



P.O. Box 815 • Winnipeg Manitoba Canada • R3C 2P4
Street Location for DELIVERY: 22nd floor - 360 Portage Avenue
Telephone / N° de téléphone : (204) 360-3946 • Fax / N° de télécopieur : (204) 360-6147
pjramage@hydro.mb.ca

August 14, 2012

Mr. H. Singh
The Public Utilities Board
400 - 330 Portage Avenue
WINNIPEG, Manitoba R3C 0C4

Dear Mr. Singh:

RE: MANITOBA HYDRO GENERAL RATE APPLICATION, INTERIM RATE INCREASE EFFECTIVE SEPTEMBER 1, 2012

Manitoba Hydro filed its submission with respect to its proposed September 1, 2012 interim rate increases on July 20, 2012, together with the additional information requested by the Public Utilities Board of Manitoba (“PUB”) in its correspondence of July 9, 2012. Three Intervenor, Consumers Association of Canada (Manitoba) (“CAC”), Green Action Centre (“GAC”) and Manitoba Industrial Power Users Group (“MIPUG”) filed submissions regarding the September 1, 2012 interim rate proposal on August 8, 2012. Order 98/12 provides Manitoba Hydro the opportunity to file its Reply to these submissions by August 15, 2012.

Jurisdiction to Approve Interim Rate Increases

Two Intervenor, MIPUG and CAC, argue that when considering interim rates, the overriding regulatory principle is that such relief cannot be granted unless urgency is established. Manitoba Hydro disagrees with this premise and notes that the PUB has consistently rejected this argument in the past. The overriding regulatory principle when considering any rate application, including interim rates, is the public interest; that is, whether the rates appropriately balance the interests of ratepayers with the fiscal health of the utility. The Manitoba Court of Appeal described the PUB’s primary concerns when dealing with rate applications:

The PUB has two concerns when dealing with a rate application; the interests of the utility’s ratepayers, and the financial health of the utility. Together, and in the broadest interpretation, these interests represent the general public interest.¹

The legislature has afforded the PUB broad jurisdiction as to when and in what circumstances it approves interim rates. The appropriate concern is whether the interim rate increase is in the general public interest. While factors such as urgency, length of time required to issue a final order or financial difficulty may be valid considerations for the PUB in coming to its decision, none are determinative of the matter. The decision to be made is whether the interim rate increase is in the general public interest.

¹ Consumers Association of Canada (Man.) Inc. et al v. Manitoba Hydro Electric Board, 2005 MBCA 55.

The PUB's jurisdiction as it relates to the conduct of Manitoba Hydro rate applications is set out in *The Public Utilities Board Act* ("PUB Act"). The power to make interim orders is set out in s. 47(2) of the PUB Act:

47(2) The board may, instead of making an order final in the first instance, make an interim order and reserve further directions, either for an adjourned hearing of the matter, or for further application.

Had the legislature intended the PUB to be limited to exercising interim rate approval powers to situations where special circumstances such as urgency exist, it would have stated such requirement. For example, s. 48 of the PUB Act provides:

48 The board shall not make an order involving any outlay, loss, or deprivation to any owner of a public utility, or any person without due notice and full opportunity to all parties concerned, to produce evidence and be heard at a public hearing of the board, except in the case of **urgency**; and in that case, as soon as practicable thereafter, the board shall, on the application of any party affected by the order, re-hear and reconsider the matter and make such order as the Board seems just.

The legislature clearly turned its mind to situations where urgency must exist prior to the PUB exercising its powers. Such requirement was not applied with respect to the issuance of interim orders with notice to the parties pursuant to s. 47(2) and such requirement cannot be inferred in the circumstance.

MIPUG has reproduced its argument filed in the last General Rate Application ("GRA") with respect to April 1, 2011 interim rates. In this written argument and previously in its submission regarding April 1, 2010 interim rates, MIPUG took the position that s. 48 applies to applications for interim rate increases (i.e. an outlay to ratepayers), such that urgency must be established if the PUB wishes to approve a rate increase prior to the full hearing having been completed. This position is incorrect at law on several counts. The intent of s. 48 is to require notice and an opportunity to be heard in the prescribed circumstance, an exception for which is made in the case of urgency. Clearly the present matter is being considered with notice to all parties and a process has been put in place to allow the parties to be heard.² There is no need to look at the urgency exception prescribed in the legislation.

The suggestion that s. 48 applies to rate changes is also erroneous. If s. 48 were to be applied broadly as suggested by MIPUG, it would render other provisions of the regulatory scheme governing Manitoba Hydro inoperative and unnecessary. Section 47(2) of the PUB Act plainly authorizes the PUB to make interim orders. Section 28 of *The Crown Corporations Public Review and Accountability Act* contemplates the compensation or refunds where final orders do not confirm interim approved rates. The legislature clearly understood interim rates could be approved in a broad range of circumstances and that a mechanism ought to be in place should

² Section 15.2 of the PUB Act makes clear that the PUB has the power to conduct its proceedings in such a manner as it determines most convenient for the speedy and effectual dispatch of business. In this case by letter dated July 9, 2012, the PUB requested additional information be provided and by Order 98/12, issued a timetable for the filing of submissions by interested parties.

final orders not confirm the interim rates. Such provision would be unnecessary if approval of interim rates were limited to urgent situations involving dire financial consequences.

MIPUG and CAC both reference the 1989 Supreme Court of Canada decision in *Bell Canada v. Canada (Canadian Radio-Television and Telecommunications Commission)*³ in support of their position that the overriding regulatory principle for interim rates is urgency. The Bell Canada decision does not deal with the PUB Act of Manitoba or the interim rate provisions found therein. Further, the issue before the court was whether the regulator had legislative authority to review the revenues made by Bell Canada during the period interim rates were in force and order Bell Canada to grant a one-time credit to its customers.⁴ The court did not look at the issue of whether the circumstances in that case warranted the granting of an interim rate increase. While the court acknowledged the appropriateness of the CRTC's policy to issue interim orders in circumstances where lengthy delays in dealing with an application could result in serious deterioration in the financial condition of an applicant absent a general interim increase, it did not suggest this CRTC policy set out the only circumstance in which interim orders, including those made under other regulatory schemes, would be appropriate. The court did not consider the issue and its comments should not be taken out of context.

The arguments presented by CAC and MIPUG are not new to the PUB and have been consistently rejected in the past. The same arguments were advanced with respect to an April 1, 2010 interim rate increase, at which time Manitoba Hydro made it clear that it was not in immediate financial difficulty, and in Order 18/10 the PUB unequivocally rejected the urgency argument stating that "urgency is not a required condition".⁵ The governing legislation has not changed since these orders. The parties have not raised any new arguments nor referenced new case law which might impact the PUB's decision. There is no reason to revisit this issue.

Final Order Not Expected Until 2013

The length of time until the hearing begins or a final decision is expected to be issued is also cited by CAC and MIPUG as a reason to deny September 1, 2012 interim rates changes. It is of note that in Order 18/10 dealing with April 1, 2010 interim rates, the PUB appeared to consider it significant that its final order was not expected for in excess of six months following the effective date of the proposed interim rate increase.⁶ Manitoba Hydro notes that the GRA hearing is scheduled to commence December 10, 2012 and expects that the hearing will carry over into January of 2013. As such and assuming the PUB intends to issue an order prior to the conclusion of the Cost of Service Study ("COSS") review, such a GRA order is unlikely to issue prior to five to six months past the proposed September 1, 2012 implementation date. More time will elapse if the PUB intends to await completion of the COSS review. In this circumstance the entire magnitude of the rate increases will have to be absorbed by ratepayers in the spring of 2013. Such result cannot be said to be in the best interest of ratepayers when there is a reasonable alternative – to approve a modest interim rate increase of 2.5% effective

³ [1989] 1S.C.R. 1722.

⁴ Ibid at p. 16 of 43.

⁵ Order 40/11, p.28.

⁶ In Attachment 2 to CAC's submission, CAC implies that that PUB set out a list of circumstances in which it would consider approving an interim rate increase. The factors cited by CAC are comments made by the PUB regarding the factual circumstance in that case. None were specifically cited as preconditions to issuing an interim order.

September 1, 2012.

Manitoba Hydro's September 1, 2012 Application is Not a Review and Vary Application

MIPUG suggests Manitoba Hydro's Interim Rate Application ought to be regarded as a Review and Vary Application of Order 32/12. Manitoba Hydro has filed a fresh application supported by four binders of detailed information including the Corporation's most recent financial forecast IFF11-2, a document not available for review at the time Order 32/12 was issued. A process has been established for a detailed review of Manitoba Hydro's filing. The PUB has requested and has been provided additional information in order to review the application for interim rates. This is not a review and vary application.

It cannot be over-emphasized that the role of the PUB is to represent the public interest by balancing the interests of ratepayers with the financial health of the Corporation. This interest would not be served by imposing strict limitations on when the PUB may review rates nor has the legislature chosen to impose such restrictions. To the contrary, the legislative scheme gives the PUB broad powers to review rate applications as it sees fit:

44(1) Upon any application to it, the board may make an order granting the whole or part only of the application or may grant such further or other relief in addition to or in substitution for that applied for, as fully and in all respects as if the application had been for such partial, further or other relief.

The Public Interest is Best Served By Implementation of September 1, 2012 Interim Rates

Manitoba Hydro's perspective is that the public interest is best served by the implementation of a 2.5 % rate increase effective September 1, 2012. While Manitoba Hydro is strongly of the view that there exists no requirement that it demonstrate urgent financial need, the fact is there has been a serious deterioration of the financial outlook of Manitoba Hydro that requires rate relief on an urgent basis.

MIPUG is factually incorrect when they state that "absent the proposed rate increase, Hydro is not projecting a net loss, nor a net cash shortage."⁷ The Application is quite clear that without the proposed September 1, 2012 interim rate increase, Manitoba Hydro faces a budget of zero net income in 2012/13 (assuming the 1% rate rollback is reinstated) or worse, a \$35 million dollar loss (assuming the 1% rate rollback is not reinstated).⁸

In addition, MIPUG's submission indicates that there has been an improvement in the 2012/13 net income of \$13 million as compared to the forecast reviewed by the PUB in setting April 1, 2012 interim rates and as such more current facts would suggest that there is less need for a September 1, 2012 interim rate increase. While it is correct that forecast net income for electric operations in 2012/13 in IFF11-2 has increased to \$20 million from \$7 million forecast IFF11-1, this increase is not related to any improvement in underlying operational results but rather due to the requested reinstatement of the 1% rate rollback directed in Order 5/12 which

⁷ MIPUG Interim Rate Submission dated August 8, 2012, p. 1, paragraph 2.

⁸ Manitoba Hydro September 1, 2012 Interim Rate Submission, p. 3, Table 1, Net Income – Electricity Operations.

would impact net income by \$23 million.

Net Income (loss) before proposed rate increase	\$ (35)
Proposed September 1, 2012 rate increases	20
Rate rollback reinstatement	35
Net Income after proposed rate increases & rate rollback reinstatement	<u>\$ 20</u>

CAC states that it “has consistently argued against budgeting for a loss in net income.”⁹ Presumably CAC accepts that to do otherwise is to place Manitoba Hydro in a very precarious financial position. In these circumstances it is puzzling that CAC opposes the proposed rate increases given the consequence is to budget for a loss in net income.¹⁰

Simply put, negative or threadbare net income results place Manitoba Hydro in a challenging financial position which could impair the financial health of the utility. With each passing month the need for the interim rate increase becomes more acute and “allowing the utility to incur a net loss on operations is not in the best interest of electricity ratepayers and could result in the requirement for substantially higher rate increases in the future.”¹¹ This situation is certainly not in the public interest and unto itself would be sufficient reason to grant the Interim Rate Increase.

With regard to cash shortage, inferences by MIPUG that a capital coverage ratio of 1.0 is somehow acceptable as it “indicates the Corporation remains cash positive on an operating basis” is troubling. Beyond the fact that a capital coverage ratio greater than 1.0 provides essential cash to reduce its debt financing requirements, a capital coverage ratio of 1.0 is (a) well below the approved and accepted 1.2 target and (b) does not provide any cash support to buffer against adverse and variable risks (such as external factors such as weather, export prices, or economic conditions). Manitoba Hydro submits that it is not in the public interest to subject the utility to a capital coverage ratio of 1.0.

Similarly, CAC made references dismissing the urgency associated with a deteriorating interest coverage ratio claiming that Manitoba Hydro “chooses not to cite any credit agency reports as authority for its alleged imminent risk.”¹² Beyond CAC’s apparent disregard for the maintenance of the approved and accepted interest coverage target of 1.2, CAC has ignored Manitoba Hydro’s long standing history of filing credit rating agency reports. While no credit rating agency reports for 2012 have thus far been filed, a review of the filing from the previous GRA would provide ample cause for concern regarding a deteriorating interest coverage ratio. For example, in the Moody’s Investors Service credit opinion on MHEB published on February 7, 2011 (and filed as Exhibit 69 in the 2010/11 GRA), Moody’s states that:

⁹ CAC Interim rate Submission dated August 8, 2012, p. 3, 3rd bullet.

¹⁰ Manitoba Hydro September 1, 2012 Interim Rate Submission, p. 3, Table 1, Net Income – Electricity Operations.

¹¹ Manitoba Hydro Interim Rates Effective September 1, 2012 Submission, p. 2, lines 28-30.

¹² CAC Interim Rate Submission dated August 8, 2012, p.2, 3rd paragraph.

“MHEB’s financial ratios, including interest coverage, are an indication of the extent to which it is capable of supporting its debt independently, which is a consideration in the rating of the Province. MHEB’s financial forecasts indicate that management expects to generate sufficient cash flow to service the interest on its debt. However, the anticipated weakening of MHEB’s financial profile means that the company has less cushion against unexpected events such as poor hydrology, capital cost overruns or construction delays. Should such unexpected events arise, MHEB might need to seek larger rate increases, curtail its capital spending or take other actions to ensure that the company continues to be able to independently service its debt.” [page 2]

Since the publication of this report, the deterioration in the interest coverage ratio has placed additional financial pressure upon the utility to seek additional rate increases. Certainly, it is in the public interest for Manitoba Hydro to be able to independently service its debt.

Cumulative impact of the proposed 2.5% interim rate increase

Both CAC and MIPUG have expressed concern in their submissions that the implementation of a 2.5% interim rate increase effective September 1, 2012 will result a cumulative rate increase of 4.5% by the end of 2012/13. While it is mathematically correct that the implementation of the proposed interim rate increase will result in an annualized rate impact of 4.5% commencing in 2013/14, both CAC and MIPUG failed to recognize the deterioration in the financial outlook of Manitoba Hydro in their submissions and the potential impacts on customers in the future.

The financial outlook for Manitoba Hydro’s Electric operations for the years 2012/13 to 2013/14 has deteriorated significantly since the 2010/11 & 2011/12 GRA proceeding concluded. Net income for electric operations is projected to be reduced by \$101 million for 2012/13 and \$119 million for 2013/14 for a cumulative reduction of \$220 million. These facts clearly demonstrate that Manitoba Hydro requires the requested September 1, 2012 interim rate increase and rate rollback reinstatement to maintain net income and financial ratios in 2012/13 and 2013/14 at acceptable levels, to preserve the financial integrity of the Corporation in the period covered by its Application, and to promote rate stability for customers avoiding the need for large or sudden rate increases in the future.

Review of Capital Development Plans

GAC argues that it is the PUB’s responsibility to review the reasonableness of resource development costs, particularly in the absence of alternative reviews.¹³ Manitoba Hydro strongly disagrees with this assertion as the reasonableness of development projects fall within the supervisory functions of the Lieutenant Governor in Council under *The Manitoba Hydro Act*.¹⁴

In the 1989 Court of Appeal stated case, counsel for CAC attempted to argue that capital plans and expenditures could not be ignored in any workable system of rate review and if specific

¹³ GAC Interim Rate Submission dated August 8, 2012, pg. 5, paragraph 12.

¹⁴ *The Manitoba Hydro Act*, R.S.M. 1987, C. H190, section 16 (1).

legislation was not available, then the court should, of necessity, imply such power in the PUB. The Court disagreed and made it clear that the prudence of Manitoba Hydro's capital plans are not matters for PUB consideration:

On the basis of the legislation as it stands, the Board has no jurisdiction to approve, reject or vary Manitoba Hydro's major capital projects such as construction of new generating power stations or transmission lines.¹⁵

Further, as recently as 2011, the Manitoba Court of Appeal stated that the PUB's role is limited to approval of rate changes in the test years which are the subject of an application:

... plans do not affect the rates that are subject to review in a particular year. While plans, if implemented, may well affect the rates for basic insurance in future years, those rates will be subject to review by the PUB if and when the plans are realized and put into effect. Until then, the mandate to review and comment on long-term plans has been left to the Crown Corporations Council and the Government, and the PUB has not demonstrated how they are relevant to, or affect its ability to carry out its mandate in any particular year.¹⁶

As has been referenced numerous times, the Government has indicated its intention to hold a Needs For and Alternatives To ("NFAT") hearing to review Manitoba Hydro's development projects.¹⁷ Manitoba Hydro expects that the reasonableness of Manitoba Hydro development costs, its preferred development plan and alternatives will be reviewed, and dealt with, in a NFAT proceeding. Until such time as the NFAT occurs and the panel appointed to review these projects has made its final recommendation to the Lieutenant Governor in Council, Manitoba Hydro has based its IFF on its preferred development plan. Further, Manitoba Hydro routinely files forward looking documents with the PUB to provide a general understanding of the projected future direction of the Corporation and to provide a clear understanding of Manitoba Hydro's financial needs in the test years. Should changes be required subsequent to the determination by the Lieutenant Governor in Council, Manitoba Hydro will update its IFF to incorporate the approved plans.

Other matters of clarification

In order to ensure clarity of the record for the PUB, Manitoba Hydro would like to address a number of other matters raised by intervenors in their submissions.

¹⁵ PUB v Manitoba (Attorney General), [1989] M.J. No. 491,

¹⁶ PUB v MPI, et al., 2011 MBCA 88, p. 21-22, paragraph 43.

¹⁷ Letter from Minister Responsible for Manitoba Hydro to the Chairman of Manitoba Hydro dated January 13, 2011 (GRA 2010/11, Exhibit #162), "Further to our discussion about the regulatory processes to be applied to major new hydro generation projects, I can advise that in addition to review and licensing under applicable provincial statutes (including, but not necessarily limited to The Environment Act and The Water Power Act), it is the provincial governments intention to assign responsibility to an independent body for carrying out an NFAT (Needs For and Alternatives To) assessment of such projects."

MIPUG states on page 1 of their submission "... the IFF11-2 projects a return to positive net income by 2013/14 (\$68 million), in part reflecting the end of the anomalously high depreciation expense for 2012/13 in IFF11-2 (\$401 million, as compared to \$353 million in the year prior, and \$354 million in the year subsequent). the main reason for failing to project a positive net income is a non-cash one-time depreciation effect." While MIPUG's reasoning is not totally clear to Manitoba Hydro, Manitoba Hydro can state categorically that the increase in depreciation for 2012/13 is not an artificially inflated number. As indicated in Tab 5, section 5.7, page 24 of its GRA filing, the increase in depreciation expense for 2012/13 is primarily related to the Wuskwatim Generating Station being placed into service and the decrease in 2013/14 is primarily related to the impacts of the implementation of IFRS including the removal of asset retirement costs from depreciation rates and the removal of amortization of rate regulated assets. As such MIPUG's assertion is unfounded.

CAC states on page 2 of their submission "Hydro alleges that it is aggressively pursuing measures to ensure that capital expenditures are only those necessary to maintain safe, reliable and efficient service to customers. However, the reality remains that for the years 2011/12 and 2012/13, the total investment in electric plant and equipment is \$2,389 M in IFF11-2 versus \$2,242 M in IFF10-2. This higher capital spending will lead to higher debt and higher interest costs impacting both the debt-equity ratio and the interest coverage ratio." It appears that CAC's source of information is the investing activities portion of the projected cash flow statement versus the capital expenditure forecast provided in the Application. As indicated in Tab 6, section 6.2, page 1 of Manitoba Hydro's GRA filing outlines that the total capital spending for electric operations in CEF11-2 is \$1,074 in 2011/12 and \$1,201 in 2013/14, totaling \$2,275, which is an increase of \$65 million of the forecast presented in CEF10-2. This increase is not a result of poor cost control as alleged by CAC, but rather is primarily related to the Wuskwatim Generating station project and the associated increases for general civil and electrical & mechanical system contracts and the first unit in-service deferral of six months, which total \$100 million.

Finally, attachment 1 of CAC's submission indicates that "Manitoba Hydro stated that it was currently projecting a net income from electric operations of approximately \$60 M, a decrease of \$79 M from the 2010/11 net income of \$139 M. However, it is also worthwhile noting that the actual net income for 2010/11 was only \$10 M less than forecast in IFF10-2 – which was the financial outlook provided at the end of the last GRA. As a result, the \$79 M reduction cannot be viewed entirely as a "surprise" and new information. Indeed, most of the reduction had been anticipated at the time of the last GRA." At the time of the last GRA, Manitoba Hydro was forecasting net income from electric operations of \$149 million in 2010/11 and \$125 million in 2011/12 for a year over year decrease of \$24 million. In the current forecast, Manitoba Hydro is projected net income from electric operations of \$60 million in 2011/12 which is a \$79 million decrease over 2010/11 actual net income of \$139 million. It is unclear to Manitoba Hydro how a \$10 million decrease in 2010/11 actual results leads to the anticipation of a \$79 million year over year decrease between 2010/11 and 2011/12 at the last GRA when IFF11-2 was not finalized until April 2012 and filed with the GRA in June of 2012.

Conclusion

In summary, as stated in Manitoba Hydro's submission, it is seeking interim approval for proposed rate changes effective September 1, 2012 for the following reasons:

1. The need is urgent to avoid continuing losses on operations as evidenced in the Quarterly Report of the Manitoba Hydro-Electric Board for the three months ended June 30, 2012, which is to be released on or about August 15, 2012;
2. Financial ratios are deteriorating and are projected to further deteriorate in the test years;
3. It is essential that the financial and credit rating integrity of Manitoba Hydro be maintained;
4. Prices on the export market are not expected to improve substantially in the near term;
5. Costs are being well-controlled and cannot be reduced further without negatively impacting the safety, reliability and efficiency of the power system;
6. The aging infrastructure issue will result in higher maintenance and capital costs in the future;
7. There is a separate government-approved process to review Manitoba Hydro's major capital projects; in the meantime, current rates do not include any costs related to capital projects before those projects are placed in service; and,
8. Even with the proposed rate changes, electricity consumers in Manitoba will continue to benefit from the lowest electricity rate structure in Canada.

Yours truly,

MANITOBA HYDRO LAW DEPARTMENT

Per:



for: **PATRICIA J. RAMAGE**
Barrister and Solicitor

PJR/