

MANITOBA PUBLIC INSURANCE

2020 GENERAL RATE APPLICATION
SUBMISSION ON PROCESS IMPROVEMENTS

October 24, 2019



MANITOBA
PUBLIC INSURANCE

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1 Introduction

- 1 Options for improving the efficiency of the regulatory process are provided herein. The objective of regulation, and foundational principles are reviewed first, to set the stage for options presented thereafter. Options range from incremental improvement to the current process, to fundamental transformation and the basis for regulation. The scope of this submission is wide, but not deep. This is deliberate.
- 2 Each of the options outlined below has positive and negative implications for the Public Utilities Board (PUB), interveners, and Manitoba Public Insurance (MPI). Consultation and careful consideration is required to implement any of the more transformative options presented below. This could extend up to and including a regulatory process to reform the regulatory process.
- 3 The first step in establishing an efficient regulatory process is determining - what information does the PUB require in order to make a decision approving rate changes for MPI? The second step is determining how best to get this information to the PUB.
- 4 This paper addresses the second step. However, no meaningful process improvement can be made until the PUB clearly articulates the information it requires to make a decision approving rate changes and why this information is required.
- 5 Currently, the PUB has approximately 10,000 pages of material and 3 weeks of testimony to consider. Is this information required? From MPI's perspective, all this information is not necessary but it would be beneficial to know the PUB's perspective and understand why particular information is required.

2 Regulation is the Surrogate for Competition

- 6 The price regulation of monopolies is fundamentally an economic function, whose outcome is intended to mimic as far as practical, the outcomes of a competitive market. Competition among firms in free and functioning markets tends to:
 - Decrease prices;

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- Drive innovation; and
- Improve product qualities and features.

7 Monopolies by definition do not face competition. The stylized 'economic theory of the firm' suggests that unregulated monopolies will maximize profits by:

- Producing about one half as much output as the competitive market
- Pricing that output at about twice the price of the competitive market

8 The unregulated monopolist has clear negative implications for social welfare – fewer people enjoy the monopolists' output, and those who do, give up far more in exchange, than they otherwise would.

9 In the absence of competition, the Regulator's role is to act as the surrogate for competition. In fulfilling this, the regulator chiefly considers three factors:

- a) Product Price;
- b) Product characteristics; and
- c) Level of service.

10 These three factors are important, because constraints on one factor, can be compensated for by reductions in another factor. Left unchecked, a profit seeking monopolist will reduce customer service, or degrade product characteristics when faced with a fixed price. However, the Regulator must balance these factors against each other – the price must be commensurate with the product characteristics, and the level of service.

3 Fundamental Principles

11 This section briefly outlines fundamental principles of the economic price regulation. They are presented in no particular order.

3.1 The Rebuttable Presumption of Prudent Management

- 12 A regulated firm's operating and investment decisions are typically considered prudent unless proven otherwise¹. While a utility bears the burden of proof when seeking a rate increase, the utilities' burden is lightened by a rebuttal presumption of prudence. Interveners must produce enough evidence to create serious doubt, thereby rebutting the prudence presumption².
- 13 The prudence standard is comprised of four features³:
1. Consistency with Industry norms: the prudence standard requires reasonable behavior based on industry norms
 2. No Hindsight: the utility is deemed to know only those facts available at the time of the decision
 3. The Utility's Special Role: in assessing prudence, Commissions must take into account a utility's unique roles and duties
 4. Factual intensity: a prudence analysis is fact intensive

3.2 The Used and Useful Standard

- 14 An asset should be used and useful in order to be included in rate base for calculating regulated tariffs⁴. The test is whether assets are used in providing services, or useful to ratepayers.

¹ Lesser, p.48

² Hempling, p.247

³ Hempling, p.236-237

⁴ Lesser, p. 49

3.3 Known and Measureable Costs

- 15 Costs included in a firm's revenue requirement must be known, and measureable, justified with documentation and facts⁵. The evidence must establish that they are legitimate expenditures.

3.4 Just and Reasonable Rates

- 16 The term "just and reasonable" is perhaps the most recognizable phrase in utility regulation, but its meaning is hardest to pin down. Hempling offers three guiding principles⁶:
1. The phrase has no fixed meaning
 2. It means more than abuse prevention, and considers the interests of buyers and sellers
 3. Just and Reasonable establishes a 'zone' rather than a fixed point

3.5 Regulatory Discretion

- 17 Regulators are typically afforded broad discretion and deference by the courts. Yet, unfettered discretion increases the risks that decisions may be arbitrary and capricious.⁷
- 18 Robust processes for appeal, both with the regulator and the courts, must be in place to act as a check on the regulator's discretion. Accountability is also derived through robust reasons for decision, as required by Natural Justice.

⁵ Lesser, p. 50

⁶ Hempling, p.220

⁷ Lesser, p.51-52

3.6 Natural Justice

19 Natural Justice, (sometimes referred to as procedural fairness) represents principles of law that have been applied over time by courts to the conduct of administrative tribunals. The three main principles Natural Justice are commonly characterized as⁸:

1. People have a right to be heard
2. The ruling must be made by someone free of bias
3. The judgment must be based on evidence with reasons for decision

4 The Current Application Process is Unusually Onerous

20 This section provides an overview of some of the features that make the existing process particularly onerous on MPI, interveners, and the PUB.

4.1 A Compressed schedule

21 The current process schedule is compressed. Points in the schedule that are particularly compressed include:

1. Limited time for public notice, which could have negative implications for natural justice, which should concern all parties
2. Limited time early in the process schedule for interveners to review and formulate budgets, and prepare first round Information Requests (IRs)
3. Very limited time for process steps after Second Round IRs including:
4. The review of intervener evidence and preparing IRs
5. Prepare Rebuttal evidence
6. Prepare witnesses for the oral hearing
7. Very limited time to prepare closing submissions
8. Very tight schedule for the PUB to deliver a decision

⁸ Principles of Natural Justice are articulated by many sources, however the Nunavut Water Board concisely articulates them here: https://www.nwb-oen.ca/regulatory-process/legal-authorities/administrative_law_and_the_rules_of_natural_justice

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9. Process occurs over the summer, every year – this is hard for vacation planning and staff with young families

4.2 Significant time spend in the Hearing room

- 22 The following table provides a comparison of hearing days per Billion dollars of Revenue Requirement for various utilities. This information is current as of about 2017.

Applicant	Total Revenue Requirement (\$ Billions)	Test Years	Hearing Days	Hearing Days per \$Billion of Rev Req.
MPI (2017 GRA)	1.0	2017	12	12
Manitoba Hydro (2013-14 GRA)	3.5	2013, 2014	23	6.6
Manitoba Hydro (2015-16 GRA)	4.8	2015,2016	19	3.9
AltaLink (2015-16 GRA)	1.8	2015, 2016	8	4.4
ATCO (2015-17 GRA)	2.4	2015, 2016, 2017	14	5.8
ICBC (2016 GRA)	3.0	2016	(written)	0

- 23 The table above shows that MPI has more hearing days per dollar of revenue requirement than many other regulated entities. This is not the only relevant measure of regulatory burden, but does highlight the intensity of MPI's annual hearing schedule.

5 Approaches to Making the Current GRA Process More Manageable

24 There are certain approaches that could improve the efficiency of the current process, and make it more manageable for all parties.

5.1 Tailoring the Scope of the GRA to the PUB's Needs

25 The GRA record routinely exceeds 10,000 pages, and at this length it is beyond the grasp of any individual to digest and draw meaning from in its entirety.

26 Tailoring the scope of the GRA to the PUB's core needs, and focusing on those topics that are most directly related to the core price setting function of the PUB will reduce the regulatory burden.

27 Key price determinants in MPI's GRA include:

1. Claims forecasts;
2. Operating expenses; and
3. Capital and Investments.

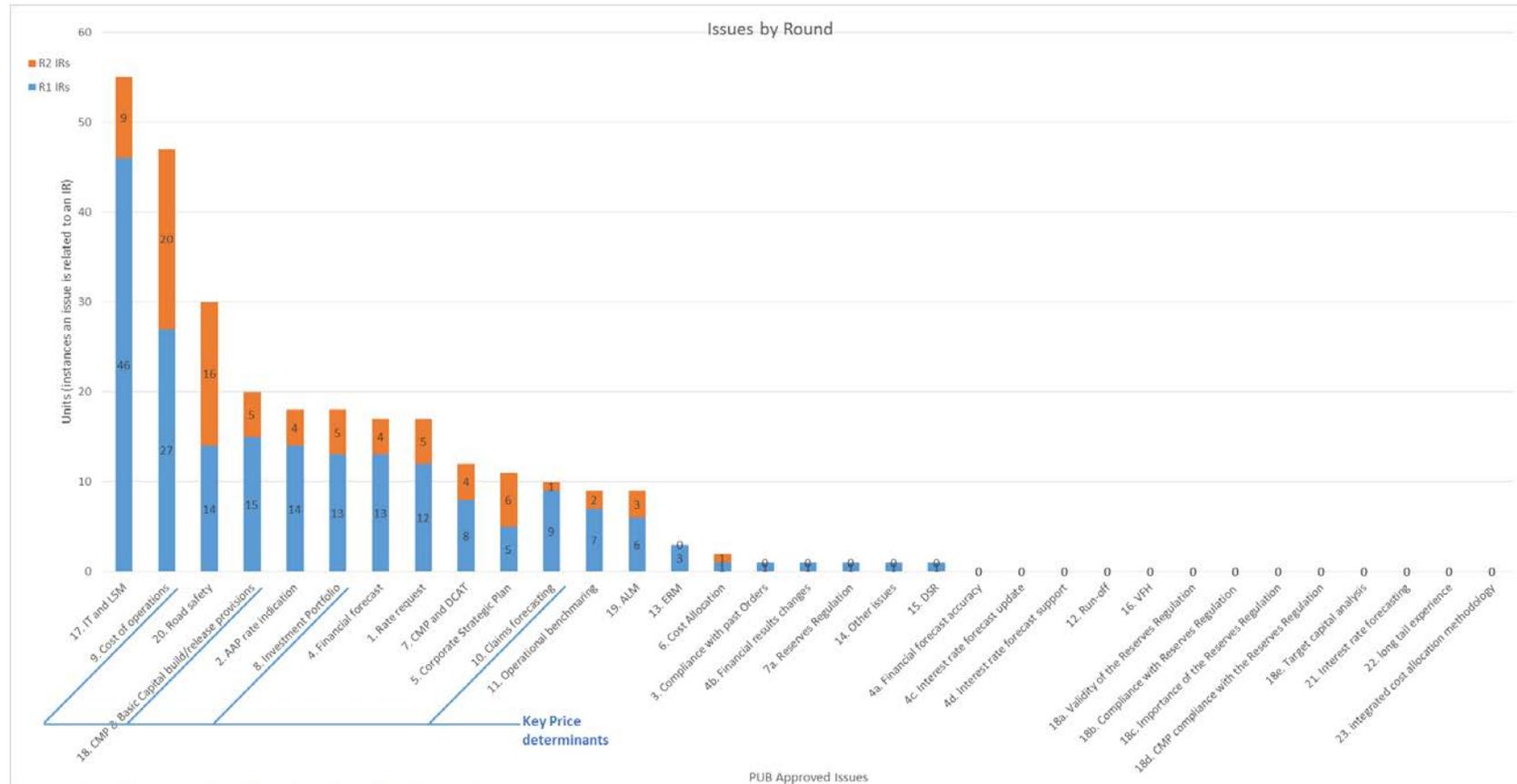
28 Matters that have a lesser impact on pricing (secondary matters) include:

1. Road Safety and Loss Prevention;
2. Minor projects and IT initiatives; and
3. Benchmarking, Shadow Portfolios, Service Delivery Models.

29 The following graph indicates the number of Information Requests in the 2020 GRA that were asked for each of the matters on the issues list. Key price determinants and secondary matters are also identified.

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- 30 Process time dedicated to those secondary matters should be commensurate with the impact those same matters have on price.
- 31 The PUB must set the agenda, and direct the scope of the hearing to align with its needs to determine just and reasonable rates. The PUB must provide feedback on the elements of MPI's application, and the cases brought by interveners, that are genuinely valuable and aid in the PUB's determination of just and reasonable rates. Natural justice does not require the process to be beholden to special interests, of either interveners or the applicant.
- 32 The PUB must offer clear reasons for decisions articulating which positions it does not accept and why, and which positions have carried weight in arriving at its decision.

5.2 Tailoring the Process of the GRA to the PUB's Needs

- 33 The process should be responsive to the issues at play in the given application. Ideally, the scope of issues should narrow as the process unfolds. First round IRs are understandably wide in scope. Second round IRs should target only unanswered or follow up issues from first round IRs. Intervener evidence and rebuttal should focus in on unresolved issues of second round IRs, and further narrow the scope unresolved issues to be dealt with at the oral hearing, or simply through closing submissions.
- 34 The current process is fixated on the oral hearing – with hearing dates scheduled before the application is filed⁹. The oral hearing is primarily a tool to assess the credibility of the case, but it often becomes a tool for further discovery, or canvassing issues that could have been dealt with through information requests.
- 35 The PUB should assess and determine the need for an oral hearing, based on the evidence and extent of the record before it. In cases where the record is sufficiently

⁹ The PUB's 'Notice of Public Hearing', sets a date for the hearing before the final scope of issues is determined, interveners are granted standing, or any evidence is tested. A 'Notice of Application' would allow the process more flexibility.

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complete, upon delivery of rebuttal evidence, the PUB should consider moving directly to argument and reply.

- 36 If an oral hearing is necessary to fill gaps in the record or address legitimate credibility concerns, the scope of the oral hearing should be narrow, and focused on only those outstanding matters addressed in intervener evidence and rebuttal evidence. Matters of the Application, and first round IRs should generally be resolved by the time the time a hearing starts. Time in hearing should be devoted to uncovering the complexities of core issues, not confirming information on the record, and establishing a posture for closing argument.

6 Alternative Regulatory Approaches for Managing Issues that are not Key Price Determinants

- 37 It is true that nearly all issues have some effect on pricing, and while pricing is the primary objective of regulation, it is not the sole objective. There is merit in canvassing the secondary issues, in a manner commensurate with the impact those issues have on pricing. The following approaches could achieve that objective.

6.1 Revolving Issues List

- 38 A revolving issues list could establish a schedule for detailed review of secondary issues, over a 2-5 year horizon, such that the full suite of GRA issues is examined in detail over time.
- 39 This approach would limit the scope of how much information must be covered annually, and puts an emphasis on the key price determinants. Secondary topics would receive a 'deep dive' on a predictable cycle, and the process could include a mechanism to ensure that unforeseen developments related to secondary topics are considered in a timely manner.

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6.2 Interim Update Applications

- 40 A full GRA could be prepared for 2 to 3 test years. That process would result in approval of the first test year on a final basis, with interim approvals for years two and three. Update applications would be brought in years 2 and 3 to crystalize any material changes in key price determinants – such as claims, expenses, or capital and investments.
- 41 Interim update applications could be heard by way of a written proceeding – IRs, evidence and rebuttal, written closing argument and reply. An oral hearing would be reserved for the full application.

6.3 Scale the GRA with the Rate Increase

- 42 The BCUC established a process by way of Order G-65-10, that scales the process with the size of the rate request¹⁰. ICBC proposed the following approach, that streamlines or eliminates the full GRA process in instances where there a minimal rate change.

Rate Change Criterion	
Actuarial Rate Indication	ICBC Will File:
Less than -1.0%	Streamlined Application
Between (and including) – 1.0% and +1.0%	Streamlined Application or Actuarial Certificate
Over +1.0% to +2.5%	Streamlined Application
Over +2.5%	Non-Streamlined Application (full revenue requirements application)

¹⁰ Note the Alberta Utilities Commission has a range of process options to consider various matters and determines the process to be used upon receiving an application. Please see [AUC Bulletin 2019-5](#) explaining Facility Application Performance Standards, for illustrative examples.

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- 43 Content of the “streamlined” application would be limited to key price determinants, such as claims, expense, investment and capital topics. In instances where the proposed overall rate change is less than +/- 1.0% (or \$10 million in total revenue requirement), the application would consist only of an actuarial certificate, attesting to the overall, and major class rate changes.

7 Alternatives to the Current Approach to Price Regulation

- 44 There are several alternatives to the current structure of the GRA that could reduce the regulatory burden, or shift it in ways that make the process more manageable. These are reviewed below.

7.1 Negotiated Settlement Agreements (NSA)

- 45 The PUB Rules of Practice and Procedure do not currently contemplate negotiated settlements, used in other jurisdictions to reduce the time and cost of the regulatory process.

- 46 For example, the Alberta Utilities Commission Rule 018: Rules on Negotiated Settlements, specifies a sequence of events that could be employed roughly as follows:

- a) MPI files full application per usual
- b) MPI requests permission to pursue a negotiated settlement, on issues pertinent to the application
- c) Following a first round of information requests MPI and approved interveners assemble to negotiate. PUB staff would be present at the negotiations to observe and ensure that the negotiating process was fairly conducted
- d) MPI would then file a settlement agreement outlining:
 - Which issues were settled through negotiation (some or all)

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- Details of issues not resolved
 - Issues where acceptance is not unanimous
 - The rates that result or will result from the settlement, supported by schedules, to assist the PUB in understanding how the rates were derived
 - A description of any outstanding issues
 - A settlement brief explaining the basis of the settlement and how it meets the interests of the parties and the public interest
- e) The PUB could seek additional information it considers necessary, and will render a decision on the issues that are unresolved, and whether the settlement results in rates that are just and reasonable
- f) The PUB makes a final determination on the reasonableness of any settlement

7.2 Performance Based Ratemaking (PBR) on Operating Expenses

- 47 Cost of Service Regulation is inherently costly to administer, and does not incentivize efficiency in operations. Performance Based Regulation (“PBR” and sometimes called Formula Based Ratemaking – “FBR”) is distinct from Cost of Service in that it:
- a) Breaks the link between cost and price – as in a competitive market
 - b) Adjusts rates (or revenue) through indexing, irrespective of the actual forecast costs
- 48 The utility is incented to increase operational efficiency by retaining any savings it achieves through gains in efficiency through the PBR term. At the end of the term, the rates are “re-based” and the efficiencies are passed on to customers through lower rates/prices.
- 49 While MPI must continue to employ actuarial standards for rate setting, PBR could apply to Operational Expenses, which would flow into the AAP rate setting calculations

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annually. Instead of the operational expense forecast, rate making would incorporate the indexed expense 'allowance' each year.

- 50 Efficiency gains under PBR could flow into the RSR, a capital fund for major initiatives, or some other mechanism to appropriately incentivize a crown corporation. The regulatory burden would be reduced through the PBR term (years 2-5), as the rate review would be limited to claims, ratemaking and capital considerations.
- 51 Significant effort would be required to design the particulars of the PBR system, including inflation and productivity factors, capital factors, off-ramps; and to establish the 'going-in' rates. However, PBR is not new, and has been employed as a regulatory tool for approximately two decades – providing ample experience to guide the design.

7.3 Separate Revenue Requirements and Rate Design

- 52 Separating Rate Design and Revenue Requirements would reduce the burden in a given GRA by shifting the rate design considerations to a separate process held once every three to four years.
- 53 Issues related to AAP Ratemaking, DSR and Vehicle Premium Discounts, Primary Driver and Registered Owner could be considered in a separate proceeding, that is not time bound by the December 1st deadline. The findings of a Rate Design proceeding would be applied to the next revenue requirements application.
- 54 This approach also has the advantage of isolating the rate design from the determination of a given year's rates. Rate design should not be determined in the context of its impact on the coming year's rates, but rather based on principles and objectives that are consistently applied through the range of circumstances that may present themselves.

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8 Conclusion

A variety of options are available to the PUB to increase the process efficiency, decrease the regulatory burden, and maintain adequate and appropriate regulatory oversight. The annual GRA is not the ideal venue to consider these options, MPI trusts that the information presented herein will spark discussion and action to move beyond the status quo.

On a final point, PUB panel members should discuss these issues directly with the parties. It is noted that judges directly discuss changes to the Rules of Court with the legal profession; discussions on rule changes are not between court staff and the legal profession.

Bibliography

1. Lesser, Jonathan, and Leonard Giacchino, *Fundamentals of Energy Regulation*, 2nd Edition, 2013.
2. Hempling, Scott, *Regulating Public Utility Performance, the Law of Market Structure Pricing and Jurisdiction*, 2013.