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**An Assessment of the Capital
Management Plan of Manitoba
Public Insurance for the 2020/21
General Rate Application Based
on Generally Accepted
Regulatory Principles**

**Report prepared by John Todd
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20 September 2019

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1 INTRODUCTION

2 On June 20, 2019 Manitoba Public Insurance Corporation (MPI) filed its 2020 General
3 Rate Application (GRA) seeking approval of the Manitoba Public Utilities Board (PUB)
4 for rates and premiums for compulsory driver and vehicle insurance for the 13-month
5 period from March 1, 2020 to March 31, 2021. MPI's evidence includes in Part VI a
6 section addressing its approach to maintaining a Rate Stabilization Reserve (RSR)¹.
7 Within that section, RSR.6 describes its Capital Management Plan.

8 The Public Interest Law Centre (PILC) retained Elenchus Research Associates Inc.
9 (Elenchus)² on behalf of the Manitoba Branch of the Consumers' Association of Canada
10 (CAC Manitoba) to prepare evidence "regarding the Capital [Management] Plan with a
11 view to regulatory principles as they relate to Crown monopolies which also operate
12 unregulated lines of business".

13 I acknowledge and strictly respect my duty to the Public Utilities Board as set out in the
14 retainer letter, which is stated as follows:

15 *It is your duty to provide evidence that:*

- 16 • *is fair, objective and non-partisan;*
- 17 • *is related only to matters that are within your area of expertise; and*
- 18 • *to provide such additional assistance as the Public Utilities Board may*
19 *reasonably require to determine an issue.*

20 *Your duty in providing assistance and giving evidence is to help the Public Utilities*
21 *Board. This duty overrides any obligation to the Manitoba Branch of the Consumers'*
22 *Association of Canada. By signing this letter of retainer, you confirm that you will*
23 *comply with this duty.*

24 In preparing this evidence I have drawn on my career specializing in the theory and
25 practice of economic regulation.

¹ See MPI's eBook, PDF pages 1710-1730.

² The evidence has been prepared by John Todd, President of Elenchus. A statement of qualifications is provided as an appendix.

1 2 BACKGROUND

2 The foundations of the RSR date back to the 1988 Autopac Review Commission
3 (Kopstein Report). Since then, a primary consideration in rates for MPI's Universal
4 Compulsory Automobile (Basic) Insurance has been that rates are set primarily to break
5 even on the basis of forecasted net income, allowing for staggered renewals.

6 A further long-standing consideration has been to absorb variances around the breakeven
7 forecast, which is the basis behind the recommendation in the Kopstein Report that a
8 retained surplus target of about 15% of premiums be maintained. Further, the Kopstein
9 Report recommended that, "if the Autopac surplus falls below ten percent or exceeds 20
10 percent of premiums, the corporation should and would be expected to take remedial
11 action." This recommendation provided the founding principles for maintaining the Rate
12 Stabilization Reserve ("RSR") in a range of 10% to 20% of annual premiums to protect
13 motorists from rate increases made necessary by unexpected events and losses arising
14 from nonrecurring events or factors.

15 The specific issues related to MPI's Capital Management Plan that are within the scope
16 of this report are the components identified by MPI at Part VI, RSR.6, page 6 of 19:

17 *The CMP includes the following components:*

- 18 • *Accepted Actuarial Practice (AAP) ratemaking;*
- 19 • *capital targets by line of business;*
- 20 • *capital transfer rules; and*
- 21 • *capital build or release provisions.*

22 More specifically, my comments relate only to the latter three components since Accepted
23 Actuarial Practice (AAP) ratemaking is a matter of actuarial expertise, not generally
24 accepted ratemaking principles as practiced by economic regulators in Canada and
25 internationally. Furthermore, my comments set aside all legal issues related to the
26 implications of the Reserves Regulation for the setting of MPI rates by the PUB. Legal
27 issues are also outside of my area of expertise and are being addressed separately in
28 this proceeding.

3 COMMON TREATMENT OF UTILITIES WITH REGULATED AND NON-REGULATED SERVICES

It is common for rate regulated utilities in Canada³ to offer competitive as well as monopoly services. This dual role is generally provided in one of two ways.

- Competitive services are frequently offered to the market by affiliates of the monopoly service provider. In some cases, the affiliate offers services to the utility's monopoly customers (e.g., the commodity, in markets where natural gas or electricity is available on an unbundled, competitive basis). In other cases, affiliates offer services to entities that are not customers (e.g., billing services such as water billing for a municipal owner and construction services to other utilities).
- It is also common for monopoly service providers to offer optional services to the market as an extension of their standard regulated monopoly services. For example, electric utilities often rent equipment such as water heaters to customers and offer streetlighting services to municipalities either with or without product maintenance and servicing. In some jurisdictions, the utility's customers have the option of purchasing the commodity (i.e., electricity or natural gas) from the utility as the default supplier for customers that do not obtain supply from independent retailers. These unregulated services are often referred to as non-utility services to distinguish them from the core monopoly services of the utility. Non-utility services are offered to customers on an optional basis at rates that may be based on competitive factors rather than the cost of service approach used to determine the rates for utility services. In some cases, utilities have provided new services that were intended to evolve the market. For example, in past decades, several

³ Most of the Canadian rate regulated utilities are electricity and natural gas distribution and transmission companies. A few are integrated electricity utilities such as Manitoba Hydro, BC Hydro, Hydro Quebec and New Brunswick Power. Most provinces do not have crown corporations that provide mandatory (Basic) vehicle insurance at regulated rates.

1 Canadian natural gas utilities introduced natural gas vehicle refilling facilities into
2 their service areas using the non-utility service model.⁴

3 MPI offers two lines of business that are analogous to the non-utility offerings of electricity
4 and natural gas utilities: Extension and Special Risk Extension (SRE). Hence, to provide
5 a full contextual background for my discussion of MPI's RSRs, the next section
6 summarizes the typical concerns of regulators and the policies that are typically adopted
7 to mitigate those concerns. The subsequent discussion of MPI's approach to the capital
8 transfers among its lines of business as described in its Capital Management Plan draws
9 on the common regulatory practices for analogous utilities providing competitive services
10 in other sectors.

11 Under either structure for providing the competitive services, regulators typically adopt
12 rules that govern the relationship between price regulated services of the utilities and the
13 non-utility services offered by either the utility or its affiliates. The primary purposes of the
14 rules governing these non-utility services is to restrict anti-competitive activities and
15 preclude subsidization of the competitive affiliate by the regulated monopoly.

16 **3.1 COMPETITIVE SERVICES OFFERED BY AFFILIATES OF REGULATED UTILITIES**

17 The relationship between regulated utilities and their affiliates tend to attract the attention
18 of regulators. For example, the OEB maintains an [Affiliate Relationship Code for
19 Electricity Distributors and Transmitter \(ARC\)](#). The ARC was one of the earliest regulatory
20 instruments developed by the OEB after it became responsible for regulating electricity
21 utilities in Ontario, which is indicative of the importance that the OEB placed on its
22 oversight of affiliate relationships. The ARC was most recently revised March 15, 2010

23 The stated purpose of ARC appears as section 1.1.

24 **1.1 Purpose of this Code**

⁴ Currently, many electric utilities are developing electric vehicle (EV) charging stations. EV charging stations are also established by other participants in the EV and energy market, in some cases with the assistance of government incentives. To date, most of these investments by utilities have been done on a modest scale and have not yet been priced on a traditional cost of service basis.

1 *This Code sets out rules that govern the conduct of utilities as that conduct relates to*
2 *their respective affiliates, with the objective of:*

3 *a) protecting ratepayers from harm that may arise as a result of dealings between a*
4 *utility and its affiliate;*

5 *b) preventing a utility from cross-subsidizing affiliate activities;*

6 *c) protecting the confidentiality of information collected by a utility in the course of*
7 *provision of utility services;*

8 *d) ensuring there is no preferential access to utility services;*

9 *e) preventing a utility from acting in a manner that provides an unfair business*
10 *advantage to an affiliate that is an energy service provider; and*

11 *f) preventing customer confusion that may arise from the relationship between a*
12 *utility and its affiliate.*

13 The ARC directly addresses in multiple ways the two primary concerns that arise when a
14 regulated entity also offers unregulated services, whether those services are offered by
15 the utility itself or through an affiliate.

16 **Issue #1: Cross-Subsidization of Competitive Services** – It is generally recognized
17 that any business offering both regulated and unregulated products in the market
18 will, in the absence of regulatory constraints, have an incentive and an
19 opportunity to subsidize its competitive (unregulated) services by shifting costs to
20 the greatest extent possible from its competitive services to its regulated
21 monopoly services. Cost shifting can take many forms, including:

22 • the regulated business providing services to its unregulated business at a
23 discounted rate (e.g., below the fair market value of the services, or below
24 the fully allocated cost of those services);

25 • the unregulated business providing services to its regulated side of the
26 business at an inflated rate (e.g., above the fair market value of the services,
27 or above the fully allocated cost of providing those services)

- 1 • allocating costs between the regulated and unregulated business in a
2 manner that either advantages the unregulated business in its competitive
3 market or disadvantages the regulated business.

4 Purposes a) and b) of the ARC relate to this concern.

5 It is noteworthy that section 6.3 of the Manitoba Public Insurance Act appears to address
6 the issues of cross-subsidization.

7 *Separation of compulsory and extended businesses*

8 6.3 *The corporation must ensure that the revenue from its plans of universal*
9 *compulsory automobile insurance and its other revenues are not used to subsidize*
10 *the corporation's plans of extension insurance.*

11 The PUB has addressed this issue in the past. PUB Order 150/07 directed MPI to
12 undertake a cost allocation review. In response, MPI filed of an external cost allocation
13 study undertaken by Deloitte in the 2010 GRA. The PUB decision in PUB Order 122/10
14 addressed the cost allocation methodology at pages 26-28 and 54-55. It stated that the
15 PUB was not ready to approve the proposed cost allocation methodology for rate setting
16 purposes until it has the opportunity to review all underlying expenses to be allocated. In
17 a supplementary order, PUB Order 145/10, the PUB discussed cost allocation
18 methodology at pages 18-19 and endorsed the new cost allocation methodology
19 proposed by the Corporation in 2009 but not for rate-setting purposes. The decision
20 states:

21 *Questions arise as to the “wisdom” of allocating costs on a basis that ignores the*
22 *centrality of Basic and the value that Basic brings to Extension, SRE and DVA*
23 *operations. In other words, the costs of Extension, SRE and DVA operations would*
24 *be much higher if each of those operations were allocated costs on the basis of each*
25 *of those operations being “stand-alone” operations. When excess retained earnings*
26 *of Extension and SRE were transferred to the Basic RSR, there was some protection*
27 *for Basic policyholders that they would not be taken advantage of by higher than*
28 *necessary Extension premiums; but now, with Extension and SRE net earnings*
29 *subject to use for purposes other than “insurance”, there is a reasonable*

1 *apprehended need for Extension, SRE and DVA operations to be the subject of the*
2 *Board's oversight.*

3 Subsequently, PUB Order 162/11 addressed cost allocation methodology at pages 33-34
4 and 69-70. The PUB was still not prepared to implement the cost allocation methodology
5 for rate-setting purposes without corporate-wide information that it had requested
6 previously and which the Corporation had refused to provide.

7 In PUB Order 157/12, pages 29-31, the PUB approved the new cost allocation
8 methodology for rate setting purposes.

9 **Issue #2: Anti-competitive Activities** - It is also generally recognized that any business
10 offering both regulated and unregulated products in the market will, in the
11 absence of regulatory constraints, have an incentive and an opportunity to
12 provide advantages to its competitive (unregulated) services in ways other than
13 cost shifting, such as:

- 14 • providing access to customer information that is not available on an
15 equivalent basis.

16 Purposes c) through f) of the ARC relate to this concern.

17 I am not aware of the issue of Extension and SRE benefiting from anti-competitive
18 arrangements in the joint operations of MPI's mandatory Basic insurance and its
19 competitive Extension and SRE lines of business. Nevertheless, although I have not
20 examined the joint operations in detail, it is my understanding that there is minimal
21 separation of customer relationships for the different lines of business.⁵ MPI
22 acknowledges that it currently about 95% market share for Extension, has dominated the
23 market for some time and anticipates that it will continue to do so.⁶

24 As discussed below, particularly in cases where rules are not in place to limit the
25 competitive advantage of a utility in providing non-utility services, regulators generally

⁵ For example, MPI's customer service operations are completely integrated, with Basic and Extension insurance and vehicle registration information included on a single form. This arrangement not only is a key consideration for cost allocation, it also implies significant competitive benefit.

⁶ CAC(MPI) 1-5c).

1 attribute the benefits to utility customers by ensuring that the benefits are used to reduce
2 utility rates. This recognizes that the benefit is derived from the monopoly services.

3 **3.2 COMPETITIVE SERVICES OFFERED AS NON-UTILITY SERVICES BY A** 4 **REGULATED UTILITY**

5 The incentive and opportunity to engage in anti-competitive activities has such broad
6 scope and is so difficult to control that regulators often impose extensive structural
7 requirements as the only effective remedy. Structural remedies that have been adopted
8 by Canadian regulators include:

- 9 • The outright prohibition on a regulated utility from offering its customers
10 competitive as well as monopoly services. For example, the competitive services
11 that electric distributors in Ontario are permitted to provide in the market is
12 extremely limited. Exceptions permitted only where there is a clear policy rationale
13 for the exception. Competitive service can be offered by affiliates, in which case
14 the ARC is applicable which requires separate staff and facilities, prohibits the
15 sharing of customer information and prohibits call centre staff from recommending
16 a provider of competitive services to a customer when asked.
- 17 • Strict rules have been adopted in several jurisdictions including Ontario and
18 Alberta that require the complete separation (ring fence) of employees that deal
19 with customers for the monopoly and the competitive services offered by the
20 company. Sharing of customer information is strictly prohibited.
- 21 • In other cases, utilities are permitted to offer competitive services as well as the
22 monopoly services, but the income and expenses related to competitive operations
23 are included in the revenue requirement that is used to setting the rates for
24 regulated services. In effect, the net income, in excess of the allowed return on
25 investment is used to reduce rates for the regulated monopoly services.

1 **4 MPI'S SEPARATION OF COMPULSORY AND COMPETITIVE** 2 **SURPLUSES**

3 **4.1 CAPITAL TARGETS BY LINE OF BUSINESS**

4 The starting point for MPI's Capital Management Plan is the capital targets that will be
5 used for rate setting purposes. MPI's proposed targets are presented in RSR.4.

6 The generally accepted principles for setting rates for regulated utilities do not address
7 the issue of the methodology that is appropriate to use in determining an adequate level
8 of reserves for an insurance utility. Unlike other regulated utilities such as electricity and
9 natural gas distributors, MPI is in the business of providing insurance. This business
10 involves unique risks that can best be assessed using insurance-specific risk assessment
11 methods. Nevertheless, it is evident that utilities in sectors other than insurance also have
12 capital structures that manage risk for a purpose that is essentially the same as the
13 purpose of the RSR as stated by MPI in RSR.3.

14 *To protect motorists from rate increases that would otherwise have been necessary*
15 *due to unexpected variances from forecasted results and due to events and losses*
16 *arising from non-recurring events or factors⁷*

17 In particular, crown corporation such as Manitoba Hydro and New Brunswick Power
18 maintain capital structures with sufficient retained earnings⁸ to serve the same purpose
19 in protecting customers from large rate increases⁹ due to unexpected variances from
20 forecasted results and due to events and losses arising from non-recurring events or

⁷ This purpose reflects PUB Order 151/13, p 33 which stated that the purpose of the RSR is "to protect motorists from rate increases made necessary by unexpected events and losses arising from nonrecurring events or factors". The PUB also has stated that "In short, the RSR is retained to meet the financial impact of events not expected to recur on a regular basis." (PUB Order 150/07, p 45).

⁸ In some case, regulated utilities have also identified specific reserves amounts as a rate stabilization reserve as a means of clearly demonstrating the reason that retained earnings are justified for an entity that does not require, and does not have access to, conventional equity investment.

⁹ Adequate retained earnings, or reserves, also serve to protect the governments that own the utilities and typically provide debt guarantees from having to provide financial support in the event of seriously detrimental events that compromise the financial integrity of the utility. Provincial debt guarantees, combined with an appropriate capital structure also reduce the cost of debt for the utility which in turn reduces the costs that must be recovered from ratepayers.

1 factors. In the case of electricity utilities for example, the events and losses that could
2 trigger large rate increases include lost revenue due to weather variances such as warm
3 winters or cool summers, low water flows for hydro utilities, major storm damage, and
4 other catastrophic events. Put differently, standard regulatory principles recognize that it
5 is in the interest of customers for any utility to maintain a capital structure that is consistent
6 with the financial risks that it faces.¹⁰ A capital structure that puts the utility at risk, will
7 tend to incur a higher cost of capital and also increase the chances that an unexpected
8 variance in financial results will necessitate an immediate large rate increase.

9 While MPI does not face the kind of infrastructure risks that are faced by Manitoba Hydro
10 or Centra Gas, its insurance portfolio does give rise to financial risk. It is therefore
11 consistent with the standard principles for utility rate setting that MPI, like other regulated
12 utilities, should include in its rate setting methodology consideration of an appropriate
13 level of the RSR. Since the method of determining the level that is appropriate is not
14 addressed in this evidence, the subsequent discussion simply refers to the level of RSR
15 that is appropriate given its purpose as the RSR Target. The RSR Target will be one of
16 the matters that the PUB will rule on in this proceeding.¹¹

17 The implication of MPI's evidence is that an RSR Target for Basic insurance that is based
18 on an MCT ratio of 100% is appropriate. In other words, in its view, the stated purpose
19 of the RSR will be met if the PUB agrees that the Basic RSR Target should be based on
20 a Basic MCT ratio of 100%, where the target is used in the manner suggested by MPI for
21 setting rates (i.e., adopt rates that will either maintain an MCT ratio of at least 100% or
22 will raise it to that level within 5 years based on MPI's revenue forecast).

23 If the PUB directs MPI to adopt a different Basic RSR capital target, its decision will imply
24 that the alternate target that is approved by the PUB provides a more appropriate level of
25 protection for customers against extraordinary rate increases due to unexpected
26 variances in forecast results. Presumably, the interests of Basic customers are best

¹⁰ A crown utility with inadequate retained earnings or reserves can also put taxpayers at risk since the financial integrity of the company is typically guaranteed by the government that owns it.

¹¹ It may be more practical to consider the RSR Target to be a range. Strict adherence to a single value target could result in rate shock or rate stability, which appears to be the rationale for MPI's approach to building capital that it is a five-year process. See RSR.6.3, step 2.

1 served by adopting the lowest Basic RSR target and hence the stable rates that would be
2 both prudent given the risks inherent in MPI Basic insurance business and the stated
3 goals of the RSR.

4 The same approach would not be directly applicable to Extension insurance since
5 Extension rates are not approved by the PUB. Assuming the overall objective of MPI's
6 operations is to minimize the cost of Basic insurance for the insured public, it follows that
7 MPI's goal would be to maximize the net revenue that is achieved by its Extension and
8 SRE lines of business.¹² Maximizing net revenue for these non-utility lines of business
9 will maximize the funds available to transfer to Basic, which in turn will minimize the rates
10 necessary to recover its costs and also maintain the basic RSR at the target level.

11 Furthermore, based on the premise that Extension insurance is properly characterized as
12 a non-utility service that is offered by MPI as an option for customers, it follows that it
13 would be consistent with generally accepted regulatory practice for the PUB to determine
14 that the extent of the financial benefits that MPI derives from Extension insurance should
15 be recognized as a benefit to Basic customers in setting rates for Basic insurance.
16 Standard regulatory practice in this situation is that excess profits realized by unregulated
17 non-utility services are used, at least in part, to reduce rates for utility customers.

18 MPI appears to recognize that Basic insurance should receive the benefit of the excess
19 earnings of Extension insurance since it is proposing to transfer capital from Extension to
20 Basic when the Extension MCT ratio exceeds 200%. MPI has relied on the Reserves
21 Regulation as the justification for Extension capital in excess of an MCT ratio of 100% but
22 less than an MCT ratio of 200% as being unavailable for transfer to Basic either to
23 facilitate Basic capital release (i.e., to set rates at a level below cost recovery) or to build
24 Basic RSR capital in the event that it is below the Basic RSR Target.

25 Unless it can be demonstrated that from an insurance risk perspective a higher Extension
26 RSR Target can be justified for Extension than is justified for Basic, it is inconsistent with

¹² It is possible that the government owner of a utility may have additional objectives. For example, if it perceives a market failure in the provision of competitive lines of business, it may be in the public interest for the crown utility to participate in the competitive market to increase competitive discipline. Barring explicit government direction, however, it would not be consistent with typical mandate of an economic regulator to permit behaviour that undermines a competitive market.

1 common practice to permit a regulated utility to earn excess profits on non-utility services
2 unless those excess profits are used to reduce rates for utility services. This result is
3 generally accomplished by including all costs of the utility in its revenue requirement
4 (including the costs incurred for the non-utility services) and deducting all non-utility
5 revenues from the utility's total revenue requirement. This approach automatically
6 deducts the net income earned on the non-utility services from the net revenue
7 requirement that is recovered for utility services. This is a simple and convenient way to
8 reduce the revenue requirement for the regulated monopoly services by the net income
9 realized on competitive services. Furthermore, in such cases, the utility is also obliged to
10 demonstrate that the competitive services are generating income that exceeds the
11 incremental cost of providing the non-utility service. This requirement ensures that the
12 competitive services are not being subsidized by the monopoly services.

13 Exceptions to the general rule that all of the net revenues must accrue to the customers
14 of the monopoly utility services occurs when there is an earnings-sharing mechanism.¹³

15 It may be noted that in shareholder owned utilities, any financial return in excess of the
16 allowed return on equity that is permitted for the regulated business may be shared
17 between utility customers and shareholders. There are several reasons for this approach.

- 18 • First, when rates for non-utility services are set either in response to competitive
19 market forces or at a level that maximizes net revenue, it would be inconsistent to
20 use excess earnings to reduce non-utility rates in future years.
- 21 • The assets used to generate profits are owned by the investors.
- 22 • Sharing excess earnings with investors provides an incentive for the company to
23 increase the level of earnings, which should ultimately increase the benefit for
24 customers of the monopoly services as well as shareholders.

¹³ For example, the revenue sharing mechanism that was approved by the OEB for transactional services that Union Gas provided in the market using surplus storage capacity when not required for its utility customers. This was approved on the basis that it served as an incentive for Union to maximize its transactional services revenue.

- 1 • In general, the profitability of the non-utility services is attributable, at least, in part,
2 to the interrelationship between the utility and non-utility services due to common
3 branding, the access gained by the non-utility operations to utility customers, etc.
- 4 • In cases where rigorous rules to limit anti-competitive activity have not been
5 imposed (which appears to be the case for MPI's Extension and SRE lines of
6 business), the financial success of the non-utility lines of business may be
7 reasonably attributed, in whole or in part, to the inter-twining of the utility and non-
8 utility lines of business. To the extent that financial success of the non-utility
9 business is attributable to its status as an extension of the utility business, it is
10 reasonable for regulators to take the view that the benefits should accrue to utility
11 customers rather than the shareholder.

12 The logic set out above is even stronger in the case of a crown corporation than it is for
13 a shareholder-owned utility. The primary rationale for creating a crown-owned monopoly
14 to provide a service that is not a natural monopoly, as in the case of vehicle insurance, is
15 to provide access to lower rates, better service and more customer-oriented service than
16 would otherwise be available. While this rationale may not apply exclusively to mandatory
17 coverage, it is reasonable to presume that the goal is not to squeeze out competition for
18 non-mandatory insurance.

19 The overall logic implies that regulators should ensure that any excess benefits realized
20 by non-utility services should be used to provide a benefit to utility customers unless there
21 is a rationale and policy that ensures that the benefits are used in a manner that is
22 consistent with other policy objectives, such as providing an incentive for management to
23 increase the total benefits including the portion shared with monopoly customers.

24 In the case of MPI, it is not clear to me who, if anybody, benefits from holding reserves in
25 excess of a defensible reserve target for Extension and SRE. Once a prudent level of
26 reserves is established, consistent with the stated objective of the RSR, any excess
27 reserves serve no obvious purpose, except perhaps as an additional buffer that exceeds
28 the formally calculated and justified level of reserves. I am not aware of any analogous
29 situation with a Canadian crown corporation electricity or natural gas utility in which the
30 utility is permitted to retain excess earnings derived from non-utility services.

1 **4.2 CAPITAL TRANSFER RULES**

2 With respect to the approach that MPI is proposing to take to transferring capital from
3 Extension to Basic, MPI states:

4 *After applying the Basic rate indication to the forecast, MPI will then determine*
5 *whether there is excess capital in MPI's Extension line of business that it can transfer*
6 *to Basic. If, at each fiscal year end, the Extension MCT ratio is:*

- 7 • *greater than 200% - MPI will transfer capital from Extension to Basic until the*
8 *ratio is 200%.*
- 9 • *less than 200% - MPI will not make any capital transfers from Extension.*

10 Consistent with comments made earlier in the report, limiting the transfer from Extension
11 to Basic to amounts in excess of an Extension MCT ratio of 200%, would not be consistent
12 with the standard practice of Canadian regulators with respect to the treatment of excess
13 revenues earned by providing non-utility services to utility customers unless it the higher
14 level of reserves for Extension is based on a higher risk portfolio.¹⁴ The most common
15 regulatory practice is to ensure that excess revenues are used primarily to reduce the
16 revenue that must be recovered by the regulated rates that are charged to their
17 customers. In the context of MPI, it would be consistent to define excess revenues as
18 revenues that are not required to maintain a prudent level of Extension and SRE RSRs
19 or to manage transfers to Basic in a manner that is consistent with the objective of
20 protecting motorists from Basic rate increases that would otherwise have been necessary
21 due to unexpected variances from forecasted results and due to events and losses arising
22 from non-recurring events or factors.

23 **4.3 CAPITAL BUILD OR RELEASE PROVISIONS**

24 MPI has proposed a set of rules to govern building the RSR level, if it falls below the target
25 level, and also to govern the release of excess capital in the event that the Basic RSR

¹⁴ I note, however, although it is not my area of expertise, that I would assume that the methods used to determine the RSR Target, whether MCT or some other method, would establish target levels that take into account any risk differences,

1 rises above the target level. The proposed approach appears to be consistent with both
2 generally accepted regulatory principles and the stated purpose of the Basic RSR.

3 It should be noted, however, that the stability objective may better be served if the RSR
4 Target is defined as a range rather than as a point value. Defining a range for the RSR
5 target would be analogous to establishing an acceptable range for the revenue to cost
6 ratio (RCR) approach that is used by many regulators for establishing acceptable
7 electricity and natural gas rates for individual rate classes. The RCR range serves the
8 goal of increased rate stability and facilitates the imposing across-the-board rate
9 increases in most cases rather than necessitating differential rate increase in most cases.

10 **5 CONCLUSIONS**

11 This report provides an overview of the approach that would be taken to approving rates
12 for MPI if the process relies on the utility rate setting principles that are generally accepted
13 by the Manitoba PUB and other economic regulators across Canada and internationally.
14 In doing so, I acknowledge that there may be stakeholders that do not accept that the
15 ratemaking principles that are appropriate for Manitoba Hydro, Centra Manitoba and other
16 power and natural gas utilities in other jurisdictions may not be applicable to MPI. MPI is
17 not a natural monopoly; it is a legislated monopoly. As such, the generally accepted utility
18 ratemaking principles may be overridden by the intent of the Manitoba legislature.

19 From my perspective as a rate regulation expert, by assigning responsibility for the review
20 of MPI's rates to the PUB, an economic regulator, the presumption is that the legislative
21 intent is that the review would be guided by the same generally accepted ratemaking
22 principles that apply to other utilities. In my view, this underlying issue needs to be
23 addressed by the PUB to provide clarity on the principles that are to be used to guide
24 ratemaking in this and future proceedings.

25 Assuming the PUB determines that generally accepted ratemaking principles are relevant
26 to the rate approval process for MPI, the following considerations should guide the PUB's
27 approach in reviewing MPI's rates.

- 1 • Ensure that there is no cross-subsidy of MPI’s non-utility lines of business by Basic,
2 which is consistent with s. 6(3) of MPI Act as well as the generally accepted
3 principles for setting rates for regulated utilities.

- 4 • MPI’s Extension and SRE insurance lines of business are analogous to the non-
5 utility services of other utilities since they are products that are also available from
6 other participants in the market and are options for MPI’s customers.

- 7 • As such, any excess earnings that are realized by MPI’s non-utility products are
8 deemed to be offsets to the revenue required to be recovered in the rates for Basic
9 insurance.

- 10 • The absence of constraints on MPI exploiting the advantages inherent in its
11 monopoly position with respect to Basic insurance to dominate the market for its
12 non-utility services implies that excess earnings (i.e., earnings in excess of those
13 required to cover its costs including maintaining prudent reserves for Extension
14 and SRE lines of business and in excess of those that would be earned if there
15 were a level competitive playing field), would be deemed to be the result of MPI’s
16 monopoly position in providing mandatory Basic insurance. Hence, the excess
17 earnings would be attributable to Basic insurance and should therefore be
18 attributed back to the Basic insurance line of business.

- 19 • Attribution back to the Basic insurance line of business implies that any funds in
20 excess of those justified as needed to maintain a prudent level of RSR for the non-
21 utility lines of business would be available in their entirety to support the objectives
22 of the Basic RSR; that is, to stabilize rates and, to the extent it is consistent with
23 prudent insurance operations, be available for release in the manner set out in
24 MPI’s evidence for the Basic RSR.

1 **Appendix A:**
2 **Statement of Qualification and Duties – John Todd**
3 **Qualifications**
4

5 John Todd has a Masters of Business Administration (Economics and Management
6 Science) (1975) and a Bachelors of Applied Science (Electrical Engineering) (1972) from
7 the University of Toronto.

8 He founded Elenchus (Econalysis) Consulting Services, Inc. (ECS) in 1980, and founded
9 Elenchus Research Associates Inc., the independent consulting firm out of which he
10 currently operates in 2003, as a spin off from ECS. Mr. Todd's prior employment includes
11 Research Officer (Government Regulation) for the Ontario Economic Council; Research
12 Assistant at the Faculty of Management Studies at the University of Toronto; and Bell
13 Canada, Western Area Engineering.

14 Mr. Todd has specialized in government regulation for over 40 years, addressing issues
15 related to price regulation and deregulation, market restructuring to facilitate effective
16 competition, and regulatory methodology.

17 Mr. Todd has provided expert assistance in a total of 46 proceedings before the Public
18 Utilities Board of Manitoba from 1990 to 2017. He has presented evidence in 23 of these
19 cases. He was retained by the Manitoba Public Utilities Board as an Independent expert
20 consultant to review aspects of Manitoba Hydro's Needs for and Alternatives to (NFAT)
21 its Preferred Development Plan.

22 With respect to Manitoba Public Insurance, Mr. Todd provided expert evidence with
23 respect to matters including the Rate Stabilization Reserve in the 2006 GRA, the 2002
24 GRA, the 2000 GRA, the 1999 GRA and the 1998 GRA.

25 His work has included advising clients and preparing expert evidence with respect to the
26 appropriate capital structure for Crown Corporation and the relationship between Crown
27 corporations and unregulated lines of business, including applicable regulatory principles.

28 Sectors of primary interest in recent years have included electricity, natural gas and the

1 telecommunications industry. John has assisted counsel in over 250 proceedings and
2 provided expert evidence in over 150 proceedings. His clients include customer groups,
3 regulated companies, producers and generators, competitors, government and five of
4 Canada's provincial regulators.

5 **Duties**

6 The following duties were assigned to Mr. Todd in the MPI General Rate Application. The
7 Public Interest Law Centre retained Mr. Todd's services to assist CAC Manitoba with its
8 participation in the Public Utilities Board review of MPI's Application on issues related to
9 the Capital [Management] Plan and regulatory principles.

10 Mr. Todd's duties include:

- 11 • reviewing the Application;
- 12 • preparing first round of Information requests;
- 13 • reviewing responses to the first round of Information Requests and preparing
14 second round of Information requests;
- 15 • preparing evidence regarding the Capital [Management] Plan with a view to
16 regulatory principles as they relate to Crown monopolies which also operate
17 unregulated lines of business; and
- 18 • preparing for and attending the hearing.

19 Mr. Todd's retainer letter also includes that it is his duty to provide evidence that:

- 20 • is fair, objective and non-partisan;
- 21 • is related only to matters that are within his area of expertise; and
- 22 • to provide such additional assistance as the Public Utilities Board may reasonably
23 require to determine an issue;

24 Mr. Todd's retainer letter also specifies that his duty in providing assistance and giving
25 evidence is to help the Public Utilities Board. This duty overrides any obligation to CAC
26 Manitoba. By signing the letter of retainer, Mr. Todd confirmed that he will comply with
27 this duty.