AVOIDING A RATE SHOCK RUSH TO JUDGEMENT

SUBMISSIONS OF THE CONSUMERS' ASSOCIATION OF CANADA (MANITOBA BRANCH) AND WINNIPEG HARVEST (THE CONSUMERS COALITION)

BYRON WILLIAMS AND KATRINE DILAY, PUBLIC INTEREST LAW CENTRE

18 JULY 2017
HYDRO'S FAILURE TO COMPLY WITH THE BOARD MANDATED METHODOLOGY FOR IFF15
COMPETING NARRATIVES

Only urgent, rate shock level increases can protect Manitoba Hydro and Manitoba ratepayers given its dramatic change in circumstances.

Only the Public Utilities Board can protect Manitoba ratepayers and the Manitoba economy against a rate shock rush to judgement which is inconsistent with:

• the methodological framework set out in PUB Order 59/16
• an assessment of Hydro’s current financial status consistent with PUB Order 59/16
• an understanding of the Public Utility Board reasoning flowing from the NFAT report, and
• a sound understanding of the industry and regulation
RECORD NUMBERS ARE EXPRESSLY RELYING ON THE PUB TO PROTECT THEIR INTERESTS

Over 2000 Manitobans have directly contacted the Public Utilities Board

Email from Darren Christle (2238), Secretary and Executive Director of the Public Utilities Board, 13 July 2017

8 intervenors

PUB Procedural Order 70/17
THE CORE ISSUE AS DEFINED BY THE PUB

What has changed in Manitoba Hydro’s Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15?

PUB letter, 9 June 2017, at p 2
KEY QUESTIONS FOR HYDRO

Why not comply with the 9 June 2017 direction of the Public Utilities Board?

Why not make 20 June 2017 submissions consistent with “Board mandated methodology for IFF15”?
THREE INTERIM RATE REALITIES FROM WHICH MANITOBA HYDRO CANNOT HIDE
REALITY 1 – THE CAPITAL COVERAGE RATIO HAS BEEN THE LONG STANDING RATIO TO MEASURE CASH FLOW

Manitoba Hydro’s consolidated target is to maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio measures the ability of current period internally generated funds to finance sustaining capital expenditures (excluding major new generation and transmission capital expenditures). A capital coverage ratio of greater than 1.20 provides sufficient cash flow from operations to fund sustaining capital expenditures and further reduces the need for debt financing. [emphasis added]
REALITY 2 – THERE IS NO EMERGENCY RELATED TO THE CAPITAL COVERAGE RATIO IN 2017/18

Foregoing any increase in 2017/18 still results in a higher capital coverage ratio for that year than forecast in IFF15

| Capital Coverage Ratio (Updated IFF16- with 3.36% increase August 1, 2016) |
|-----------------|---------------|---------------|---------------|---------------|---------------|---------------|
| 2017/18 – 0%    | N/A           | 1.33          | 1.37          | 1.35          | 1.74          | 2.18          |
| After - 7.9%4   |               |               |               |               |               |               |
| 2017/18 – 1.6%  | N/A           | 1.36          | 1.43          | 1.40          | 1.81          | 2.25          |
| After - 7.9%5   |               |               |               |               |               |               |

Appendix 3.7
REALITY 3 – THERE IS NO EMERGENCY RELATED TO NET INCOME IN 2017/18

### 2017/18 Net Income Results

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MANITOBA HYDRO'S INTERIM RATE SUBMISSION IS NOT CONSISTENT WITH THE “BOARD MANDATED METHODOLOGY FOR IFF15”? 

A radical re-imagining of cash flow concepts for a regulated public utility

20 June 2017 Interim Submission of Manitoba Hydro at p 4 as well as Tab 2, p 15-20 of its Application

New and aggressive financial target achievement dates

20 June 2017 Interim Submission of Manitoba Hydro at p 22

Inconsistency with Board accounting directives
AN ADVERSE INFERENCE CAN BE DRAWN

Open to the Board to draw an adverse inference:

Hydro cannot credibly argue for an 7.9% interim rate increase based upon the Board mandated methodology for IFF15
DECISION-MAKING CONTEXT FLOWING FROM LEGISLATION AND PAST ORDERS
JUST AND REASONABLE RATES REQUIRE CONCLUSIONS BASED ON RELIABILITY AND NECESSITY

Fix Just and Reasonable Rates for Service

The Public Utilities Board Act, s 77(1),

Crown Corporation Public Review and Accountability Act, s 25(1)(2)

Sufficient funds to recover necessary expenses and reserves taking into account compelling policy considerations

Crown Corporation Public Review and Accountability Act, s 25(4)(a) i) v) viii),

The Manitoba Hydro Act, s 39 1) a)
JUST AND REASONABLE RATES REQUIRE CONCLUSIONS BASED ON RELIABILITY AND NECESSITY

- Ensuring that forecasts are reasonably **reliable**
- Ensuring that actual and projected costs incurred are **necessary** and prudent
- Assessing the reasonable revenue needs of an applicant in the context of its overall general health
- Determining an appropriate allocation of costs between classes; and
- Setting just and reasonable rates in accordance with statutory objectives.

PUB Order 5/12 at p 27 and PUB Order 98/14 at p 28, 29

The PUB is not in a position to make a judgment call on reliability of estimates or necessity of expenditures at the interim rate stage
SHIFTING NUMBERS AND MALLEABLE METRICS MAKE JUDGMENTS ON SUFFICIENCY, NECESSITY AND PRUDENCE VERY CHALLENGING

• Regulatory reality since 2010 has been rapidly shifting and *materially unreliable* forecasts and cost estimates
• NFAT hearing saw a cacophony of fast shifting forecasts and assumptions
• Pace of changing forecasts and estimates since the NFAT has continued
• The regulatory challenge has been compounded by the malleable cash flow metric deployed for the first time in the 2017/18 General Rate Application

*Can there be a "just and reasonable rate" based on untested assumptions and metrics that are materially shifting?*
JURISDICTION AND PROCESS IN MAKING ORDERS

Power to order partial or other relief

44(1) Upon any application to it, the board may make an order granting the whole or part only of the application or may grant such further or other relief in addition to or in substitution for that applied for, as fully and in all respects as if the application had been for such partial, further or other relief. [emphasis added]

Interim order

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

Orders involving expense to parties to be after notice and hearing

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

Noting the exception for urgency, s 48 underscores the importance of hearing both sides of the story before rushing to judgement.
ORDER 59/16 - CONSIDERATIONS RELATING TO NET INCOME, RATE SHOCK AND EMERGENCY

Test Year
no additional revenue needed for positive net income in test year
therefore Company has not made a *prima facie* case for rate increase to flow to revenues

Beyond Test Year
looking beyond test year, contribution to BIPOLE III Deferral Account given rate shock concerns

Unforeseen or Emergency Situations
not prepared to consider future interim rate applications unless warranted by unforeseen or emergency situations
ORDER 59/16 - IMPORTANCE OF ACCOUNTING CONSIDERATIONS

IFF15 did not completely comply with the accounting directives issued by the Board in Order 73/15

Over the long term, compliance with accounting directives would reduce equal annual rate increases required to achieve debt/equity 75/25 by 2033/34

The PUB has made it clear that it expects its accounting directives to be complied with for the purposes of interim rates
ORDER 49/14 - WOULD THERE BE DELETERIOUS EFFECTS TO HYDRO IN ABSENCE OF A RATE INCREASE?

Note non urgent situations considered during very lengthy 2010-12 GRA Interim rate orders are intended to relieve Manitoba Hydro from the deleterious effects caused by the length of a regular regulatory proceeding. The questions to be determined by this Board are whether it would be reasonable to grant interim rates, and whether Manitoba Hydro would suffer a deleterious effect in the absence of a rate increase. [emphasis added]
INTERIM RATE APPLICATIONS MATERIALLY DISADVANTAGE INTERVENERS – ESPECIALLY GIVEN HYDRO’S CREDIBILITY CHALLENGES

No opportunity to produce evidence within the meaning of s. 48 of the Act or to meaningfully test Hydro's evidence

The Board shares the Interveners' concerns that interim applications ought not be the 'norm' for Manitoba Hydro. Interim rate applications do not offer the same level of public review as General Rate Applications.

Material credibility challenges have been identified in recent Orders:
• Operating, Maintenance and Administrative Expense
• Load forecast for Top Consumers
• Export prices
• Finance Expense
• Capital Costs

Board Order 59/16, p 22, 37, 38, 16, Board Order 73/15, p 66,
See also generally the UMS Report, Tab 5, Appendix 5.1,
UNTESTED METHODOLOGICAL CHANGES SHOULD NOT DRIVE THE INTERIM RATE PROCESS

Financial forecast and interim rate application heavily dependent upon:

- material changes to the methodology for estimating domestic load and export revenues

- a radical re-imagining of cash flow concepts for a regulated public utility

20 June 2017 Interim Submission of Manitoba Hydro at p 4 as well as Tab 2, p 15-20 of its Application

- new and aggressive financial target achievement dates

Manitoba Hydro June 20, 2017 submission, page 22

Meaningful testing requires discovery, cross examination and competing expert analysis

Manitobans need to hear differing perspectives and to have their informed voices heard by independent decision-maker
THE COALITION'S ANALYTIC FRAMEWORK FOR INTERIM RATES
THE CONSUMER COALITION ANALYSIS RELIES ON PUB DIRECTIONS

What has changed in Manitoba Hydro’s Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15?

PUB letter, 9 June 2017, at p 2
QUESTION 1 - HAS MANITOBA HYDRO MADE A PRIMA FACIE CASE FOR AN INTERIM RATE INCREASE CONTRIBUTING TO 2017/18 REVENUES?

Is Hydro likely to face an “emergency” situation in the absence of a rate increase, taking into account:

• the projected cash flows for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16; and
• the projected net income levels for the 2017/18 year based on the Board mandated methodology for IFF15 as approved by Order 59/16

More colloquially,
• does Manitoba Hydro finds itself in emergency adverse circumstances not contemplated by the PUB at the time of Board Order 59/16 or the 2014 NFAT hearing?
QUESTION 2 - WILL THERE BE A MATERIAL “DELETERIOUS” EFFECT IN THE ABSENCE OF A RATE INCREASE JUSTIFYING A CONTRIBUTION TO THE BIPOLE III DEFERRAL ACCOUNT?

What has changed in Hydro’s Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15 over the short, medium and long term?

Have Manitoba Hydro's interim rate submissions complied with the 9 June 2017 direction of the PUB to apply the Board mandated methodology?

What are the trade-offs between weaning Manitoba Hydro off its unhealthy addiction to interim rate applications versus future rate smoothing?

The Consumer Coalition’s response to Question 2 will take into account:

• ongoing challenges with Hydro’s credibility
• the untested nature of Hydro's evidence, and
• rate shock considerations
THE BURDEN OF PROOF
HYDRO'S BURDEN OF PROOF

The burden of proof to show that any such increases, changes, or alterations are just and reasonable is upon the owner seeking to make the increases, changes, or alterations

PUB Act, at s 84(2)
HAS MANITOBA HYDRO DEMONSTRATED IT IS LIKELY TO FACE AN "EMERGENCY" SITUATION IN THE ABSENCE OF A RATE INCREASE?
RESPECTING THE 9 JUNE 2017 DIRECTION OF THE PUB

“Manitoba Hydro's interim rate submission be focused on what has changed in its Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15.”

Public Utilities Board, 9 June 2017 letter to Manitoba Hydro and Interveners of record
THE CAPITAL COVERAGE RATIO IS THE REGULATOR'S APPROVED CASH FLOW MEASURE

Manitoba Hydro’s consolidated target is to maintain a capital coverage ratio of greater than 1.20. The capital coverage ratio measures the ability of current period internally generated funds to finance sustaining capital expenditures (excluding major new generation and transmission capital expenditures). A capital coverage ratio of \textbf{greater than 1.20 provides sufficient cash flow} from operations to fund sustaining capital expenditures and further reduces the need for debt financing. [emphasis added]

Manitoba Hydro, 2015/16 General Rate Application, Tab 3, p 15
A $162 million difference based upon a malleable metric as compared to the approved metric

| Schedule 1: Capital Expenditures Included in Capital Coverage Calculation ($M) |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| IFF16                           |                 |                 |                 |                 |                 |                 |                 |
| MH Interim Rate Submissions – Revised Metric | 664             | 668             | 685             | 669             | 654             | 632             | Tab 2, Fig. 2.6 |
| MH Capital Coverage Ratio       | 529             | 526             | 517             | 516             | 511             | 499             | PUB MFR 17 Fig. 4 |
| IFF16-Updated                   |                 |                 |                 |                 |                 |                 |                 |
| MH Revised Cash Flow Metric     | N/A             | 688             | 709             | 689             | 674             | 652             | PUB MFR 51 - Updated |
| MH Capital Coverage Ratio       | N/A             | 526             | 517             | 516             | 511             | 499             |                 |

Note: The 11 July 2017 Update did not include updated values for 2016/17
HYDRO RELIES ON ITS MALLEABLE METRIC TO TRY TO MAKE ITS CASE

Manitoba Hydro claims that “the most fundamental and compelling reason for Manitoba Hydro’s proposed and indicative rate increases, as contemplated in its current financial forecast, is the need to increase the level of the Corporation’s cash flow”.

Manitoba Hydro Interim Rate Submission, 20 June 2017, p 4
CASH FLOW BASED UPON THE APPROVED METRIC IS IMPROVED AND ABOVE TARGET IN 2017/18

Capital Coverage Ratio (Based on IFF16 Updated) Source Appendix 3.7

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<td>N/A</td>
<td>1.33</td>
<td>1.37</td>
<td>1.35</td>
<td>1.74</td>
<td>2.18</td>
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<td>N/A</td>
<td>1.36</td>
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<td>1.81</td>
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<td>2018 - 3.36% After – 7.9%</td>
<td>N/A</td>
<td>1.40</td>
<td>1.48</td>
<td>1.47</td>
<td>1.88</td>
<td>2.34</td>
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<td>N/A</td>
<td>1.49</td>
<td>1.63</td>
<td>1.64</td>
<td>2.07</td>
<td>2.56</td>
<td>Appendix 3.6</td>
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Note: The 11 July 2017 Update did not include updated values for 2016/17

Based on the Updated IFF16, Manitoba Hydro’s capital coverage target would be met even if there was no interim rate increase approved
### THERE IS NO EMERGENCY IN TERMS OF 2017/18 NET INCOME

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COST OVERRUNS AND REVENUE SHORTFALLS WERE ANTICIPATED

The construction of new generation and associated transmission facilities will add to and prolong these rate increases. Furthermore, construction costs will most likely grow and revenue projections may not be achieved. This gap between rising costs and unrealized revenues will be borne by ratepayers.

NFAT Report, 20 June 2014, p 252

THE NEED FOR MITIGATION ALSO WAS ANTICIPATED

• using incremental capital taxes and water rental fees from the development of the Keeyask Project to mitigate adverse rate impacts on vulnerable consumers
• taking internal actions to moderate rate increases; and
• relaxing Hydro's 75/25 debt-to-equity ratio policy to moderate its proposed electricity rate increases.

NFAT Report, 20 June 2014, p 252

Manitoba Hydro's current financial situation was not unforeseen. It was specifically contemplated in the family of PUB decisions reaching from the NFAT Report to Order 59/16.
NO BASIS FOR AN EMERGENCY INTERIM INCREASE TO BOLSTER 2017/18 CASH FLOW OR NET INCOME

Capital coverage target ratio is forecast to be exceeded for 2017/18 even with no interim rate increase

Forecast net income for 2017/18 is positive even with no interim rate increase
THE CURRENT BEST ESTIMATE FOR WATER CONDITIONS IS IFF16-UPDATED

Manitoba Hydro has made no claims/case that the forecast reservoir levels underpinning its 2017/18 outlook (which is based on current information regarding reservoir levels and water flow conditions) are not the best forecast available for forecasting 2017/18 financial results.
ASYMMETRIC ANALYSIS OF RESERVOIR LEVELS COMPARED TO EXPORT PRICES

The revised export price forecast (again based on the best information currently available) more than offsets the favourable impact of the higher water flows.

Manitoba Hydro Interim Rate Submission, 20 June 3027, p 18, Figure 9
HAS MANITOBA HYDRO DEMONSTRATED A MATERIAL DELETERIOUS EVENT JUSTIFYING A CONTRIBUTION TO THE BIPOLE III DEFERRAL ACCOUNT?

What has changed in Manitoba Hydro’s Integrated Financial Forecast since the Board issued Order 59/16 based on the Board mandated methodology for IFF15 over the short, medium and long term?

Have Manitoba Hydro’s interim rate submissions complied with the 9 June 2017 direction of the PUB to apply the Board mandated methodology?

What are the trade-offs between weaning Manitoba Hydro off its unhealthy addiction to interim rate applications versus future rate smoothing?

Taking into account:

• ongoing challenges with Hydro’s credibility
• the untested nature of Hydro’s evidence, and
• rate shock considerations
ANY ANALYSIS OF WHAT HAS CHANGED MUST CONSIDER HYDRO'S CREDIBILITY CHALLENGES AND THE INTERIM NATURE OF THE HEARING?

The Consumers Coalition places limited reliance on Hydro’s forecasts of costs beyond the test year given:

• unreliable forecasting practices of the past,
• malleable metrics used in the interim rate application, and
• material methodology changes

Given the malleable metrics employed in the interim rate submission there is no basis to conclude that the approach of the current leadership of Manitoba Hydro will be any more reliable
IN THE TEST YEAR, THINGS HAVE IMPROVED

In all cases (even where there is no interim rate increase for 2017/18

• the projected net income for 2017/18 now exceeds the 2017/18 forecast income in the IFF15 scenarios, including the one which Board Order 59/16 is based
LONG TERM FORECAST IN IFF16-UPDATED REPUDIATES THE REQUEST FOR 7.9%

Based on IFF16-Updated achieving a 25% equity ratio by 2033/34 would require 4.05%/annum.

PUB MFR 73 – Updated
(the same date used by the Board in its assessment of IFF15 and the need for an interim rate increase effective 1 April 2016)
ASYMMETRIC ARGUMENTS DO NOT DEMONSTRATE THAT THE PREVIOUS RATE PLAN IS UNTENABLE

The same underlying market/global conditions that underpin the lower load forecast and export price outlook have also reduced forecast interest rates in (at least) the near term.

The forecast Operation, Maintenance and Administration cost reductions are also assisting.
APPLYING THE COALITION'S INTERIM RATE ANALYSIS
NO CREDIBLE CASE FOR 7.9% GIVEN THE SCOPE OF THE 9 JUNE 2017 LETTER

Preemptive strike before Manitoba consumers and intervenors have had opportunity to hear competing evidence or share their views based on evidence

Effectively accepts a rate shock application based upon non-approved and untested methodological changes

Inconsistent with the direction of the 9 June 2017 letter of the Board
3.36 TO 4.05 CONSIDERED UNREASONABLE

Range generally consistent with the PUB Interim Order 59/16

But:

• IFF16-Updated suggests significantly stronger test year results in terms of capital coverage ratio and net income than IFF15

• No emergency has been demonstrated

• Material changes in Hydro's forecasting methodology and metrics exacerbate credibility challenges

• Hydro did not comply with Order 59/16

• Hydro did not comply with 9 June 2017 letter of Board
1.6% INFLATION CONSIDERED

• inflation is a relatively objective measure of some cost pressures
• based on the IFF16 Update, Manitoba Hydro forecasting $109 Million in net income
  • (even using Manitoba Hydro’s treatment (Expensed) of the amortization of the ELG/ASL difference and
capitalized overheads rather than the Board’s treatment)

• no credible evidence to argue that Hydro has or will be in an unforeseen or emergent situation by
time final GRA Order issued

But:
• IFF16-Updated suggests significantly stronger test year results in terms of capital coverage ratio
  and net income than IFF15
• Material changes in Hydro's forecasting methodology and metrics exacerbate credibility
  challenges
• Hydro did not comply with Order 59/16
• Hydro did not comply with 9 June 2017 letter of Board
0% RECOMMENDED

- Full rate hearing process is well underway and any delays in initiating process are the sole responsibility of Manitoba Hydro
- No urgency or emergency has been demonstrated
- Manitoba Hydro's capital coverage target for 2017/18 would be met even if there was no interim rate increase (Updated IFF16)
- $92 Million in net income forecast in 2017/18 even without a rate increase (Updated IFF16)
- Hydro did not comply with past PUB directives to avoid interim rate increases and get its regulatory house in order
- Credibility challenges exacerbated by material changes in Hydro's forecasting methodology and malleable approach to metrics
- Hydro's interim submissions and forecasts for 2017/18 not in compliance with the directive found in the PUB Letter of 9 June 2017
- Long term interests of consumers best served by testing Hydro's application in a full process before granting any demonstrably necessary rate increase
RECOMMENDED FINDINGS - ADEQUACY OF CASH FLOW TO FUND CURRENT OPERATIONS

the approved target for cash flow is the Capital Coverage ratio

the application of a revised form of cash flow target ("CFO to Capex") is not consistent with the Board mandated methodology for IFF15 as approved by Order 59/16.

based on the Updated IFF16, there is a $162 million difference between the revised cash flow calculation based on CFO to Capex and the Capital Coverage ratio results

applying the Board-mandated methodology for IFF15 as approved by Order 59/16, Manitoba Hydro does not face an emergency issue in terms of the adequacy of cash flow to fund current operations;

based on the Updated IFF16, Manitoba Hydro's capital coverage target for 2017/18 would be met even if there was no interim rate increase approved;
RECOMMENDED FINDINGS - FORECAST OF 2016/17 AND 2017/18 RESULTS

the Manitoba Hydro forecast for 2016/17 results filed in support of its interim rate application does not comply with the “Board mandated methodology for IFF15”

the Manitoba Hydro forecast for 2017/18 results filed in support of its interim rate application does not comply with the “Board mandated methodology for IFF15”

based on the Update IFF16, Manitoba Hydro is looking at $92 Million in net income in 2017/18 even without a rate increase and $109 Million in net income based on a 1.6% rate increase even using Manitoba Hydro’s treatment (Expensed) of the amortization of the Equal Life Group/Average Service Life (ELG/ASL) difference and capitalized-overheads rather than the Board’s treatment

the water flow forecast underpinning Manitoba Hydro’s 2017/18 outlook is the best forecast currently available for the purposes of forecasting 2017/18 financial results

there is no prima facie case based on recent actual results or projected 2017/18 results for an interim increase.
RECOMMENDATIONS

No interim rate increase be granted

Manitoba Hydro be directed to present a proposal to the Public Utilities Board and to Manitoba consumers by no later than 1 May 2018 to bring its regulatory house into order and end its unhealthy addiction to interim rate increases