

**Comments on the scope and process of a technical conference  
on rule-based regulation and a minimum retained earnings test  
by Green Action Centre**

**August 15, 2018**

**BACKGROUND**

In Order 59/18, the PUB directed Manitoba Hydro

*to participate in a technical conference hosted by Board Staff or an external consultant appointed by the Board for the consideration of the establishment of a minimum retained earnings or similar test to provide guidance in the setting of consumer rates for use in rule-based regulation. The test or rule is to be based on maintaining appropriate or minimum levels of retained earnings and meeting other financial metrics in the face of potential risks to the Utility. The Board will develop the terms of reference for the technical conference. Parties will be invited to contribute to the scope and terms of reference for this initiative. (66 of 316)*

On May 30, 2018, Manitoba Hydro filed an application to review and vary Orders 59/18 and 68/18. Among other matters, MH expressed concern that the above directive had the following implications.

*Read together with Directive 9, Manitoba Hydro interprets that the PUB is seeking to use a technical conference to establish for itself an objective, quantitative means of setting rates to assure a reasonable probability that Manitoba Hydro maintains minimum retained earnings during the test years. Manitoba Hydro understands this directive to mean that going forward, so long as retained earnings are at a minimum level (which Manitoba Hydro interprets Order 59/18 to say is, at most, today's level) then rates will be set such that there is a reasonable probability of Manitoba Hydro achieving zero net income.*

And MH expressed frustration that

*Unfortunately, Order 59/18 provides no clarity on how or when the achievement of financial targets are to be actioned or on what a long term plan acceptable to the regulator will look like. (Appendix D, 2 of 10)*

In Order 90/18, the PUB offered the following to clarify its position.

*Manitoba Hydro appears to have misinterpreted Order 59/18 as requiring that a minimum retained earnings test be established and that all other financial metrics will be abandoned. This misreads the Board's intent. Order 59/18 sets out that the aim of the technical conference is to gain a better understanding of rule-based regulation in Manitoba Hydro's particular operational context and circumstances. As such, Directive 9 provides for a Board-hosted technical conference that will be a forum for stakeholders to discuss and explore the use of rule-based regulation that considers the level of financial reserves required by Manitoba Hydro under various circumstances and meeting other financial metrics in the face of potential risks to the Utility. The technical conference is to bring clarity on these matters, which were discussed in the evidence at the GRA but not fully canvassed as to whether and how rule-based regulation could be employed by the*

*Board going forward. As set out in Order 59/18, the scope of the technical conference will be determined by the Board following the receipt of comments from the parties. (35 of 45)*

## **GREEN ACTION CENTRE COMMENTS**

### **Perspective**

Green Action Centre is a champion of sustainability, guides its interventions by principles of sustainability, and urges other parties to do the same. Manitoba is fortunate to have a Sustainable Development Act, which has endured since 1997 with the support of all political parties (<https://web2.gov.mb.ca/laws/statutes/ccsm/s270e.php>). In Order 135/05, the PUB found that Manitoba Hydro, including Centra Gas, and the PUB itself were bound by Manitoba's Sustainable Development Act. Principles and Guidelines for Sustainable Development contained in the Act are attached to this submission as Appendix A. In short, they prescribe guiding actions by a wide-ranging long-term perspective on well-being, which is executed, insofar as possible, on the basis of shared understanding and collaboration.

Particularly relevant to deliberations on the forthcoming technical conference are the Principles of Stewardship, which includes an intergenerational perspective and the need to balance today's decisions with tomorrow's effects, and Shared Responsibility and Understanding, which underwrites collaborative efforts based on broad and inclusive understanding.

### **Observations and concerns**

1. The PUB's characterizations of the technical conference suggest a variety of questions.
  - a. What is meant by rule-based regulation? Is it a pure type, a matter of degree, or a variety types of regulation? How does it compare with alternative forms of regulation, e.g. principle-based regulation? Can it prescribe precise rates (e.g. the weekly surplus energy program rates) or only numerical values to be weighed alongside other considerations (e.g. COSS)? What are the pros and cons of this approach (these approaches) to regulation?
  - b. How are rules derived in rule-based regulation? To what extent is a rule a determination of technical analysis vs. a consensus or negotiated or adjudicated decision? How do rules function in rule-base regulation? What principles and/or objectives do they serve? What complementary considerations are required?
  - c. More specifically, how do the above questions apply to a minimum retained earnings test.
  - d. Is the proposed technical conference intended (a) to consider whether rule-based regulation is useful or desirable in Manitoba Hydro's current context (or not) and/or (b) to develop a minimum retained earnings test and/or (c) to initiate a process to develop a minimum retained earnings test and initiate a rule-based regulatory regime?

Conclusions:

For the technical conference to be productive, the PUB (1) needs to consider questions like these in clarifying the scope and terms of reference for the technical conference and (2) should commission a qualified consultant to produce a paper on issues and alternatives regarding the topics chosen for consideration to provide a shared background, focus and foil for the discussion. This document should be distributed sufficiently in advance of the conference for participants to prepare questions and comments. If the intention of the conference is to make progress in the actual development of rules and a rule-based regulatory regime, further iterations of written questions, comments, and synthesis of an evolving document by the consultant will be required, as occurs in rule-making dockets in other jurisdictions.

2. We share Manitoba Hydro's concern that the language of Order 59/18 suggests a focus on minimum retained earnings to guide near- to mid-term rate-setting with an absence of longer-term considerations. For example, 59/18 states

*As such, the Board is not prepared to look at the issue of pacing to achieve a particular equity level target at least until the current phase of major capital construction is completed, now projected by Manitoba Hydro to be in 2024. (64 of 316)*

We have several observations.

- a. An equity to debt ratio of 25/75 has functionally served as a long-term target for Hydro's financial planning. Removing that target from consideration without identifying other longer-term goals creates a financial planning vacuum in which only short-term considerations bear weight. As indicated in our GRA and Review and Vary submissions, we believe that such a policy may not be the most economic and could reduce Manitoba's energy competitiveness in the long run for Manitoba Hydro's customers if carrying charges on the remaining debt load are too high and costs of alternative technologies continue to decline. Unfortunately, no analysis of the risk to future competitiveness was provided in the GRA.
- b. Regardless of the merit of these views, under the Sustainable Development Act, both the PUB and Manitoba Hydro have longer term Stewardship responsibilities. It would be unfortunate if the PUB left long-term planning to Manitoba Hydro alone and took only a short-term perspective in making its decisions. For example, Order 59/18 states

*Any benefits of Manitoba Hydro's financial plan must be balanced against the interests of ratepayers. Funds taken out of the pockets of ratepayers through higher rate increases have a cost. In balancing this against the benefits of Manitoba Hydro's plan, the Board finds that the cost to ratepayers is not justified. (63 of 316)*

This formulation separates and opposes Hydro's planning and the interests of ratepayers. It is a truism that "Funds taken out of the pockets of ratepayers through higher rate increases have a cost." It is also true that any level of rates has a cost and that higher future rates because of lower rate increases now will have a lingering cost. Financial planning and stewardship require

taking account of and optimizing costs and benefits over time. Both the PUB and Hydro should share that responsibility. The supposition should be that both institutions are guided by the public interest over time including the interests of ratepayers, short- and long-term. If, in the PUB's view, Hydro got it wrong this time, then the PUB should help Hydro to get it right.

- c. An acknowledgment of shared principles, responsibilities and goals sets the stage for collaborative inquiry. Order 90/18 explicitly rejects the notion that it intends to regulate by a singular minimum retained earnings test to the exclusion of other metrics. We believe that longer-term risks, opportunities, objectives and relevant metrics should be included to serve Manitoba Hydro's and the PUB's planning and stewardship responsibilities for a balanced set of rules.
- d. What might complementary, future-oriented guidelines or metrics look like? Examples can be found in the Boston Consulting Group's report of various benchmarks defining headroom for rate increases, including current rate levels of other utilities, recent rate increases of other utilities, and electric bills as a percentage of income (204 of 615 and following). BCG also recognizes that some customers are more vulnerable than others and that other utilities provide mitigative measures to increase affordability for vulnerable customers. Manitoba Hydro's six-year 7.9% proposal exceeded some of the BCG benchmarks for comparability and competitiveness and lacked mitigation for vulnerable customers.

Thus notionally, a channel for rate increases is defined by BCG's comparative benchmarks with mitigation for vulnerable customers as an upper limit and Morrison Park Advisors analysis as a lower limit. An analysis of longer term costs and benefits would help determine where in the channel the increases occur.

#### Conclusions:

1. The PUB should heed Manitoba Hydro's request for guidance on acceptable long-term planning guidelines and include that discussion within the technical conference on rule-based regulation along with retained earnings guidelines.
2. The discussion of particular rules should be accompanied by a discussion of the principles and objectives they are designed to serve as well as the risks they seek to avoid.

## **Appendix A – Principles and Guidelines of Sustainable Development**

### **Schedule A Principles of Sustainable Development**

#### **Integration of Environmental and Economic Decisions**

- 1(1) Economic decisions should adequately reflect environmental, human health and social effects.
- 1(2) Environmental and health initiatives should adequately take into account economic, human health and social consequences.

#### **Stewardship**

- 2(1) The economy, the environment, human health and social well-being should be managed for the equal benefit of present and future generations.
- 2(2) Manitobans are caretakers of the economy, the environment, human health and social well-being for the benefit of present and future generations.
- 2(3) Today's decisions are to be balanced with tomorrow's effects.

#### **Shared Responsibility and Understanding**

- 3(1) Manitobans should acknowledge responsibility for sustaining the economy, the environment, human health and social well-being, with each being accountable for decisions and actions in a spirit of partnership and open cooperation.
- 3(2) Manitobans share a common economic, physical and social environment.
- 3(3) Manitobans should understand and respect differing economic and social views, values, traditions and aspirations.
- 3(4) Manitobans should consider the aspirations, needs and views of the people of the various geographical regions and ethnic groups in Manitoba, including aboriginal peoples, to facilitate equitable management of Manitoba's common resources.

#### **Prevention**

4 Manitobans should anticipate, and prevent or mitigate, significant adverse economic, environmental, human health and social effects of decisions and actions, having particular careful regard to decisions whose impacts are not entirely certain but which, on reasonable and well-informed grounds, appear to pose serious threats to the economy, the environment, human health and social well-being.

#### **Conservation and Enhancement**

- 5 Manitobans should
- (a) maintain the ecological processes, biological diversity and life-support systems of the environment;
  - (b) harvest renewable resources on a sustainable yield basis;
  - (c) make wise and efficient use of renewable and non-renewable resources; and
  - (d) enhance the long-term productive capability, quality and capacity of natural ecosystems.

## Rehabilitation and Reclamation

6 Manitobans should

- (a) endeavour to repair damage to or degradation of the environment; and
- (b) consider the need for rehabilitation and reclamation in future decisions and actions.

## Global Responsibility

7 Manitobans should think globally when acting locally, recognizing that there is economic, ecological and social interdependence among provinces and nations, and working cooperatively, within Canada and internationally, to integrate economic, environmental, human health and social factors in decision-making while developing comprehensive and equitable solutions to problems.

## Schedule B Guidelines for Sustainable Development

1 **Efficient Use of Resources** - which means

- (a) encouraging and facilitating development and application of systems for proper resource pricing, demand management and resource allocation together with incentives to encourage efficient use of resources; and
- (b) employing full-cost accounting to provide better information for decision makers.

2 **Public Participation** - which means

- (a) establishing forums which encourage and provide opportunity for consultation and meaningful participation in decision making processes by Manitobans;
- (b) endeavouring to provide due process, prior notification and appropriate and timely redress for those adversely affected by decisions and actions; and
- (c) striving to achieve consensus amongst citizens with regard to decisions affecting them.

3 **Access to Information** - which means

- (a) encouraging and facilitating the improvement and refinement of economic, environmental, human health and social information; and
- (b) promoting the opportunity for equal and timely access to information by all Manitobans.

4 **Integrated Decision Making and Planning** - which means encouraging and facilitating decision making and planning processes that are efficient, timely, accountable and cross-sectoral and which incorporate an inter-generational perspective of future needs and consequences.

5 **Waste Minimization and Substitution** - which means

- (a) encouraging and promoting the development and use of substitutes for scarce resources where such substitutes are both environmentally sound and economically viable; and
- (b) reducing, reusing, recycling and recovering the products of society.

6 **Research and Innovation** - which means encouraging and assisting the researching, development, application and sharing of knowledge and technologies which further our economic, environmental, human health and social well-being.