2017/18 & 2018/19 ELECTRIC GENERAL RATE APPLICATION

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Manitoba Hydro to provide the written notes for Mr. Riley’s presentation filed in PUB MFR 71

Response:

Please see the attached speaking notes.
PUBLIC INFORMATION SESSIONS

DRAFT OCT 18

Date: Tuesday, October 18, 2016
Time: 7:00 – 9:00 pm
Location: Victoria Inn Hotel
1808 Wellington Ave., Winnipeg, MB

H. Sanford Riley
Chair, Manitoba Hydro-Electric Board
Thanks Scott. Good evening everyone. I want to start by thanking all of you for taking the time to come out and discuss a subject that, in my opinion, is of importance to all of us in this province – Manitoba Hydro’s future.

I’m going to take the next few minutes to provide some background on the Board’s review of Manitoba Hydro, our decision to proceed with Bipole III and the financial challenges that are facing the company. Then Kelvin Shepherd, will talk about the next steps Manitoba Hydro must take in the months ahead and what that means for our customers and indeed all Manitobans as we move into the future.
Back in May, the government of Manitoba asked the Board to review the Bipole III project. Very quickly we realized the situation with Manitoba Hydro was much more serious than expected. So, we expanded our review to include other major projects, such as Keeyask, and the corporation’s financial situation.

We also realized we needed help to assemble, organize and interpret the data we were working with. So, shortly after we started this process we retained the Boston Consulting Group, a leading management consult, to assist us in this review. I believe copies of their report are available at the back of this room.

SLIDE 3: Provincial Map showing BP I, II, and III

To give you a bit of background on the projects the Board reviewed: the Bipole III Transmission Project is a 1,300 kilometre High-Voltage Direct Current Transmission Line that will run from the Keewatinohk Converter Station,
about 40 kilometres east of Gillam, Manitoba, down the west side of the province, before cutting back towards Winnipeg and terminating at the Riel Converter Station, just east of the city. Bipole III is being developed to provide additional reliability to Manitoba Hydro’s Direct Current Transmission system, by providing an alternate path for electricity from northern generating stations to flow to southern Manitoba.

SLIDE 4: Provincial Map Keeyask and other GS

The Keeyask Generating Station, located just upstream from the existing Kettle Generating Station near Gillam, is being developed by Manitoba Hydro in partnership with four northern First Nations — Tataskweyak Cree Nation, War Lake First Nation, York Factory First Nation, and the Fox Lake Cree Nation — through the Keeyask Hydropower Limited Partnership.
At 695 megawatts, Keeyask will be the fourth largest generating station in our system.

So, after an in-depth study, what did the Board conclude?

**SLIDE 5: Key Findings and Conclusions — Bipole III**

We concluded that there is no choice but to move ahead with the completion of Bipole III on its current west-side route. It is urgently needed to protect Manitobans from the very real risk of blackouts that would result from a failure of the current Bipole I and II lines, which run side-by-side through Manitoba’s Interlake.

The risk of failure of these two lines — or the Dorsey Converter Station, where they both terminate — because of a weather disruption, forest fire or other natural catastrophe, is very, very real. In fact, it has already happened.
In 1996, a major storm brought down 19 towers on both Bipole I and II during the month of September. Fortunately, the fact it occurred during our shoulder season, with minimal heating load and demand on the system, is the only reason electrical service was maintained during that emergency.

SLIDE 6: Key Findings and Conclusions — Bipole III

Today, with much higher electrical demand and usage, it is quite likely that a similar incident would result in rolling blackouts for days or weeks until the lines could be repaired. If Dorsey was damaged, it could be months before normal service is restored. We simply could not import enough energy over our existing transmission interconnections to keep the lights on over that period. More than 70 percent of all electricity generated in Manitoba flows down these two lines to Dorsey — a situation that the Boston Consulting Group — called the
largest single risk exposure of any utility they had seen in North America.

This growing gap has heightened the consequences and impacts of a failure on the existing HVDC lines. Without Bipole III, an extended failure of Bipole I and II could result in up to $20 billion in societal impact — an unacceptable risk that could do permanent damage to our provincial economy.

**SLIDE 7: Key Findings and Conclusions — Bipole III**

Bipole III is also required to carry the additional electricity that will be generated by the Keeyask Generating Station.

Bipole I and II are largely maxed out in terms of capacity. Without Bipole III, it simply is not possible to carry all the power from Keeyask to southern Manitoba to be fed into our provincial grid. Power from Keeyask would
effectively be stranded, creating an even larger financial problem, as Keeyask will generate significant revenue for Manitoba Hydro once it enters service. If you cancel both projects the implications are enormous. You are looking at approximately $7 billion dollars spent without any functioning assets to show for the money. That’s just not a palatable option.

SLIDE 8: Key Findings and Conclusions — Bipole III

The review clearly showed that the east side route for Bipole III was the most favourable option. Though it was not formally assessed, it is estimated that going down the east side would have saved Manitobans an additional $900 million. The line is clearly shorter and doesn’t require a complete navigation around Winnipeg. However, Manitoba Hydro was directed not to pursue the east side routing by the previous government.
We concluded it was not economically viable or practical to change Bipole III’s route at this point, given the advanced stage of construction.

To date, $2.9 billion has been spent or committed; 95% of the contracts for the project are in place; and it would cost another $1 billion to cancel the project. And most importantly, it would still leave our province exposed to the significant risk of an extended, major outage.

**SLIDE 9: Findings and Conclusions — Bipole III**

The review also identified that there is a risk of Bipole III not meeting its target completion date or budget, with a potential delay of between 12 and 15 months and a potential cost increase from the current budget of $4.65 billion to between $4.9 and $5 billion.

**SLIDE 10: Key Findings and Conclusions — Keeyask**
Regarding Keeyask, the Board concluded that while Keeyask’s energy won’t be needed by Manitobans until 2027 at the earliest — and quite possibly later — the project should be completed without delay.

Determining the exact timing of Manitoba’s need is dependent on a number of factors, including ongoing economic growth, the addition of major loads — industrial customers, for example — and future effectiveness of Demand-Side Management efforts.

However, the need will eventually be there — this we know. And Keeyask is a virtually carbon-free, long-term source of renewable energy that will last well into the next century. $2.1 billion has already been spent on the project, and cancelling it at this stage would cost at least another $1 billion in addition to other risks that would be difficult to manage.
And, because valuable long-term export contracts worth $4.5 billion in revenues are already in place for the majority of power from Keeyask, there is an upside to completing the project.

Now, I want to take a moment here to address the confusion around export prices. You may hear that export prices are falling. And that is in fact, true — especially for short-term, opportunity sales on the spot market. This is energy that is only available when water flows are above average. The other option for this water in high flow years is to simply open the spillways and dump it downstream, and generate no revenue with it. Or Manitoba Hydro can run it through their turbines at virtually no incremental cost, and sell it on the opportunity market, and create an important revenue stream for the company.

But, through our review, the Board clearly found that long-term, firm power sales which have been entered
into at premium pricing levels, make economic sense for Manitoba Hydro.

So, where it makes sense to do so, Manitoba Hydro should continue to grow that firm export market.

**SLIDE 11: Key Findings and Conclusions — Keeyask**

Finally, the review identified that Keeyask is also at risk of not being completed as originally scheduled, with a potential delay of between 21 and 31 months. There is also a risk that the budget for Keeyask could rise from the current control budget of $6.5 billion to between $7.2 and $7.8 billion.

**SLIDE 12 — Key Findings and Conclusions — Finances**

We started this process focused on the decision to build Bipole II but quickly concluded that Bipole III was not the main issue facing hydro, but a side issue - if you can say
that a $900 million mistake is a side issue. By far the more significant problem is the fact that the decision by the previous Board to undertake these two projects at the same time is having a significant, and in our judgment and unacceptable impact on Hydro’s financial situation, with serious knock on consequences for the Province of Manitoba.

Manitoba Hydro's debt is expected to grow from its current level of $13 billion to $25 billion within the next three to four years. That’s an extraordinary increase and a significant concern.

This Board, looking at Manitoba Hydro’s finances from the perspective of their considerable business and financial backgrounds, considers Manitoba Hydro’s debt/equity ratio a major problem that needs to be fixed.

**SLIDE 13 — Key Findings and Conclusions — Finances**
The chart you see on the screen shows projections for Manitoba Hydro’s debt-equity ratio as we move forward with completing these projects. Debt-equity was already forecast to fall to an 88% debt to 12% equity scenario — potentially degrading to 9% equity — a very low level by any measure. In a worst case scenario, such as a prolonged drought, you can see that equity measure goes even lower —below 5%.

SLIDE 14 — Key Findings and Conclusions — Finances

As this comparison chart shows, Manitoba Hydro is out of step with other crown and private utilities across North America.

The board believes these equity levels are too low to manage known and expected risks. Risks like drought, and the resulting low water flows and reduction in hydro generation. Simply put, we have no cushion to absorb what Mother Nature will — at some point — throw at us.
It’s not much different than the equity you build up by paying the mortgage on your home. If something unexpected happens – say, your car breaks down and you need a new one – a bank is far more likely to lend you the money to buy that car if you’ve built up sufficient equity in your home.

If, however, you’ve also just taken out a big loan to buy a new cottage and a new boat, the equity in your home may not be sufficient relative to your debt. That bank may not give you that loan or it will but at a much higher interest rate.

Manitoba Hydro is no different. The numbers are much bigger, but the principles are the same. If we don’t have a sufficient equity base and something unexpected happens, like the drought we saw back in 2004, we have no cushion.
Manitoba Hydro’s debt is also putting an enormous strain on the credit capacity of the Province.

Manitoba Hydro borrows on the credit of the government of Manitoba. And, up until now, credit rating agencies have looked at the Province’s debt as separate from Manitoba Hydro’s debt. They do this because they view Manitoba Hydro as self-sustaining. That means, the rating agencies think Manitoba Hydro has sufficient equity and the capacity to generate sufficient revenues to support its operations.

However, when rating agencies make the decision that Manitoba Hydro is no longer self-sustaining, then they
will look at all of the debt together, the Province of Manitoba’s and Manitoba Hydro’s.

What you see in this chart, is the debt of Manitoba Hydro growing from $13 billion to $25 billion -- almost 50% of the total debt for the Province of Manitoba. The total combined debt climbs to nearly $50 billion and, more importantly, that debt as a percentage of Gross Domestic Product climbs from 35% to 60%.

That puts Manitoba among the worst in this country.

Now, you may ask, why does that matter? Well, it matters because we are borrowing $50 billion and if rating agencies downgrade the Province’s credit rating, the cost of borrowing goes up. If we see the cost of borrowing increase by just 1%, that’s another half-a-billion dollars in borrowing costs. That’s half-a-billion
dollars that could be used to finance schools, hospitals etc, that is now being used to service debt.

This is why we, as a Board, believe action is required. We need to ensure this doesn’t happen.

I want to point out that this didn’t happen overnight. A combination of 10 years of low rate increases, coupled with increasing borrowing to support major projects and infrastructure renewal, have led us to where we are today.

**SLIDE 16 — Key Findings — Policy & Regulatory**

But there are other reasons Manitoba Hydro finds itself in its current position. Our review revealed Manitoba Hydro currently has conflicting objectives – things that can’t all realistically be achieved.
So, what are the right measures of success?

- Is it the lowest electrical rates for residential consumers...or for industry...or both?
- Is it all about providing a reliable energy supply?
- Is it economic development in the north?
- Employment?
- Or earning a return on investment?

SLIDE 17 — Key Findings — Policy & Regulatory —
Government Objectives

The need for clarification also extends to clearly defining government objectives for Manitoba Hydro.

We currently generate over $350 million in revenues for government, through water rental fees, debt administration and capital taxes.
At the same time, legislation encourages low electricity rates. We are seen as an economic engine for development. We are also seen as a major tool in achieving climate change and environmental goals. And, in a world where other jurisdictions in Canada and aboard are searching for ways to reduce their carbon footprints, we are seen as a potential solution for their problems, which could in turn generate economic benefits for Manitobans.

Which is most important? And is this clearly articulated, either in legislation or in government policy?

99% of electrical energy created in Manitoba is non-greenhouse gas emitting, but hydroelectric development does carry other environmental and social costs, sometimes disproportionately impacting our Indigenous communities. How should those costs be addressed?

Then there is social policy. For example, how does the government want to go about protecting low income or those without access to lower cost natural gas heating
from increasing electrical rates? Should this be the responsibility of Hydro, or could it be more effectively met through other measures and programs?

These are questions we need to answer to put Manitoba Hydro on an effective path going forward. This corporation can no longer be all things to all people.

**SLIDE 18 — Key Findings — Regulatory Framework**

Our review also identified that the regulatory framework within which Manitoba Hydro operates could be improved. Take, the Public Utilities Board and how rates are set, for example.

In most other jurisdictions, rates are set based on achieving a regulated return on investment – that means if a utility spends X amount of dollars, rates are set to ensure that investment is recovered plus a guaranteed return or profit on that investment. That profit can be
reinvested into the company providing financial stability and building up the equity cushion needed to provide adequate protection against risks.

The current framework in Manitoba promotes setting rates to recover costs – but there is no “return on investment” or profit motive for Manitoba Hydro.

While some argue that may be appropriate for a crown corporation, the current circumstance that Manitoba Hydro and the Province find themselves in is to the contrary. The current approach to regulations has clearly not encouraged maximum capital efficiency, or the consideration of a full view of financial risks, particularly when it comes to large capital projects.

Under the current model, Manitoba Hydro is always playing catch-up. The company makes the investments needed to maintain a reliable energy supply then goes to the regulator hoping to get the rate increases needed to
cover the cost of that investment – after the money is already spent or committed to be spent. If the regulator chooses not to approve the full amount of those requested increases, Manitoba Hydro’s financial situation deteriorates further. Is this how rates should be set here in Manitoba?

SLIDE 19 — The Board’s focus going forward

So, as you can see there are a lot of questions that need to be answered. Getting those answers -- setting clear objectives and establishing an appropriate regulatory framework for Manitoba Hydro -- will be the focus of this Board going forward. We will need to work with government, regulators and you, the public, to set our clearly what Manitoba Hydro should be.

Now, it took a long time to get Hydro into the position we find it today and it will take a fair amount of time to get it back to where it needs to be. However, as a Board, we are already working with Kelvin and his leadership
team to develop a plan that will put Manitoba Hydro on the path to financial stability – ensuring that it continues to effectively serve the energy needs of Manitobans.

That plan will need to be balanced in its approach – Manitoba Hydro, taxpayers and ratepayers will all need to contribute to the solution. For Manitoba Hydro, it means some significant reductions in costs and a renewed focus on successful completion of the major projects. For taxpayers, it probably means a significant equity investment to strengthen the corporation’s balance sheet. And, for ratepayers, it likely means rate increases substantially higher than the 3.5% to 4% increases that have been forecasted until now.

Thank you again for your time. I will now hand the podium over to Kelvin so he can provide more detail on what Manitoba Hydro is doing to address the financial challenges it faces.