

April 21, 2023

THE PUBLIC UTILITIES BOARD OF MANITOBA
400-330 Portage Avenue
Winnipeg, Manitoba, R3C 0C4

ATTENTION: Dr. D. Christle, Board Secretary and Executive Director

Dear Dr. Christle:

RE: Manitoba Hydro's 2023/24 & 2024/25 General Rate Application and MIPUG Recommendation 4 of Expert Witness Patrick Bowman

In the report of expert witness Patrick Bowman, filed on April 3, 2023, as Intervener evidence on behalf of the Manitoba Industrial Power Users Group ("MIPUG"), Mr. Bowman makes the following recommendation:

Recommendation 4: Balances in the Conawapa deferral account, the Loss on Disposal account related to discontinued operations, and the Asset Removal cost deferral account, totalling approximately \$382 million, should be written-off to income in 2022/23. The Board should ensure the necessary Orders are provided in time for this transaction to be recorded in the 2022/23 fiscal year.

On April 11, 2023, the Public Utilities Board of Manitoba ("PUB" or "Board") issued Order 42/23 with respect to Manitoba Hydro's 2023/24 & 2024/25 General Rate Application ("GRA" or "Application"), providing the following direction with respect to Recommendation 4 of Mr. Bowman's evidence:

The Board is prepared to consider MIPUG's recommendation before the oral hearing and invites each party to provide a written submission on that issue by Friday, April 21, 2023. The submissions should address the following matters:

- *Is it appropriate to write off Board-approved regulatory deferral accounts against 2022/23 net income?*

- *Are there adverse consequences (e.g., a perceived lack of regulatory certainty) to writing off a Board-approved regulatory deferral account? If so, what is the anticipated impact of those consequences?*
- *Should any other deferral accounts be written off completely or partially against 2022/23 net income?*

For the PUB's review and consideration, Manitoba Hydro's comments on MIPUG Recommendation 4 for the write off of the Conawapa and loss on disposal regulatory account balances against 2022/23 net income are provided below:

1. Summary

- Conawapa deferral account was approved by the PUB in Order 59/18. The balance in the deferral account as at March 31, 2022 was \$329 million and is anticipated to have a balance of \$316 million as at March 31, 2023.
- The Loss on Disposal regulatory deferral account was established based on Manitoba Hydro's interpretation of clarification received from the PUB via letter on April 4, 2016 in relation to Order 73/15. The balance in this account as at March 31, 2022 was \$67 million consisting of both discontinued and continuing operations. \$43 million of the balance relates to discontinued operations and \$24 million relates to continuing operations, of which \$23 million is cost of removal.
- Had these regulatory deferral accounts not been established, the full impact of the losses associated with each account would have been included in the revenue requirement when the losses occurred, rather than being smoothed out over time.
- The primary driver for the recommendation to write-off these balances in 2022/23 appears to be the high forecasted net income in that year. Manitoba Hydro's net income, high or low, should not affect/change the original decision that it is appropriate to collect these costs over time rather than in a single year.
- Since the write-off of the Conawapa deferral account is not anticipated to improve or change the achievement of the debt ratio targets set out in *The Manitoba Hydro Amendment and Public Utilities Board Amendment Act* (the "Act"), there is no anticipated clear benefit to customers resulting from a write-off.

- A decision to write-off these accounts would be considered a non-adjusting subsequent event to Manitoba Hydro's fiscal year ended March 31, 2023 based on IAS10. This means the 2022/23 financial statements would not be adjusted to reflect these write-offs and the write-offs would be reflected in the 2023/24 financial statements.
- A decision to write-off the Conawapa and/or Loss on Disposal regulatory deferral accounts could create precedence for the treatment of other deferral accounts and could create uncertainty around the valuation and future recovery of all regulatory deferral accounts. This uncertainty exists in relation to both current accounting standards as well as the new IFRS Exposure Draft (ED) on Regulatory Assets and Liabilities.
- For all of the above noted reasons, Manitoba Hydro recommends that these regulatory deferral accounts be kept in-place and not be written-off against 2022/23 net income.

2. Background on each Regulatory Deferral Account

Manitoba Hydro recorded the full losses associated with each deferral account as an expense in the year the loss occurred for financial reporting purposes, then the deferral accounts were established to smooth the impact to customers of these losses over the amortization period of each deferral.

Conawapa Regulatory Deferral Account

In Order 59/18, the PUB accepted Manitoba Hydro's proposed treatment of the \$380 million of past costs incurred with respect to the Conawapa Generating Station. Manitoba Hydro proposed that the costs pertaining to the construction of Conawapa be charged to net income under IFRS, then recorded in a regulatory deferral account effective March 2018, with the amortization of the regulatory deferral on a straight-line basis into revenue requirement over a period of 30 years beginning on April 1, 2018. The PUB ruled that the treatment of Conawapa costs via a regulatory deferral was appropriate because the decision to discontinue Conawapa construction was part of the NFAT review of the Utility's long-term system planning for long-lived assets. Further, the approach smoothed out the impact of this one-time cost on consumers.

Loss on Disposal Regulatory Deferral Account

The Loss on Disposal regulatory deferral account was established based on Manitoba Hydro's interpretation of clarification received from the PUB via letter on April 4, 2016 in relation to Order 73/15. Manitoba Hydro was advised to maintain its existing CGAAP accounting for regulatory purposes and to seek guidance from its financial advisors as to accounting treatment for financial reporting purposes. This issue is related to the decision on Manitoba Hydro's depreciation methodology for rate setting purposes, which is a topic of this proceeding. This interpretation resulting in creation of this regulatory deferral account is described in GSS-GSM/MH I-1 I) pages 4-5 "Gains and Losses on Disposal of Assets" from this proceeding.

3. Analysis Based on Questions Asked by the PUB

Manitoba Hydro submits that there are several aspects that should be considered in relation to the questions that the Board has asked on the potential write-off of these deferral accounts. These aspects are incorporated in Manitoba Hydro's response to the PUB's questions below:

PUB Question: Is it appropriate to write off Board-approved regulatory deferral accounts against 2022/23 net income?

In considering whether it is appropriate to write-off these regulatory deferral accounts against 2022/23 net income the following should be considered:

- 1) Net Income in a single year should not impact the original intent of the deferrals.

The regulatory deferral accounts in question were established to provide rate smoothing in relation to the recovery of costs associated with Conawapa and items within the Loss on Disposal account. Had these regulatory deferral accounts not been established, the associated losses would have significantly impacted Manitoba Hydro's revenue requirement in the years the losses occurred and would likely have impacted rates charged to customers in those years to allow Manitoba Hydro to recover its costs. High net income for Manitoba Hydro should not affect/change the original decision that it is appropriate to collect these costs over time rather than in the year where they were incurred (or in a single year).

In contrast to the current situation, it has not been the practice of the PUB to pause or extend the amortization of deferral accounts when Manitoba Hydro is forecasting a loss, such as when a drought occurs.

2) Benefit to customers

In responding to information requests PUB/MH I-33b and PUB/MH I-111c, Manitoba Hydro demonstrated that a decision to write-off the Conawapa regulatory deferral is not anticipated to improve or change the achievement of the debt ratio targets set out in the *Act*. Since the write-off of the Conawapa deferral account is not anticipated to improve or change the achievement of the debt ratio targets set out in the *Act*, there is no anticipated material benefit to customers resulting from a write-off.

3) Challenges to recording these write-offs in 2022/23

Based on further review of the recommendation and consideration of accounting standards, Manitoba Hydro anticipates that there will be challenges to recording a write-off of these deferral accounts against 2022/23 net income even if the PUB were to reach such a decision.

Such a decision would be considered a subsequent event to Manitoba Hydro's fiscal year ended March 31, 2023. Subsequent events are classified as either an adjusting or non-adjusting event. IAS 10 covers the accounting treatment for subsequent events and provides guidance on whether such an event would be "adjusting" or "non-adjusting" in nature. The differentiating factor between an adjusting and non-adjusting subsequent event is whether the information received is regarding conditions that existed at or before the year-end date (March 31, 2023). If the conditions existed at or before the year-end date, then the event would be classified as an adjusting subsequent event and the financial statements would need to be adjusted to incorporate the event. Alternatively, if the information is indicative of conditions that arose subsequent to the year-end date, then the event would be classified as a non-adjusting event and it would only be disclosed (if material).

To be considered as an adjusting subsequent event, which would result in the write-offs being incorporated into the 2022/23 financial statements, an argument would need to be advanced that the conditions triggering the write-off arose either on or before March 31, 2023. Recognizing that a new directive or order from the PUB to write-off the deferral accounts (i.e. treat them differently than outlined in earlier orders) would be issued after the year end date, Manitoba Hydro believes it's more likely than not that this event would be considered a non-adjusting subsequent event

and would not result in the write-off being incorporated in the 2022/23 financial statements.

PUB Question: Are there adverse consequences (e.g., a perceived lack of regulatory certainty) to writing off a Board-approved regulatory deferral account? If so, what is the anticipated impact of those consequences?

A decision to write-off the Conawapa regulatory deferral account and the discontinued operations and cost of removal portions of the Loss on Disposal regulatory deferral account has the potential to create adverse consequences by:

- 1) Creating uncertainty around the valuation and recovery of all regulatory deferral accounts in relation to both current accounting standards as well as the new IFRS Exposure Draft (ED) on Regulatory Assets and Liabilities.

A decision to write-off these deferral accounts without recovery of their remaining balances is likely to create uncertainty associated with the recovery of other regulatory deferral balances. A key consideration for regulatory deferral accounts under current accounting standards (IFRS 14 and the U.S. GAAP regulatory standard) is the likelihood of future recovery of the relevant costs through future rates. A decision to write-off these deferral accounts due to high net income in 2022/23 could set a precedent whereby other regulatory deferral balances are questioned in future years where net income is favourable.

Under the new IFRS Exposure Draft (ED) on Regulatory Assets and Liabilities, the measurement (or valuation) of a regulatory deferral account would involve an assessment of the “risks and uncertainties” associated with their future cash flows. The assessment of risk would factor into the establishment of book value, planned amortization period, and the discounting process when determining the amount to record on the financial statements for the deferral accounts and any future revaluation. A decision to write-off the Conawapa and Loss on Disposal regulatory deferral balances against 2022/23 net income would likely introduce significant estimation uncertainty in evaluating when and how to recognize and measure regulatory deferrals going forward under the new IFRS Exposure Draft (ED) on Regulatory Assets and Liabilities.

- 2) In relation to the Loss on Disposal account, creating a precedence that could impact the treatment of other existing deferral accounts including those for Manitoba Hydro's gas segment.

The Loss on Disposal regulatory deferral account includes losses related to discontinued operations, the cost of removal related to both continuing and discontinued operations and gains/losses on continued operations. A decision to write-off the amounts in this account related to discontinued operations and all costs of removal could imply or create a precedent that there should be no future deferrals in the event of a large loss associated with discontinued operations. Similarly, the write-off of the cost of removal portion included in the Loss on Disposal account would suggest future such costs should not be deferred. In such a case, costs to decommission an asset like Selkirk GS would be expensed as incurred.

A further complication on this issue relates to Centra Gas Manitoba Inc. ("Centra"), as subsidiaries normally follow accounting practices of the parent entity, and regulatory principles should be applied consistently to both entities. Centra also has a Loss on Disposal account and the amounts in that account are nearly all related to service line abandonments, which total approximately \$2 million per year and pertain to interim retirements for an on-going account. A write-off of this account and requirement to expense service line abandonments as incurred would have a very material impact to Centra's financial statements.

At minimum, there is likely a need to treat the cost of removal related to interim retirements for on-going accounts (e.g. Centra service line abandonments) differently than the cost of removal for discontinued operations (e.g. Selkirk GS). However, the continued deferral of costs related to discontinued operations likely still has merit from a rate smoothing perspective.

For all of the above noted reasons, Manitoba Hydro submits that these regulatory deferral accounts should remain in-place and not be written-off against 2022/23 net income as recommended by Mr. Bowman.

Should you have any questions with respect to the aforementioned, please do not hesitate to contact the writer at 204-360-3257.

Yours truly,

MANITOBA HYDRO LEGAL SERVICES

Per:



Brent Czarnecki
Senior Counsel