar -- off-tariffed deferral account not associated in the application with the diesel cost of service.

Manitoba Hydro, in the discussions that I had with them, had confirmed that there’s no statutory policy or regulatory directive, that explicitly links the uniform grid rate for residential and general services customers to the rate for residential and general service customers in the diesel zone.

It is done by practise, I don’t disagree that the rates are identical, but there’s no policy directing them to do so and that was the evidence of the corporation, including a directive from this Board.

In respect of any linkage between grid and diesel rates that may have been established by past practice, that is the precise matching of residential and general service rates, in former Zone 3, of course, it’s Hydro’s position that the Zone 3 has been dissolved and that no further reliance or attention should be placed on the distinction.

In respect of any linkage between grid and diesel rates that may have been established by the uniform rate legislation in 2001, subsection 3 -- 3.1(b) of the Manitoba Hydro Amendment Act II, being Chapter 23 of the Statutes of Manitoba, 2001, provides Manitoba Hydro with the authority to quote:

> "Provide non-grid customer with similar reductions in regions where grid customers' rates are reduced".

So that is, any linkage between grid and diesel rates that may have been established by the Statute, applies only in the case of reductions and diesel service rates, not to increase this.

> "Moreover the Manitoba Hydro Amendment Act provides that any authority reduced rates from those charged as at the coming of force of the Statute, is exempt from any requirement to seek the Board's approval under Section 3 and sub-Section 26.1 of the Crown Corporation's Public Review and Accountability Act."

So if it was linked, they wouldn't be seeking approval for it, under that Statute.

Also, I would just make the observation that when we began to examine Manitoba Hydro and this Mr. Mayer, at Transcript 1693 and 1694, had initially, questioned the justification for that aspect of the application on the basis that it had just been dealt with by an Order before the Board. And we would not disagree with that assessment, that we have substantially dealt with it previously and that we would expect it would be dealt with as diesel service rate applications in the future.

In terms of the rate design aspect of the application as another reason to -- to reject it and finally in this matter and in respect of Hydro's application to blend residential and general service rates for the first 2000 kilowatt hours in 2005. There's no evidence indicating that the combination of the first and second rate blocks is appropriate in fact for the diesel zone.

Particularly in light of the significantly higher cost of service reflected in the already significantly higher tail block in the current rates or in fact whether blending the rate blocks is consistent with the Board's order in respect of a review that future application -- that the intent of the Board's order in respect of a review of future application of inverted rates in the diesel zone.

Sort of taking a step back from what the Board has indicated and interested in doing. Therefore this Board should reject Manitoba Hydro's rate design proposal for the 2005 diesel residential and general service rates.

And for all the above reasons, the Board should reject Manitoba Hydro's present application to increase diesel residential and general service rates as an automatic pass through of any increase this Board may grant in respect of the rates for Manitoba Hydro's grid residential and general service customers.

Now that brings me to, sorry my -- my -- other than those things that we have -- we're preparing in writing at the invitation of the Board based on the transcript of yesterday, to some final matters with respect to a process including costs and so forth.

I had mentioned in -- Mr. Chair? Okay.

I had mentioned during some time that I was taking up while we were looking for some exhibits, that I complimented Digi-Tran for providing searchable transcripts. It's an immense assistance to us not to be carrying them around as well as everything else.

To the extent that MKO can encourage the Board to consider electronic filing and that they would do so now. Or at least to encourage having the option of doing so. Some parties like -- I mean, I'm surrounded and have been for the entire proceeding, with paper that's comfortably marked up and highlighted and -- I like it. But much of the work that we've been able to do has been electronic to the extent that it can be.

We think that also the other reason for doing this would be to make the proceedings of this Board and the application of the Corporation available to all customers generally on the internet. And we think that's very important.

THE CHAIRPERSON: You should know, Mr. Anderson, we're making progress.

MR. MICHAEL ANDERSON: I -- I'm very pleased to hear that. I noticed that when the current government, I'm not sure whether it was incidental or not, that would also include building a good website for the Public Utilities Board itself in terms of all of the cases that it deals with, if I might make that suggestion.

THE CHAIRPERSON: Underway.

MR. MICHAEL ANDERSON: Thank you. It really does provide assistance and it allows for -- it reduces photocopy time and -- and other issues because if there's a question, we can for example, we could refer an individual who might be interested in a community, teachers, schools, Band administrators, directly to evidence, it's filed on your website and it would assist greatly to do so.

So, I am glad that you're working on it and I just wanted to provide that. In respect of costs, I know that typically at this point is when we follow the rules of procedures for the Board and seeking an award of costs and so on and so forth.

But as the Board may know under its current rules of procedure, we're not in a position to make a claim for an award of costs. The Board does not grant costs for the cost of an organization if it self participates.

If we retain counsel and experts we could file for their costs but the cost of our -- my participation and particularly are not recoverable under the current cost award rules of the Board.

Which does -- which has had --

MR. ROBERT MAYER: You need therefore spend no more time on that, Mr. Anderson.

MR. MICHAEL ANDERSON: No. But I would like to say that it does have the affect of effecting the total ability of the organization as a whole to commit its personnel. Because none of those costs would be recoverable.

As an organiza -- First Nation organization and many others our resources in in-house are extremely limited and we do -- virtually all of our specialized project work like this on a cost recovery basis. Strictly on a cost recovery basis.

It's required in affect special discussions to provide leave for us to proceed in this way because there is no cost recovery. The other aspect of it is is that to some extent although it's probably a detail and who we talk to, having the opportunity to obtain experts on a contingency basis is getting somewhat more difficult.

And we do not have the resources to front-end the cost of experts over an extended period of time. I didn't make the observation then but I will now, and part due to the unavoidable, and the understandable delay in the diesel proceeding. MKO carried those costs for an extremely long period of time.

And it was a -- and I wanted just to say for the record, on behalf of My Colleagues, that it was at some great difficulty on the part of our management and financial administrators to do so.

So, what I'm suggesting is that the Board consider amending its rules for costs, to maintain the same standards that you would normally apply for relevance, for participation and so forth, but to provide some mechanism for bridging the cost of activities, similar to what you've done with -- what was done in the joint review of Wuskwatim.

I'm not suggesting that necessarily the same process be adopted, but some mechanism.

What would assist would be at least the cost of recovery of parties with direct experience in regulatory matters like ourselves, where the Board accept and recognize that certain parties to it and perhaps to the Corporation are acceptable as participants for the recovery of their direct costs, and that would assist greatly in at least knowing that down the road, the costs would be recoverable.

So, unlike My Colleague, Mr. Williams, I’m not in a position to recommend or seek an award of costs, unless the Board invites us to do so. But I wanted to place on the record, that it does have a factor that does in a real measure, limit our participation before the Board, in Proceedings such as these.

And I just wanted to place it on the record for the Board and for its consideration.

THE CHAIRPERSON: We appreciate those remarks and we’ll take them under advisement.

MR. MICHAEL ANDERSON: And having added that, which is always the customary sum, and end of this type of commentary that ends this aspect of our final submission in this matter. And we thank all parties for their patience.

THE CHAIRPERSON: Thank you for a very interesting presentation, Mr. Anderson. Thank you.

MR. MICHAEL ANDERSON: Thank you, Mr. Chair.

THE CHAIRPERSON: Now I suppose we should put on the record, Professor Miller’s for TREE and RCM, Mr. Peters?

MR. BOB PETERS: Yes, thank you, Mr. Chairman, I think that’s appropriate that we ask Carol and Digi-Tran Inc. to include in the transcript that they are preparing of today’s Proceedings, at this point in time, to transcribe the final argument from Time to Respect Earth’s Eco Systems Inc., and the Resource Conservation Manitoba Intervenors, which has been submitted in writing and has been circulated to all parties.

So at this point we’ll take it as inserted in the transcript, and we can take it as read at this point in time, and turn to the utility when it’s appropriate, thank you.

(ARGUMENT FROM TREE AND RCM)
(SUBMITTED BY PETER MILLER)

I appreciate the opportunity to present this written final argument on behalf of TREE and RCM. The attached Introductory Remarks from TREE and RCM for the PUB Hearing on Manitoba Hydro’s 2004 GRA, presented as we began this process a month ago, elaborates the motivation, context, and legal argument for this intervention and is thus an integral part of the submission. Key points will be summarized in my remarks to follow.

In this docket, we have a number of specific decisions that we would like from the PUB.

a) Direct Manitoba Hydro (MH) to incorporate into its new Power Smart Resource Plan a broadened set of purposes and associated targets and performance measures that better reflect the energy efficiency and sustainability mandates found in The Manitoba Hydro Act and the Sustainable Development Act and the justice principle of helping customers meet their basic needs.

b) Direct Manitoba Hydro to include amongst the targets of the new Power Smart Resource Plan the identification of low-income customers with high electrical usage and devise appropriate DSM programs to mitigate impacts of increased rates on their electric bills.

c) Direct Manitoba Hydro to file an inverted residential rate design, with no increase to the customer charge, to take effect in 2006. The actual rates and blocking should reflect what is learned in the inverted rate study to be filed at the end of this year.

d) Direct Manitoba Hydro to study at least two (2) alternative methods of implementing inverted rates for commercial and industrial customers as part of the inverted rate study to be filed at the end of this year.

e) Determine that the "export credit" should be calculated using an "export class" methodology that assigns the cost of resources OTHER THAN Winnipeg River resources to export customers. Winnipeg River resources should be reserved exclusively for domestic customers.

f) Determine that the FIRST application of the export credit shall be to support the impact of the "uniform rates" legislation. Rates for the residential and small general service class should be set so that Zone 1 falls within the 95 percent to 105 percent "zone of reasonableness" and any deficiency that results for Zone 2 and Zone 3 shall be covered with a portion fo the export credit.

g) Determine that the NEXT application of the export credit shall be to support research and development, demonstration and pilot projects and special initiatives to promote end-use efficiency and non-hydro renewable energy resources that will ultimately reduce the cost and environmental impact of electricity consumption in Manitoba.

h) The export credit as currently applied distorts prices and encourages excessive consumption of electricity in Manitoba. After paying the costs associated with uniform rates and investing in developmental efficiency and non-hydro renewable energy projects, the remaining export credit shall be distributed to customers in one of the following methods, which are listed in order of decreasing preference:

1. Rebated to customers through governmental programs unrelated to electricity, such as health care or education.
2. An annual credit to customers unrelated

to usage on the model of the Alaska Permanent Fund.

3. An annual credit on the electric bill, computed by multiplying usage or revenue by a uniform systemwide factor, but, not specifically identified as being usage-related. It should appear on the bill as a lump sum.

4. A monthly credit on the electric bill computed by multiplying usage or revenue by a uniform systemwide factor, but, not specifically identified as being usage-related. It should appear on the bill as a lump sum.

I) Implement a connection charge for new inefficient homes and non-residential buildings, offset by conservation credits for measures installed that go beyond minimum requirements of code. The goal is not to raise revenue, but, to move the market for new construction to a higher level of efficiency.

Absent a different proposal, MH should be directed to implement the $2,000 charge per home, and $200 per kilowatt for non-residential structures recommended by Mr. Lazar.

j) Direct Manitoba Hydro to initiate natural gas efficiency programs that parallel the current and planned electricity efficiency programs, and authorize Manitoba Hydro to file a uniform system benefit charge on natural gas throughput to pay the costs of the program.

In the brief that follows, we consider first the perspective and conceptual issues that underlie these recommendations and then elaborate the recommendation themselves.

Perspective and Conceptual Issues:

Time to Respect Earth's Ecosystems (TREE) and Resource Conservation Manitoba (RCM) are committed to the advancement of a more sustainable society in which our planet's natural endowments of living and non-living systems and resources are valued, respected and conserved.

Recognizing that this natural legacy is finite and subject to degradation and depletion, we promote eco-efficiency -- improving the ratio of social benefits to environmental harms and resource depletion - as an essential pillar of a sustainable society. Conservation is a social imperative.

It is thus troubling to find that Canada is 27th out of 29 OECD nations in order of increasing per capita energy consumption and 28th out of 29 in energy efficiency (energy used per $1000 of GDP), which is 33 percent less energy efficient than is the U.S., our largest trading partner.(1)

Footnote 1:
OECD = Organization for Economic Cooperation and Development, an association of industrialized democracies. The comparative statics are available at http://www.environmentalindicators.com/htdocs/

In short, by global comparisons, we are energy hogs. These statistics are worrisome from both our environmental and economic perspectives.

We believe that this poor showing is not simply owing to physical climate and geography. Rather it is attributable, in part, to perverse economic incentives, inadequate conservation investments and regulations, and policy failures.

To simply somewhat, as a society, instead of looking at our high usage and asking, how can we achieve the same or greater social benefits more efficiently, with less energy consumption, we have asked instead, how can we keep rates low? (2)

Footnote 2:
See, for example, this exchange between the Chair and Mr.

Warden on June 22nd, at 97-77 of the transcript:

THE CHAIRPERSON: Mr. Warden, some of the confusion related on the fact that Manitoba Hydro does not have the objective of a private utility. With a private utility, my understanding is, the objective is maximization of shareholder wealth.

Is it fair to portray Manitoba Hydro's purpose is that achieving lowest cost generation and supply?

MR. VINCE WARDEN: Well, maximizing shareholder wealth through low rates, I think we have essentially the same objective, really. And we do that at the same time as providing a safe and reliable source of supply.

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MR. VINCE WARDEN: The -- the goal, just to elaborate a little bit on that point though. The -- the reason that an investor owned utilities want to maximize net income is to increase the wealth of their shareholders. Our shareholders are the people, the Province of Manitoba.

And through maintaining low rates we're doing just that, we're increasing the wealth of Manitobans through -- through low rates.

(End of footnote)

To do this, we have been prepared to price our crown-owned electrical resources well below market value and divert great sums of Manitoba's wealth in the form of foregone taxes and dividends and allocation of export earnings to subsidize domestic energy rates even further, while at the same time cutting back on DSM investments in the last decade.

Because low rates to consumers have trumped and, to some extent, replaced energy efficiency goals, it is not surprising that Canada's energy profile has continued to worsen relative to other OECD countries and that Manitoba Hydro's residential Power Smart program was able to achieve only 0.7 percent energy savings in the twelve (12) years from 1989/90 to 2000/01 (June 28 transcript, 1204).

Despite the above shortcomings, we note more optimistically that in Manitoba the social imperative to conserve is enshrined in the Manitoba Hydro Act and the Sustainable Development Act, as discussed in the attachment, TREE and RCM have intervened in this process in response to the social imperative and legal requirement for Manitoba Hydro to promote efficiency throughout the electrical system, including end-users.

The wealth of Manitobans is increased not just by low rates, but by the greater productivity of energy supplied; more efficient and comfortable homes and businesses; a thriving energy-efficiency business sector;

reinvestment in the Manitoba economy and jobs of money otherwise spent on wasted energy (including dollars sent to Alberta for wasted gas); greater earnings on the export market; a financially sound government and crown corporation; an enhanced, less-depleted natural resource legacy; and the social capital and moral satisfaction of living in a more just and sustainable society.

We believe that a suitably broad conception of the wealth of Manitobans and the principles of sustainability should guide the planning, operations, financial management, and rate setting of Manitoba Hydro and the review of these by the Public Utilities Board and the Intervenors. Attention to these principles will be required to arrived at an informed determination of "just and reasonable" rates.

From this perspective, we are somewhat heartened that, Mr. Kuczek, in his responses to cross examination (June 28 transcript, 1290ff), has linked DSM programming to a variety of corporate goals, including environmental leadership. We are encouraged that Manitoba Hydro has recently reversed its policy of lowered investment in the DSM and is in the process of ramping up its DSM programs and personnel.

We hope that this signals an important shift from the corporate testimony at the 2002 Status Update hearings that DSM is:

"not a social responsibility that we [Manitoba Hydro] bear" {September 24,,2004 transcript, 4302).

We believe that, Mr. Kuczek's verbal assurances in this regard need to be formalized in an upgraded DSM plan that better reflects the legal mandate of the corporation and the sustainability principles of the Province.

The "current" 2001 plan cites only the narrower economic goals of improving the bottom line of customers and the corporation.

We are also encouraged that CAC/MSOS have spoken favourably of DSM investments as economic good sense for Hydro (Mr. Harper's evidence, 59:5-9). On the other hand, we can't leave unchallenged the appropriate of the word "principled" by Mr. Bowman to describe the current averaged embedded cost methodology and allocation of export revenues to assign system costs (July 5 transcript, 1919-20).

In particular, it is not more principled to treat every kilowatt hour alike in either cost or price nor to define cost responsibility exclusively in terms of average embedded costs.

Proper analysis of cost responsibility should recognize that incremental kilowatt hours, both historic or future, are supplied to the system at a higher-than-average cost. For example, Mr. Warden noted that Kelsey Generating Station, which has nearly the capacity of Limestone, cost far less when it was built.

And the evidence at the 2002 update hearing indicated that the older Winnipeg River generation was cheaper per kilowatt hour than most northern generation with DS transmission by about 1.5 cents (TREE/RCM 2002 Final Argument, paragraph 39).

Moreover, in the current electrical market, growth in domestic demand creates opportunity costs to the system by reducing the available supply of power for export at higher-than-domestic prices. Application of the principle of cost-based pricing of electricity should recognize both that current power is supplied with a range of costs and that growth in usage imposes higher-than-average costs on the system and thus on existing users if the new revenues produced are not commensurate with the added costs.

In addition to the above internalized costs reflected in Manitoba Hydro’s balance sheet, growth in domestic consumption increases external environmental costs from new dams and transmission in Manitoba or from reduced opportunities to displace greenhouse gas emissions from fossil fuel generation in the export markets.

Thus environmental considerations reinforce the need to charge incremental usage at higher rates to reflect higher costs, which will also increase the incentives for, and cost-effectiveness of, conservation measures.

In contrast, the current methods of cost determination better reflect precedent than principle. As indicated above, the relevant principles are those expressed in the Manitoba Hydro Act and the Sustainable Development Act, neither of which is cited by Mr. Bowman in his characterization of what is "principled".

These are the principles that should guide Manitoba Hydro in its planning and submissions in this process and the PUB in its review and Orders. The evidence and recommendations of the parties to this process should likewise be evaluated in terms of these principles and discounted where they run contrary to them.

Such a truly principled approach does not require that past precedents or special circumstances should be ignored; a degree of gradualism to create some predictability and minimal disruption to people and organizations is a desirable principle of rate-setting.

But, these principles do not justify a slavish adherence to precedents set under different circumstances and prior to the adoption of the Sustainable Development Act, for example.

Gradualism does not preclude the setting of new targets and steady movement towards them. When circumstances, understanding and mandates evolve, it is incumbent on Manitoba Hydro to respond to these and to educate and communicate clearly with its customers regarding the reasons for the measures it takes, so that customers can revise their expectations and adjust their behaviour accordingly.

Explanations on or accompanying customers' bills and other communications can help to make this process transparent.

Finally, it is important that electrical rates reflect principles of justice, equity and fairness. The primary surrogate for fairness in rate-setting by the PUB has been the notion of assessing revenues proportional to cost-responsibility for various customer classes and sub-classes. The goal has been to create revenue cost coverage ratios approaching one (1), and preliminary to that, between 95 percent and 105 percent, the so-called "zone of reasonableness".

We do not dispute that assessing revenues proportional to cost-responsibility is an important concept in rate determination, provided that some approximation to full-cost accounting is employed, as prescribed under The Sustainable Development Act (Schedule B,1. Efficient use of Resources, (b)).

As previously discussed, however, the current method of cost assignment based on averaged embedded costs falls short of full-cost accounting in several ways. It does not reflect the range of costs for power supplied and, in particular, does not recognize that incremental usage imposes higher-than-average costs on the system by necessitating more expensive new generation and/or reducing the power available for export at higher-than domestic rates.

It also fails to take into account that load growth engenders incremental environmental costs from local generation and transmission impacts and reduced displacement in export markets of GHG-emitting generation from fossil fuels.

As an aside, a wider social accounting would note that current tax exemptions, e.g. for heating load, impose a higher tax burden on other activities from which the revenue requirement of government services must be met.

For example, incremental insulation energy used for inefficient heating does not. This particular form of cost causation is unfair and perverse, but it is a mater for the provincial government to rectify.

It is also important to recognize that there are other important ingredients to our notions of justice, equity and fairness besides balancing revenues with costs, including the just distribution of benefits; the equality of citizens in meeting basic needs; the rewarding of social benefactors; and compensation of past injustices.

While many determinations of justice will lie beyond the purview of a rate-setting exercise before the PUB, these other elements of justice should not be ignored where relevance to rates can be demonstrated.

when the determination of cost responsibility diverges from the principles of full cost accounting and the other ingredients of justice are ignored, the determination of the "zone of reasonableness" may be unreasonable.

The just distribution of system benefits has been a matter of considerable discussions in the last few years. Two forms of benefit distribution at issue are the allocation of export revenues or dividends and the allocation of lower cost power in the system.

There is a growing sense of unfairness that substantial portions of Manitoba's wealth generated from natural and corporate assets owned by Manitobans collectively are distributed on the basis of consumption of the electrical commodity supplied. (In its rebuttal evidence paragraph 13-14, Manitoba Hydro likened this to the trucking industry being the primary beneficiary of the economic rent from oil in Alberta).

In his oral testimony, Mr. Bowman, indicated that economic rent was already collected by the provincial government through water rentals. While this may address rent on the raw natural resource (comparable to stumpage fees in the forest industry), it ignores the wealth generated from Manitoba Hydro’s assets and organization as a going concern (corresponding to corporate dividends and taxes paid on them in the forest industry).

It is the position of TREE and RCM that a more just distribution of the system benefits of low-cost power and export dividends can be found by decoupling them from levels of consumption, with the added benefit of encouraging the efficient use of power.

We believe that rate policies should be integral to the pursuit of overall corporate, social and environmental objectives, many of which are summarized in principles of sustainability and justice.

A just and efficient rate policy is one that (a) based on equity between people, not equality between the costs or prices of kilowatt hours supplied, (b) retains appropriate price signals to promote behaviour that reduces social and environmental costs (or promotes net environmental and social benefits), and ¬) enhances people's capabilities to act in response to those signals.

Equity between people means that one group is not unduly favoured at the expense of others, while basic needs are methodology and life opportunities created. We do and should, as a society, share the burdens of meeting basic needs and creating opportunities for one another (e.g. through health care and education).

A warm home in the winter is a basic need of all Manitobans and it would be inequitable not to afford fellow citizens the opportunity to live in one. At the same time, ways of heating one's home that impose unnecessary costs on others are also inequitable.

In general, where subsidies from export dividends or low-cost system resources are required to meet the basic needs for home heating and other electrical services, they should be for limited basic consumption and for efficiency measures that improve home comfort and utility while reducing the costs that incremental loads impose on the customer himself, on other customers and on the environment.

Subsidies should not be indiscriminately attached to unlimited quantities of power, but, should be decoupled from higher levels of consumption.

To take the example of Mr. Kuczek's rich and poor relatives (3)...

Footnote 3:
June 30 transcript, 1747-48:

MR. BOB PETERS: Can you indicate to the Board what limitations exist from reaching those new [DSM] targets?

MR. LLOYD KUZCEK: The -- the limitations that we face with those targets are similar to barriers that we realize with all our DSM initiatives, there's general barriers out there within DSM initiative, that -- and they range from consumer awareness, financing capability of consumers -- consumer priorities.

To give you an example of that, my -- my sister -- or my brother, for example, when I go over there and talk about energy efficient measures, he pretty much shows me the door. He's financially wealthy, an doesn't really care about saving a hundred dollars ($100).

My sister, on the other hand, is on the low income category, and she's very interested, but she can't afford to implement any measures. So, there's a number of areas involved.

...a just and efficient policy would have the rich relative pay for his high consumption without imposing the incremental costs of services on the rest of us or securing a greater share of the system subsidies and dividends, while the poor relative would be assisted to conserve through an energy audit and assistance in securing, paying for, or financing efficiency measures that would reduce her bills.

It is misguided policy to insist on low rates for all because of the impact of higher rates on the poor.

Rather than subsidizing rates for high consumers into the indefinite future, Manitoba Hydro can do better by subsidizing conservation program delivery costs that provide long term dividends to the recipients, to other ratepayers who would otherwise have to continue to subsidize the high consumers, and to the system, by freeing up power for export or other uses.

An important byproduct is the stimulation of economic activity throughout the province to create these conservation measures, which lead ultimately to a more efficient economy.

Recommendations:

In this section we elaborate on the decisions that we are seeking from the PUB that were listed in the Introduction.

Revised Power Smart Mandate:

The 2001 Power Smart Resource Plan identifies only those objectives for DSM: "to provide alternative cost-effective methods of power supply and to minimize the total cost of energy services to customers" (Power Smart Resource Options, Executive Summary, iii in Appendix 88 of Manitoba Hydro's filing).

Although prominent in Power Smart advertising, environmental and sustainability objectives are not among the stated purposes. This is incongruent with the public values appealed to and contained in legislation.

It also ignores an important component of a just society, enabling citizens to meet their basic needs. Hence we recommend first that the PUB:

a) Direct Manitoba Hydro to incorporate into its new Power Smart Resource Plan a broadened set or purposes and associated targets and performance measures that better reflect the energy efficiency and sustainability mandates found in The Manitoba Hydro Act and The sustainable Development Act and the justice principle of helping customers meet their basic needs.

Just and reasonable rates will reflect principles of cost-causation, including the incremental costs to the system of higher usage. Increasing tail-block rates more than first block rates, as proposed in the flat rate proposal of Manitoba Hydro and invested rate proposals of TREE and RCM, will improve the tracking of costs by rates.

However, it must also be recognized that this transition from higher to lower levels of subsidy for high consumers will have a greater impact on the bills of high consumers (June 28 transcript, 1208-09).

For high-consuming customers who are better off, this increase may be of little import and readily absorbed (just as escalating gas rates have been absorbed by gas customers), but, for low-income customers it could be more significant.

Note, though, that low-income customers with below average usage, e.g. many apartment dwellers, will be better off under flat or inverted rates than they would be if the current declining block structure were retained. This leaves the high consuming low-income customers are the group most impacted by the proposed rate changes and most in need of bill mitigation.

At this point another principle of justice comes into play, i.e. helping customers to meet their basic needs. There are several approaches to doing this. one (1) external to Hydro’s operations is to have appropriate adjustments to social assistance allowances for those who receive them to reflect this increase in the cost of living.

However, since such allowances are based on averaged costs, they would be unlikely to address the specific needs of the high-consuming poor.

A second approach is to provide some rate relief to the poor. For example, the city-owned utility, Seattle City Light, while retaining an inverted block structure, has a lower set of rates for the poor.

A third approach, which we recommend as most beneficial to customers and the utility in the long run and most congruent with Hydro's core mandate, is to target special DSM programming and delivery to the high-consuming poor to bring down their levels of consumption to more affordable levels.

Even if such targeted programming should exceed the threshold of cost-effective DSM, it is justifiable because it addresses a basic component of justice and provides a social license for implementing an overall rate reform that is otherwise more equitable and conducive to energy efficiency.

We note that Hydro has either initiated or has on the drawing boards several exploratory and pilot programs for DSM delivery to the urban poor and several northern communities. These efforts must be strengthened and rolled out on a much larger scale.

There is, for example, as yet nothing in DSM programming comparable to the Wuskwatim project in the level of effort, commitment of resources and training involving Hydro, federal and provincial resources. Hence the PUB should:

> Direct Manitoba Hydro to include amongst the targets of the new Power Smart Resource

Plan the identification of low-income customers with high electrical usage and devise appropriate DSM programs to mitigate impacts of increased rates on their electric bills.

Inverted Residential Rates:

Manitoba Hydro has acknowledged that inverted rates are appropriate for its system. TREE and RCM have recognized that Manitoba Hydro is moving deliberately in that direction, with a proposal for flat rates in this proceeding. The Manitoba Hydro proposal for flat rates should be approved at this time, but, Manitoba Hydro should be directed to take the next step.

Manitoba Hydro has acknowledged that a rate inversion of approximately one (1) cent per kilowatt hour is justified on the basis of load factor differences of small users versus large residential users alone.

It has further acknowledged that there are low-cost and higher-cost generating resources on its system, as well as a gap between embedded and marginal costs of generation and transmission, and that these form a second basis for inverted rates (June 29,2004 transcript, 1225-26).

We are confident that Manitoba Hydro understands this issue and wants to move forward. We believe that Commission support of this will cause it to happen without further delay.

The simplest direction to give Manitoba Hydro is that prices for the basic charge and the initial block of power shall NOT be increased (except to reflect the re-configuration of the export credit, discussed below) until there is at least a one (1) cent inversion.

The inverted rate study to be filed in December of this year should provide a guide as to the level of ultimate inversion that is appropriate. Our recommendation is that rates be moved gradually, so as to avoid economic dislocation.

Since Manitoba Hydro has acknowledged that at least one (1) cent inversion is appropriate, this should be implemented in 2006-2007, perhaps in two steps. The Board will have time to review the inverted rate study and other information during the next two years and determine how much further, if at all, it is appropriate to move residential rates.

Thus we recommend that the Board:

c) Direct Manitoba Hydro to file an inverted residential rate design, with no increase to the customer charge, to take effect in 2006. The actual rates and blocking should reflect what is learned in the inverted rate study to be filed at the end of this year.

The impact of inverted rates on northern customers and those without access to gas should be given serious consideration by the Board. As Mr. Lazar testified, there is no economic basis for providing a larger share of low-cost power to larger users, but there may be a public policy basis for doing so based on equal benefits of citizenship.

We believe that our proposed treatment of the export credit -- with a portion first applied to offset the impact of the uniform rates legislation -- is a reasonable way to address the needs of these customers. A further measure would be to target the delivery of DSM programs to these customers to ensure that those with high loads have the opportunity to reduce their electric bills through conservation.

However, if the Board determines that an additional subsidy is appropriate, providing a larger initial block of low-cost power to customers in this region during winter is not unreasonable. A reasonable goal would be to provide no more than a customer with a geothermal heat pump would need to heat a modest-sized home.

Manitoba Hydro should be directed to submit information that would enable the Board to make a reasoned judgment of the size of this block of power, as well as advising the Board if there are regions where geothermal heating is not an option.

Inverted General Service Rates:

Manitoba Hydro is currently selling power to general service customer for as little as $.03/kwh, when export markets will pay nearly twice that amount. Mr. Lazar warned of the potential migration of energy-intensive industrial load to Manitoba, providing few jobs, but, draining one of the Province’s principal sources of export revenue. To the extent this materializes, all ratepayers and Manitoba citizens will share this burden of subsidy.

The best way to solve this dilemma is with an inverted general service rate that would price incremental usage at a level closer to incremental cost. Doing so would protect existing industries, invite investment in efficient new industry, and encourage existing customers to use electricity more wisely.

Manitoba Hydro has recognized this issue, but, has not proposed actions to resolve the dilemma caused by the low average costs and high export earnings. TREE and RCM have identified a combination of responses that would address this.

First, reconfiguring the export credit so that it is not directly rebated in the form of a lower price per kilowatt -hour will help. As Mr. lazar testified, after subtracting the cost of power, the export credit is about $.008/kwh. The Board should direct Manitoba Hydro to reconfigure the export credit promptly. The options for doing so are discussed below.

Second, directing Manitoba Hydro to begin developing the data to implement rolling baseline rates, providing each customer a percentage of historical usage at one rate, with a higher rate for incremental use will begin the process of moving toward inverted rates. Manitoba Hydro should study, at a minimum, a 90 percent and 70 percent rolling baseline in the filing due in December.

The study should look at how many customers would have been affected to what degree had this rate design been implemented five (5) years ago. The study should also review, in this context, the findings of the new study on DSM potential to estimate what levels of response to the new rate signals are possible.

It is not our goal to cause widespread disruption for business -- only to cause them to value Manitoba's incremental power supplies at least as much as our export customers value it.

Thus PUB should:

d) Direct Manitoba Hydro to study at least two (2) alternative methods of implementing inverted rates for commercial and industrial customers as part of the inverted rate study to be filed at the end of this year.

Export Credit:

Manitoba Hydro currently calculates the "net export credit" by subtracting only variable costs from export revenues. They understand that this is flawed and we concur. The NERA methodology is one (1) appropriate way to compute the export credit, by subtracting AVERAGE power supply costs.

We suggest a modest improvement, in that the low-cost Winnipeg River resources should be allocated exclusively to domestic users, in support of the low-cost initial block of power we propose under our inverted rates discussion.

The northern and newer resources should be used to support upper-block domestic usage and exports. This would place the COST basis for both on a similar basis, and therefore, help to achieve the goal, described above, of causing Manitoba domestic customers to value incremental power supplies as highly as do export customer.

Thus the PUB should

e) Determine that the "export credit"

should be calculated using an 'export class" methodology that assigns the cost of resources OTHER THAN Winnipeg River resources to export customers. Winnipeg River resources should be reserved exclusively for domestic customers.

Once the export credit is calculated on a "net of power cost" basis, the next decision is how it should be allocated to the citizens of Manitoba. Currently, this is done entirely through reductions in Manitoba Hydro prices and divided among the customer classes on the basis of energy consumption (generation and transmission basis).

This leads to distorted prices and distorted consumption. The record in this proceeding identifies many ways to distribute the net export credit in ways that will distort consumption less severely.

Minimal change, the NERA report:

The first change is recommended by Manitoba Hydro, based upon the NERA report. This would compute the export credit as described above, subtracting average power costs from export revenues, and then allocate that between customers based on the total Manitoba Hydro power bill -- including distribution revenues.

We believe this is the minimal change that should be considered, but, we encourage the Board to go further.

Progressive Change within the Current Structure:

As discussed above, we recommend that two (2) changes to the NERA method be implemented at this time. The first is to reserve the low-cost Winnipeg River resources to domestic customers. The second is to apply a portion of the export credit to offset the subsidy of Zone 3 customers dictated by the uniform rates legislation.

Our approach to inverted rates is to have them reflect costs. The initial block should consist of low-cost resources used to service high load factor loads such as lights, appliances and other non-heating and cooling uses. reserving the low cost Winnipeg River Hydro to meet initial block usage of domestic customers is consistent with that.

Applying a portion of the export credit to offset the costs of the uniform rates legislation is also reasonable.

There is no reason that southern Manitoba residential customers should bear the cost of subsidies under this legislation, but, that is the net effect of the way Manitoba Hydro has applied the cost of service study, export credit, and uniform rates legislation.

The record in this proceeding shows that Zone

1 and Zone 2 residential customers are comfortably within the 95 percent to 105 percent zone of reasonableness, but, that the residential class as a whole is dragged down by the 80 percent parity ratio of Zone 3 customers.

Taking this subsidy from the export credit will achieve two (2) mutually beneficial goals. First, it will offset the cost of uniform rates without placing the burden on any one group of customers.

Second, it will reduce the net export credit and the distortion it causes for other rates. Under this approach, the export credit would still be reflected as a component of Manitoba Hydro rates, causing them to be lower than those of adjacent utilities.

Thus the PUB should:

f) Determine that the FIRST application of the export credit shall be to support the impact of the "uniform rates" legislation. Rates for the residential and small general service class should be set so that Zone 1 falls within the 95 percent to 105 percent "zone of reasonableness" and any deficiency that results for Zone 2 and Zone 3 shall be covered with a portion of the export credit."

Progressive Change Beyond the Current Structure:

In order to really move forward to electricity prices that reflect resource costs on a going-forward basis, some additional change is needed.

Mr. Lazar posed several alternative approaches to the export credit that would reduce the distortion that the credit causes to electricity prices.

These include a separately stated credit, a separately stated annual credit tied to actual hydro export earnings, a separately stated annual credit unrelated to usage, and removing the export credit from Manitoba Hydro bills entirely by using it for developmental investments in end use efficiency and alternative energy sources or as a dividend to government for public service.

The latter approach is not that radical - it was the net effect of the $200 million dividend appropriated by Government last year, given the NERA calculation that the net credit is about $169 million per year.

However, it may lie outside the role of the PUB to order unilaterally, but, should be a matter for discussion between the PUB, the provincial government, Manitoba Hydro and the stakeholders.

In the meantime, it does lie within the core mandate of Manitoba Hydro to make developmental investments in energy efficiency and alternative energy sources.

Currently Hydro supports research to develop more efficient electric motors including their rehabilitation and rewinding.

However, there are many other opportunities such as those identified in the federal/provincial Conservation and Renewable Energy Demonstration Agreement (CREDA), signed on May 9, 1980 and terminated March 31, 1984, which was discussed in the pre-filed testimony of Mr. Barry Wild, Exhibit TREE-5 in the 2002 Status Update proceedings. (4)

Footnote 4:
The objectives of CREDA were:
To develop and demonstrate promising new technologies which, when widely adopted, will exploit renewable resources, conserve energy and/or use energy more efficiently.
To develop broad public awareness of the potential of renewable energy and conservation technology.
To provide opportunities for the commercial application of the technologies within Manitoba.
To create economic spin-off benefits for manufacturing industry and commerce.
To create employment in new or existing energy-related industries.

There is a particular need to research, test and demonstrate more efficient and cost-effective building shell techniques and technologies for both new construction and retrofits to complement incentive programs, in order to create a market transformation to more efficient building standards.

There is also a need to develop effective models of DSM deployment, including training opportunities, for northern communities and the poor in order to mitigate rising bills and satisfy principles of justice in the delivery of services.

There may also be initiatives that Manitoba Hydro could take to encourage co-generation opportunities with some industrial customers or to further the development of the wind resource in Manitoba. Thus the PUB should:

g) Determine that after covering the costs of uniform rates legislation the NEXT application of the export credit shall aboriginal to support research and development, demonstration and pilot projects, and special initiatives to promote end-use efficiency and non-hydro renewable energy resources that will ultimately reduce the cost and environmental impact of electricity consumption in Manitoba.

Coverage of the costs of uniform rates and investment in development initiatives for efficiency and alternative energy will use some, but not all, of the export credit.

Mr. Lazar clearly stated the goal to have the credit not distort retail prices. By making it a separately stated element of the bill, some consumers might not see it as related to consumption, but, he acknowledged (as did Manitoba Hydro) that sophisticated consumers would quickly see through that.

He therefore, suggested that the credit be computed and paid annually, so that customers would see bills computed on a sans credit tariff in 11 months of the year and see a one-time cheque or credit during the winter (he suggested December). We believe that this degree of change is clearly within the tariff making authority of the Board.

Mr. Lazar also suggested that the credit amount be made "uncertain" so that customers would not have their consumption decisions affected. He suggested that tying it to actual export earnings on a year-to-year basis would achieve this. Transitioning to such an approach over a three (3) year period would avoid rate shock, gradually implementing this approach.

To facilitate this transition seems relatively simple. In the next rate year, say October 2004, through September 2005, the credit should be reduced by one-third. Two-thirds of the expected export net revenue would be reflected in the tariff, and one-third paid as a lump-sum once a year.

Using the NERA approach, the net credit would be reduced from $160 million to $155 million first, by applying $14 million to offset the Zone 3 subsidy caused by uniform rates legislation. $105 million of this would continue to be reflected in Manitoba Hydro rates (or some lesser amount to be determined after developmental investments in DSM and alternative energy).

Based on retail sales of about 21 billion kwh/year, this would reduce the average export credit from about $.008/kwh to $.005 /kwh. In effect, rates would go up by three (3) mills per kilowatt hour. This is NOT rate shock.

Then, Manitoba Hydro would be expected to pay a one-time dividend of one-third of its actual net export earings (after covering the Zone 3 subsidy) in a lump sum credit in December of 2005. If actual net export revenues were $169 million as estimated by NERA, the December credit would be about $50 million or about three (3) mills/kwh. For a customer using 15,000 kwh per year, it would be a $45 cheque or credit.

In the event that export earnings were negative, no dividend would be paid, and Manitoba Hydro would continue to pay no dividend until its retained earnings had been restored by subsequent export sales.

In the second year, Manitoba Hydro would again reduce the amount embedded in rates, from $100 million/year down to $50 million per year. Rates would again go up about 3 mills/kwh, again not creating rate shock. At the end of the second year, in December 2006, Manitoba Hydro would pay a one-time dividend equal to two-thirds of its net export earnings, in this case, about $105 million.

For the same customer using 15,000 kwh per year, the one-time credit would increase to $90. However, if export earnings were larger or smaller than $169 million, the credit would be different.

In the third year, the export credit would be completely removed from tariff rates, and Manitoba Hydro customers would receive all of the credit in the once-a-year credit based on actual export earnings.

This approach has several benefits. First and foremost, it would remove the incentive to consume power uneconomically caused by the current price distortion of the credit, but, avoid rate shock by doing so in three (3) annual steps, each of which would increase tariff rates by only about three (3) mills per kilowatt hour.

Second, it would create an annual credit that would rebate the net export earnings to consumers, but, the credit would be tied to actual earnings, and therefore be uncertain, so customers would not be able to "plan" on a specific amount.

As Mr. Lazar testified, receiving it in a single lump sum that was not predictable would effectively decouple it from the consumption decision. It would also serve to greatly stabilize Manitoba Hydro finances, as by the third year, a credit would only be paid in years when it was earned and never in an amount in excess of the actual net export earnings.

Having a strong balance sheet at Manitoba Hydro is in the interests of all Manitobans.

Progressive Reform: Removal of the Credit From Manitoba Hydro Rates Completely: The final option for removing the distortion of the export credit discussed by Mr. lazar is to remove it entirely from Manitoba Hydro rates and have it rebated to consumers in some manner completely unrelated to consumption.

This could be a per-customer rebate (as BC Hydro did), or simply a transfer of the export credit to the government for us in reducing other taxes and/or funding essential government services.

TREE/RCM believe that this is exactly what happened when the Government appropriated a $200 million dividend from Manitoba Hydro in 2003, and clearly this approach would remove the price distortion caused by the credit.

However, we believe this is probably beyond the role of the PUB and we will leave it as a matter of discussion for the Board, Manitoba Hydro and the Government to consider in the future.

In summary, with respect to the application of the export credit that remains after covering the cost of uniform rates legislation and developmental investments in DSM and alternative energy, we make the following recommendations for PUB directives.

h) The export credit as currently applied distorts prices and encourages excessive consumption of electricity in Manitoba. After paying the costs associated with uniform rates and investing in developmental efficiency and non-Hydro renewable energy projects, the remaining export credit shall be distributed to customers in one of the following methods, which are listed in order of decreasing preference:

- Rebated to customer through governmental programs unrelated to electricity, such as health care or education.

- An annual credit to customers unrelated to usage on the model of the Alaska Permanent Fund.

- An annual credit on the electric bill, computed by multiplying usage or revenue by a uniform systemwide factor, but, not specifically identified as being usage-related. It should appear on the bill as a lump sum.

- A monthly credit on the electric bill computed by multiplying usage or revenue by a uniform systemwide factor, but, not specifically identified as being usage-related. It should appear on the bill as a lump sum.

Hook up Charges and Credits

Mr. Lazar proposed that Manitoba Hydro increase its emphasis on efficient new building techniques by implementing a symmetrical program of hookup charges and credits to cause builders of new homes and non-residential buildings to see the impact that their efficiency decisions have on Manitoba Hydro and its customers.

He proposed two (2) specific programs:

> Residential: A $2,000 connection charge, offset by a $2,000 credit for meeting the Power Smart Program standard and an additional $1,000 credit for meeting the R2000 efficiency standard.
>
> Non-Residential: A $200 per kilowatt connection charge for new load, offset by a set of incentive rebates for going beyond minimum energy code requirements that would be expected to refund substantially all fo the revenue to non-residential builders choosing to install greater efficiency.

The benefits of these programs was not challenged by Manitoba Hydro. Mr. Kuczek thought that likely would be effective in getting most builders to construct to a higher standard (June 28 transcript, 1211:3-20.)

The Manitoba Hydro panel said that they wanted to encourage stronger energy codes, but, did not want to use a "stick" to do so. The symmetrical programs described by Mr. lazar need not be viewed as a stick, but, rather as a carrot-and-stick.

The key reason for implementing this charge to apply to builders is that they choose the energy efficiency level of new structures, but, do not pay the ultimate electric bill. By providing a clear incentive for them to choose a more efficient building design and more efficient equipment, we are putting the incentives directly to the decision maker.

This will help to avoid situations where consumers move into newly designed structures that are not as efficient as they should be, but, it is by then too expensive to retrofit the building economically. Fancy cupboards can be added later with relative ease, but, not so for a weather-tight and well-insulated building shell and a efficient HVAC system.

Manitoba Hydro did not challenge the cost-effectiveness of the R2000 efficiency standard, saying only that builders "didn’t want to go that far." We submit that letting builders call the shots is inappropriate. Builders may be primarily concerned about first cost of buildings, and not about life-cycle costs, environmental impacts, homeowner comfort, or the costs that they impose on the system and hence on other customers.

Mr. Lazar’s approach, already tried in many places as discussed in his paper included as an exhibit to his evidence, puts the incentives in the right place.

Thus the Board should direct Manitoba Hydro to:

I) Implement a connection charge for neighbours inefficient homes and non-residential buildings, offset by conservation credits for measures installed that go beyond minimum requirements of code. The goal is not to raise revenue, but, to move the market for new construction to a higher level of efficiency. Absent a different proposal, Manitoba Hydro should be directed to implement the $2,000 charge per home, and $200 per kilowatt for non-residential structures recommended by Mr. Lazar.

Natural Gas Efficiency Program:

Manitoba Hydro has a large number of very excellent electrical energy efficiency programs in place or in various phases of preparation, as discussed in its rebuttal evidence.

However, the utility has fewer programs for natural gas consumers, and is particularly lacking in incentive programs.

The impact of natural gas conservation on Manitoba is essentially identical to the impact of electricity conservation. The current electricity conservation programs reduce expenditures by Manitobans on electricity, and free up electricity to be exported from Manitoba.

The result is that money flows INTO Manitoba from outside. The effect of natural gas conservation would be to reduce expenditures BY Manitobans on energy imported from Alberta. less money would flow OUT of Manitoba.

The net effect is the same - more money is spent WITHIN Manitoba meeting the energy or other needs of Manitobans and the Manitoba economy is stronger from the export revenues or reduction in import expense.

TREE and RCM have proposed a 2 percent system benefit charge be applied to all throughput of natural gas across the Manitoba Hydro system, with the proceeds of about $10 million per year applied to energy efficiency programs for natural gas.

TREE and RCM have proposed a 2 percent system benefit charge to be applied to all throughput of natural gas across the Manitoba Hydro system, with the proceeds of about $10 million per year applied to energy efficiency programs for natural gas.

Under the current situation, customers actually have an incentive to switch from natural gas heat to electric heat in order to be able to take advantage of Manitoba Hydro electric heat conservation programs.

Exhibit TREE-5C shows comparative heating costs, and shows comparative heating costs and show clearly that a customer with an older gas furnace is paying a higher heating bill than if they used electricity.

Putting in baseboard heat is pretty cheap. If Manitoba Hydro customers would save money by switching to electric heat, however, this is only due to the declining-block rate design. But, if they can also access conservation financing by switching to electric heat, the incentive to do so is significant.

Having natural gas conservation programs available to gas heat users would eliminate this incentive to switch, help protect Manitoba Hydro electricity export revenues, reduce the amount sent to Alberta for gas purchases and help make businesses ore cost-competitive and homes more comfortable and economical.

Manitoba Hydro did not rebut this proposal. No other party took exception to it. Hence the Board should:

j) Direct Manitoba Hydro to initiate natural gas efficiency programs that parallel the current and planned electricity efficiency programs and authorize Manitoba Hydro to file a uniform system benefit charge on natural gas throughput to pay the costs of the program.

ATTACHMENT

Introductory Remarks from TREE and RCM for the PUB Hearing on Manitoba Hydro's 2004 GRA - June 14, 2004

We welcome the new PUB Chair, Mr. Graham Lane and member Mr. Len Evans. Particularly for their sake, I shall recycle some material from the Wuskwatim hearing, which closed last week, to introduce our perspective and the concerns that drive our intervention in the rate hearing. My apologies to Mr. Mayer and others who have heard it already.

The purpose of our intervention:

Time to Respect Earth's Ecosystems (TREE) and Resource Conservation Manitoba (RCM) are non-government organizations committed to the advancement of a more sustainable society in which our planet's natural endowments of living and non-living systems and resources are valued, respected and conserved.

Recognizing that this natural legacy is finite and subject to degradation and depletion, we promote eco-efficiency - improving the ratio of social benefits to environmental harms and resource depletion - as an essential pillar of sustainable society.

We have previously argued that concern for the environment and long-run sustainability generate a social imperative first for energy conservation and efficiency measures and second for least-impact generation options. This is so because of the incremental environmental impacts from new generation and finite global energy supplies, including the limited hydroelectric potential in Manitoba.

We also noted that Canada's standing, relative to other OECD countries, in per capita energy consumption (27th out of 29, ranked from lowest to highest) and energy efficiency (28th out of 29, ranked from least to most energy used per dollar of GDP) indicates that we are global energy hogs.

Canada's energy use if 50 percent higher than countries with similar climates, namely Sweden.(5)

Footnote 5:
Peter Miller's May 13,2004 testimony, p. 2, and
http://www.environmentalindicators.com/htdocs/

These figures intensify the conservation imperative and pose the question: To what extent is our socio-economic climate well adapted to promote energy conservation?

High energy usage should provide a powerful incentive and opportunity to energy conservation, but, we concluded on the basis of our experience in the 2002 Manitoba Hydro rate hearing before the PUB that Manitoba's poor showing is not simply owing to our physical climate and geography.

Rather it is attributable, in part, to perverse economic incentives, inadequate conservation investments and regulations, and policy failures. To simplify somewhat, as a society, instead of looking at our high usage and asking, how can we achieve the same social benefits more efficiently, with less energy consumption, we hae asked instead, how can we keep rates low?

To do this, we have been prepared to divert great sums of Manitoba's wealth in the form of foregone taxes and allocation of export earnings to subsidize domestic energy rates. Indeed, part of Wuskwatim justification is to be able to maintain that subsidy in order to keep rates low.(6)

Footnote 6:
MH NFATT Vol.1, Overview, PUB 5,1,5 ff

Because low rates to consumers have trumped and, to some extent, replaced energy efficient goals, it is not wonder that Canada's energy profile has continued to worsen relative to other OECD countries.

Despite the above shortcomings in application, we note optimistically that in Manitoba that social imperative to conserve is enshrined in the Manitoba Hydro Act and the Sustainable Development Act, as we discuss in the next section. Thus TREE and RCM have intervened in these hearings in response to the social imperative and legal requirement to prioritize conservation and least impact generation alternatives.

Our determination to intervene was strengthened by consideration of Canada and Manitoba's poor showing in global comparisons and the failures in resource pricing and energy policies to promote conservation.

A legal framework for our intervention: (7)

Footnote 7:
Adapted from the legal arguments in TREE/RCM's final Argument for the 2002 MH rate hearing before the PUB

Section 2 of The Manitoba Hydro Act, which provides the legal foundation for Manitoba Hydro declares that:

> The purposes and objects of this Act are to provide for the continuance of a supply of power adequate for the needs of the province, and to engage in and to promote economy and efficiency in the development, generation, transmission, distribution, supply and end-use of power ...

And Section 2 of the Sustainable Development Act states that:

> The purpose of this Act is to create a framework through which sustainable departments will be implemented in the provincial public sector and promoted in private industry and in society generally.

Section 1 of the At specifies that a "provincial public sector organization" means:

> "a board, commission, association or similar body whether incorporated or unincorporated, all the members of which, or all the members of the board of management, board of directors or other governing boards, of which are appointed by an Act of the Legislature or by the Lieutenant Governor in Council, to which

this Act has been made applicable by regulation;

The Sustainable Development Act, therefore, clearly applies not only to Manitoba Hydro, but, also to the Public Utilities Board and the Clean Environment Commission.

Appended to The Sustainable Development Act are principles and guidelines of sustainable development (Schedules A and B of the Act). Particularly relevant to the examination of alternatives to Wuskwatim in the current hearing is the first of the guidelines:

1. Efficient Use of Resources - which means:

a) encouraging and facilitating development and application of systems for proper resource pricing, demand management and resource allocation together with incentives to encourage efficient use of resources; and

b) employing full-cost accounting to provide better information for decision makers.(8)

Footnote 8:
Section 1 of the Sustainable Development Act defines some of

these terms as follows: "demand management" means measures to influence the amount of resources consumers use, as well as how and when the resources are used; "full cost accounting" means accounting for the economic, environmental, land use, human health, social and heritage costs and benefits of a particular decision or action to ensure no costs associated with the decision or action, including externalized costs, are left unaccounted for.

The Stewardship principle expresses the notion of planning for the long run and promoting inter-generational equity:

> 2(1) The economy, the environment, human health and social well being should be managed for th equal benefit of present and future generations.
>
> 2(2) Manitobans are caretakers of the economy, the environment, human health and social well-being for the benefit of present and future generations.
>
> 2(3) Today's decisions are to be balanced with tomorrow's effects.

The principle of Global Responsibility directs that:

> Manitobans should think globally when acting locally, recognizing that there is economic, ecological and social interdependence among provinces and nations, and working cooperatively, within Canada and internationally, to integrate economic, environmental, human health and social factors in decision-making while developing comprehensive and equitable solutions to problems.

Together, these three (3) principles imply that Manitoba Hydro's energy planning should be developed against a backdrop of global long-run energy scenarios that include analyses of resource availability, limits and constraints; environmental loadings and impacts; and socio-economic consequences of alternative paths that can be taken.

Planning should identify the preferred sustainable futures to which the utility can contribute. Efficiency improvements will be a primary component of any preferred path.

Because ever-rising trends in energy consumption and production cause incremental harms and face global limits, a sustainable scenario must contemplate the levelling of and possible decline in available energy and thus in aggregate customer consumption.

Hence we argued in our May 13 testimony that it is not too soon for Manitoba Hydro to sketch an end-game for the province once the hydro-electric potential of the Nelson is fully installed.

Indeed 3,700 MW of the existing Nelson River capacity came on line in the short space of 16 years from 1974 to 1990. (9)

Footnote 9:
Dates and capacities taken from:
http://www.hydro.mb.ca/about_us/hydraulic_stations.shtml

A similar building binge, such as is currently contemplated by Manitoba Hydro and the provincial government, could come close to completing the job in a comparably short time.

For these reasons, alternative resource plans are to be assessed for their sustainability and eco-efficiency, i.e. achieving the greatest long-run human benefits with the least degradation of resources and the environment, both locally and globally.

We also believe that conservation alternatives hold the best prospects for long-run economic stimulation and jobs and the improvement of Manitobans' homes, institutions and businesses.

Perverse incentives and subsidies:

Our 2002 PUB intervention was initiated when we asked what are the implications of low electricity rates in Manitoba for energy conservation, given the general economic principle that lower costs of a product tend to increase its consumption?

We sought to explore rate options that were more favourable to conservation and proposed an inverted rate for the residential sector, in combination with greater DSM investment and corporate targets, strategies, and performance measures having a clearer focus on conservation and efficiency.

The PUB ordered a study of inverted rates for all customer classes and a review of DSM programs.

In our view, there are a number of factors that depress Manitoba's rates and subsidize high energy consumption at the expense of conservation measures.

These include reductions in provincial taxes for some consumers and giving more of the benefits from low-cost Winnipeg River generation and export dividends to the highest consumers.

We have argued that current methods of allocating costs and the system export dividend, which are the foundation for rate-setting, are both inefficient and inequitable.

They are energy inefficient because low-cost power encourages wastage and reduces the incentive to conserve. (This principle was uncontested at the 2002 hearings).

They are environmentally inefficient, because the wasted energy is unavailable to displace GHG-producing fossil fuel generation elsewhere on the continental grid, thus adding to the global environmental costs of North American electricity.

They are economically inefficient, because (a) waster energy is non-productive and (b) using the system export dividend to subsidize inefficient consumption makes the dividend unavailably for more productive investments (including conservation investments that would reduce both energy wastage and customer bills and increase the system export dividend to Manitoba).

They are inequitable, because high consuming customers grab more than their share of both (a) the benefits of low-cost resources in the system, such as Winnipeg River generation, and (b) the export dividend earned by a crown corporation and resource belonging to all of us.

We believe that these perverse subsidies are not only economically and environmentally unfortunate, but, also contrary to the legislation cited earlier.

If it possible to stop subsidizing wastage of energy while still trying to reduce customer energy costs. Two principle ways of doing this are to redirect subsidies (a) from rates to conservation measures, and (b) from tailblock rates to initial block rates and fixed charges.

It is thus possible to do this in a revenue neutral way that will lower the bills of conservers, raise the bills of larger consumers, bring tailblock rates closer to the marginal cost of energy and thus increase the incentives and cost-effectiveness to consumers of conservation measures.

Such measures can also improve the incentives for non-utility generation (NUG) and generate further economic stimulus and jobs to the economy, we maintain.

2002 Recommendations:

TREE and RCM made the following recommendations in the final argument to the PUB in 2002.

> Recommendation 1: Add to the Power Smart Program the explicit goal of increasing the eco-efficiency for the use of energy supplied by Manitoba Hydro, i.e. increasing

the ratio of benefits to ecological impacts.

Recommendation 2: Adopt methods for measuring absolute and relative efficiency performance for different customer and end-use classes.

Recommendation 3: Consider for adoption comparative efficiency performance measures such as the following:
a) Sector by sector, Manitoba residential, industrial and commercial consumers of electrical power and natural gas shall be among the most energy and carbon-efficient in the industrialized world (or North America): and
b) Sector by sector, Manitoba consumers of electricity and natural gas shall enjoy the lowest costs (not the lowest rates) for comparable benefits in the industrialized world (or North America).

Recommendation 4: Adopt a more aggressive conservation program for the residential sector.

Recommendation 5: Create a rate regime in which each customer faces tailblock rates that are much closer to the marginal costs of electrical demand and energy (or even higher, to recognize environmental costs).

Specifically:

Recommendation 6: First, that Manitoba Hydro be directed to file an invested rate along the lines proposed by Mr. Lazar, holding the customer charge to $6.25 for all customers, providing 250 Kwh of power at a rate of $0.038/kwh, and additional power at the level needed to make Manitoba Hydro revenue-neutral, estimated by Mr. Lazar at $0.059/kwh. In the alternative, the Board could direct Manitoba Hydro to file an inverted rate modified to give a larger low-cost first block to all electric residential customers. A third alternative is (Mr. Wiens') proposed minimum bill to replace the basic charge.

Recommendation 7: Second, that Manitoba Hydro be directed to prepared load research on the relative load shape and load factor of large versus small use residential customers on the generation, transmission, and distribution systems. Further, Manitoba Hydro should be directed to complete these studies in not more than 15 months, and report to the Board, with a further rate inversion to take effect in 24 months if the results of the study confirm the evidence that Manitoba Hydro and Mr. Lazar presented.

Recommendation 8: Third, that Manitoba Hydro be directed to study options for general service rate design changes to improve the efficiency of pricing information to customers, with changes to the General Service rate design to be implemented after 24 months, concurrent with the second stage of residential rate reform.

Recommendation 9: Fourth, that Manitoba Hydro be directed to implement an energy efficiency grant program, designed to initially apply up to one-fourth of the export dividend in energy efficiency measures in customer homes and businesses. We believe that such investments will reduce energy costs and benefit all customers.

(End of written argument for TREE and RCM)

MR. ROBERT MAYER: Mr. Peters, I noticed in RCM's final argument, they have added Attachment 1, which is in effect -- in effect, their introduction. Ordinarily an attachment wouldn't be read in or typed into the transcript would it? It starts at page 18. I'm not sure how we handle it.

MR. BOB PETERS: Because it was -- it may have had Mr. -- or had Professor Miller been here, he may have handed it out much like other parties have and it had matters marked as exhibits, so I don't think there's any downside to including it in the transcript. It may be a duplication of some material, but I think because it is an attachment we could -- we could take it as -- as that.

THE CHAIRPERSON: Thank you, Mr. Peters. Ms. Ramage, if you would prefer, we could take a short break now, and then --

MS. PATTI RAMAGE: A one (1) minute break.

THE CHAIRPERSON: Thank you.

--- Upon recessing at 4:01 p.m.
--- Upon resuming at 4:15 p.m.

THE CHAIRPERSON: The crowd is thinning, but we are still all here. Ms. Ramage...?

MS. PATTI RAMAGE: Yes, thank you, Mr. Mayer (sic). If we're doing the movie analogies, right now I think Manitoba Hydro's feeling like Rocky, we've taken a few hits, but we're still standing.

And I'm going to attempt to ensure that Mr. Mayer doesn't end up starring in Planes, Trains and Automobiles, but...

Manitoba Hydro is seeking its first general rate increase since 1997, primarily to take the first small steps towards rebuilding retained earnings after the unprecedented large losses incurred in 2003/04 as a result of the recent drought.

Manitoba Hydro believes that in the circumstances, the proposed average rate increases of 3 percent in 2004/05 and a further 2.5 percent in 2005/06, provides the utmost consideration to customer sensitivity, as testified by Mr. Warden, a strictly financial perspective would have dictated a more aggressive approach to rebuilding the Corporation's dangerously low financial reserves.

While Manitoba Hydro does not necessarily expect Intervenors to endorse the proposed rate increases, modest as they are, and that's the rate increases, not the Intervenors, we are somewhat surprised that so little recognition appears to have been given to the Corporation's seven (7) year rate freeze.

And that's eleven (11) years for industrial customers, or the fact that its customer rates are -- are 6 to 37 percent lower than those in Quebec, even though Manitoba Hydro's debt ratio is 16 percent higher.

In real terms, customer rates are only 84 percent of what they were in '91/92, perhaps the sheer amount of information in the seventeen (17) volumes of the filing has drowned out these key accomplishments and benchmarks, or perhaps they're simply taken for granted.

As stated at the outset of this Hearing, Manitoba Hydro will not reach its long term financial debt equity target of 75:25, a target which was endorsed by this Board in Order 7/03, over -- it won't reach it over the ten (10) year term of its financial forecast.

Nor, will short term targets of interest and capital coverage be met over the next five (5) years. This is a serious matter.

Evidence has been placed on the record by Mr.

Surminski, noting that a combination of adverse water flow and price conditions could reach a cost as much as $2 billion over a five (5) year period. As time advances, the magnitude of this price tag increases, simply because import costs and foregone export revenues will be greater.

Given that just two (2) of the major risks facing Manitoba Hydro, could result in a depletion of $2 billion of its retained earnings, and that's assuming the Corporation is fortunate enough to have accumulated this much in advance of the next drought, Manitoba Hydro does not understand the reluctance of some of the Intervenors, to accept the need for a long term 25 percent equity target, without comprehensive further study.

As Ms. Wray emphatically stated at page 2339 of the transcript:

> "This type of resource intensive exercise, is not required to justify a level of equity target, which is the norm for other Crown owned electric utilities."

Mr. Williams' contention that we survived the worst drought of 1987 to 1992 with retained earnings well below the 2004 forecast of $805 million referenced in CAC/MSOS Exhibit 14 is without merit or logic.

Mr. Williams should know that the world has changed dramatically since the early 1990's and the financial and operational risks faced by the Corporation are vastly different today. For example, in 1992 export revenues were only $97 million compared to the peak of $588 million in 2002.

The cost of a drought in the early 1990's was estimated at $360 million compared to a number approaching $2 billion today. The infrastructure risks faced by the Corporation post September 11, 2001 are also a big issue for Manitoba Hydro. To quote Mr. Anderson, the good old days are gone.

Just to put an answer on the record to Mr. Mayer's question regarding the level of retained earnings prior to entering the 1987 drought, retained earnings at March 31, 1987 were $137 million and the debt ration was point nine four (.94). With respect to the notion floated by MIPUG that specific reserves should be established within retained earnings to address specific risks such as drought.

Manitoba Hydro does not support this at all. This idea is a throw-back to the old rate stabilization reserve and contingency reserve that Manitoba Hydro had fifteen (15) years ago and abandoned for good reason.

When credit rating agencies look at the financial strength of Manitoba Hydro, they look at the total retained earnings and if those retained earnings were designated or restricted for certain purposes, it would weaken the ability of the Corporation to respond to unforeseen events.

Segregating reserves would also be countered to good management practices which stipulate that risks and opportunities should to the extent possible, be offset and balanced within the Corporation. Notwithstanding the urgency of attaining the financial targets, the focus of this Hearing is on the next two (2) years.

It should be recognized that IFF-03-1 is a directional indication of the long term given certain assumptions including the water and price -- including that water and price conditions will normalize. Future rate increases will be dependent on future conditions and will be assessed by the PUB at that time.

Although Manitoba Hydro previously forecast that there would be rate increases in the upcoming years it is possible that without the recent major drought, these increases may not have been requested despite the rising costs which affect every growing business.

However, a drought did occur causing a variance of five -- some $550 million in net export revenues in 2002/03 and 2003/04 relative to the forecast that was -- that last presented to the PUB in 2002. In that regard I direct your attention to Manitoba Hydro Exhibit 61 and the testimony of Ms. Wray at page 340 of the transcript.

Extrapolated out to 2011/12 this drought will cost nearly $1 billion in lost revenues and interest impacts. It should be noted that the no drought scenario referred to by MIPUG and CAC/MSOS witnesses considered only the generic impacts of low versus medium water flows in a single year. Not the actual experience impact of this drought and it's accompanying rise in import prices.

Considerable time was spent with Mr. Cormie in the early days of this Hearing reviewing Manitoba Hydro's management of its power supply operations in the face of the drought. Manitoba Hydro had neither a crystal ball nor the benefit of hindsight when making decisions which would impact not only the financial well being of the Corporation but also its ability to keep the lights on.

This latter consideration by necessity must drive the Corporation's decisions. Mr. Cormie testified he had no means of predicting the length of the drought and that he was not prepared to put the security of the province's supply of power at risk by drawing down reservoirs.

I doubt there's anyone in this room who would -- would've wanted to be in Mr. Cormie's shoes when making those decisions or heading into Mr. Warden's office to report to him about the impacts of those decisions. And it's not reasonable to second guess them now and is particularly given the evidence about water flows and market uncertainties that have been placed on the record.

During Mr. Anderson’s final argument he suggested that it would be appropriate for Manitoba Hydro to -- to re-file the IFF based on current water flows. I would note that the IFF -- the forecasts in water flows that on which the IFF is based are -- are those going forward from the time it is -- it is prepared back in the fall and it -- in the first year; in the second year based on medium flows and thereafter, based on the SPLASH model.

So, the IFF we’re dealing with, the current water flows’ portion of it already expired on March 31st of last year, in terms of their relevance to it. So, it’s not reasonable or -- to expect that the Corporation will continually revise the IFF based on water flows as they change day to day and week to week.

Further, I point out, I don’t think there’s any evidence that the drought is over. Mr. Cormie had said that things are looking up but it could all change tomorrow depending on what happens with rain over the summer.

Throughout this Hearing Intervenors have attempted to diminish the significance of the drought impacts; focusing instead on operating and capital costs, on provincial payments, on Winnipeg Hydro, the inners of the Corporation’s forecasting models or on the cost related to subsidiaries.

Manitoba Hydro doesn’t disagree that these are factors which should be examined by the PUB as part of the Corporation’s revenue requirements. However, when the dust is cleared and all the interrogatories and exhibits have been examined, Manitoba Hydro does not believe that anyone has seriously challenged the prudence of any of the Corporation’s expenditures or the validity of its financial forecasts.

Contrary to what Mr. Williams’ alleged, there has been plenty of cumbersome line-by-line analysis that Manitoba Hydro was asked to provide through this filing. Just turn at random to almost any one (1) of the eleven hundred (1100) interrogatory responses.

The evidence with respect to the Winnipeg Hydro acquisition has been clear. The impact on net income is essentially bottomline neutral for the duration of the forecast. There will be small impacts on the debt ratio and interest coverage, but, not enough to affect rates.

The Corporation’s auditors have agreed that good will is not impaired. Synergy savings have been accounted for in the projections of O&M costs. There is no evidence that revenue requirements will be affected by the acquisition; either in the test years or thereafter.

The evidence on the record regarding capital expenditures is that relative to IFF 01 the forecast which was presented at the status update Hearing two (2) years ago, additional investment was justified in order to support the Corporation's goals.

Details of particular items and actions taken to restrain or re-prioritize were provided in numerous IR responses and in the filing itself; as well as in oral testimony.

Mr. Harper suggested during his testimony that Manitoba Hydro's capital spending has not been controlled as directed by this Board. Yet, when the question was put to him in cross-examination of what capital expenditures he would have deferred or foregone, he was unable to identify any particular project. But, nevertheless, he was prepared to offer the conclusion that capital spending was too high.

Contrast this with the conclusions of the Crown Corporation's counsel review of Manitoba Hydro's 2003 spending which Mr. Warden provided during his direct testimony. The Crown Corporation's counsel concluded the program as consistent with Manitoba Hydro's mandate and strategic plan, project and expenditure levels address and reflect risk management, rate considerations, high system reliability, public safety, environmental sensitivity, sustainable development principles, service and power quality and export commitments.

Projects and expenditures included it in the 2004 and subsequent years' forecast are those deemed necessary to provide a safe and reliable supply of energy in an efficient and sustainable development manner.

Crown Counsel also concluded, the board and management have appropriate capital budgeting, approval and monitoring processes in place.

Manitoba Hydro submits that the conclusions of an oversight body charged with the responsibility of conducting a detailed review of the Corporation's capital spending, testing that capital spending against specific considerations such as safety and reliability, the same considerations the Board has identified, should be preferred over the conclusions of a witness who simply based his comments on the overall dollar value of capital spending from one (1) year to another.

Manitoba Hydro has always maintained that the vast majority of forecast capital items are nondiscretionary and, rather, are driven by the obligation to serve customers, safety, environmental and electrical regulations and standards and the requirement to sustain viable existing capital assets.

The timing of the asset additions or modifications may be the only variable within the constraints imposed by system or legislated criteria. The evidence on the record regarding current capital expenditures is that relative to IFF 01 the largest percentage increases in capital funding excluding new generation and transmission were in the categories of safety of a -- at a 153 percent, environmental and contractual at 136 percent, and load and reliability at a 105 percent.

And these figures can be derived by extrapolating information provided in MIPUG/MH-I-9(a), and comparing those to the capital expenditure forecast in ’01.

Mr. Feldschmid, representing CCEP is concerned that Manitoba Hydro was not rigorous in making the decision to convert Selkirk Thermal Plant from coal to gas. His concern is unfounded, since Manitoba Hydro undertook a business case analysis, based on preserving the benefits that that plant had provided in the past.

This analysis was based on avoiding the uncertainty of continued operation of coal, due to the likelihood of stricter regulatory requirements, to control initial emissions from thermal stations.

Such regulatory requirements would require costly emission control upgrades, which would exceed the costs of conversion to natural gas.

As provided in response to Inter -- Interrogatory PUB/MH-I-32(f), in the Status Update Process, the business case indicated a benefit of $6 million per year, over the remaining life of the plant to at least 2020.

This analysis considered the possibility of drought years, when increased costs would result due to higher energy production costs, due to operation on gas.

However, there are overall benefits when the entire range of flow conditions are considered over the long term.

Manitoba Hydro has con -- has demonstrated that its operating costs have been exceptionally well controlled, despite inflationary pressures and new programs related to aboriginal relations and export marketing and increases in customer growth.

As demonstrated in Exhibit 50, over the past five (5) years, the consumer price index has increased at an ann -- at an annual average of 2 percent. Manitoba Hydro's OM&A has increased at an average of 2.1 percent over the same time period.

That -- that cost increase -- the cost increases have been restain -- restrained to this level for so long is no small achievement. We would ask the Board to take this into account when evaluating Manitoba Hydro's testimony, that adherence to this level of increase is becoming increasingly difficult to achieve.

To test the reason -- reasonableness of Manitoba Hydro's OM&A costs, Manitoba Hydro compared OM&A per customer with that of other utilities, which compares -- and that comparison would be found at Exhibit number 74. When making comparisons between utilities, the most useful indicator is the trend, rather than the absolute numbers.

Manitoba Hydro acknowledges we don't know what goes into their numbers, and so it isn't a pure apples to apples comparison. I think that's the one (1) point we might be able to agree with Mr. Williams on.

But Manitoba Hydro's cost per customer has grown by a much smaller percentage than either BC Hydro or Hydro Quebec. Comparisons of costs per customer is shown in Manitoba Hydro Exhibit number 74, which is based on recently published Annual Reports, demonstrates that BC Hydro's cost per customer has grown an average of 5.7 percent over the last five (5) years.

Hydro Quebec has seen a similar average annual increase of 5 percent over the last five (5) years. In comparison, Manitoba Hydro's costs per customer has increased from five hundred and sixteen dollars ($516) to five hundred and sixty (560), or an average of 1.7 percent over the last five (5) -- five (5) years.

If the forecast years are included, Manitoba Hydro's costs per customer has increased from five hundred and sixteen dollars ($516) in 1998 and '99, to five hundred and eighty-six (586) in 2005/'06, which represents an annual increase of 1.8 percent. This is significantly lower than either BC Hydro or Hydro Quebec.

And while Mr. Williams may have attempted to discredit some of these figures by virtue of his analysis with Mr. -- walking through with Mr. Warden, he -- I would point out that the analysis he used was -- was based on old Annual Reports information, whereas Manitoba Hydro's analysis was based on statistic -- the most current statistical information published by those utilities.

Mr. Harper notes in his testimony, that the cost per customer of five hundred and eighty-four dollars ($584) in 2004/'05 and five hundred and eighty-six (586) in '05/'06, put forth by Manitoba Hydro in Exhibit 50, is virtually the same as the value calculated by him.

From this it appears Manitoba Hydro and Mr. Harper have no issue with respect to cost per customer amounts.

In his testimony, Mr. Harper notes that $5.1 million of pension savings realized in 2003/'04 will carry forward into future years, and that these savings have not been incorporated into the forecast.

While it is true that the pension savings are expected to continue, Manitoba Hydro suggests that without doing a complete re-forecast of all cost, it's inappropriate to select this one item and reduce the forecast for that.

The forecast used in this Hearing was prepared in the fall of 2003. Since that time, one may expect numerous changes, some small, some larger, and it'll go in both directions. It's inappropriate to cherry-pick convenient items to bolster one's position on what the appropriate level of OM&A should be.

Mr. Warden provided evidence yesterday regarding the confusion arising from the different treatment of subsidiary OM&A in Manitoba Hydro's Application and responses to various information requests. Manitoba Hydro regrets that confusion arose and recognizes the need to consistently separate out subsidiary costs and revenues in the future.

I think this example, however, sheds light on the reasonableness of the increase sought by Manitoba Hydro. Mr. Harper suggested a rollback of approximately 1 percent for Manitoba Hydro's requested rate increase, due to what he perceived was an over-statement of OM&A which, based on yesterday's exchange, would be in the order of $10 million for the difference between the top-down target setting and bottom-up detail, budget setting process, plus an additional $5 million for pension savings.

At the same time, Manitoba Hydro has requested no change in its Application, despite the fact that actual losses faced by the Corporation in '03/'04, are in the range of four hundred (400) to $430 million, or forty-five (45) to $75 million greater than the forecasted losses of $355 million, upon which this Application was premised.

So if we're going to cherry-pick, Mr. Chairman, I'd suggest we pick that number also. And that number, just for the record, can be found in Manitoba Hydro Exhibit No. 19.

Now, in explaining the difference between the bottom-up and top-down approach to budgeting, Manitoba Hydro acknowledged that the cost of subsidiaries has been usurped with the gap between the two approaches. When this was recognized by Manitoba Hydro, a series of exhibits were filed to represent actual and forecasted OM&A costs on a consistent basis.

It's unfortunate, although certainly not unexpected, that in this voluminous Application, there have been inconsistencies and, for this, Manitoba Hydro takes responsibility and has attempted to resolve the confusion which may have arisen.

Mr. Chairman, I think you seem to have best summarized Manitoba Hydro's attempt to reconcile the numbers at page 2424 of the transcript. But it's even more unfortunate that Mr. Williams has inappropriately characterized this as padding the books.

Padding the book -- padding the books implies, no, it outright says, that Manitoba Hydro has intentionally attempted to mislead. Mr. Chair, Manitoba Hydro is not some face -- faceless corporation, but it’s the people you see before you. Characterizing any inconsistency as an intent -- intentional attempt to mislead, is stating that these people before you are, in fact, being consciously deceitful. I can assure you that they are extremely disappointed and quite frankly, angered, by this unsubstantiated shot at their character.

But let us disect -- disect the facts behind Mr. Williams’ allegation that OM&A costs are being padded, that there -- that there is a lack of proper budgetary controls and that productivity savings have been usurped. The facts are as follows:

First, Mr. Warden has acknowledged that CAC/MSOS’s mathematics are correct, but has requested the resulting adjustment not be incorporated into the 2004/’05 net income of net forecast, because of increasing cost pressure -- pressures, such as maintenance to meet aging system requirements.

Second, these cost pressures are related to the constraints placed by Manitoba Hydro on its OM&A costs for the last five (5) years. At some point, the gap between stringent top-down budgetary controls and bottom-up real costs requirements, becomes very difficult to close.

Third, productivity savings have not just evaporated. Their existence and value to ratepayers are demonstrated by the gap between the modest increases in OM&A expense achieved in the last five (5) years and the strat -- strategic initiatives, collective bargaining increases, and other special cost pressures that were absorbed during the same time period.

Surely, Mr. Williams is not suggesting that these EFT editions, 3 percent wage adjustments and other special market increases for supplies and consultants, could be covered simply by an overall 2.1 percent OM -- OM&A increase, without offsetting productivity savings.

To claim such a thing, would be as mathematically inconsistent as -- be a mathematically inconsistency as serious as the one he has been preoccupied with. And I would note that Mr. Williams himself issued a caution to this Board that it's getting harder to get good consultants because of rising costs outside of his control. Yet he -- he does not seem to accept that Manitoba Hydro must deal with the same rising costs, only on a much larger scale.

In any event, as indicated by Mr. Warden yesterday, in the unlikely but happy circumstance that we could add another $10 million to the bottom line of Manitoba Hydro in each of the next two (2) years, retained earnings would still be far too low and a far outside what may be considered a retained earning zone of reasonableness.

And I think we've invented -- or I've invented our first new -- my first acronym, a RESOR (phonetic) especially -- this is especially for a company of the size of Manitoba Hydro and for a company confronted with the multitude of risks faced by Manitoba Hydro today.

Manitoba Hydro takes great exception to Mr. Williams’ statement that budgets are too generous to being with. Manitoba Hydro believes keeping average annual OM&A increases to 2.1 percent, almost identical to avera -- the average increase in the Manitoba CPI over the same five (5) year period is quite -- is quite an accomplishment.

And it’s a genuine accomplishment in that it has required sufficient productivity savings to offset the cost impact of collective agreements in excess of inflation, increased maintenance requirements, other normal cost increases and greater emphasis on staff in such strategic areas as Aboriginal relations and power trading.

These facts clearly rebut the change that productivity sav -- these facts clearly rebut that productivity savings have been usurped. Service can only be maintained with a growing customer base and an increase in complex environment if staff do more with less. This is what restraining OM&A has meant.

Much attention has been made of the fact that the overall annual increases Manitoba Hydro is seeking are slightly above the forecast rate of inflation. It is appropriate here to point out that while Manitoba Hydro strives to limit increases to the rate of inflation and has been very successful in doing so, there is no specific directive or constraint to hold Manitoba Hydro to limit -- to such a limit should higher increases be deemed to be warranted.

Further, it is important to recognize that should such constraint be in place, it is unlikely Hydro would ever decline to pursue a rate application as it did in the last eight (8) years -- eight (8) of the last twelve (12) years I should say.

A formal inflation cap on the increasage (phonetic) would necessitate a more aggressive approach to building up reserves in advance of adverse events whose financial implications could not be addressed subsequently through appropriate rate increases.

Mr. Anderson on behalf of MKO has noted that the Board does not have the authority to specifically deny certain capital expenditures but suggests you have the ability to do indirectly by reducing or denying the rate increases sought. Like other Intervenor, MKO has not pointed to any particular expenditure as unnecessary.

It’s extremely easy to say Hydro spent too much but we are at a loss to see where and none of the Intervenor have offered any evidence to help us. The refaring (phonetic) has been share the pain by cutting back on expenditures, dig in deeper and sharpening the pencils.

Yet no Intervener has offered specific reduc -- reductions that should be undertaken except in the most general of ways. Would any Intervener be prepared to compromise safety, reliability, efficiency or financial integrity? I think not.

The Intervenor are not the ones who have to pick up the phone in the middle of the night to find out an employee has been seriously injured or worse because we shared the pain indiscriminately and they're not the ones responsible for ensuring communities have power when temperatures reach minus 30 degrees.

Sharing the pain without -- without specific knowledge of what -- where you're going to make these cutbacks is just not reasonable.

Now I'm going to move to rate design. Manitoba Hydro's application is requesting class rate increases which reflect the degree to which class revenues currently over-recover or under-recover relative to costs. The extent of differentiation amongst classes in the rate proposals also considers the need to be sensitive to customer impacts.

For classes with RCC's less than 100 percent, class increases are proposed, which are greater than the general consumers average, and for classes with RCC's greater than -- I'm sorry, for class -- I'm going to start that over.

For classes with less than 100 percent, class increases are proposed, which are greater than general consumers average, and for classes with RCC's greater than 100 percent, less than average rate increases are proposed.

The extent of divergence by class, from general consumers average, is similar in each year covered by the Application, and was related to the degree to which the -- a class succeeds or falls short of the Zone of Reasonableness for RCC's.

For example, the rates to the residential class, which falls short of the ZOR, by about 4 + percentage points, are proposed to increase about 1 percentage more than the general consumers, four point zero one (4.01) compared to 3.0 percent in 2004, and three point five one (3.51) as compared to 2.5 percent in '05/'06.

At the other end of the scale, the general service large classes served at voltages in excess of thirty (30) kVs are above the ZOR and the rate increases proposed for them are about 1 percentage point less than the general consumers average.

Mr. Wiens noted in his direct evidence, that Manitoba Hydro has concerns with the results of the 2004 prospective Cost of Service Study, related to the treatment of export revenues; a subject I'll address shortly. But he also noted that most alternatives, which could reasonably be considered, would still show the large general service classes at the upper end of ZOR or beyond. And the reference there can be found at transcript page 1167.

Mr. Osler and Mr. Bowman, on behalf of MIPUG had suggested that there should be no rate increase to the general service large greater than one hundred (100) kV class in the years 2004/'05 and '05/'06. They have provided calculations at page 3 of their pre-filed evidence, that indicate zero (0) or negative increases would be required for the next five (5) to seven (7) years, to bring their RCC from about a 114 percent to within ZOR or unity.

Mr. Wiens advises me that the page reference isn't correct, but we won't worry about it now.

Such a conclusion is entirely dependent on acceptance of the method used in the prospective Cost of Service Study '04, to allocate export revenues.

Ms. McCaffrey recommended that that prospective Cost of Service Study be accepted by this Board and Manitoba Hydro concurs in that recommendation. Alternative approaches such as the rec -- recommendation of NERA would result in an RCC level for this class still at or slightly above the ZOR, but which is amenable to realignment within five (5) to seven (7) years, with lower than average rate increases in the order of magnitude proposed in Manitoba Hydro's Application.

One (1) such approach is shown in Manitoba Hydro's rebuttal evidence at page 17.

On the other hand, Mr. Harper, on behalf of his client, CAC/MSOS is suggesting that the extent to which residential increases exceed general consumers average, need not be as much as 1 percent point -- be as much as the 1 percentage point requested in Manitoba Hydro's Application, and could be as little as half a percent.

To demonstrate this, he has provided CAC/MSOS Exhibit 12. This demonstrates that if allowance is made for the impact of uniform rates, and if it is only necessary to bring the residential class to the lower bound of ZOR, this can be accomplished in five (5) to seven (7) years, with increases over and above the general consumers average, in the order of point six (.6) to .8 percentage points.

Because the residential class is the only class of any size with RCC's less than 100 percent, it is likely not possible to reduce the RCC's of those classes, which are above 100 percent, even into ZOR, without also raising the residential class to near unity.

Mr. Harper agreed during cross-examination by Ms. Fernandez, at transcript page 2205, that residential class increases would have to be well above 1 percentage point over and above the general consumers average, to move to unity within five (5) to seven (7) years.

To conclude on this matter, the extent to which rate increases proposed for individual classes of service, diverge from the overall average, is intended to reflect both meaningful progress in terms of aligning revenue with costs, and sensitivity to customer impacts.

In light of all the evidence provided to this Panel, no Intervenor has been able to demonstrate that the differentiation proposed in this Application is not reasonable, or that any alternative proposed by the Intervenors is more reasonable.

In developing rates to achieve the revenue requirement for each class, Manitoba Hydro has emphasized the run-off block in the case of the residential and general service small classes and the energy charges in the case of the other general service classes.

Customer charges, first-block rates and demand charges have not been increased as much as energy charges and, in some cases, have not been increased at all. This type of design is intended to move toward the achievement of another key objective: Pricing the most sensitive parts of usage more closely to the marginal cost associated with usage.

This is in keeping with the general objective of encouraging conservation and efficient use of electrical energy. No Intervenor has objected to the emphasis on run-off blocks and energy charges in rate design for the individual classes. Mr. Harper, on behalf of CAC/MSOS has indicated support for the rate design approach insofar as it affects the residential class.

Manitoba Hydro believes that this approach sends the right price signal regarding the most sensitive aspects of usage and gives effect to the efficiency objective and the simplicity objective, all the while, continuing to recognize fairness and cost-recovery objectives. As such, this approach merits the Board's approval.

One Intervenor, TREE RCM is advocating Manitoba Hydro do more to encourage conservation. With respect to rate design; this Intervenor is asking the Board the direct Manitoba Hydro to file a rate design incorporating rate inversion for the residential class by 2006 and to investigate the application of similar rate design for all commercial and industrial customers.

While Manitoba Hydro believes there's a legitimate case to investigate the merits and impacts of inverted rates for all customer classes and also believes that a Board directive to implement inverted rates to the residential class by 2006 should not be issued at this time.

The Board has already directed Manitoba Hydro to study the method -- merits of inverted rates and to file a report with the Board by December 31st, 2004. This study will examine the applicability of inverted rates to all customer classes.

Until this study has been filed, its findings accepted by the board of Manitoba Hydro and an application reflecting this acceptance is filed by Manitoba Hydro with this Board, it would be premature to direct a specific course of action on inverted rates for any class of service.

I'm now going to turn to cost of service issues. The key cost of service issues reviewed during the course of these proceedings have been, first, the allocation of net export revenues to customer classes; second, the recommendation of the NERA report, particularly, its recommendation that the cost of service study should incorporate an export class and assign a fixed -- a share of fixed cost to that class and third, the impact of uniform rates on cost of service RCC results.

I'll deal with each of these issues in turn. First, the allocation of net export revenues. The choice among methods for allocation of net export revenues has significant impact on cost of service results for most classes of service. Manitoba Hydro's long standing practice in regard to the allocation of these revenues back to customer classes has been to allocate them to generation and transmission or, on the same basis as generation and transmission are allocated.

This approach gives full weight to recognition that it is these assets that are used to produce and deliver the power which is exported. As long as exports have the characteristics of a bi-product of generation that is sold at distressed prices, this approach was reasonable. However, over time exports have increased, not only in volume but in the extent to which they are sold on a firm basis as opposed to an opportunity and the unit value of these sales.

Imbedded costs are allocated to Manitoba Hydro domestic customers and are the basis of rates. But, the export markets reflect the actual value of the product, as well as the marginal cost of diverting an additional unit from the export to the domestic market. The extent to which average export prices exceed average domestic prices, now, reflects a type of economic rit.

MIPUG's witnesses have tried to make the case that the Provincial Government extracts the economic rents through water rentals; but, these water rentals are only about $3.50 per megawatt hour while the extent to which export revenues exceed the embedded cost of generation and transmission is closer to $20 a megawatt hour.

In the old days, when average export revenues were less than domestic rates, a decision by a domestic custom -- customer to consume additional energy would increase Manitoba Hydro’s revenues. Today, such a decision often decreases.

With today’s treatment of export revenues and the cost of service study, an increase in the value of electricity paradoxically would result in a reduction in domestic rates with the largest users getting the biggest reduction.

Mr. Weins’ direct evidence has shown that the persistent gap in RCC between industrial and residential classes is substantially explained by the fact that we maintain the long standing treatment of export revenues in the face of increasing market values.

It is also shown that relatively small changes in the treatment of export revenues, such as adoption of the NERA recommendations, could have a significant impact on that gap.

Finally, Mr. Wiens’ direct has shown that use of other benchmarks, such as RCC’s before allocation of export revenues and/or class relative rate advantage with other hydro electric utilities, suggests that the gap is not really as wide as it appears on the 2004 Cost of Service Study. Hence, it is timely to consider some alternative method of treating these revenues.

A key concern raised by Manitoba Hydro in this, and other proceedings, is that the current method of allocation of export revenues is contributing to inappropriately low price levels, particularly, for the largest users, where domestic revenues are often lower than short running marginal cost of supply.

Some of MIPUG's evidence is encouraging in this regard, in that it expresses an interest in pursuing pricing options which would increase the price signal on that part of consumption which is most amenable to conservation by the customer. Obviously, there could be considerable difficulty in agreeing on the details of implementation of such a concept, but if it could be achieved, it would go a long way towards addressing pricing issues insofar as efficiency is concerned.

Such rate design measures, however, do not address the question as to whether or not significant economic rents, derived from the resource endowment, are fairly distributed on the basis of usage alone. The analogy provided in Manitoba Hydro's rebuttal evidence that such allocation is analogous to Alberta Rebating its resource revenues to the petroleum users may not be 100 percent accurate, but it's directionally correct.

Recommendations such as those in the NERA report would modify this type of allocation, only slightly, but with material impact. Therefore, they merit further serious examination.

At this time, Manitoba Hydro is seeking a Board Order which recognizes that ongoing review of this subject is merited, and that the Board supports Manitoba Hydro's filing cost of service results in support of future rate applications which incorporate revised treatment of export revenues.

Mr. Jim Lazar, on behalf of TREE RCM is also seeking the Board's support to modify the treatment of net export revenues. First, he appears to concur that net export revenues should be characterized as residential revenues after the allocation of not only incremental costs associated with exports, but a full share of embedded costs.

That is, he supports the NERA recommendation regarding the creation of an export class. For those residual or net export revenues remaining, approximately $170 million in the 2003/04 Cost of Service Study, Mr. Lazar is recommending that this Board direct the credit be separated from the normal electricity rate and separated -- separately stated on each customer's bill.

He wants rates to be recovered to -- designed to recover the full allocated cost of each -- of serving each class. The export credit, to the extent it has flowed through to customers, should be a separate element on the bill, according to Mr. Lazar.

Manitoba Hydro acknowledges that such bill presentment might remind some customers that export revenues have a positive impact on their bills. But the corporation is not convinced that -- that it would -- it would necessarily provide an inducement to conserve. Moreover, large users would quickly understand that a lump sum related to consumption is little different from embedding credits in rates, as ackno' -- this was acknowledged by Mr. Lazar himself.

Customers may or may not pay attention to higher line items on their bills, with an offset for export credit. Manitoba Hydro suggests that many will simply be confused by one more element on a bill, whose current details they do not scrutinize in more than a cursory manner. It's the bottom line that counts to most customers.

Mr. Lazar is also recommending that any export credit applied explicitly on a customer's bill should be based on actual export earnings from the previous year, thus, in a drought year, like we're dealing with now, the credit would be significantly negative and the customer's bottom line bill could increase by as much as 40 percent.

This type of application would provide great revenue stability for Manitoba Hydro, but at the cost of instability in customer bills, to a degree which is likely intolerable for most customers.

Manitoba Hydro believes that the issues related to appropriate rate design and equitable allocation of export revenues are more important than whether or not they receive explicit treatment on the customer bills.

Mr. Bowmen has made comments to the effect that Manitoba Hydro may -- may have decided that Manitobans, and I'm quoting, shouldn't be able to use low cost power, because we can make more money elsewhere. And that's at transcript page 2500.

Just to be clear, nothing in the evidence Manitoba Hydro has given can, in any way, be construed to imply Manitoba Hydro does not want to sell power to any domestic customer, residential, commercial, or industrial, at reasonable rates.

However, Manitoba Hydro is charged with the responsibility for maximizing the value of its hydro generated power for the benefit of all Manitobans. Yes, we have some disagreement about how we should define cost based rates, but Manitoba Hydro has always -- has and always will be prepared to sell power to Manitoba customers at rates approved by this Board, and will always be prepared to provide those customers with the very best in customer service.

In dealing briefly with the recommendations of the NERA Report, in response to Board Order 7/03 and specifically the directive to file a study on generation and classification methods, Manitoba Hydro filed on April 1st, 2004, a study on alternatives and recommendations regarding classification and allocation of generation costs, which could comprise about 57 percent of Manitoba Hydro's costs of providing service to domestic customers.

In addition, this study dealt with a number of other issues raised in Order 7/03, those being whether or not an export class should be included as part of the Cost of Service Study, and the appropriate treatment of net export revenues in that study.

Manitoba Hydro has indicated in its response to PUB-II-3-A of this Proceeding, that it supports in principle, the recommendations provided in that study, but further analysis of the NERA recommendations, particularly the recommendation pertaining to the use of marginal supply costs as weighting factors in the classification of generation cost is required.

And it's required before these recommendations can receive final support and incorporation into the Cost of Service Studies, which are filed with this Board.

It would be premature for Manitoba Hydro to provide definitive comment on the recommendations contained in the NERA Report, until the Corporation has fully studied their impact and has obtained the direction of both Manitoba

Hydro’s executive and Board.

Manitoba Hydro is not in favour of reviewing the NERA Report in the context of a generic Hearing. I unlike Mr. Williams, am not a dreamer, and I fully expect that Manitoba Hydro will be back before this Board for another GRA in probably two (2) years time.

I would also expect that any such application will incorporate those aspects of NERA’s Report, which are ultimately adopted by the Corporation, and they can be reviewed in detail at that time.

And lastly, under cost of service, dealing with the impact of the uniform rates on Cost of Service Study results, Manitoba Hydro’s in general agreement with the evidence provided by Mr. Bowman on behalf of MIPUG.

Sections 39.2.1 and 2.2 of the Manitoba Hydro Act, serve to eliminate the concept of zones within the Province. 2.1 reads that:

> "Rates charged for power supply to a class of grid customer within the Province shall be the same throughout the Province."

2.2 reads -- this is sub B of 2.2:

> "Customers shall not be classified based solely on the Region of the Province in which they’re located, or the population density of the area in which they are

located."

It’s inconsistent with the explicit intent of the legislation to suggest that customers will accept the benefits of uniform rates for some purposes, but will look behind them to the old zones when it doesn’t suit their purposes. Zones are a thing of the past.

Residential customers on the grid are residential customers, regardless of where they reside in the Province.

MR. ROBERT MAYER: Here, here.

MS. PATTI RAMAGE: Thank you, Mr. Mayer.

Dealing with the timing of the increase, given the severe impacts of the 2003/04 drought, Manitoba Hydro believes that the minimum approved revenue requirement over the current and next fiscal years, is the $79 million, which has been requested, and which is equivalent to an increase in general consumers revenue of 3 percent, effective April 1st, 2004, and a further 2.5 percent effective April 1st, 2005.

Obviously April 1st, has long since past, and it’s not possible to implement rate increases prior to August 1st, 2004, and perhaps not until September 1st.

If the Board were to allow Manitoba Hydro’s requested increases, effective August or September, the revenue -- the revenue increase during 2003/04 would be reduced by approximately $8 to $10 million, relative to the situation that would have occurred, had the increase been effective April 1st, 2004.

Consequently, Manitoba Hydro has requested that the rates to be put in effect at the time of approval be adjusted upward in the application to permit the recovery of the full 2004/05 requested revenue increase of $28 million during the remaining months of the fiscal year.

This would result in an actual increase of 4.3 percent if August 1st and 4.8 percent if implemented September 1st.

As an alternative, Manitoba Hydro has provided evidence, and that's Exhibit MH-72, which indicates that the desired revenue could be collected over the remaining tie period in the test years by virtue of increases of 3.2 percent effective August 1st, 2004 and a further 3.4 percent effective April 1st, 2005 if they are implemented or, alternatively, 3.6 percent effective September 1st, 2004 and 3.4 percent effective April 1st, 2005 is implemented.

The increases for individual classes would have to be adjusted accordingly and those numbers are also shown in Exhibit 72. Manitoba Hydro is willing to implement an alternative arrangement along those lines if so directed by this Board.

Dealing with DSM, Mr. -- and I'm nearing the end here, Mr. Mayer, you'll be -- I see you were looking at the clock. You could maybe help me, how much time do we have here? Okay. I think we can do it.

Mr. Kuzcek on behalf of Manitoba Hydro testified that Manitoba Hydro offers one of the most aggressive and long standing commitments to DSM in Canada; that its efforts are comparable to leading edge US utilities and agencies and that Manitoba Hydro's programs exhibit best practices for energy efficient program design in today's markets.

In their pre-filed evidence, Intervenors appear critical of Manitoba Hydro not having updated the Corporation's formal DSM plan since 2001. Manitoba Hydro has testified that the decision to forego updating the formal plan was judged to have minimal negative impacts on Manitoba Hydro's energy conservation efforts.

This decision was part of a broader long-term strategic planning decision which involved undertaking a comprehensive market potential study while concurrently continuing to aggressively pursue available DSM opportunities in the marketplace, regardless of whether these opportunities were included in the 2001 PowerSmart Plan.

Mr. Kuzcek provided an extensive list of examples of such programs but, in the interests of time, I won't be repeating them.

Mr. Lazar, on behalf of TREE, advocated

Manitoba Hydro introduce the concept of hookup fees to Manitoba Hydro's DSM menu. Manitoba Hydro recognizes that there are a number of methods available to transform the market and to encourage new home builders to make energy efficient choices.

The Corporation's preference at this time is to continue to pursue what it believes is the more customer friendly approach of using codes and standards so that there is market acceptance rather than, as Mr. Kuzcek put it, ramming it down the customer's throat by using hookup fees.

I would note also that while this may -- this issue may make for interesting discussion, a hookup fee is not part of the rate for power, a fact which Mr. Lazar agreed and, therefore, respectfully, does not fall within this Board's area of jurisdiction.

Mr. Lazar also provided recommendations regarding natural gas DSM programs. Manitoba Hydro submits that this recommendation is clearly outside the scope of this Hearing -- of this electric GRA, and it's a matter more appropriately dealt with in the context of a gas hearing where the appropriate Panel is -- is in place.

I'm going to -- there's a few, sort of, miscellaneous rate options that were dealt with, the first of which was the surplus energy program. Manitoba Hydro's application to extend the surplus energy program terms and conditions is included in the application as Appendix 9.2.2.

In Order 153/03 the Public Utilities Board approved, on an ex parte basis, the extension of the surplus energy program to March 31st, 2005. In addition to obtaining final approval of Order 153/03, Manitoba Hydro is seeking approval to extend the SEP an additional two (2) years to March 31st, 2007.

This application has not been opposed by any party to this proceeding, nor has it formed any substantive part of the record of the Hearing. Manitoba Hydro, therefore, submits that the surplus energy program should be extended an additional two (2) years to March 31st, 2007.

There were also several ex parte orders -- other ex parte orders to deal with relating to the curtailable rate program --

MR. ROBERT MAYER: We have that list and that isn't in -- in issue at all.

MS. PATTI RAMAGE: Okay. Then I'll move -- the -- the last point is with respect to certain issues raised by Mr. Anderson on the -- with respect to the diesel communities and there, I simply point out that the point of diesel rates is that they be offered -- of the diesel rate structures, they be offered grid rates for the first two thousand (2000) kilowatt hours of usage a month.

As you indicated, Mr. Mayer, they're not related to cost of service by any stretch of the imagination.

One would have to be a dreamer to think that there would be an over recovery, but, if there were such an-- if there were such an over recovery, an adjustment would be made in the ensuing years.

Other matters related to diesel rates are currently being mediated and it would be imprudent to comment further on this issue at this time. However, we do urge the Board to approve the requested rate changes in the diesel zone consistent with approvals granted and applicable to grid customers.

So in summary, Mr. Chairman, this has been a comprehensive Hearing comprising of Manitoba Hydro's rate application itself, two (2) rounds of Information Requests, the presentation of expert witnesses by three (3) different Intervenor and seventeen (17) binders of materials; not to mention the eighty (80) plus undertakings filed over thirteen (13) Hearing days.

The bottom line is that Manitoba Hydro absolutely must start recovering a portion of the losses incurred as a result of the recent drought.

Manitoba Hydro submits that it has acted responsibly both in regard to management of the drought itself, to ongoing operational and capital expenditures and in the apportionment of cost to customers.

Accordingly, Manitoba Hydro requests that the PUB grant the proposed rate increases for 2004/05 and 2005/06 and with that, Mr. Chairman, I'll paraphrase what my children said this morning when I thought we were going to be done today which was, Yahoo.

THE CHAIRPERSON: Thank you, Ms. Ramage.

Mr. Peters, is there any housekeeping?

MR. BOB PETERS: I can indicate that through the good graces of our friends at Manitoba Hydro, I will circulate to all the parties and the Board members a copy of the undertaking list to correlate them to the transcript.

There is, I think, one (1) more undertaking to come and I have, perhaps, been remiss in marking two (2) of the undertakings that have been filed, filed in confidence, and I will provide exhibit numbers and circulate that through correspondence, if that suits the Board.

So, that completes my matters.

THE CHAIRPERSON: Thank you, Mr. Peters. Just a couple of comments.

Ms. Ramage, your comparison of your Hydro and Rocky speaks to the adversarial nature that seems to be part of this process. I think balancing that side of this Hearing's personality are two (2) other aspects that bond the participants; these being, cooperation and, for the most part, considerable civility.

Let us hope that we can carry forward those aspects into another Hearing at some point. I believe at the root of the views of the parties is a common appreciation of the importance of hydro to Manitoba and I think that the vigor displayed by the Intervenor is a testimony to the value of hydro to the principals.

I want to on behalf of the Board thank Manitoba Hydro, the Applicant, for the detail and cooperation in presenting your case. I want to extend particular thanks to Manitoba Hydro's counsel Ms. Ramage and Ms. Fernandez. I want to thank the members of both witness panels who have been most helpful.

I also want to thank the support personnel not only in the back row but also in the back room. I did hear that you had nicer lunches than we do and given the grilling that you've gone through, I don't deny you that.

I also want to thank the Intervenor and their representatives and witnesses and principals that attended from time to time for assisting the Board in understanding many of the issues that came before us.

I would be remiss as well of not thanking the Board advisers and staff in assisting the Board and I, particularly, want to thank Mr. Peters for guiding me in my first full Hearing which has been quite an experience.

I also want to thank the court reporter from Digi-Tran Inc. for the assistance with our daily transcription. It's been most helpful and we'll recall Mr. Anderson's suggestions with respect to getting a little bit more modern as we go forward.

I also want to thank the fellow Board members for their work to date and in the weeks to come and, in particular, draw attention to Mr. Mayer who's done double-duty for the citizens of Manitoba this year in two (2) sets of Hearings which must try the patience of a saint, I'm certain.

We will render our decisions as soon as possible, thanks again and we are done. Thank you.

--- Upon concluding at 5:12 p.m.

Certified Correct,

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Carol Wilkinson, Ms.