

Manitoba Hydro
2023/24 & 2024/25 GRA

Response to Undertaking #50 (Transcript Page 2715) – Exhibit CC-31

Undertaking #50:

Please provide Mr. Rainkie’s commentary drawing on his expertise in utility regulation on whether the definition of “revenue requirement” in Section 39(1) of the Manitoba Hydro Act is sufficiently inclusive and focused on the appropriate items or whether it is cause for concern in terms of the PUB’s ability to set just and reasonable rates

Response:

In Mr. Rainkie’s experience, the definition of revenue requirements for utility rate setting is usually based on the applicants items of expenses and revenues as presented in their audited financial statements, consistent with accrual accounting and the accounting framework of the applicant, which may or may not include regulatory deferral accounts depending on whether the applicant qualifies for regulatory accounting.

Return on debt (financing costs) and return on equity (contributions to financial reserves) are dependent on the form of regulatory methodology that it used to set rates. Under the RBROR methodology return on debt and equity is set based on a utilities approved rate base and capital structure, while under a MCOS methodology, return on debt is based on forecasts of finance expense and contributions to financial reserves (net income) are set on a judgemental basis to achieve financial metrics over time.

In the case of Manitoba Hydro, the definition of revenue requirements used by the PUB to set electricity rates has evolved over time to be consistent with its statement of income under IFRS, which if placed into an illustrative equation form, would be as follows:

- + Operating & Administrative Costs
- + Net Finance Expense
- + Depreciation & Amortization
- + Capital & Other Taxes
- + Other Expenses
- + Corporate Allocation
- - Net Export Revenues (Export Revenues – Water Rentals & Assessments – Fuel & Power Purchased)
- - Other Revenues

- +/- Net Movement in Regulatory Deferrals
- +/- Net Income or Net Loss Attributable to Non-Controlling Interests
- +/- Contribution to Financial Reserves (Net Income or Net Loss)

Mr. Rainkie's observations with respect to the definition of revenue requirement contained in Section 39(1) of the Manitoba Hydro Act, not to become operative until April 1, 2025 are as follows:

- Section 39(1)(a) does not explicitly contain all of the expense or revenue items noted in the illustrative equation above, the most concerning of which would be the exclusion of export revenues that have been historically used to offset a portion of the revenue requirements from domestic customers and the exclusion of a contribution to financial reserves to mitigate the risks of the Corporation (although Section 39(1) (b) does mention the achievement of financial targets that inherently involves such contributions as naturally forming part of equity);
- The definition of "amounts in respect to capital expenditures" and "debt service costs" in Section 39(1)(a) are unclear for rate-setting purposes. As noted in the illustrative revenue requirement equation above, it is common utility regulatory practise to included depreciation & amortization of capital expenditure in rates as these expenditures have enduring benefit to customers over their useful lives and it is common regulatory practise to include the annual financing costs related to forecast levels of debt. It is not common utility regulatory practise to include the total capital expenditures themselves and repayment of debt principal in rates; and
- Section 39(1)(a) includes the words "reasonable costs", "including" and "other amounts to be paid out of the corporation's revenue" but does not include words such as "limited to the following". These facts could imply flexibility to the PUB in using its discretion to determine the precise definition of revenue requirements to set electricity rates for Manitoba Hydro.