



# **An Assessment of the Capital Management Plan of MPI for the 2020/21 GRA Based on Generally Accepted Regulatory Principles**

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on behalf of Consumers' Association of Canada (Manitoba)**

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# Five Questions

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- Q1. Is MPI a regulated public utility?
- Q2. What are the guiding principles for utility ratemaking?
- Q3. What is the standard regulatory treatment of competitive services offered by a utility?
- Q4. What are the primary models for the treatment of competitive services?
- Q5. How can the standard treatment of non-utility service revenue be applied to MPI?

# Q1. Is MPI a regulated public utility?

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- My evidence assumes MPI is a public utility
  - Most public utilities are **natural monopolies**
  - MPI's Basic insurance is a **legislated monopoly**
  - Airlines, railways, trucking, electricity generation and natural gas production were legislated monopolies; the same rate setting principles were applied to them
  - I see no reason for rate setting principles or practices to differ for a legislated (vs. natural) monopoly
- My evidence sets aside all legal issues

## Q2. What are the guiding principles for utility ratemaking?

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- Foundational principles derive from Bonbright's ten "Attributes of a Sound Rate Structure" (reproduced as slides attached to this deck)
  - The principles relate to setting rates for utility services
  - They provide for setting **just and reasonable rates** based on **prudently incurred costs**
  - Only indirectly applicable to non-utility service rates (capital targets; capital transfer rules or capital build or release provisions)

## Q3. What is the standard regulatory treatment of competitive services offered by a utility?

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- The standard treatment reflect two primary concerns:
  - Utility ratepayers should not subsidize competitive services (See MPI Act, section 6.3)
    - “Subsidy” is not consistently defined. May include any benefit that provides a competitive advantage through shared service cost savings, access to customer information, customer convenience, etc.
  - Utilities should not engage in anti-competitive behaviour; competitive benefits derived from utility services should be fully compensated
- Assumes goal is to benefit monopoly customers, not the utility, or customers of the competitive services

# Manitoba Public Insurance Act, S. 6.3

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*Separation of compulsory and extended businesses*

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

How should PUB define “subsidize”?

- Narrow view: Do not incur avoidable costs
- Broad view: Maintain a level playing field, with utility ratepayers receiving the benefit of joint operations

## Q4. What are the primary models for the treatment of competitive services?

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- Option #1: Mandatory Separation (Affiliate)
  - With transfer pricing rules to prevent cross-subsidization and competitive advantage
  - No access to confidential info; no preferential referrals
- Option #2: Non-utility service
  - Revenues and costs included for utility rate-setting
  - “Excess” profits (in excess of prudent cost recovery including a normal ROE) used to reduce utility rates
  - Complaints of anti-competitive activities may be resolved by resorting to Option #1

## Q5. How can the standard treatment of non-utility service revenue be applied to MPI?

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- In theory, compensate Basic for all services/support using fair market value
  - This would not be practical
- In practice, treat the excess earnings of Extension and SRE as the value of the benefits derived from the joint operations with Basic
  - Without this benefit, competitive pricing would not result in excess earnings



# Conclusion: Implications for MPI's Capital Management Plan

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- To reflect standard utility rate-setting practices:
  - Recognize the benefit that Extension & SRE derive from Basic as a legitimate value for Basic to recover
  - Limit the capital target for Extension and SRE to a level that reflects sound actuarial practices, consistent with Basic (so competitive does not retain the benefit of joint operations as a subsidy from Basic)
  - Establish capital transfer rules that flow “excess” Extension & SRE reserves to Basic systematically
  - Establish capital build and release provisions to return excess Basic capital to customers systematically

# Attributes of a Sound Rate Structure

**Bonbright, James C., Albert L.  
Danielsen and David R Kamerschen,  
(1988) *Principles of Public Utility Rates*,  
Second Edition, Public Utility Reports**

**Pages 383-384**

# Bonbright: Attributes of a Sound Rate Structure

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## Revenue-related Attributes:

1. Effectiveness in yielding total revenue requirements under the fair-return standard without any socially undesirable expansion of the rate base or socially undesirable level of product quality or safety.
2. Revenue stability and predictability, with a minimum of unexpected changes seriously adverse to utility companies.
3. Stability and predictability of the rates themselves, with a minimum of unexpected changes seriously adverse to ratepayers, and with a sense of historical continuity.

# Bonbright: Attributes of a Sound Rate Structure

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## **Cost-related Attributes:**

4. Static efficiency of the rate classes and rate blocks in discouraging wasteful use of the service, while promoting all justified types and amounts of use: (a) in the control of the total amounts of service supplied by the company; (b) in the control of the relative uses of alternative types of service by ratepayers (on-peak versus off-peak service or higher quality versus lower quality service).
5. Reflections of all of the present and future private and social costs and benefits occasioned by the service's provision (i.e., all internalities and externalities).

# Bonbright: Attributes of a Sound Rate Structure

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## **Cost-related Attributes (cont'd):**

6. Fairness of the specific rates in the apportionment of total cost of service among the different ratepayers, so as to avoid arbitrariness and capriciousness, and to attain equity in three dimensions: (1) horizontal (i.e., equals treated equally); (2) vertical (i.e., unequals treated unequally); and (3) anonymous (i.e., no ratepayer's demands can be diverted away uneconomically from an incumbent by a potential entrant).

7. Avoidance of undue discrimination in rate relationships so as to be, if possible, compensatory (i.e., subsidy free with no intercustomer burdens).

# Bonbright: Attributes of a Sound Rate Structure

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## **Cost-related Attributes (cont'd):**

8. Dynamic efficiency in promoting innovation and responding economically to changing demand and supply patterns.

## **Practical-related Attributes**

9. The related, practical attributes of simplicity, certainty, convenience of payment, economy in collection, understandability, public acceptability, and feasibility of application.

10. Freedom from controversies as to proper interpretation.