

MANITOBA HYDRO
2015/16 & 2016/17 GENERAL RATE APPLICATION

OVERVIEW & REASONS FOR APPLICATION

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MANITOBA HYDRO
2015/16 & 2016/17 GENERAL RATE APPLICATION

OVERVIEW & REASONS FOR APPLICATION

2.0 OVERVIEW

The purpose of Tab 2 is to provide an overview of Manitoba Hydro's 2015/16 & 2016/17 General Rate Application and summary of the reasons for the Application.

Manitoba Hydro has a long history of providing safe, clean, reliable energy to Manitoba communities, households and businesses; energy that has fueled prosperity and economic growth in the province.

Manitoba Hydro also takes great pride in providing Manitobans with reliable service and some of the lowest electricity rates in North America. Manitoba Hydro has maintained stable rates through careful management of its assets, prudent spending on capital projects, and by managing its operating and administrative costs.

Today, Manitoba Hydro must invest in the system that has served customers for decades to ensure that it can continue to deliver safe, clean, reliable energy to Manitobans for generations to come. This required investment will mean that rates will need to increase gradually over the next decade to pay for these investments, and Manitoba Hydro believes that the rate increases proposed in this General Rate Application carefully balances the need for investment with the need to provide ratepayers with steady, predictable rates.

The key reasons for the Application are:

1. Manitoba Hydro is entering a period of extensive capital investment to meet the growing energy requirements of Manitoba, to replace aging utility assets and address increased capacity needs on the system.
2. While a portion of the required investments will be funded by cash flow from operations, the majority will be funded through unprecedented levels of debt financing.

- 1 3. The requirement for the proposed rate increases are primarily being driven by the
2 required investments, which are expected to double the asset base and carrying costs
3 (finance expense, depreciation and amortization expense and capital taxes) of Electric
4 operations in the next 10 years.
5
- 6 4. Rate stability for customers is dependent on Manitoba Hydro maintaining its financial
7 strength. The required investment in assets will place pressure on Manitoba Hydro's
8 financial strength by deteriorating the financial results and key financial ratios.
9
- 10 5. The following significant risks are associated with rate increases lower than 3.95%:
11 i. Increased risk to customers of rate instability and rate shock;
12 ii. Increased risk to customers of decreases in service and reliability;
13 iii. Increased borrowing requirements and associated financing costs, which will
14 ultimately be recovered from customers;
15 iv. Potential negative implications to the Provincial credit rating and Manitoba
16 Hydro's borrowing costs.
17
- 18 6. Manitoba Hydro is committed to effectively controlling its OM&A costs and
19 managing these costs below inflationary levels (excluding accounting changes that
20 impact OM&A), during a time of significant and increasing cost pressures. This will
21 assist in maintaining the 3.95% proposed rate increases.
22
- 23 7. The proposed 3.95% rate increases are the minimum that are required to maintain:
24 i. A reliable energy supply to Manitobans, to which they are accustomed, and fund
25 Power Smart Programs to assist customers in meeting their energy needs.
26 ii. Rate stability and manage the deterioration in the Corporation's financial strength
27 during the period of extensive capital investments.
28 iii. Manitoba Hydro's 2015/16 and 2016/17 net income and financial ratios at
29 acceptable levels.
30
31

1 **2.1 MANITOBA HYDRO'S CORPORATE PROFILE & STRATEGIC DIRECTION**

2
3 **2.1.1 Corporate Profile**

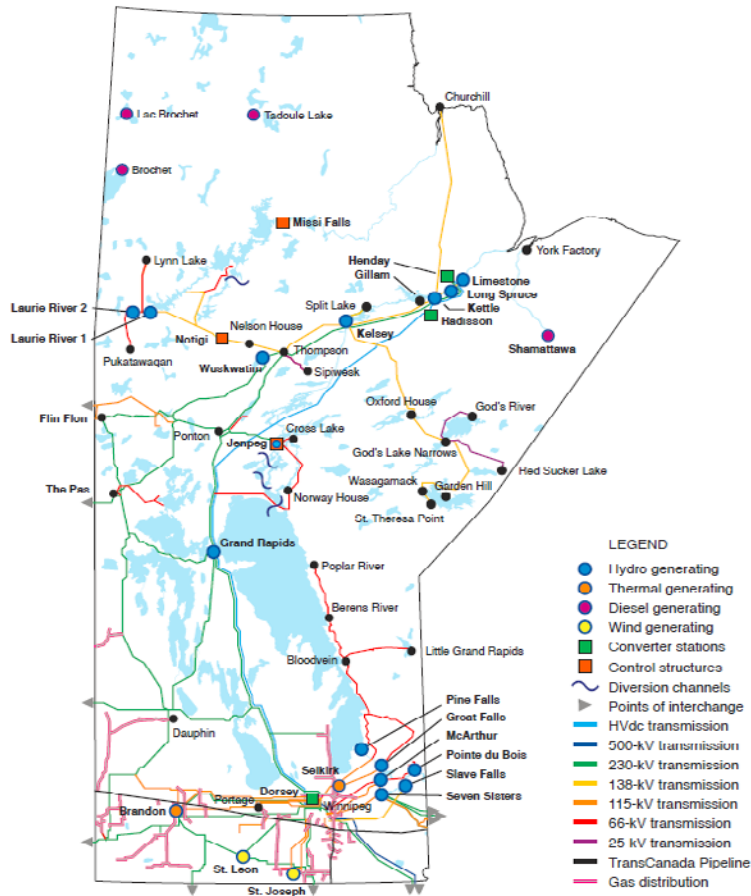
4 Manitoba Hydro is a provincial Crown Corporation governed by the Manitoba Hydro-
5 Electric Board, whose members are appointed by the Lieutenant-Governor in Council.
6 With over \$16 billion in assets at historic cost, Manitoba Hydro is one of the largest
7 integrated electricity and natural gas distribution utilities in Canada, with 5,725
8 megawatts of installed capacity. Manitoba Hydro serves over 555,000 electricity
9 customers across Manitoba and 272,000 natural gas customers in the southern part of the
10 province.

11
12 Manitoba Hydro has a long history of providing reliable energy to communities,
13 households and businesses in Manitoba and operating one of the cleanest, most
14 sustainable power systems in North America. Nearly all of the electricity Manitoba
15 Hydro typically produces each year (approximately 98% on an energy basis) is clean,
16 renewable water power generated at 15 hydro-electric generating stations. As part of its
17 electrical system, Manitoba Hydro operates and maintains 13,000 kilometers of electric
18 transmission lines, and 76,000 kilometers of electric distribution lines throughout the
19 Province. Manitoba Hydro also maintains two thermal generating stations to back up its
20 hydro-electric system and purchases electricity from two independent wind farms.

21
22 The following figure depicts Manitoba Hydro's major electrical and gas facilities.
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Figure 2.1: Major Electrical and Natural Gas Facilities

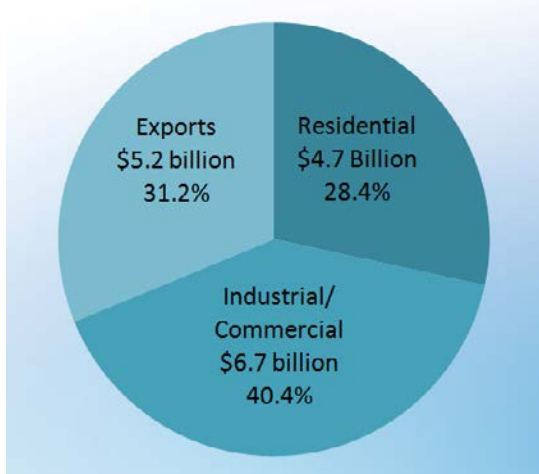


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Manitoba Hydro's ongoing operations and future projects represent a major contributing factor to the provincial economy, translating to employment and business opportunities for thousands, especially in the northern regions where much of the new development is taking place.

In addition to providing electricity to Manitobans, Manitoba Hydro exports surplus electricity to utilities within three wholesale markets in the Midwestern U.S. and Canada. In the last decade, export sales have contributed \$5.2 billion in revenues to Manitoba Hydro. These revenues are used to keep rates low for Manitobans.

1 **Figure 2.2: Share of Total Electric Revenue 2005-2014**



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2.1.2 Corporate Strategic Plan

Manitoba Hydro’s Corporate Strategic Plan (“CSP”) is summarized in the following figure and sets out the Corporation’s vision and mission, and outlines key objectives focused on meeting Manitobans’ long-term energy needs and achieving operational excellence in electric and gas operations.

Figure 2.3: Manitoba Hydro Vision, Mission and Key Areas of Focus




Vision

To be recognized as a leading utility in North America with respect to safety, reliability, rates, customer satisfaction and environmental leadership.

Mission

To provide for the continuance of a supply of energy to meet the needs of the province and to promote economy and efficiency in the development, generation, transmission, distribution, supply and end-use of energy.

Key Areas of Focus

| Safety | Customer value | Financial strength | Aboriginal relations | Workforce management | Protecting the environment | Demand side management |
|---|---|---|---|--|---|---|
|  |  |  |  |  |  |  |

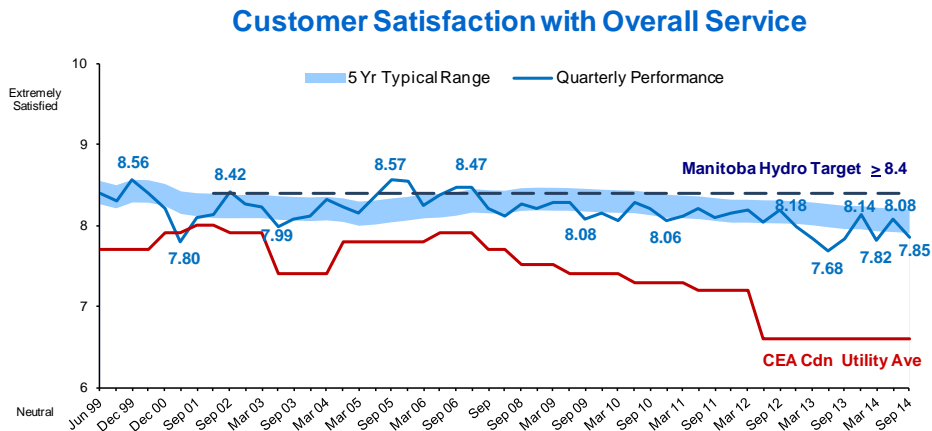
1 A full copy of Manitoba Hydro’s current CSP is provided as Appendix 2.1 to this Tab.

2
3 Using the CSP as a guide, Manitoba Hydro’s business units develop supporting business
4 objectives that establish priorities, and outline strategies and measures designed to
5 contribute towards achieving overall corporate objectives. To accomplish these
6 objectives, Manitoba Hydro is organized into 10 business units. A description of each
7 Business Unit and Manitoba Hydro’s current Organizational Chart is provided in
8 Appendix 2.2.

9
10 **2.1.3 Manitoba Hydro is a Leader in Customer Satisfaction**

11 An industry leader in customer satisfaction, Manitoba Hydro is committed to providing
12 high system reliability, excellent customer service and affordable rates. Manitoba Hydro
13 continues to receive satisfaction ratings for customer service, corporate citizenship and
14 corporate image components that are consistently higher than the national average for
15 Canadian electric utilities. Manitoba Hydro’s customer satisfaction results compared to
16 the CEA Canadian Average are shown in the following figure.

17
18 **Figure 2.4: Customer Satisfaction with Overall Service**

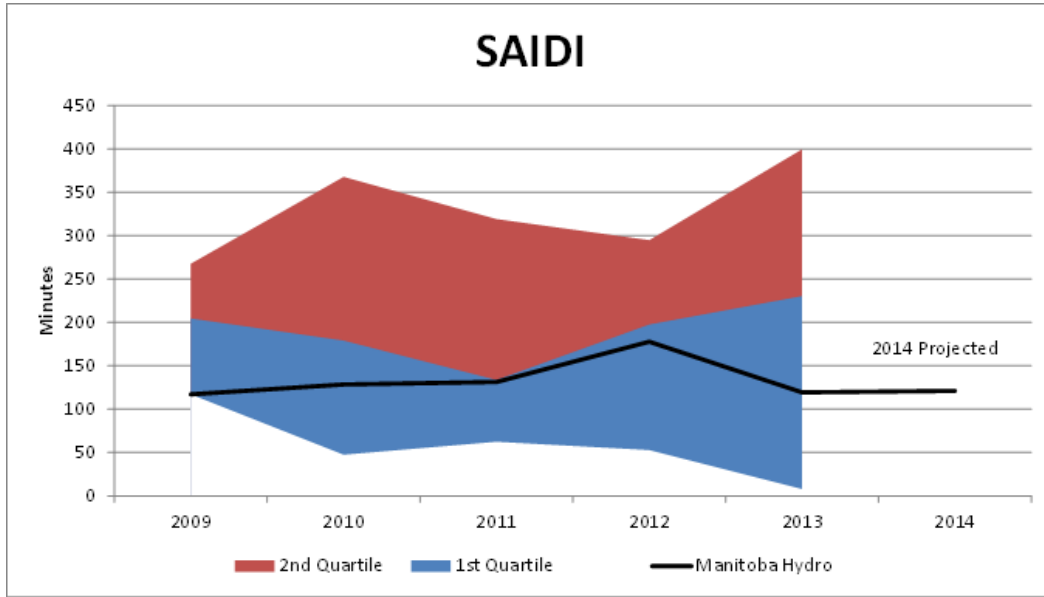


19
20
21 **2.1.4 Manitoba Hydro Provides High System Reliability**

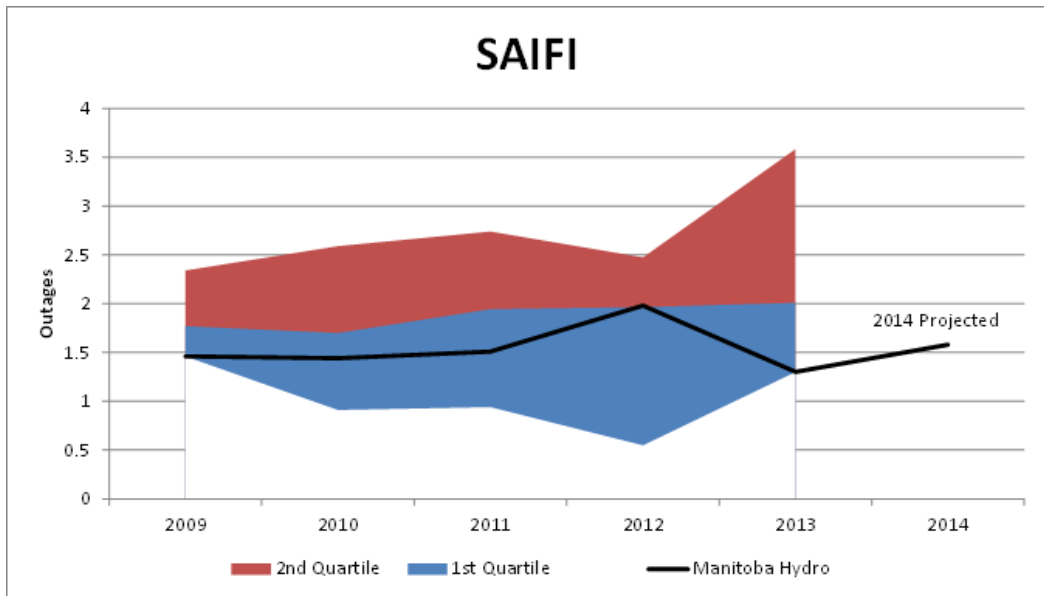
22 Electricity is essential to the lives and livelihoods of Manitobans and is a contributor to
23 the prosperity of Manitoba’s economy. The investment in electric infrastructure that
24 Manitoba Hydro has made over decades has resulted in one of the most reliable,
25 sustainable and affordable power systems in Canada. The following figures show that
26 Manitoba Hydro has historically been in the first quartile of CEA member utilities as it
27 relates to the System Average Interruption Frequency Index (“SAIFI”) and the System
28 Average Interruption Duration Index (“SAIDI”) reliability indicators, on a calendar year

1 basis. The SAIFI indicator measures the average number of interruptions that a customer
2 has experienced, and the SAIDI indicator measures the average outage duration
3 experienced by customers.
4

5 **Figure 2.5: Manitoba Hydro SAIFI Indicator Compared to CEA Member Utilities**



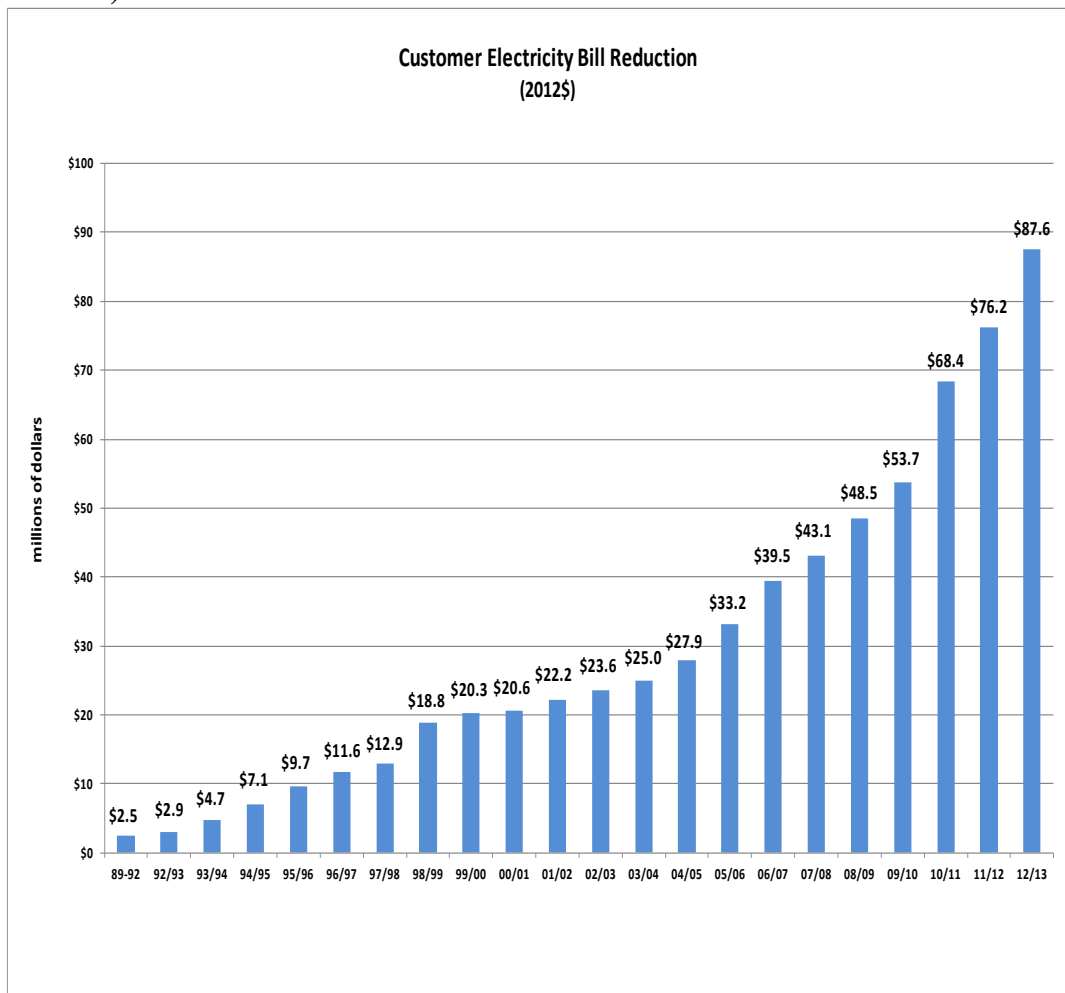
6
7
8 **Figure 2.6: Manitoba Hydro SAIDI Indicator Compared to CEA Member Utilities**



1 **2.1.5 Manitoba Hydro is a Leader in Offering Power Smart Programs**

2 Manitoba Hydro’s Power Smart Programs have been and continue to be very successful
3 at reducing customers’ energy bills while contributing to a sustainable energy supply in
4 Manitoba. As demonstrated in the following figure, Power Smart electrical savings
5 translate into a growing annual reduction in customer electricity bills with a total of \$660
6 million cumulative reduction to 2012/13. In addition, Power Smart has led to reductions
7 in indirect greenhouse gas emission reductions of approximately 1,532,000 tonnes of
8 carbon dioxide equivalent emissions in 2012/13.

9
10 **Figure 2.7: Annual Power Smart Savings—Customer Electricity Bill Reduction (\$**
11 **millions)**

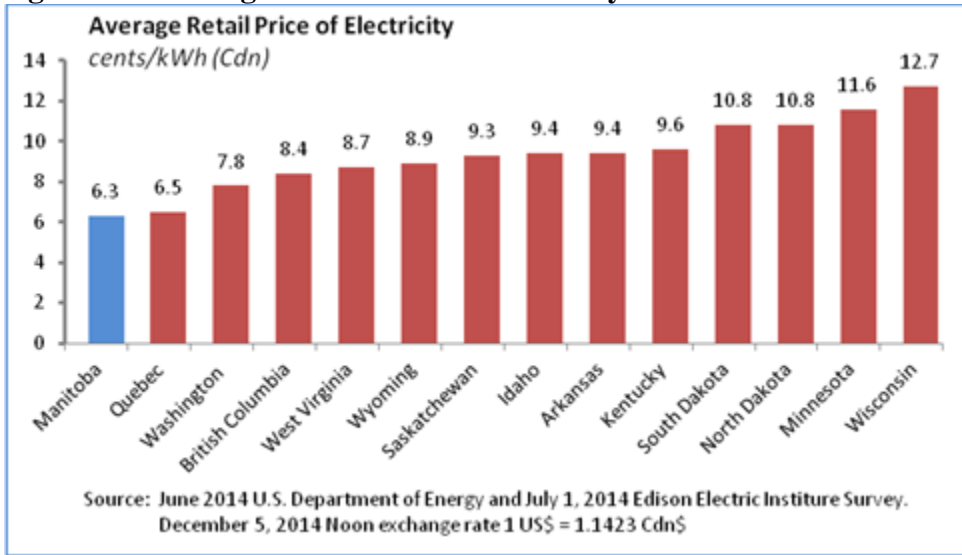


12
13
14 **2.1.6 Manitoba Hydro Offers Affordable and Competitive Rates to Customers**

15 Manitoba Hydro’s domestic electric rates are affordable for Manitoba families and
16 support the competitiveness of Manitoba businesses. The following figure shows

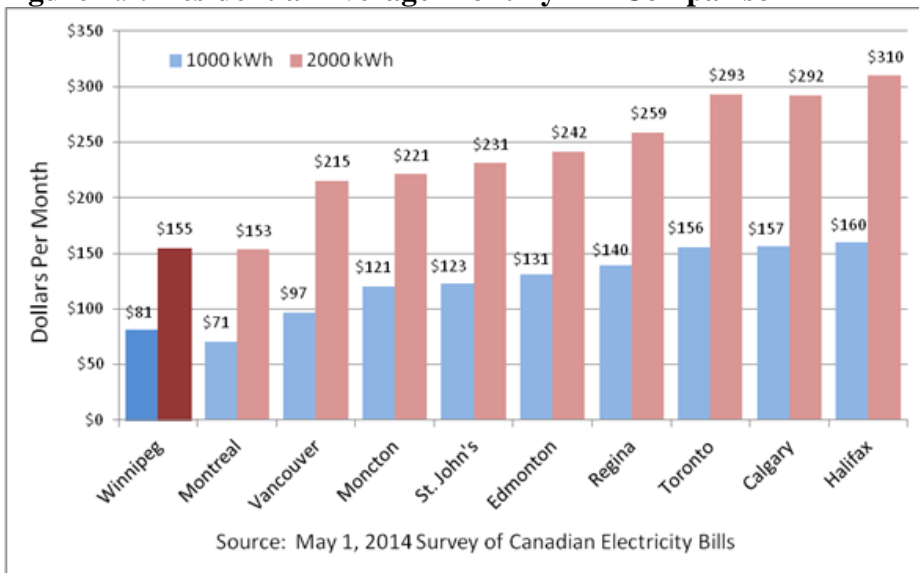
1 Manitoba Hydro's current weighted-average retail electricity price for all customer
2 classes (as compared to other low-cost jurisdictions and neighbouring utilities), and
3 demonstrates that Manitoba Hydro has among the lowest average retail electricity rates in
4 North America.
5

6 **Figure 2.8: Average Retail Price of Electricity**



7
8
9 As is demonstrated in the following figure, Manitoba enjoys a distinct advantage over
10 most of the Canadian jurisdictions with respect to the average monthly bills of residential
11 customers.
12

13 **Figure 2.9: Residential Average Monthly Bill Comparison**



1 The April 1, 2015 rate increase, if approved, would result in a modest \$3.20 increase in
2 the monthly bill of a residential customer without electric space heat using 1,000
3 kilowatt-hours (“kWh”) per month, and a \$6.11 increase in the monthly bill for a
4 residential customer with electric space heat using 2,000 kWh per month.

5 The April 1, 2016 rate increases, if approved, would result in an additional \$3.33 increase
6 in the monthly bill of a residential customer without electric space heat and an additional
7 \$6.36 increase in the monthly bill for a residential customer using electricity for space
8 heat.

9
10 It is recognized that other Canadian utilities are also encountering the need to replace and
11 refurbish aging utility assets, which will place upward pressure on electricity rates across
12 most jurisdictions in the coming years. As can be seen in the following charts, Manitoba
13 Hydro is not alone in needing to address the required investment in its electrical system
14 through higher rate increases.

15
16 **Figure 2.10: Required Investment in Canada’s Electricity System 2011-2030**
17



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Figure 2.11: Proposed Rate Increases in Other Jurisdictions

Rates in other Canadian provinces must also rise in the coming years to fund the re-investment in electricity infrastructure

SaskPower Investing for the future

Investing in our infrastructure also opens the door to future possibilities. Learn more about the work we're doing. We applied for a multi-year rate increase to help our industrial customers with their business planning and enable our residential customers to budget household expenses in advance. As a result of our application, the government has announced: Approval of a 5.5 per cent average rate increase, effective Jan. 1, 2014; Approval of a 3 per cent average rate increase, effective Jan. 1, 2015 (reduced from original request of 5 per cent); and Denial of an increase for 2016 at this time.

BC Hydro rates to increase 28 per cent over 5 years

"Our rates are still among the lowest in North America," says BC Hydro CEO Charles Reid
CBC News Posted: Nov 20, 2013 10:53 AM PT | Last Updated: Nov 20, 2013 7:54 PM PT
Energy Minister Bill Bennett and BC Hydro CEO Charles Reid announced a 28 per cent electricity rate hike over five years, with a nine per cent jump coming April 1, 2014.

In a press conference in Victoria this morning, Bennett and Reid said the rate hikes were part of a 10-year plan to keep rates as low as possible, while still allowing BC Hydro to invest in infrastructure and future power projects.

Ontario hydro bills to rise 42% in 5 years

BY ANTONELLA ARTUSO, QUEEN'S PARK BUREAU CHIEF
FIRST POSTED: MONDAY, DECEMBER 02, 2013 01:43 PM EST | UPDATED: MONDAY, DECEMBER 02, 2013 03:47 PM EST
TORONTO - Ontario hydro bills are headed up, up, up.

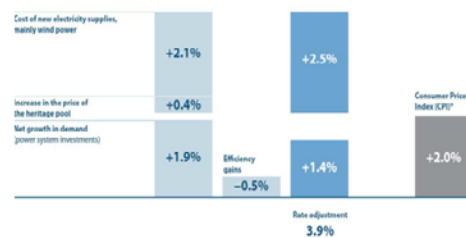
The Liberal government's new long-term energy plan shows that the average monthly residential bill of \$125 will rise to \$178 within five years — a 42% increase.

Hydro bills are expected to dip slightly in 2019 to \$177 a month, and then rise again until 2022 when they'll hit \$193 a month.

A second decrease in prices is forecast for 2023-24 and then the trend for prices is onward and upward for the foreseeable future.

Hydro-Québec filed an application for a 3.9% rate increase

PROPOSED RATE ADJUSTMENT AS OF APRIL 1, 2015 (3.9%)



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While Manitoba Hydro will be required to gradually increase rates to pay for its increased investment in generation, transmission and distribution infrastructure, the electrical rate advantage enjoyed by energy consumers in Manitoba over those in most other jurisdictions is expected to continue.

1 **2.2 MANITOBA HYDRO'S CAPITAL INVESTMENT DRIVERS & BORROWING**
2 **REQUIREMENTS**
3

4 **2.2.1 Manitoba Hydro is Entering a Period of Extensive Capital Investment**

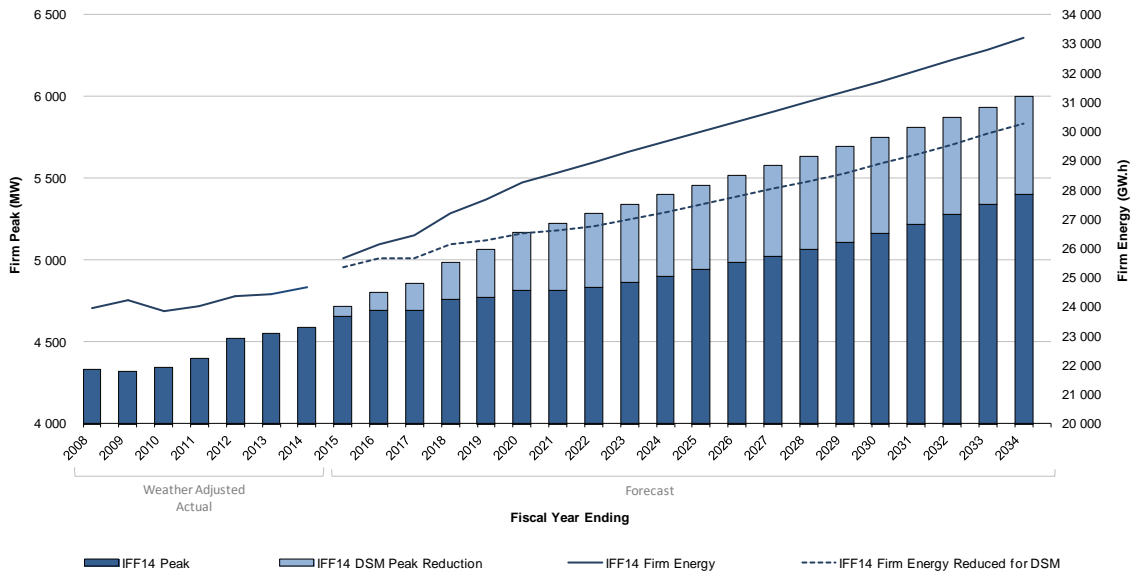
5 The provision of electric service is inherently a capital intensive business which requires
6 a substantial investment in generating stations, transmission lines, distribution facilities
7 and supporting infrastructure. Another characteristic of an electric utility is that the
8 investments in major projects are large and lumpy and tend to have a significant impact
9 on revenue requirements when they are first placed into service. In order to provide safe
10 and reliable service to customers, Manitoba Hydro is continuously investing in assets.
11

12 Manitoba Hydro is entering a period of extensive investment and re-investment in its
13 infrastructure in order to meet the growing energy needs of Manitoba, to replace aging
14 utility assets that are approaching the end of their service lives, and to address capacity
15 constraints on its existing system. The required infrastructure investment costs will be
16 many multiples higher than the historic cost of the existing asset base.
17

18 Manitoba Hydro is also committed to significantly higher levels of investment in Demand
19 Side Management ("DSM") programs on behalf of customers. Manitoba Hydro's Power
20 Smart Programs play a key role in meeting Manitoba's future energy needs in a
21 sustainable manner and assisting customers in reducing their energy bills by using energy
22 more efficiently.
23

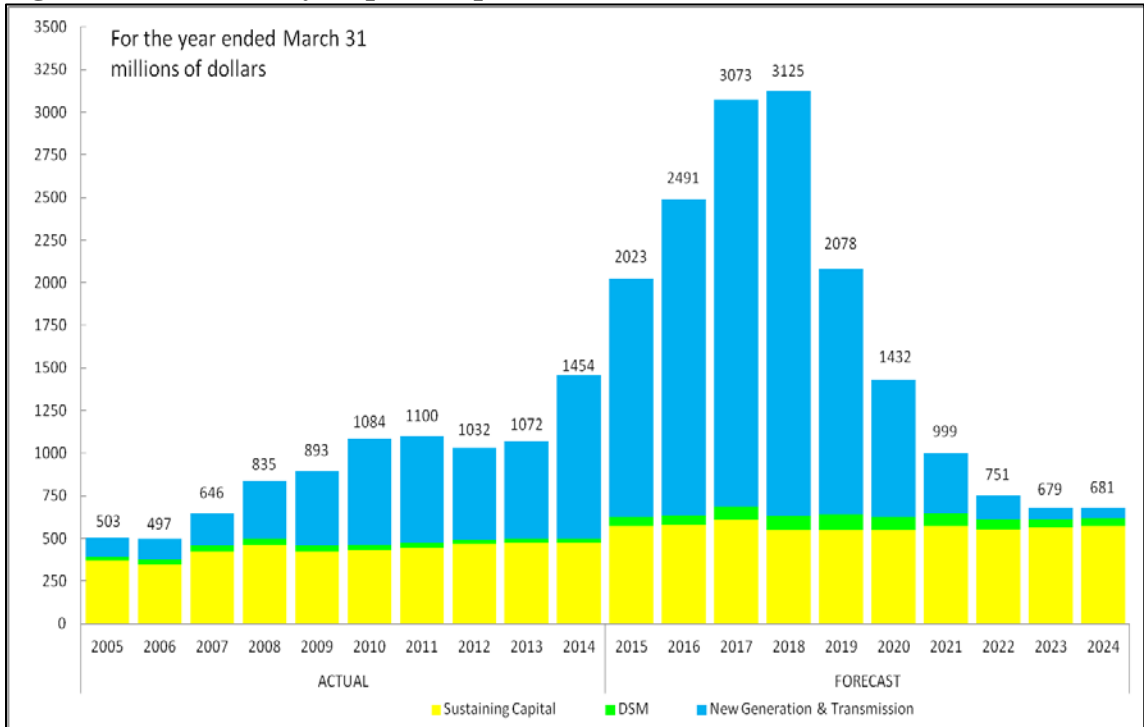
24 Even with load reductions from Power Smart initiatives, the demand for electricity in
25 Manitoba is continuing to grow as a result of increases in population, higher average
26 energy usage, and industrial and commercial customer expansion. The following figure
27 shows the actual and forecast growth in Manitoba Hydro's load, as well as the forecasted
28 impact of the Power Smart Plan.
29

1 **Figure 2.12: Forecast Load Growth Before and After Impact of DSM**



2
 3
 4 The required investment in new and replacement assets, as well as DSM programs, will
 5 result in significantly higher capital expenditures over the next 10 year period, as
 6 demonstrated by the following figure.
 7

8 **Figure 2.13: Electricity Capital Expenditures**

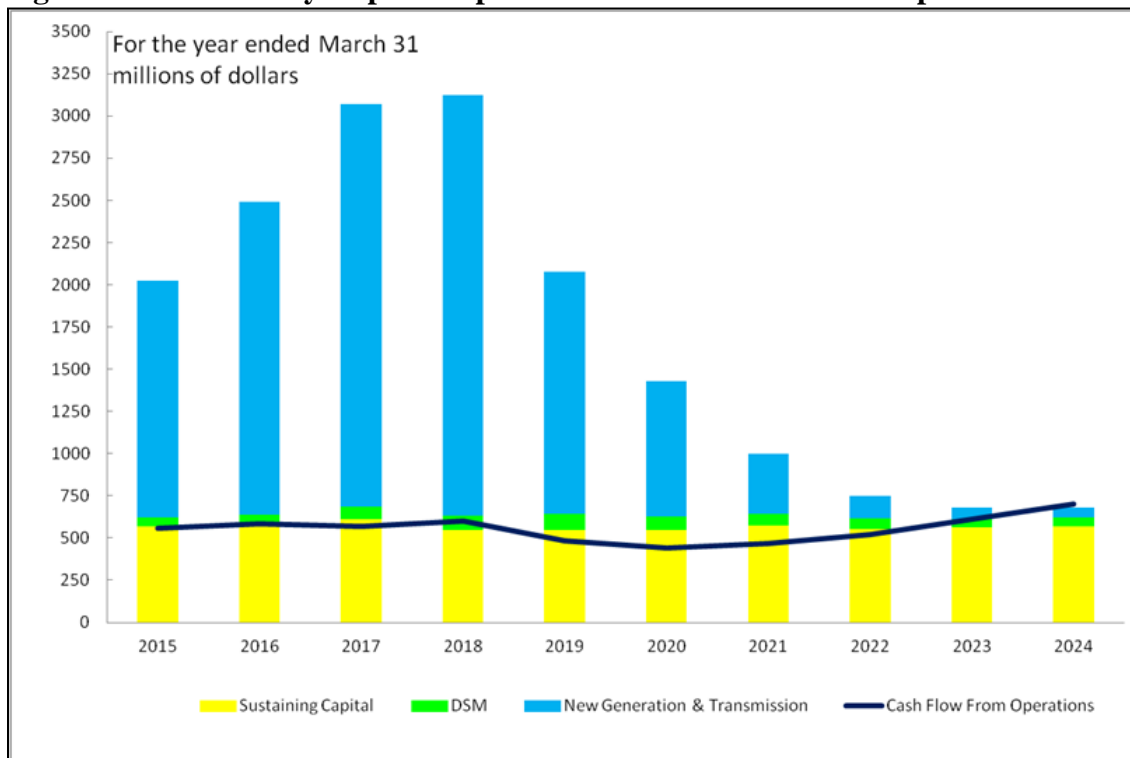


1
2 **2.2.2 Investment Requirements will Lead to Unprecedented Levels of Debt**
3 **Financing**

4 Unlike private utilities, Manitoba Hydro does not have access to share capital as a source
5 of funds and must rely on a combination of internally generated cash from operations and
6 debt financing in order to fund its capital investment program.

7
8 The following figure depicts the capital investment requirements for the next 10 years
9 along with the forecasted cash-flow from operations, including the proposed and
10 indicative 3.95% rate increases. Manitoba Hydro has historically targeted to fund
11 sustaining capital expenditures with cash flow from operations. This chart indicates that
12 the cash that is projected to be generated from operations is just sufficient in 4 of the 10
13 years to fund sustaining capital expenditures. From 2019 to 2022, Manitoba Hydro is
14 projecting that it will be required to borrow funds to finance sustaining capital
15 expenditures.

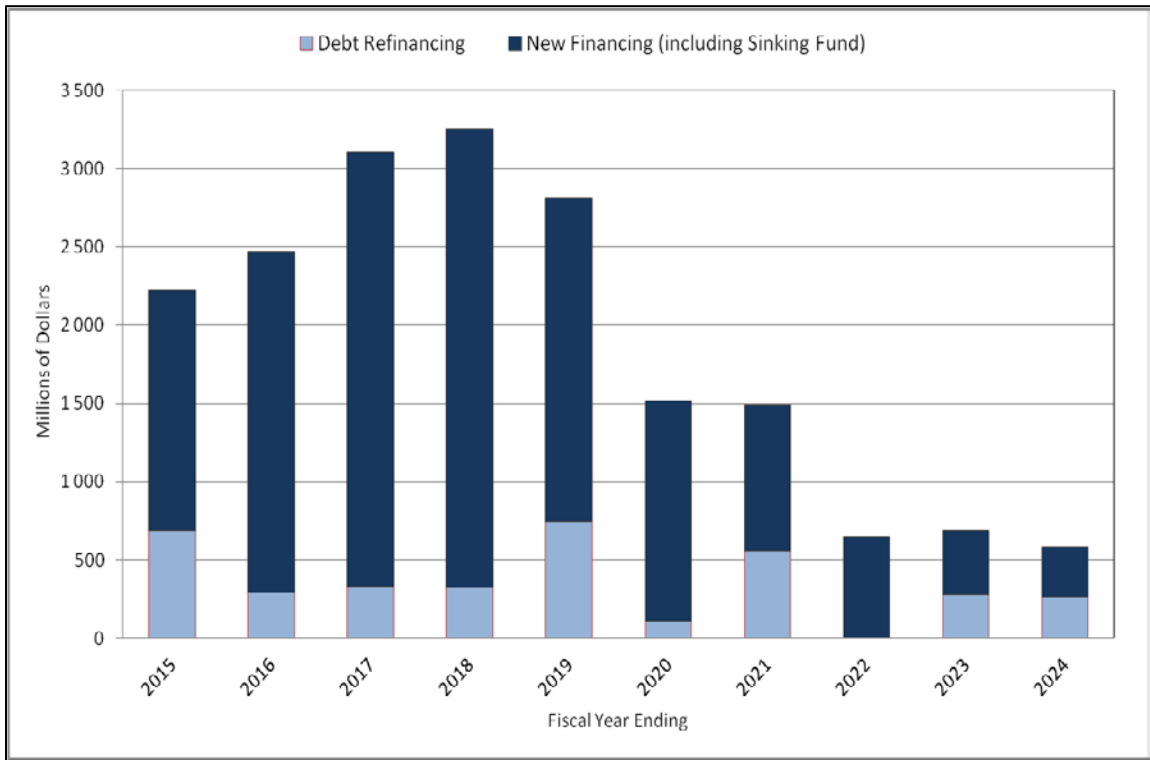
16
17 **Figure 2.14: Electricity Capital Expenditures & Cash Flow from Operations**



18
19
20 The implications of the above-noted figure is that Manitoba Hydro is forecasting that in
21 the next 10 years it will fund the vast majority of new major generation and transmission
22 capital expenditures through debt financing. When combined with debt refinancing

1 requirements, the total debt requirements for Manitoba Hydro’s electric operations in the
2 next five-year period will peak at levels in excess of \$3 billion per year, as illustrated in
3 the following figure. These total forecast debt requirements are unprecedented in
4 Manitoba Hydro’s history.
5

6 **Figure 2.15: Projected Electric Operations Borrowing Requirements**



7
8
9 The proposed and indicative rate increases are necessary to stabilize Manitoba Hydro’s
10 cash flow from operations to the minimum level to fund the majority of sustaining capital
11 expenditures thereby avoiding: higher levels of debt; higher cash flow requirements to
12 pay the interest on the incremental debt; higher interest expense; and higher customer
13 rates, all to the benefit of the customer.
14

1 **2.3 THE COMPELLING NEED FOR RATE INCREASES**

2
3 In the previous section, Manitoba Hydro described the business requirements that are
4 driving the need for investments in assets to allow the Corporation to continue to provide
5 safe and reliable service to customers. In this section, Manitoba Hydro will describe how
6 these same investments will impact revenue requirements and necessitate the requested
7 rate increases.

8
9 **2.3.1 Revenue Requirements are Driven by Assets Being Placed into Service**

10 As a result of the capital intensive nature of Manitoba Hydro’s business, a significant
11 portion of the overall revenue requirement of the Corporation is made up of carrying
12 costs (finance expense, depreciation, and capital taxes) of the assets that are utilized to
13 provide service to customers, along with the operating and maintenance costs of these
14 assets. While assets are under construction, the capital expenditures and associated
15 financing costs are held in construction work in progress. Once these assets are placed
16 into service, the associated carrying costs form part of the Corporation’s revenue
17 requirements.

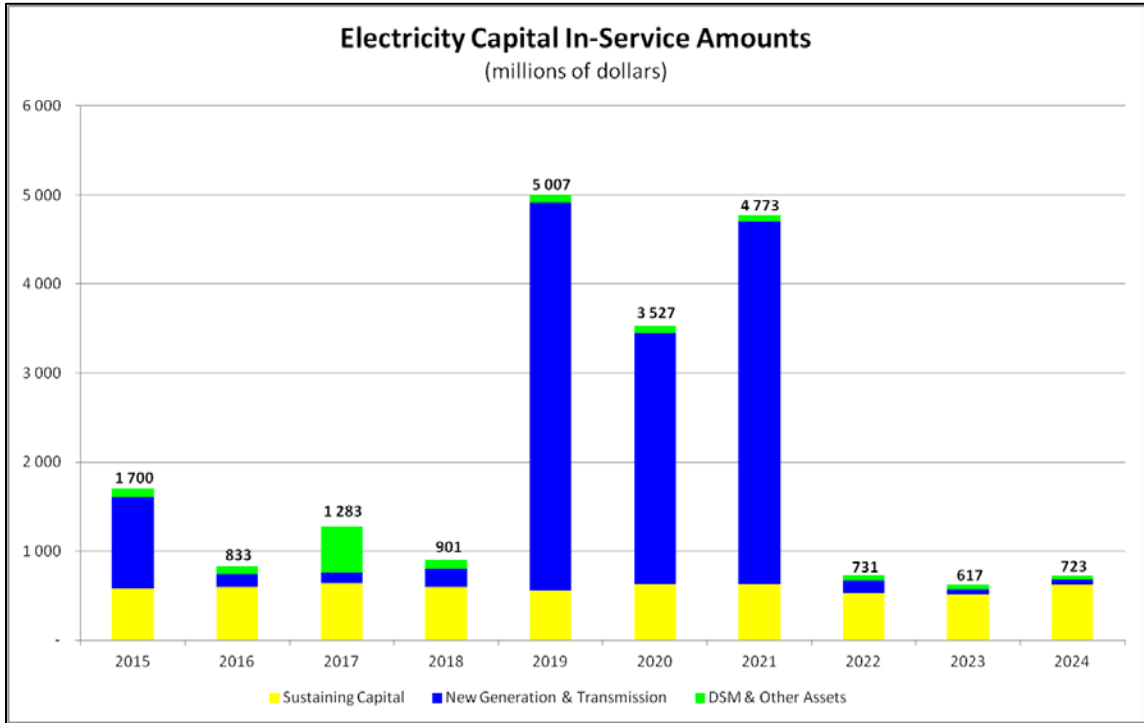
18
19 As is demonstrated in the Figure 2.16, the annual amount of assets that are forecast to be
20 placed in service for electric operations will range between \$0.6 billion and \$5.0 billion
21 over the next 10 year period. In the three year period for which rates are being reviewed
22 as part of this Application (2015-2017), it is forecast that \$3.8 billion of assets will be
23 placed into service or commence amortization. The most significant assets being placed
24 in-service during this period include the Pointe du Bois spillway replacement, and the
25 Riel 230/500kV Station in 2015. In this three year period, there is also approximately
26 \$1.8 billion of sustaining capital expenditures that will be placed into service, and \$0.2
27 billion of DSM expenditures that will commence amortization.

28
29 Over the 10 year period between 2015 to 2024, it is projected that \$20.1 billion of assets
30 will be placed into service related to electric operations, the most significant of which are
31 the Bipole III Reliability Project (\$4.6 billion) and the Keeyask Generating Station (\$6.5
32 billion). In this 10 year period, it is projected that approximately \$5.9 billion of sustaining
33 capital expenditures will be placed into service, \$0.7 billion of DSM expenditures will
34 commence amortization and \$0.4 billion of deferred Conawapa costs will commence
35 amortization.

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Figure 2.16: Electric Capital In-Service 2015-2024



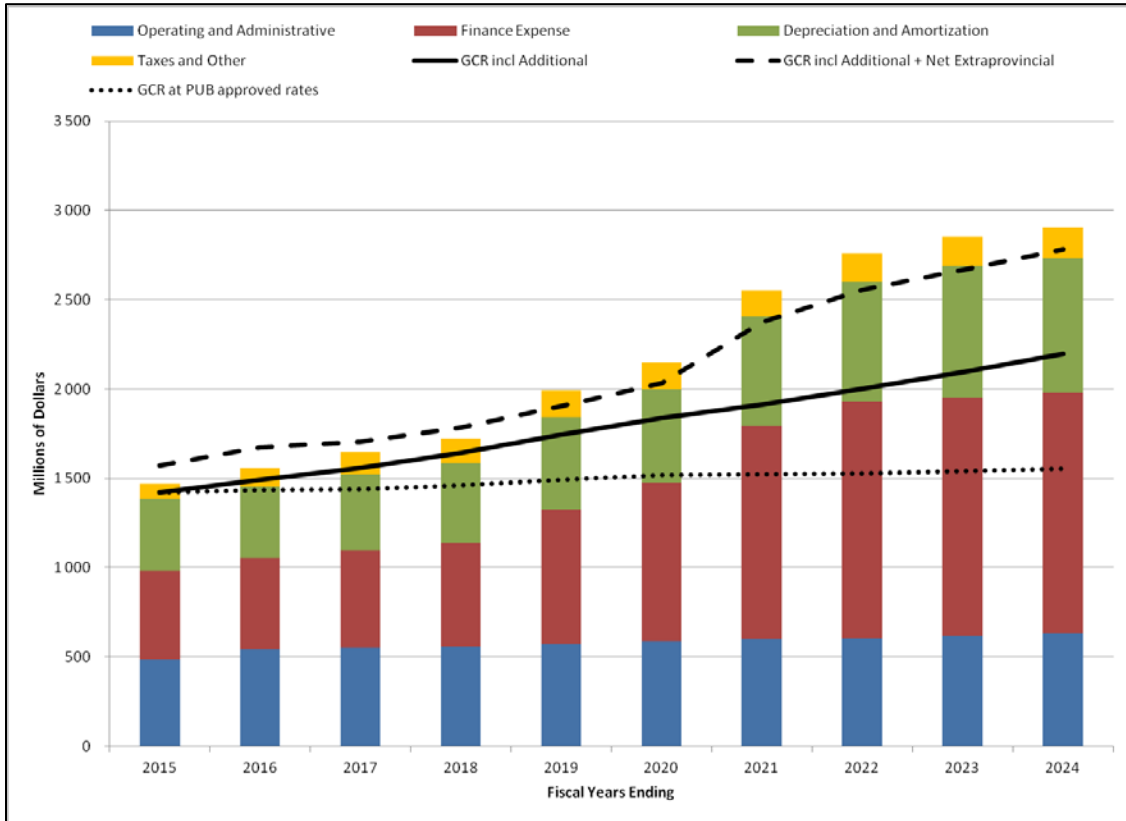
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2.3.2 Carrying Costs on Electric Assets are Expected to Double in Next 10 Years

The required investment in new and existing infrastructure is expected to double the asset base and associated carrying costs of electric operations in the next 10 years.

The graph below provides a depiction of the increase in the costs for electric operations over the next 10 year period compared to the revenues that are projected to be generated from domestic and export customers.

1 **Figure 2.17: Electric Expenses Compared to Revenues**



2
3
4 The bars in Figure 2.17 provide the projected operating & administrative expense (blue
5 bar), finance expense (red bar), depreciation & amortization expense (green bar), and
6 taxes and other costs (orange bar) for the next 10 year period. Over that period, the total
7 costs of the electric operations are projected to increase from the current level of
8 approximately \$1.5 billion to nearly \$3.0 billion. The increase in costs in the years that
9 are under review in this Application (2015-2017), and in the next 10 years are primarily
10 related to increases in finance expense and depreciation as a result of the assets that are
11 coming into service. Operating, maintenance and administrative costs are relatively
12 constant throughout this period and do not materially contribute to the \$1.5 billion
13 increase in electric costs.

14
15 The dotted line in the Figure 2.17 represents domestic general consumers' revenue
16 (GCR) at current PUB approved rates and the solid line represents GCR including the
17 proposed and indicative rate increases of 3.95% per year to 2023/24. The dashed line in
18 the graph represents the total of GCR at the proposed rates including rate increases and

1 net extra-provincial revenues (extra-provincial revenues net of water rentals and fuel and
2 power purchased).

3
4 Even with the proposed and indicative rate increases, Manitoba Hydro is projecting
5 losses on electric operations in 2018/19 to 2023/24 totaling approximately \$900 million
6 as forecast domestic and export revenues will not be sufficient to cover the increased
7 costs.

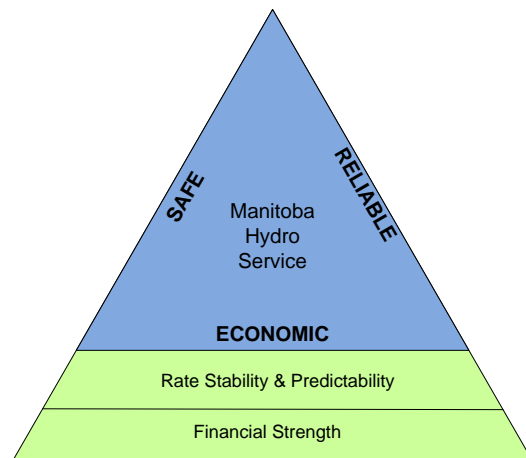
8
9 In the next 10 years there is significant financial risk and potential for rate volatility as
10 Manitoba Hydro's financial position deteriorates due to the large investment
11 requirements. In the longer term, the indicative 3.95% rate increases and export revenues
12 generated from the Keeyask Generating Station are projected to accumulate to a
13 sufficient level to cover the increased costs and Manitoba Hydro will begin to rebuild its
14 financial reserves.

15
16 **2.3.3 Rate Stability for Customers is Dependent on the Financial Strength of the**
17 **Corporation**

18
19 In order to ensure rate stability and predictability for customers, it is necessary that
20 Manitoba Hydro maintains its financial strength. In other words, if Manitoba Hydro does
21 not receive the necessary rate increases to maintain its financial strength, then there is
22 significant risk to customers that rate changes will become more volatile and there will be
23 a need for sudden or larger rate increases in the near future. This risk is particularly acute
24 in the upcoming period of extensive capital investment and reinvestment.

25
26 Manitoba Hydro's safe, reliable and economic service is based upon a solid foundation of
27 financial strength which promotes rate stability and predictability for customers.

28
29 **Figure 2.18: The Foundation of Safe, Reliable and Economic Service**



1 **2.3.4 Investments in Capital Assets Will Place Pressure on Manitoba Hydro's**
2 **Financial Strength**

3
4 The proposed and indicative rate increases are the minimum rate increases necessary to
5 provide for the required investment in infrastructure to allow the Corporation to continue
6 to provide safe and reliable service, and are essential to preserve the financial integrity of
7 the Corporation in order to promote rate stability for customers.

8
9 Even with the proposed and indicative rate increases projected in MH14, retained
10 earnings from electric operations are projected to fall from \$2.7 billion in 2014/15 to \$2.0
11 billion by 2023/24. This amount is barely sufficient to absorb the impact of the
12 reoccurrence of a historic 5-year drought, and does not provide sufficient reserves to
13 mitigate the potential financial impacts of the considerable array of risks the Corporation
14 faces in fulfilling its mandate.

15
16 Manitoba Hydro's equity ratio for electric operations is projected to deteriorate from the
17 current level of 23% to 10% by 2022/23 as a result of the increase in carrying costs and
18 levels of debt associated with the extensive investment in infrastructure, combined with
19 the reduction of revenues primarily as a result of increased DSM savings.

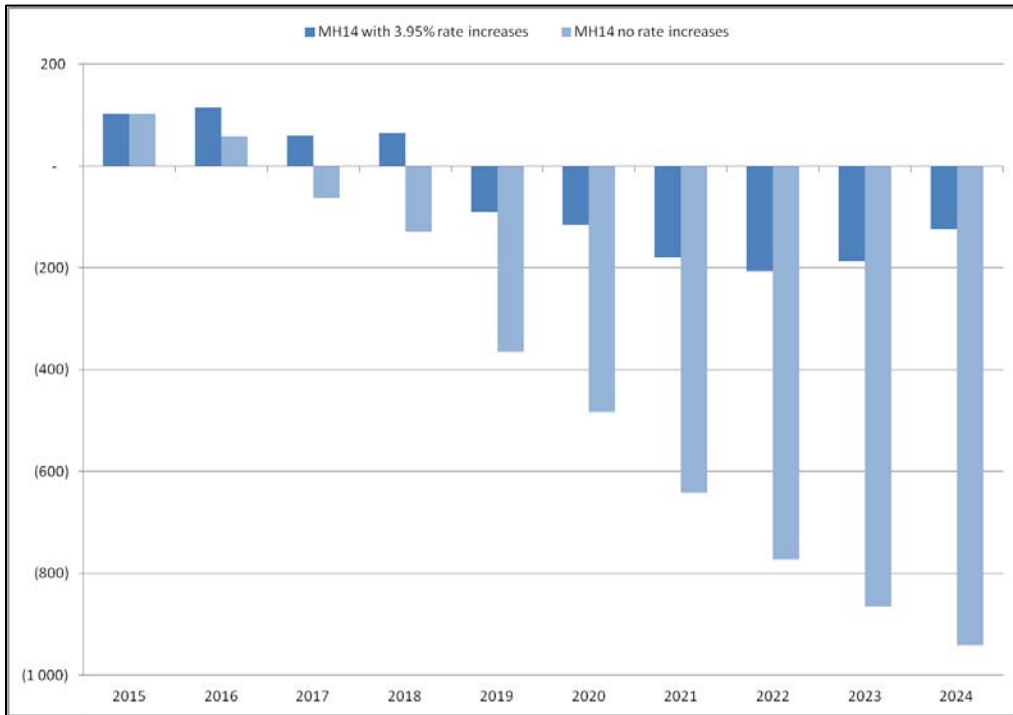
20
21 With the proposed and indicative 3.95% rate increases, Manitoba Hydro's interest
22 coverage ratio is also forecast to be well below target for several years of the forecast. In
23 six years of the 10 year forecast, Manitoba Hydro's interest coverage ratio is projected to
24 be below 1.0, which indicates that the utility would experience elevated operational
25 liquidity risk and may have difficulty generating sufficient revenues and cash flow from
26 operations to pay its interest obligations.

27
28 Similarly, the capital coverage ratio is below target for several years as a result of lower
29 net earnings and the increase in capital requirements for the renewal and replacement of
30 aging infrastructure. Manitoba Hydro has historically funded sustaining capital
31 expenditures through internally generated funds; however, it is projecting capital
32 coverage ratios below 1.0 in six years of the 10 year forecast, which indicates that the
33 utility will not generate sufficient revenues to fund its sustaining capital expenditures and
34 must borrow in order to renew or replace existing infrastructure.

35
36 The following figures demonstrate the significance of the projected rate increases by
37 comparing the net income, retained earnings, and financial ratios of electric operations

1 including and excluding the proposed and indicative rate increases. As can be readily
2 seen in the following figures the rate increases are vital to the continued financial strength
3 of Manitoba Hydro.
4

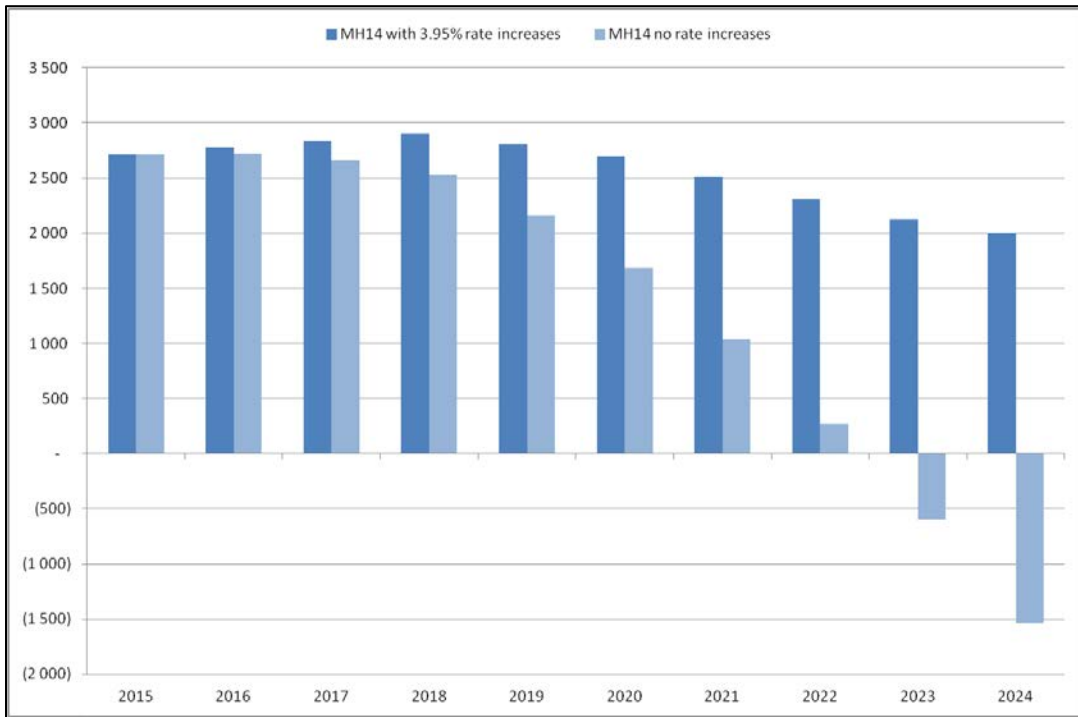
5 **Figure 2.19: Projected Net Income (2015-2024)**
6



7

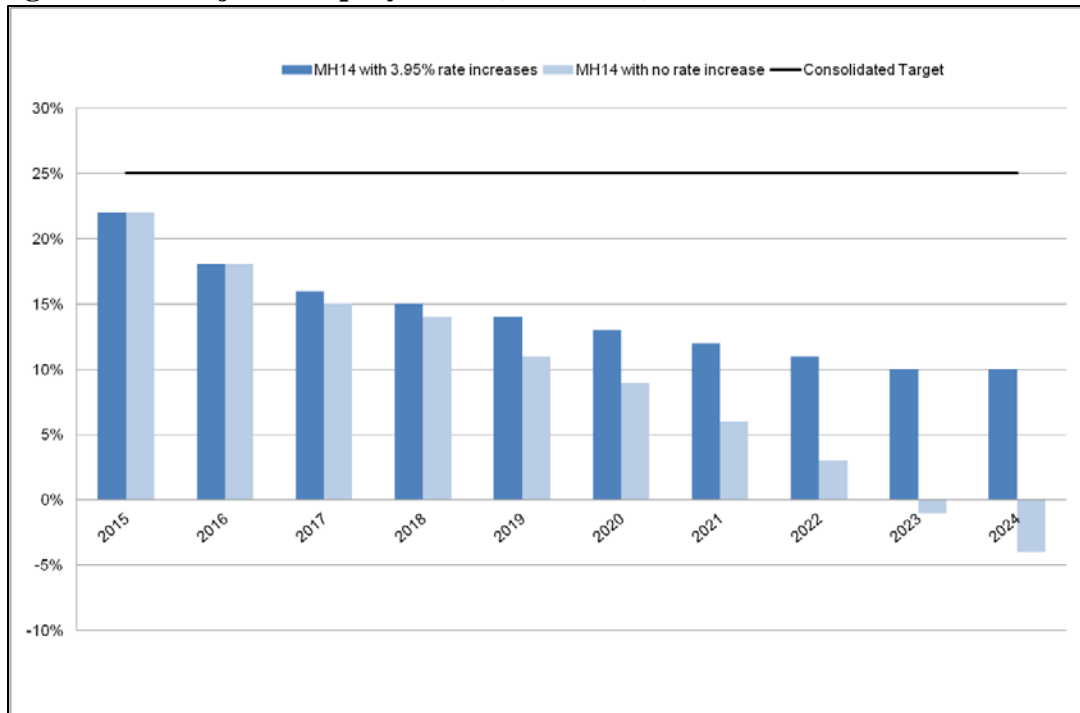
1

Figure 2.20: Projected Retained Earnings (2015-2024)



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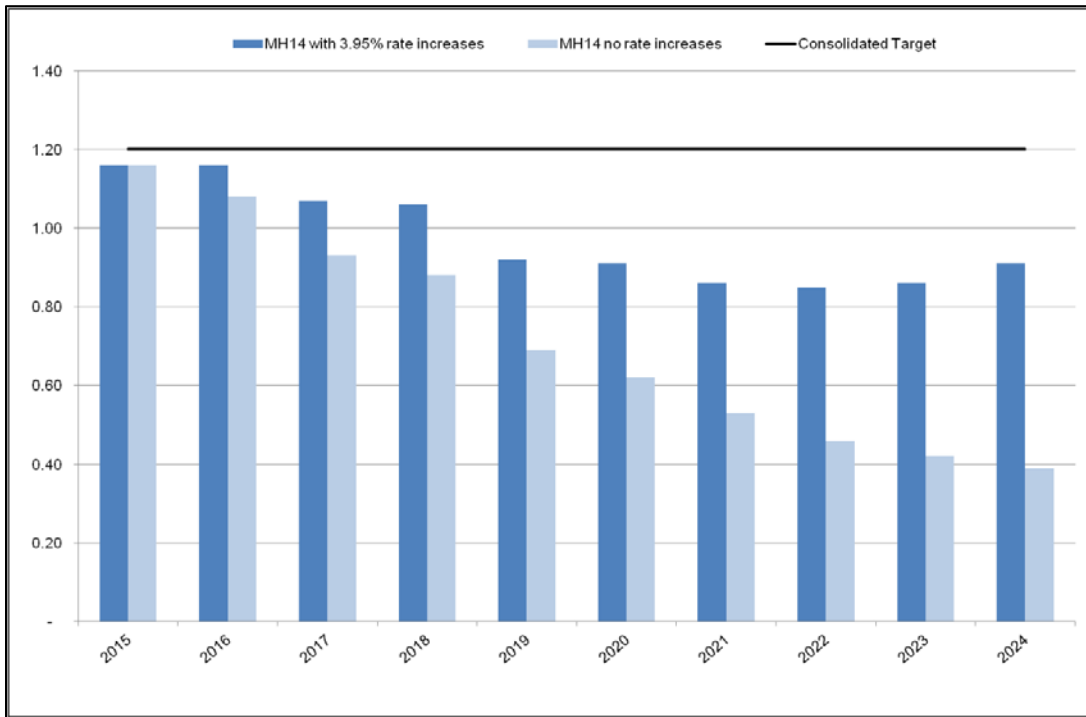
Figure 2.21: Projected Equity Ratio (2015-2024)



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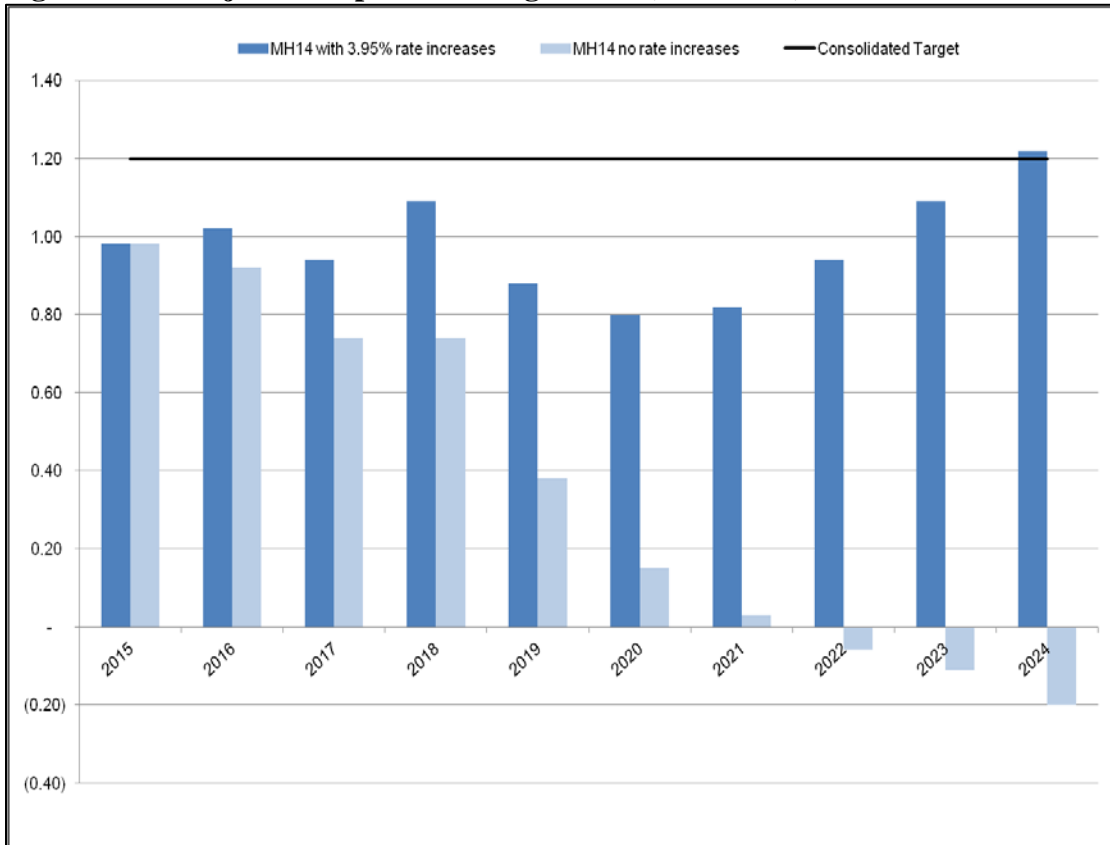
1

Figure 2.22: Projected Interest Coverage Ratio (2015-2024)



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 3
 4

Figure 2.23: Projected Capital Coverage Ratio (2015-2024)



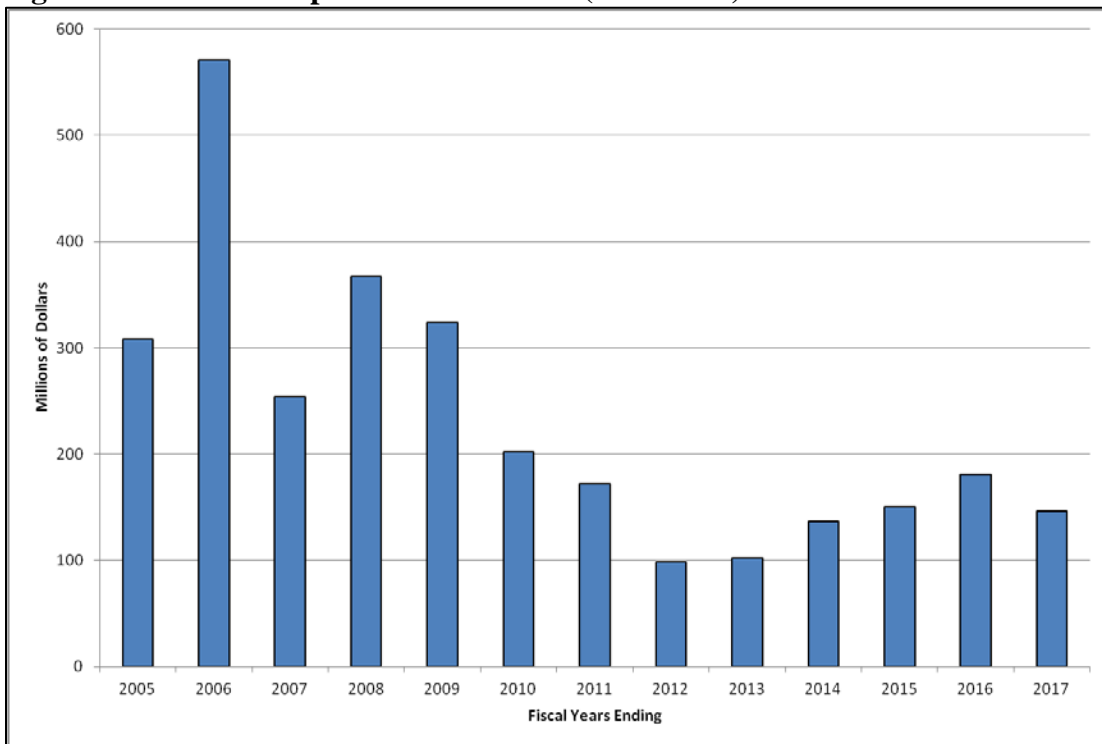
5

1 **2.3.5 Rates Have Not Increased to Fully Compensate for Reductions in Net**
2 **Extraprovincial Revenue**

3 Historically, net extraprovincial revenues have made a significant contribution to
4 overall revenues which has enabled Manitoba Hydro to maintain lower electricity
5 rates for Manitobans.

6
7 As illustrated in Figure 2.24, net extraprovincial revenues have not been as strong as
8 in previous years. Manitoba Hydro's net extraprovincial revenues are projected to be
9 \$150 million in 2014/15, \$181 million in 2015/16 and \$147 million in 2016/17, which
10 is significantly lower than the average net extraprovincial revenues generated from
11 2004/05 to 2008/09 of approximately \$365 million per year. It is necessary to
12 gradually increase rates over time to compensate for the reduction in net
13 extraprovincial revenues.

14
15 **Figure 2.24: Net Extraprovincial Revenue (2015-2017)**



*Actuals 2004/05 to 2013/14; forecast 2014/15 to 2016/17

16
17
18

2.3.6 Manitoba Hydro's 2015/16 & 2016/17 Rate Proposals Maintain Net Income and Financial Ratios at Acceptable Levels

Approval of the proposed rate increases in this Application are required to maintain net income and financial ratios for 2015/16 and 2016/17 at acceptable levels, and are necessary to promote rate stability for customers and ensure the financial integrity of the Corporation.

Figure 2.25 below summarizes the actual electric operations net income for the past two fiscal years and the projected net income for 2014/15, 2015/16, and 2016/17 from MH14.

Figure 2.25: Net Income from Electric Operations

| Net Income - Electricity Operations | | | | | |
|---|--------------|---------------|---------------|---------------|----------------|
| (in millions of \$) | 2013 | 2014 | Forecast | | |
| | | | 2015 | 2016 | 2017 |
| Revenue | | | | | |
| General Consumers Revenue | | | | | |
| - at approved rates | \$ 1 341 | \$ 1 424 | \$ 1 437 | \$ 1 454 | \$ 1 460 |
| - Bipole III Reserve | - | (19) | (30) | (32) | (34) |
| Extraprovincial Revenue (net of Fuel & Power Purchased and Water Rentals) | 101 | 137 | 150 | 181 | 147 |
| Other Revenue | 30 | 22 | 15 | 14 | 14 |
| | <u>1 472</u> | <u>1 564</u> | <u>1 572</u> | <u>1 617</u> | <u>1 587</u> |
| Expenses | | | | | |
| Operating, Maintenance and Administrative | 1 407 | 1 439 | 1 495 | 1 571 | 1 653 |
| Finance Expense | 463 | 481 | 486 | 542 | 552 |
| Depreciation and Amortization | 452 | 435 | 495 | 510 | 548 |
| Capital and Other Taxes | 392 | 411 | 405 | 401 | 422 |
| Corporate Allocation | 86 | 97 | 99 | 107 | 121 |
| Other expenses | 9 | 9 | 9 | 8 | 8 |
| | 5 | 6 | 2 | 2 | 2 |
| Non-controlling Interest | 13 | 22 | 25 | 12 | 8 |
| Net Income (loss) before proposed rate increases | <u>\$ 78</u> | <u>\$ 147</u> | <u>\$ 102</u> | <u>\$ 58</u> | <u>\$ (58)</u> |
| Proposed rate increases (3.95% April 1, 2015 and 3.95% April 1, 2016) | | | | 57 | 118 |
| Net Income including proposed rate increases | <u>\$ 78</u> | <u>\$ 147</u> | <u>\$ 102</u> | <u>\$ 115</u> | <u>\$ 59</u> |

Retained Earnings and Financial Ratios (without proposed rate increases)

| | | | | | |
|---|----------|----------|----------|----------|----------|
| Retained Earnings (electric operations) | \$ 2 468 | \$ 2 615 | \$ 2 717 | \$ 2 721 | \$ 2 663 |
| Debt to Equity Ratio (electric operations) | 75:25 | 77:23 | 78:22 | 82:18 | 85:15 |
| Interest Coverage Ratio (electric operations) | 1.13 | 1.25 | 1.16 | 1.08 | 0.93 |
| Capital Coverage Ratio (electric operations) | 1.26 | 1.39 | 0.98 | 0.92 | 0.74 |

Retained Earnings and Financial Ratios (including proposed rate increases)

| | | | | | |
|---|----------|----------|----------|----------|----------|
| Retained Earnings (electric operations) | \$ 2 468 | \$ 2 615 | \$ 2 717 | \$ 2 778 | \$ 2 837 |
| Debt to Equity Ratio (electric operations) | 75:25 | 77:23 | 78:22 | 82:18 | 84:16 |
| Interest Coverage Ratio (electric operations) | 1.13 | 1.25 | 1.16 | 1.16 | 1.07 |
| Capital Coverage Ratio (electric operations) | 1.26 | 1.39 | 0.98 | 1.02 | 0.94 |

1 The proposed interim rate increase of 3.95% effective April 1, 2015 is expected to
2 generate additional revenue of \$57 million in 2015/16. With this increase, the forecast net
3 income from Electric operations for 2015/16 is projected to be \$115 million; the equity
4 ratio is projected to be 18%; and the interest coverage and capital coverage ratios are
5 projected at 1.16 and 1.02 respectively.

6
7 Absent the proposed rate increase for 2015/16, Manitoba Hydro is projecting net income
8 of \$58 million from Electric operations; the equity ratio is projected to be 18%; and the
9 interest coverage and capital coverage ratios are projected to deteriorate to 1.08 and 0.92
10 respectively. Furthermore, without the proposed rate increase for 2015/16, Manitoba
11 Hydro is projecting net income of only \$2 million in 2016/17 even if it obtained a 3.95%
12 increase effective on April 1, 2016. In this scenario, projected retained earnings are
13 forecast to be \$57 million and \$115 million lower in 2015/16 and 2016/17 respectively.

14
15 The proposed rate increase of 3.95% effective April 1, 2016 is expected to generate
16 additional revenue of \$60 million in 2016/17. With this increase, the forecast net income
17 from Electric operations is \$59 million; the equity ratio is projected to be 16%; and, the
18 capital coverage and interest coverage ratios are projected to be 1.07 and 0.94
19 respectively.

20
21 Without the proposed rate increase for 2016/17, Manitoba Hydro is projecting a net loss
22 of \$58 million; the equity ratio is projected to decline to 15%; and the interest coverage
23 and capital coverage ratios are projected to further deteriorate to 0.93 and 0.74
24 respectively (well below the 1.20 target levels).

25
26 Considering the financial outlook as projected in MH14, there is financial justification for
27 requesting rate increases in excess of 3.95%. Higher rate increases in the order of 5.5% to
28 6.0% for the next four years would be necessary to reduce the losses that are projected in
29 the next 10 year period and maintain financial reserves at current levels. This would
30 reduce the risk of the need for larger rate increases in the event of a significant drought or
31 other adverse financial conditions.

32
33 Despite these risks, Manitoba Hydro has maintained the minimum proposed rate
34 increases at the 3.95% level in consideration of customer sensitivity to rate increases.

35
36

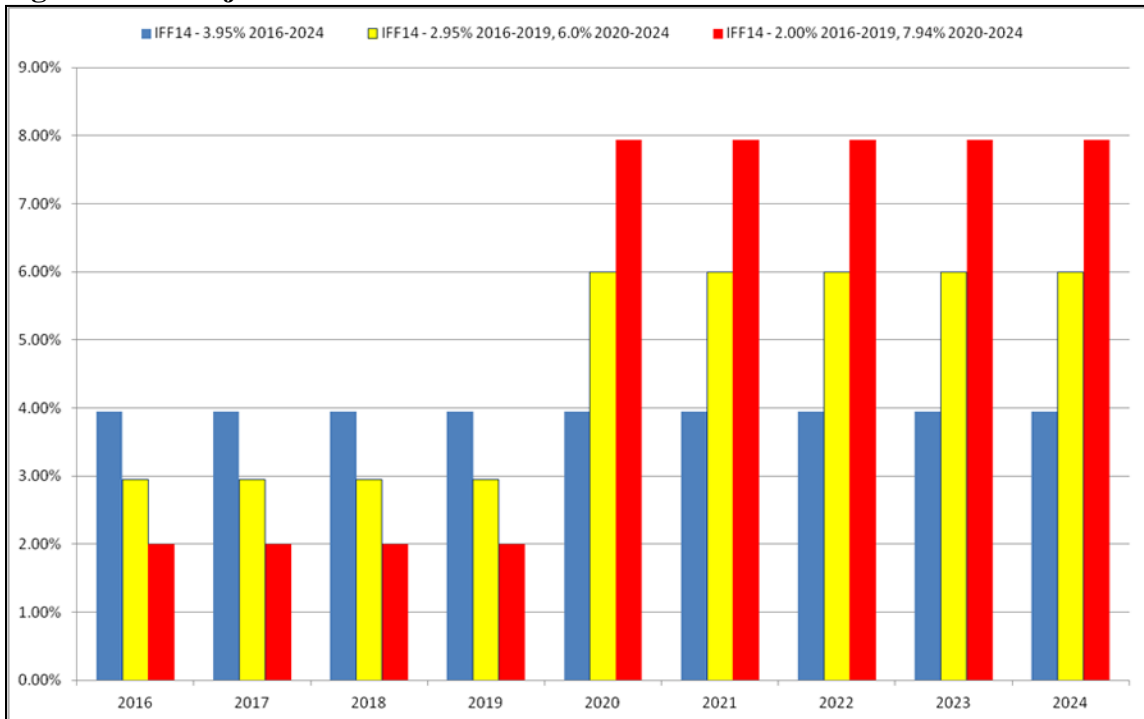
2.4 RISKS IF PROPOSED RATE INCREASES ARE NOT GRANTED

2.4.1 Increased Risk to Customers of Rate Instability and Rate Shock

To demonstrate the potential rate volatility of reducing the near term 3.95% indicative rate increases in MH14, Manitoba Hydro has prepared two scenarios that calculate the compensating rate increases that are required in the five year period from 2020 to 2024 if rate increases for the four year period from 2016 to 2019 were reduced to 2.95% or 2.00%, respectively.

The following figure demonstrates that with 2% rate increases for the next 4 years, Manitoba Hydro would require 8% rate increases for the following five years, and with 2.95% rate increases for the next four years, Manitoba Hydro would require 6% rate increases in the five years that follow. This analysis demonstrates how future rate increases would have to significantly increase in order to compensate for lower rate increases obtained in the near term.

Figure 2.26: Projected Rate Increase Scenarios



Given that these rate scenarios are also derived using average water flow assumptions and that adverse drought conditions may occur in the future, it is of vital importance that the rate increases be regular and occur even when there are short-term favorable water

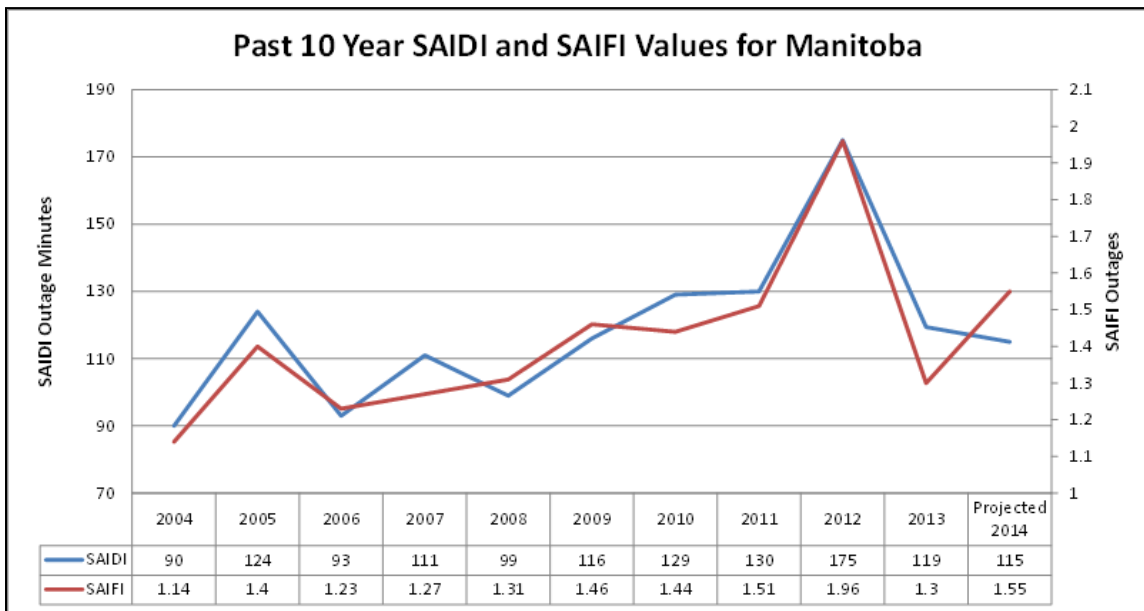
1 flow or financial conditions. In Manitoba Hydro’s view, gradually raising rates by the
2 minimum 3.95% rate increases is in the customer’s best interest as this maintains
3 customer rate stability and predictability, and reduces the risk of severe rate shock in the
4 future.

5
6 **2.4.2 Increased Risk to Customers of Decrease in Service & Reliability**

7 A considerable portion of Manitoba Hydro’s assets were installed when many of the first
8 generating stations and transmissions lines were built (1911-1950) and a large portion of
9 the province was electrified (1940-1960), and subsequently when generating stations and
10 supporting HVDC systems were developed in Northern Manitoba (1960-1990).
11 Historically, the reliability performance of Manitoba Hydro’s electric assets has been
12 excellent, and ratepayers in Manitoba have enjoyed the benefits of an affordable supply
13 of safe and reliable electricity for many decades. However, many of Manitoba Hydro’s
14 generation, transmission and distribution assets have reached an age where their overall
15 condition is such that system reliability has begun to degrade.

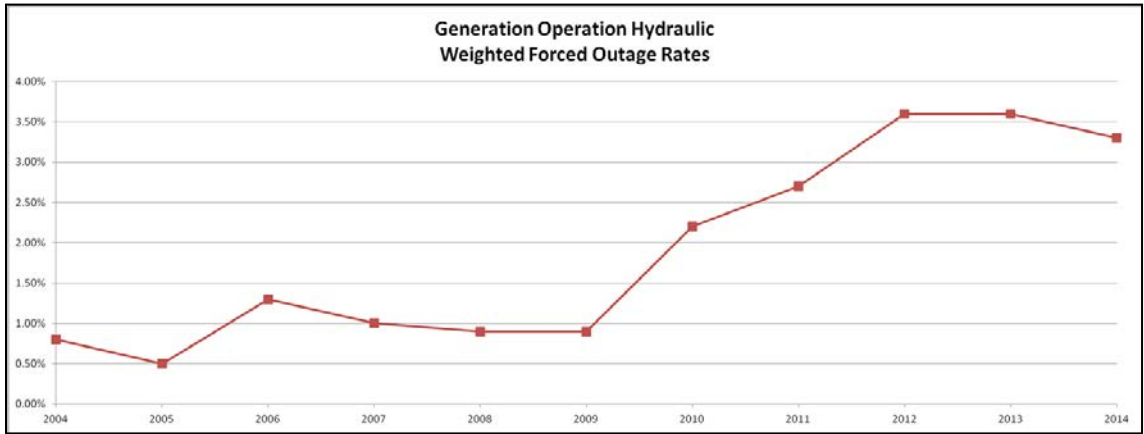
16
17 As shown in the following figures, Manitoba Hydro’s reliability performance based on
18 the SAIFI and SAIDI indicators show an increased trend of outage frequency and
19 duration. Likewise, generation forced outage rates have increased significantly in the past
20 four years.

21
22 **Figure 2.27: Manitoba Hydro SAIDI and SAIFI Indictors**



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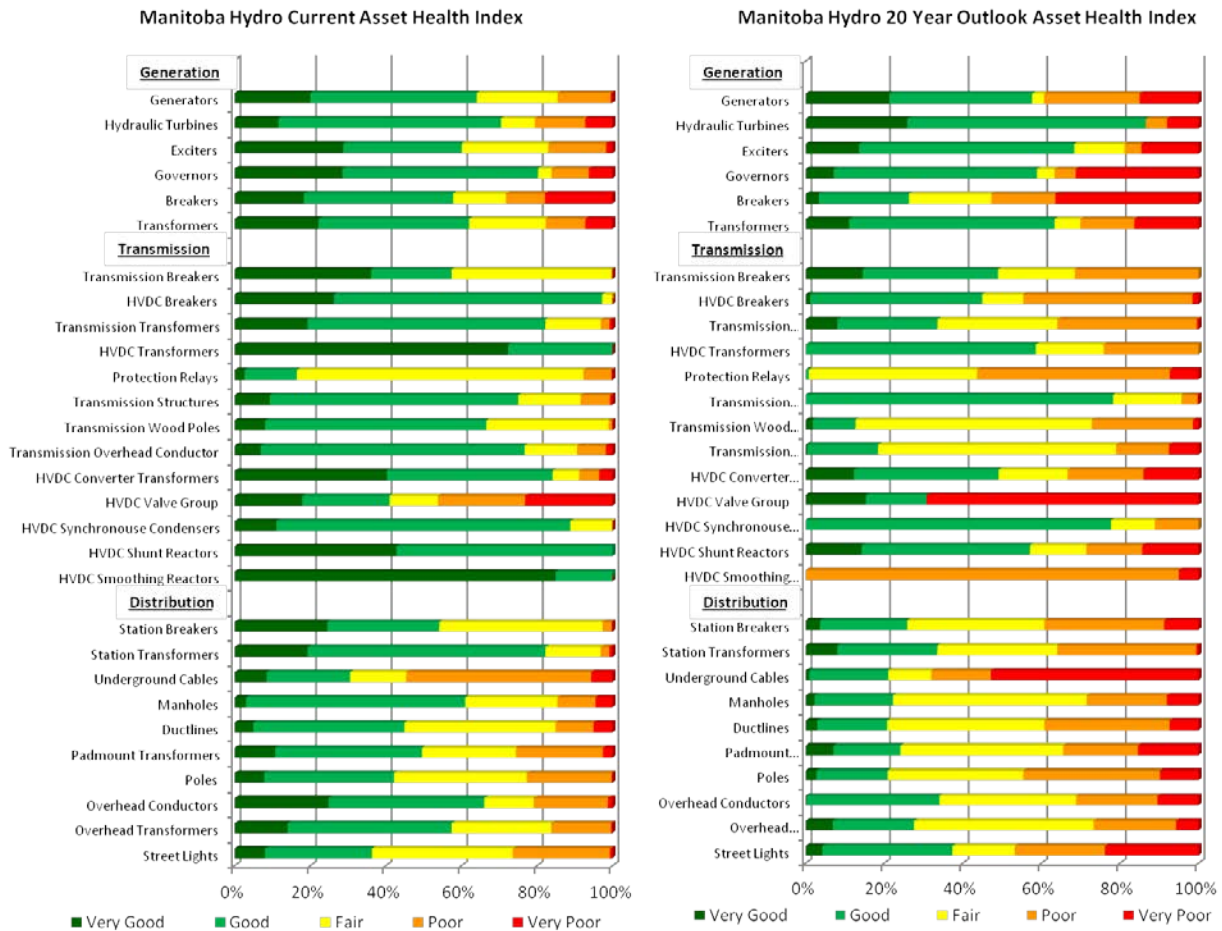
Figure 2.28: Hydraulic Generation Forced Outage Rates



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Manitoba Hydro uses an Asset Health Index (“AHI”) to quantify equipment condition based on numerous parameters, to indicate whether the asset type is in very poor, poor, fair, good or very good condition. The figures below provide a summary of current AHI results for Manitoba Hydro’s generation, transmission and distribution asset types, as well as the 20 year outlook of the AHI based on current asset replacement rates.

Figure 2.29: Asset Health Indices- Current & 20 Year Outlook



As a larger percentage of assets age beyond life expectancy, they will begin to fall into the poor and very poor categories and system failures and customer outages are expected to occur on a more regular basis. As such, replacement rates in the majority of Manitoba Hydro's asset types need to be increased to better align with life expectancy.

The rate increases proposed in the Application are the minimum required to fund the necessary capital investment to replace Manitoba Hydro's aging infrastructure. The following summarizes some of the major risks that would be associated with inadequate funding of sustaining capital:

- Reliability would degrade further, outages would become longer and more frequent;
- Extraprovincial revenues would be lost as a result of additional generation equipment failures;

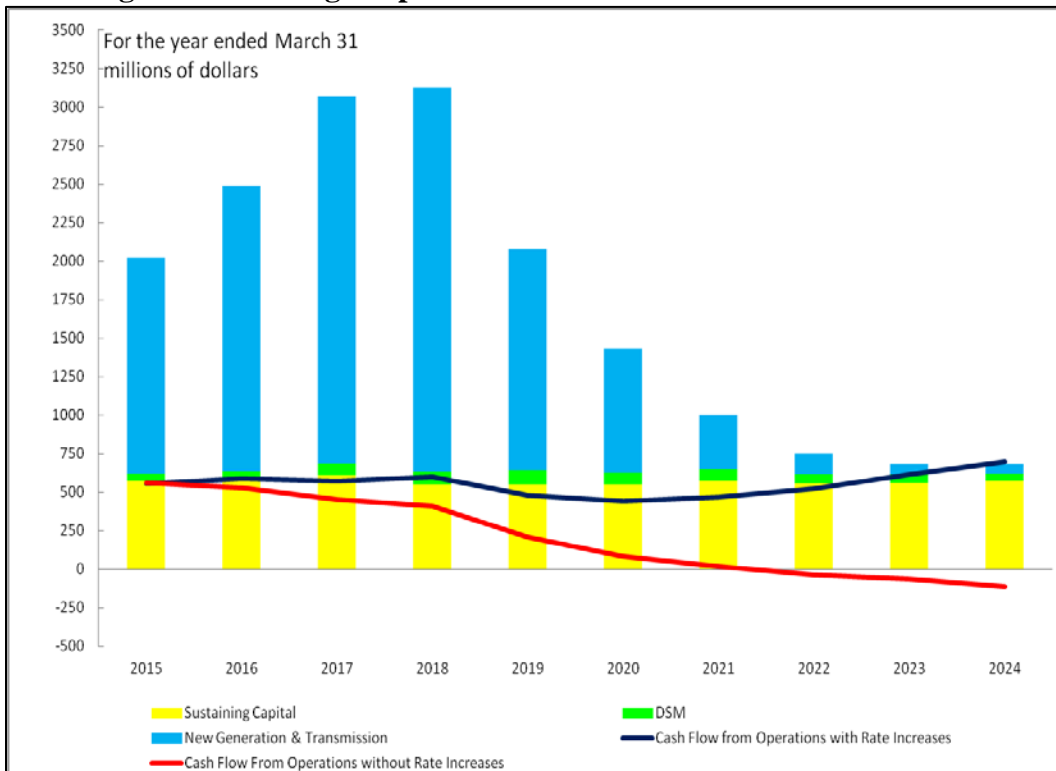
- Timeframes for repair/replacement would be impacted by insufficient lead times;
- Increased safety risks to public and staff;
- Maintenance and emergency costs would increase; and,
- Backlog of requirements would overwhelm the capability of resources to respond.

With the proposed rate increases, Manitoba Hydro will be in an improved position to fund the necessary investments in order to continue to provide the high level of safe and reliable service to which customers are accustomed.

2.4.3 Increased Borrowing Requirements Result in Higher Levels of Debt and Carrying Costs, which will Ultimately Need to be Recovered from Customers

As can be seen in the following figure, without the proposed and indicative rate increases, Manitoba Hydro would be required to fund a continually increasing portion of its sustaining capital expenditures through debt financing as opposed to through the cash flow generated from operations.

Figure 2.30: Electricity Capital Expenditures and Cash Flow from Operations Including and Excluding Proposed and Indicative Rate Increases



1 Maintaining reasonable financial ratios through regular and reasonable rate increases is in
2 the best interests of customers as it reduces the need for borrowing and additional
3 financing costs that must be borne by customers, which serves to reduce the pressure on
4 future rates and provide more financing flexibility in the event of adverse financial
5 circumstances.

6
7 It is important that Manitoba Hydro be granted the proposed rate increases to be able to
8 generate sufficient cash flow from operations to finance sustaining capital expenditures.
9 This will allow Manitoba Hydro to maintain reliable service to customers in a sustainable
10 manner.

11
12 **2.4.4 Potential Negative Implications to the Provincial Credit Rating and Manitoba**
13 **Hydro’s Borrowing Costs**

14 The Province of Manitoba has a high credit rating as can be seen in the following figure
15 that shows the long term credit ratings for each of the Canadian provinces. As Manitoba
16 Hydro receives a flow through credit from the Province of Manitoba, this high credit
17 rating benefits its customers by reducing the cost of borrowing that the Corporation must
18 recover in its rates.

19
20 **Chart 2.31: Provincial Long Term Credit Ratings Comparison**

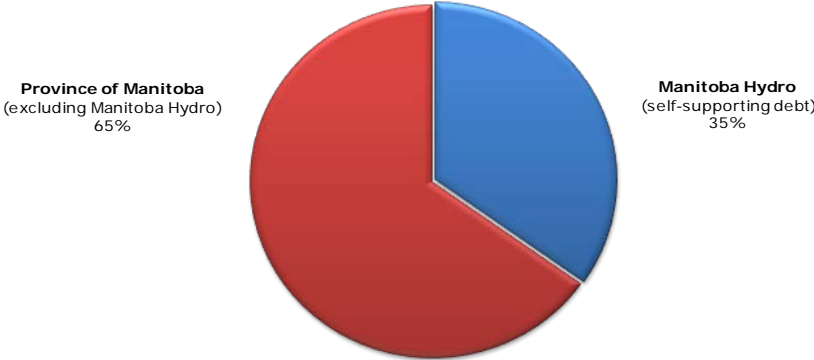
| Province | Standard & Poors | DBRS | Moody's Investors Service |
|-------------------------|------------------|-----------|---------------------------|
| British Columbia | AAA | AA (high) | Aaa |
| Saskatchewan | AAA | AA | Aaa |
| Alberta | AAA | AAA | Aaa |
| Manitoba | AA | A (high) | Aa1 |
| Ontario | AA- | AA (low) | Aa2 |
| Nova Scotia | A+ | A (high) | Aa2 |
| Newfoundland & Labrador | A+ | A | Aa2 |
| Québec | A+ | A (high) | Aa2 |
| New Brunswick | A+ | A (high) | Aa2 |
| Prince Edward Island | A | A (low) | Aa2 |

21 Rating reports are issued to individual provinces and not necessarily at the same time.

22
23 As demonstrated in Figure 3.32, debt advances to Manitoba Hydro form a significant
24 portion of the total provincial debt and the Corporation’s financial performance is
25 therefore a contributing factor toward the financial strength and stability of the Province’s
26 credit rating. The Credit Rating Agencies view Manitoba Hydro to be financially self-
27 supporting in that the Corporation is able to meet its financial obligations based on its
28 own revenues without being supported by the tax-base of the Province.

1 **Figure 2.32: Composition of Province of Manitoba Debt**

2 **Composition of Province of Manitoba Debt**
3 (\$30.0 billion, net of sinking funds)
4 Actuals as at March 31, 2014



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13
14 Credit rating agencies view Manitoba Hydro’s current low rates and reasonable
15 regulatory framework as positive ratings considerations. It is important that credit rating
16 agencies continue to view Manitoba Hydro’s debt as self-supporting and that weakened
17 financial ratios as a result of major capital investments and reinvestments do not
18 negatively impact the credit ratings of the Province or Manitoba Hydro’s borrowing
19 costs.

20
21 The proposed rate increases are necessary to continue to demonstrate to the credit rating
22 agencies that the regulatory framework in Manitoba is supportive of Manitoba Hydro’s
23 self-supporting financial status.
24
25

1 **2.5 AREAS OF CONCERN RAISED IN PREVIOUS PROCEEDINGS**

2
3 In the 2012/13 & 2013/14 GRA and Interim Application for Rates Effective April 1,
4 2014, there were a number of concerns expressed that Manitoba Hydro would like to
5 address in this section of the Application.
6

7 **2.5.1 Rate Increases are Required Notwithstanding More Favourable Near-term**
8 **Financial Results**

9 In past proceedings, it has been suggested that in years where the current financial results
10 are favourable, lower rate increases would be sufficient to maintain the short-term
11 financial position of the Corporation.
12

13 Manitoba Hydro's MH14 is forecast based on expected water flows for the first year of
14 the forecast (2014/15), median water flows for the second year of the forecast (2015/16),
15 and the average revenues for all water flow conditions for the past 102 years for the
16 subsequent years of the forecast (2016/17 and thereafter).
17

18 In the near term, to 2016/17, projected net income from electric operations (including the
19 proposed rate increases) is higher in MH14 as compared to MH13, largely due to
20 favourable water flow conditions, as well as lower finance and depreciation expense.
21 Although inflow conditions are currently favourable and Manitoba Hydro has confidence
22 that these conditions will persist until the end of March 2015, water inflow conditions in
23 fiscal 2015/16 are very uncertain and can be quite different from those assumed in
24 MH14. The main factor that determines water supply conditions in 2015/16 is
25 precipitation, which is highly variable and unknown at this time. MH14 assumes median
26 water inflows in 2015/16 which means that there is an equal probability that water
27 inflows will be higher or lower.
28

29 Notwithstanding the more favourable near-term results, there are lower net earnings
30 projected in the remaining years of MH14, such that between the period 2017/18 to
31 2023/24 projected net earnings from electric operations (including indicative rate
32 increases of 3.95% per year) are \$666 million lower compared to MH13.
33

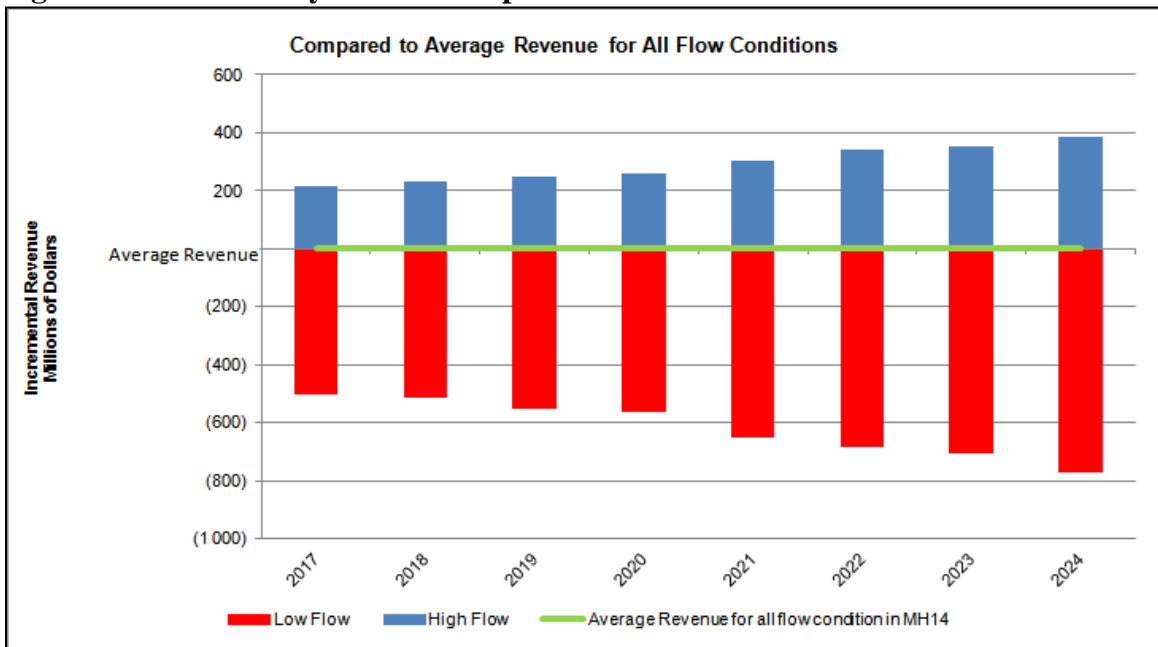
34 In total, MH14 projects net losses of \$901 million between 2018/19 and 2023/24. As a
35 result, financial reserves are projected to deteriorate from the current level of \$2.7 billion
36 to \$2.0 billion by 2023/24.
37

1 **Figure 2.33: Comparison of Electric Operations Net Income MH14 to MH13**

| | Forecast 2014/15 | Forecast 2015/16 | Forecast 2016/17 | 10 Year Cumulative to 2023/24 | 20 Year Cumulative to 2033/34 |
|--------------------------|-----------------------------|-----------------------------|-----------------------------|--|--|
| Current Forecast (MH14) | \$ 102 | \$ 115 | \$ 59 | \$ (559) | \$ 3 003 |
| Previous Forecast (MH13) | 55 | 12 | 19 | (85) | 4 775 |
| Increase/ Decrease | \$ 48 | \$ 103 | \$ 41 | \$ (474) | \$ (1 772) |

2
3 It is also important to recognize that Manitoba Hydro’s financial results are subject to
4 significant volatility based on potential changes in water flow conditions. This is
5 demonstrated by the following chart which compares the potential increase in net
6 extraprovincial revenues as a result of high water flows (blue bars) with the potential
7 decrease in net extraprovincial revenues associated with low water conditions (red bars)
8 for the period from 2016/17 to 2023/24. In this chart, the bolded green line represents the
9 average revenues for all flow conditions upon which the extraprovincial revenues in
10 MH14 have been forecast.

11
12 **Figure 2.34: Variability of Net Extraprovincial Revenue**



13
14
15 The 3.95% indicative rate increases are derived based on the assumption of average
16 revenues for all water flows. Actual water flows and the associated financial impacts will
17 deviate either up or down from the assumption of average. Over time, the financial
18 impacts resulting from low and high water flows will balance out. In order to maintain

1 the indicative even annual rate increases over the long-term, it is necessary that rate
2 increases be implemented gradually even in years with favourable water flows and
3 financial results. The law of averages dictates that implementing lower rate increases in
4 reaction to years with favourable water conditions, will result in the need for higher rate
5 increases in years with lower water conditions in order to balance out with average
6 revenue requirements over the longer term. This approach does not contribute to rate
7 stability for customers.

8
9 As a result of the extensive investments that Manitoba Hydro has to make to continue to
10 provide safe and reliable service to customers, there is a requirement for a period of
11 continual rate increases to cover the associated costs. Setting rates considering longer-
12 term revenue requirements, as opposed to being overly focused on the shorter term
13 financial outlook, is the prudent approach and in the best interest of customers. Focusing
14 only on the short term, will inevitably result in rate instability as ratepayers will be
15 faced with substantially higher rate increases in the future, especially considering the
16 longer term and significant investments Manitoba Hydro is undertaking.

17
18 The Corporation believes that the position advanced by the Green Action Centre (page 3
19 of its written submission) as part of Manitoba Hydro's Application for Interim Electric
20 Rates effective April 1, 2014 appropriately acknowledges that the proposed rate increases
21 should be assessed through a longer-term perspective.

22
23 *"In order to reconcile the variability of the Manitoba Hydro revenue*
24 *stream with the stability desired by many of Manitoba Hydro's customers,*
25 *the Board ought to look at setting rates on the basis of longer term trends*
26 *as opposed to the actual results of last year's revenues or the short-term*
27 *conditions, be they favourable or unfavourable. GAC is of the view that*
28 *the current longer term trends point strongly in the direction of requiring*
29 *more revenue for Manitoba Hydro"*

30
31 While reducing rate increases in the short-term may offer some temporary relief to
32 ratepayers in the immediate year, the reality is that doing so does not eliminate the impact
33 on consumers but only defers the rate increase to a future period. Regular and moderate
34 rate increases, such as those proposed in this Application, minimize the impact to
35 ratepayers arising from the unavoidable need to make the necessary investments in
36 Manitoba Hydro's system and the risk associated with adverse conditions such as below

1 average water flow conditions. Such an approach is critical when considering the long
2 term significant investments that Manitoba Hydro is undertaking on behalf of customers.

3
4 If Manitoba Hydro has short-term results that are more favourable than forecast, the
5 situation is actually beneficial for customers as the Corporation would be required to
6 borrow less debt, which would ultimately reduce the costs to be recovered from
7 ratepayers. The forecast net income for the three-year period is not unreasonable when
8 one considers the size of Manitoba Hydro's asset base, and that the implied return on
9 equity would be less than 2-3%, well below the return requirements if Manitoba Hydro
10 was a privately owned utility.

11
12 To ensure rate stability for customers, Manitoba Hydro submits that the most reasonable
13 and prudent approach is to implement regular and reasonable rate increases, even during
14 periods of favourable water flows, thereby balancing the inevitable years of less
15 favourable than forecast results where water flows are below average.

16 **2.5.2 Inflationary Rate Increases are Not Sufficient to Maintain Rate Stability for** 17 **Customers**

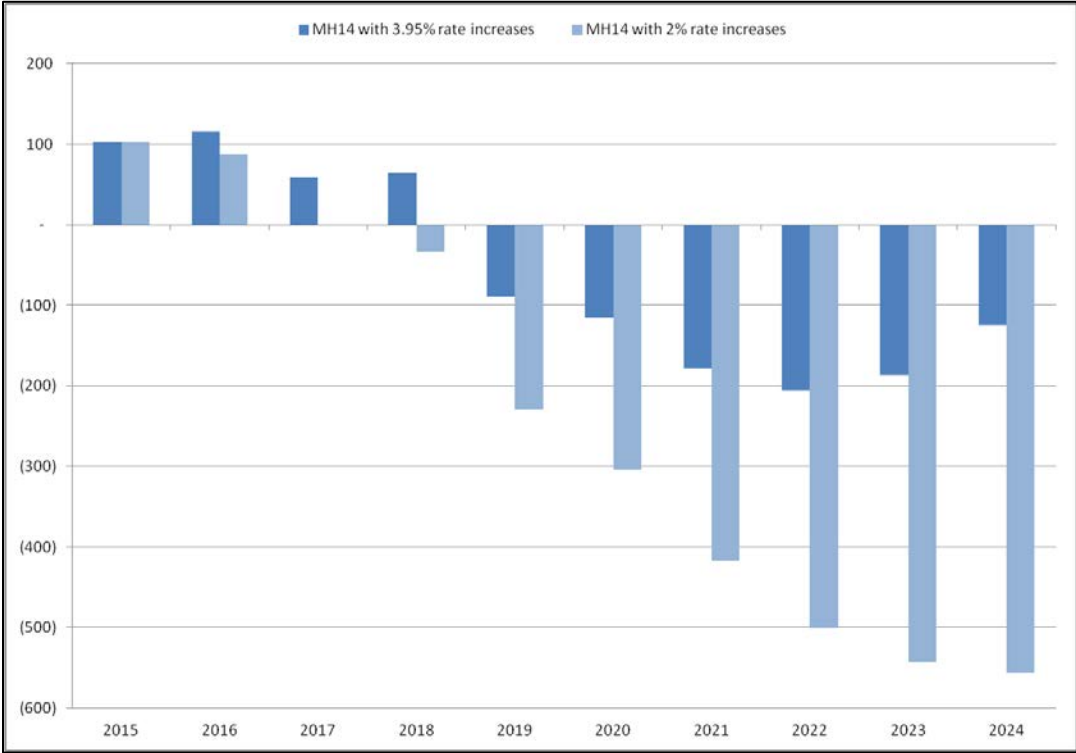
18
19 In past proceedings, it has been suggested that Manitoba Hydro's rate increases be
20 limited to inflationary adjustments, in or around 2% per year, in order to maintain
21 Manitoba Hydro's short-term financial position.

22
23 As an example of the risk to customers of allowing only 2% rate increases in the short-
24 term, the following charts demonstrate the impacts to net income, retained earnings, and
25 financial ratios of continual 2% rate increases for the period from 2016 to 2024, as
26 compared to the proposed and indicative rate increases of 3.95%.

27
28

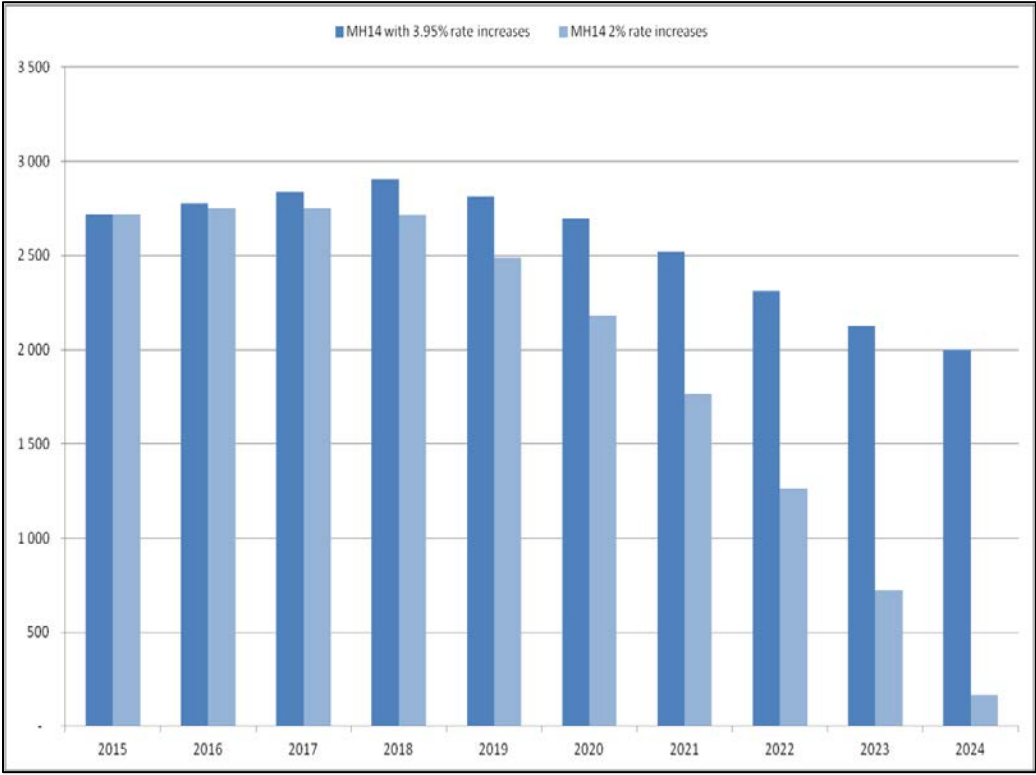
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Figure 2.35: Projected Net Income (2015-2024)



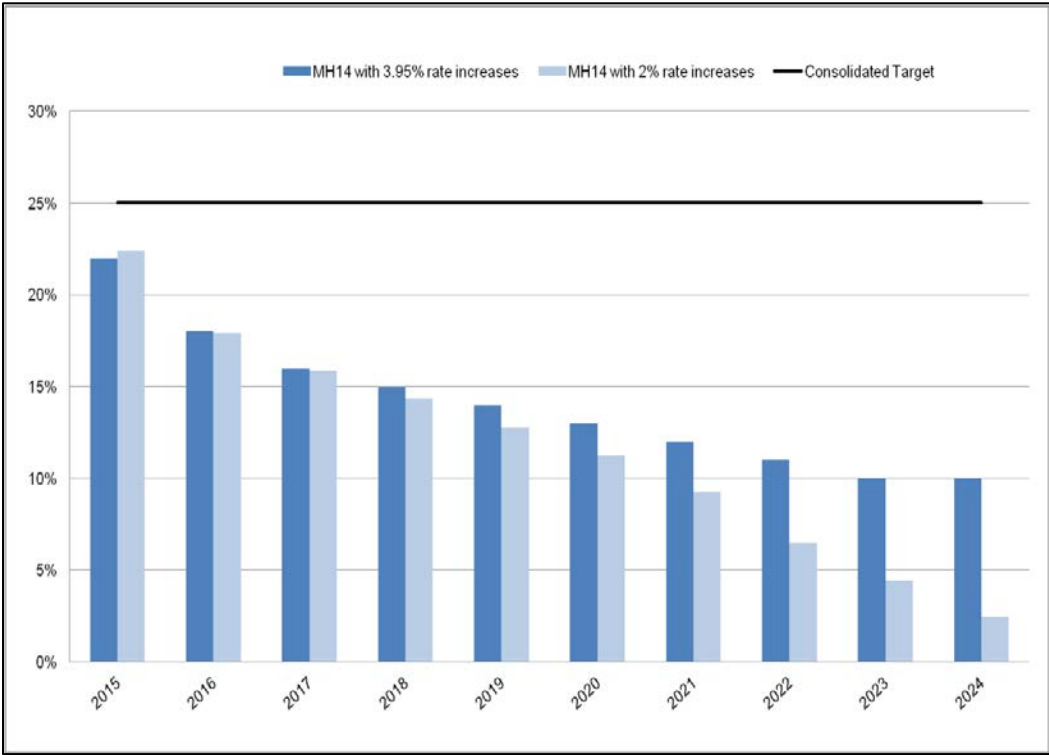
3
4
5

1 **Figure 2.36: Projected Retained Earnings (2015-2024)**



2
3
4

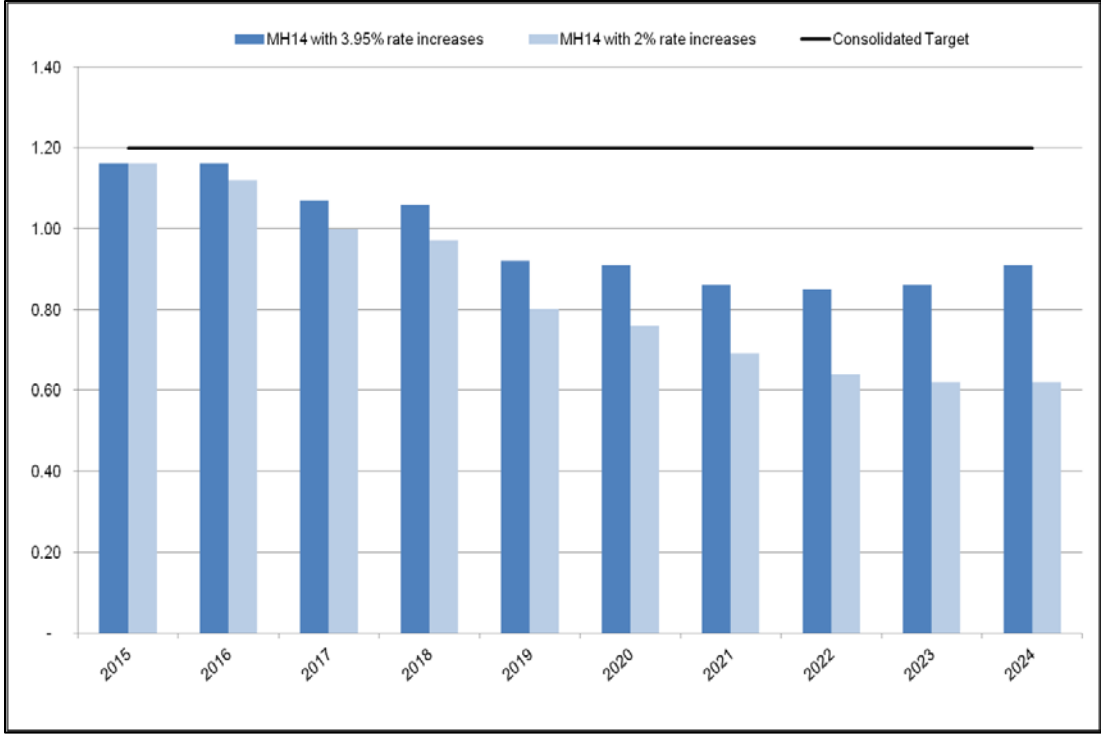
Figure 2.37: Projected Equity Ratio (2015-2024)



5

1

Figure 2.38: Projected Interest Coverage Ratio (2015-2024)

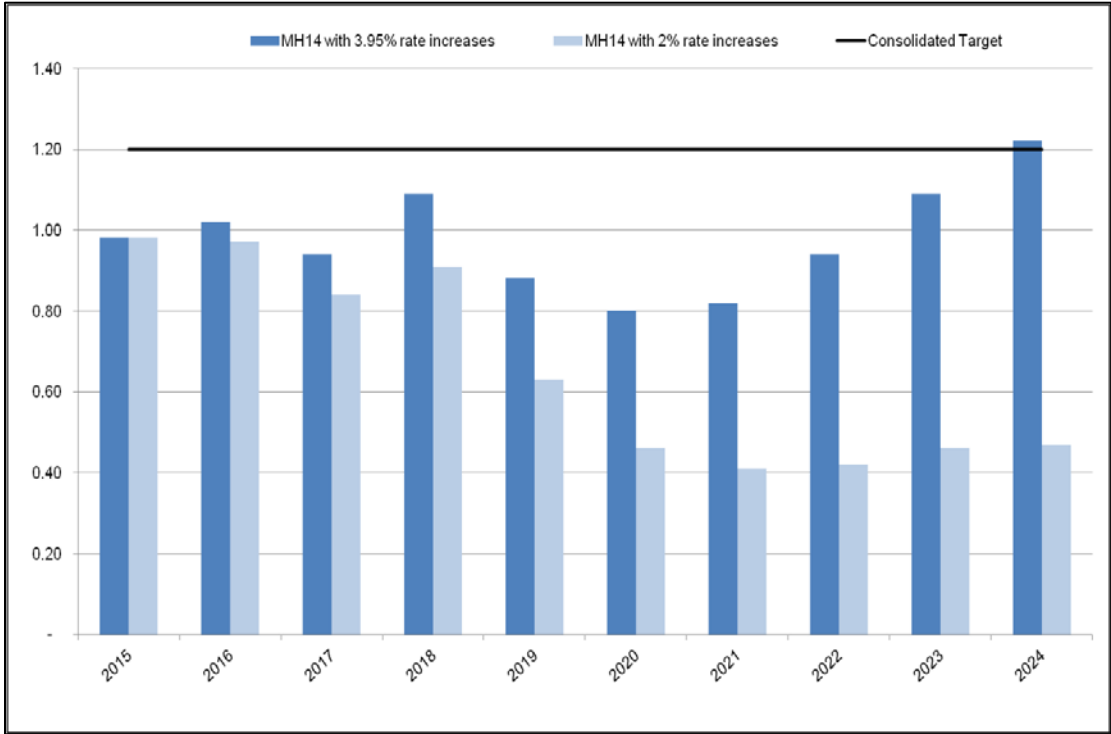


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3

4

Figure 2.39: Projected Capital Coverage Ratio (2015-2024)



5

6

1 The projected increases in Manitoba Hydro's revenue requirement are being largely
2 driven by the extensive investments to be made on behalf of domestic customers, which
3 are much more significant than inflationary cost pressures.
4

5 A rate increase that is based upon inflation jeopardizes Manitoba Hydro's ability to
6 provide rate stability to customers as it will be unable to recover its costs of providing an
7 essential service and ensure sufficient financial reserves are in place. Similar to the
8 suggestion that a rate increase can be forgone during those years where current results are
9 better than projected, granting a rate increase that does not allow the utility to recover its
10 costs each year will only result in higher borrowing requirements in future. The impact of
11 deferring or reducing the needed 3.95% rate increases will be to the detriment of
12 customers, as it serves to increase the requirements for higher rate increases in the future
13 than have been projected in MH14. This approach does not achieve rate stability in the
14 long-run and will subject consumers to increased rate volatility in the future.
15

16 **2.5.3 Manitoba Hydro is Effectively Controlling its Costs to Maintain Projected** 17 **3.95% Rate Increases**

18 In past proceedings, concerns have been expressed about Manitoba Hydro's efforts to
19 contain its operating costs.
20

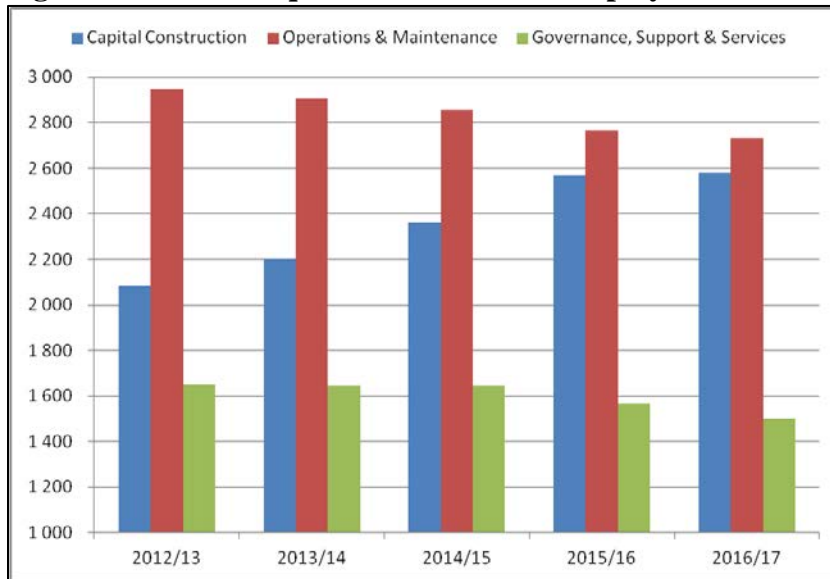
21 Manitoba Hydro is committed to carefully managing its costs and utilizing resources
22 efficiently and effectively to fulfill its mandate and provide maximum value to its
23 stakeholders and ratepayers. In order to fulfill this commitment, Manitoba Hydro
24 continues to develop measures to manage its operating costs, while at the same time
25 balancing the need to ensure staffing levels are adequate to provide safe and reliable
26 service.
27

28 Manitoba Hydro's most significant cost in providing service to customers is wages and
29 benefits. Manitoba Hydro has undertaken an extensive review of its staff complement and
30 is committed to reducing approximately 300 operational positions over the 3 year forecast
31 period from 2014/15 to 2016/17. These reductions will be achieved through attrition
32 through the application of technology, and the consolidation and elimination of work
33 processes where appropriate.
34

35 The following figure provides a summary of the Corporation's actual and projected
36 Equivalent Full Time ("EFT") employees for the period 2012/13 to 2016/17 segregated
37 between those EFTs that work on capital construction, operations & maintenance, and

1 provide governance & support services. As should be expected during a period of
2 significant capital investment the EFTs associated with capital construction are
3 increasing. In contrast, consistent with Manitoba Hydro's commitment to manage its
4 operating costs, the number of EFTs associated with operations & maintenance and
5 governance & support activities are forecast to decline.

6
7 **Figure 2.40: Total Equivalent Full Time Employees**



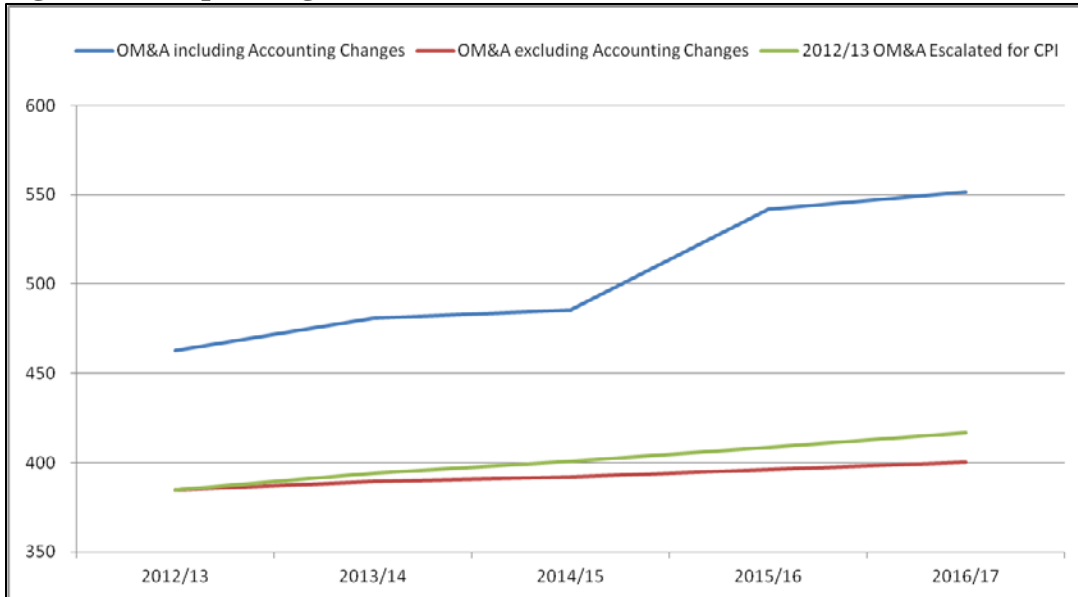
8
9
10 Manitoba Hydro is continually undertaking a number of initiatives across the various
11 Business Units that are intended to result in further operating and capital cost savings.
12 Some of these key initiatives include:

- 13 • Consolidation of Rural District Offices
- 14 • Implementation of Mobile Workforce Management
- 15 • Review of the Gillam Redevelopment & Expansion Project
- 16 • Supply Chain Management Initiatives

17
18
19 As shown in the following figure, these measures will allow the Corporation to maintain
20 Operating, Maintenance & Administrative cost increases at an annual average increase of
21 1% per year (excluding accounting changes that impact OM&A) through fiscal 2016/17
22 and beyond, which is below inflationary levels. These cost containment measures have
23 assisted the Corporation in maintaining projected annual rate increases at the same 3.95%
24 level as those projected in MH13, despite the Corporation facing significant and
25 increasing cost pressures. This is consistent with the expectations of the PUB in Order

1 43/13, wherein it recommended that Manitoba Hydro control OM&A costs increases
2 below inflation.

3
4 **Figure 2.41: Operating, Maintenance & Administrative Costs**



5
6
7 **2.5.4 Proposed Rate Increases are Not Being Driven by Aggressive Accounting**
8 **Policy Selection**

9 In past rate proceedings, concerns have been expressed that Manitoba Hydro's rate
10 increases are being driven by aggressive accounting policy choices, in particular the
11 expensing of additional overheads and the proposed change to the depreciation
12 methodology.

13
14 In Order 43/13, the PUB accepted the accounting policy changes that have been made by
15 Manitoba Hydro to 2013/14 for the purposes of rate setting but indicated that until an
16 IFRS Status Update Report is filed at the next GRA, no further changes should be made
17 for rate-setting purposes.

18
19 As is outlined in further detail in this Application, there are a number of prospective
20 accounting changes that Manitoba Hydro is making for financial reporting purposes in
21 2014/15 and 2015/16. The most significant of these include the implementation of a
22 comprehensive depreciation study in 2014/15 and further changes to the level of
23 capitalized overhead and depreciation methodologies as part of the implementation of
24 IFRS in 2015/16.

25

As summarized in Figure 2.42, these changes offset each other and result in an overall reduction in Manitoba Hydro's future revenue requirements. The significance of the net changes are minimal in the 2015 to 2017 period, and are clearly not driving the need for future rate increases during this timeframe.

Figure 2.42: Accounting Policy & Estimate Changes

| Accounting Policy & Estimate Changes | | | | | | | | | | |
|--|------|------|------|------|------|------|------|-------|-------|-------|
| Electric operations (in millions of \$) | | | | | | | | | | |
| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
| OM&A Expense Changes | | 51 | 56 | 57 | 58 | 58 | 59 | 60 | 61 | 62 |
| Depreciation Expense Changes | (25) | (53) | (57) | (60) | (76) | (86) | (96) | (101) | (103) | (105) |
| Other | | (3) | (3) | (4) | (3) | (3) | (4) | (4) | (3) | (4) |
| Total Increase (Decrease) in Revenue Requirement | (25) | (4) | (4) | (7) | (22) | (31) | (41) | (45) | (46) | (48) |

Given that the net impact of these changes are not driving the need for rate increases and not harming ratepayers, it is the position of Manitoba Hydro that IFRS financial reporting policies should be adopted for rate-setting purposes.

Furthermore, as has been the position of Manitoba Hydro in previous rate proceedings, under the cost of service rate-making approach that has been utilized by Manitoba Hydro, it is unnecessary and undesirable to maintain two sets of financial records, one for financial reporting purposes and one for rate-setting purposes. To have two sets of financial records could cause confusion for Manitoba Hydro's various stakeholders, including the PUB as they would be using different sets of financial information to make important decisions with respect to the Corporation's operations and finances.

2.5.5 Manitoba Hydro is Projecting Deterioration of its Financial Ratios to Mitigate the Rate Increases to Customers

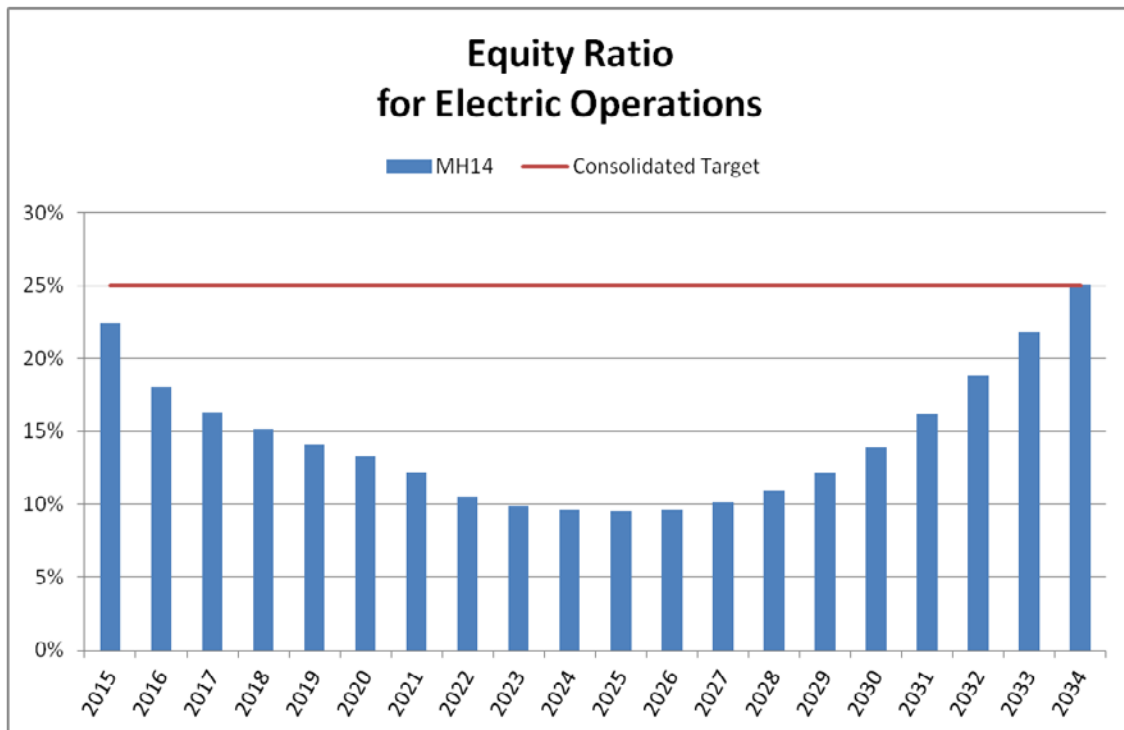
There has been a suggestion that Manitoba Hydro should relax its 75/25 debt-to-equity target to moderate its proposed electricity rate increases.

Manitoba Hydro recognizes that the rate increases that would be necessary to maintain its financial ratios at or above targets in the near to medium term, would be financially challenging for its customers. Further, this would be inconsistent with Manitoba Hydro's approach of smoothing rate increases over time in order to promote rate stability. Consequently in MH14, financial results and ratios are projected to be significantly below target for an extended period of time. Notwithstanding Manitoba Hydro's desire to smooth rate increases to customers over time, the Corporation recognizes that the 3.95%

1 rate increases are the minimum that are required to maintain rate stability and financial
2 integrity.

3
4 As demonstrated in the following figure, even with the 3.95% rate increases Manitoba
5 Hydro's electric operations equity ratio is expected to deteriorate to 10% by 2022/23, and
6 not recover to the 25% target until 2033/34.

7
8 **Figure 2.43: Equity Ratio for Electric Operations MH14**



9
10
11 Manitoba Hydro's interest coverage and capital coverage ratios are also well below
12 targets for an extended period of time and only recover within the later years of the 20
13 year forecast period. The retained earnings with respect to electric operations are
14 projected to decrease to \$1.9 billion by 2024/25, which is barely sufficient to absorb the
15 impact of the reoccurrence of the historic 5-year drought, and does not provide sufficient
16 reserves to mitigate the potential financial impacts of the considerable array of the risks
17 the Corporation faces in fulfilling its mandate.

18
19 Relaxing the longer-term financial targets will not negate the need for the requested rate
20 increases, as the 3.95% proposed and indicative rate increases are the minimum necessary
21 to manage the significant deterioration in Manitoba Hydro's projected financial results
22 and ratios in the next 10 year period.

1 **2.5.6 It is Appropriate to Set Rates for 2016/17 as Part of the Current Rate**
2 **Proceeding**

3 In Order 49/14, the PUB indicated that it would be reluctant to approve rates for 2016/17
4 as Manitoba Hydro is undergoing a period of significant and fairly rapid change.

5
6 Manitoba Hydro acknowledges that it is embarking on a period of unprecedented capital
7 expenditures to meet the energy needs of Manitobans. While there have been a number of
8 regulatory proceedings in the past where Manitoba Hydro's major capital plans have been
9 discussed at length, the Corporation has now received the necessary approvals and has
10 commenced construction on the Bipole III Reliability Project in the winter of 2013, and
11 the Keeyask Generating Station in the summer of 2014. As well, the Corporation has
12 completed a more comprehensive assessment of the condition of its assets and the capital
13 requirements associated with the renewal of its existing asset base, and is pursuing an
14 enhanced Power Smart program with a significantly higher level of investment. As such,
15 there is now more certainty with respect to Manitoba Hydro's investment requirements
16 than there has been in the recent past.

17
18 In this environment, it is the view of Manitoba Hydro that it is most appropriate to begin
19 to address the rate-setting and revenue requirement matters associated with these
20 investments on a proactive basis, rather than to defer their consideration solely to future
21 rate proceedings. Accordingly, Manitoba Hydro submits that the examination of the
22 2016/17 rate increase during this proceeding is both appropriate and desirable.

23
24 Manitoba Hydro also notes that, in the normal course, it seeks approval of rates for two
25 forward looking test years based on the Corporation's most up to date financial forecast.
26 Accordingly, the filing of a GRA early in 2015 would normally address two future test
27 years (2015/16 and 2016/17).

28
29 If Manitoba Hydro were to proceed with a GRA for the 2014/15 and 2015/16 test years
30 only at this time, the financial requirements are such that it would be necessary to file a
31 subsequent GRA later in 2015, which would include the 2016/17 test year. Such an
32 Application would follow only a few months after the conclusion of the proceeding for
33 the current GRA and would necessitate the need for Manitoba Hydro to request another
34 interim rate increase in order to implement new rates effective April 1, 2016. In Manitoba
35 Hydro's view, deferring the consideration of the 2016/17 rate change to a future
36 regulatory proceeding is not in the best interest of customers as it exposes them to
37 another interim rate increase for 2016/17 and does not promote regulatory efficiency.

1 **2.6 THE PROPOSED RATE INCREASES ARE ESSENTIAL TO PROVIDE**
2 **CUSTOMER VALUE**

3
4 Manitoba Hydro takes great pride in providing Manitobans with reliable service and
5 some of the lowest electricity rates in North America. This has been accomplished
6 through careful management of its assets, prudent spending on capital projects and by
7 managing its operating and administrative costs.

8
9 Manitoba Hydro is now entering a period of extensive investment and re-investment in its
10 infrastructure. This investment is needed for three main purposes: 1) to meet the growing
11 energy needs of Manitoba families and businesses, 2) to replace aging generation,
12 transmission and distribution assets that are approaching the end of their service lives,
13 and 3) to address capacity issues on the existing system. Manitoba Hydro is committed to
14 using revenues prudently for these purposes and demonstrating that its actions are cost
15 effective, efficient and fiscally responsible.

16
17 The revenues from the proposed rate increases are necessary so that Manitoba Hydro can
18 deliver on its mandate by:

- 19 • Continuing to deliver a reliable energy supply to Manitobans by funding the
20 necessary investments to respond to the need for system growth and asset
21 replacement;
- 22 • Funding Power Smart programs to assist customers in meeting their energy needs
23 in a cost effective manner;
- 24 • Continuing to provide rates that are affordable for Manitoba families and that
25 support the competitiveness of Manitoba business;
- 26 • Ensuring rate stability and predictability for customers by maintaining its
27 financial strength; and,
- 28 • Equitably serving the needs of all Manitoba residents, regardless of where they
29 live in the province—urban or rural, remote or central, north or south.

30
31 Manitoba Hydro conducts its business operations in an environmentally, socially, and
32 fiscally responsible manner, and with the revenues from the proposed rate increases can
33 continue to provide customers with reliable service and stable rates into the future.