Primer - on Hydro

LOW RATES DOESN'T MEAN EFFICIENT
ACCOUNTING AIDS ANNUAL RESULTS
RATES AFFECTED BY NEW PLANT AND EXPORTS
HYDRO DAMS GENERATE MAJOR REVENUE STREAMS FOR GOVERNMENT
PRIMER - On Utilities

USUALLY A MONOPOLY

RATES REQUIRE REGULATORY APPROVAL

BASIS FOR RATES - COSTS PLUS

WHO IS AT RISK:

PRIVATE FIRM - SHAREHOLDERS

CROWN CORPORATION - RATEPAYERS
OBJECTIVES

Presentation will touch upon the following:

- Needed - an independent, transparent, expert review
- PUB-led rate regulation and NFAT not good enough
- Rash Spending - ahead of a proper assessment
- What's in it for Government - lots
- Non-performing assets on the books boost retained earning
- Lack of Transparency - even with the regulator
- Changed circumstances require a re-think
- Risks aplenty: ratepayers only backstop
- Audits, long overdue
- Governance and conflict of interest issues
- History of Government Boondoggles
The Elephant and its Master

- **Government Controlled**
  - Monopoly
  - Government picks board
  - Hydro a major source of revenue for government

- **Hydro's Financial Position**
  - No Cash Reserves
  - Over $200 million/year of deferred costs
  - Borrows for capital expenditures
  - Reliant on ever-more significant rate increases

- **Current direction - the ill-fated status quo**
  - Overly optimistic projections
  - Risks are significant
  - Implications for ratepayers, negative
History - Mistakes and Debacles

- Political boondoggles are as old as time itself
  - Athens and Sparta, England invades Afghanistan, Napoleon invades Russia, Japan bombs Pearl Harbour, Bush invades Iraq

- Present-Day Challenges
  - Portugal, Ireland, Iceland, Spain, Italy, Cyprus, and more

- Canada has had its share
  - Newfoundland's electricity deal with Quebec and Muskrat Falls; Ontario’s 1st nuclear adventure, e-health, solar incentives; Wuskwatim, Churchill Forest industry, and more.
**Choices and Options**

- Poor Forecasts and Risky Strategy
  - Led to Wuskwatim, an economic disaster
  - Successive and massive increases in capital cost forecasts
  - Estimates for export demand and pricing consistently out

- Gamble, Recklessness, Conflicts of Interest
  - Major spending ahead of a proper review improper
  - Value for money audit needed, First Nations negotiations
  - Present plans maximize cash return to government
  - Options exist, with lower costs and risks
Wuskwatim - Economic Disaster

- Cost underestimated by half
- Export revenue overestimated by half or more
- NCN Partnership poorly executed
- Hydro “moves the goal posts”
- NCN Deal a Poor Template for the Future
Winners and Losers

- **Winners:**
  - Government, First Nations, Contractors, Hydro suppliers, low employment power hogs, American utilities

- **Losers:**
  - Hydro Ratepayers
  - Lower income households
  - Rural and northern consumers
  - Manitoba Economy
What Can Go Wrong

- Construction cost estimates soar
- Export demand and prices plateau or fall
- Infrastructure failure
- Domestic demand slows
- Drought, inevitable, occurs
- Credit Downgrade
- Higher interest rates
- Currency fluctuations
- Black Swan Event
Implications

Bad to Worse

- Hydro rate increases reduce consumer disposable income
- Conflicts of interest continue - decisions benefit government
- Subsidization of American utilities continue
- Subsidization of power hogs continues and increases
- Plight of the poor worsens (particularly outside gas network)
Timing is Crucial

- **Government plans were conceived pre-2008**
  - Affected by grandiose sham vision - "Manitoba’s oil, hydro-electric power"

- **Expectations**
  - Natural gas prices stay high, price on carbon, demand growth, reasonable construction costs, lower Canadian dollar, higher fixed export prices, eastern Bipole route, higher rate for new or expanded power hogs, increased revenue streams for government

- **Reality**
  - Global credit crisis and recession, American focus shifts away from climate change, Wuskwatim disaster, construction cost estimates soar, dollar at par, natural gas prices plunge as shale gas production soars, industrial growth stagnates, power hogs being subsidized by other ratepayers, while increased revenue stream for government

- **Result**
  - Rates increases mount
  - Borrowing increases
  - Economy tanks

- **Who Backstops the Risk?**
  - Ratepayers
Unanswered Questions

- Questions abound, on
  - Provisions and value of export contracts
  - Absence of diversified supply
  - Cost to ratepayers of FN contract provisions
  - Risk to ratepayers from power hogs
  - Solidity of reported equity
  - Quality of risk assessment
  - Future rate increases
  - Accountability
Protectors, Conspirators and the Rest

- Government - raking in the money, conflict of interest
- Hydro's government appointed Board
- Restricted PUB mandate results in a sham
- Auditor General - recused, out of the game
- Media
- Lobbyists
And Meanwhile…

- This is all happening while:
  - Government deficits, borrowing increasing
  - Hydro props up government revenue - consumers pay
  - Manitoba, a high tax environment, a state-dominated economy
  - Risk of energy poverty growing
  - Good options ignored
  - Ineffective risk management
Remedial Actions Needed

- Slow down the bus, the cliff is too close
- Re-think the development plan
- Implement an Energy Intensive Industry rate
- Value ratepayers over narrow political objectives
- Expand PUB jurisdiction or scrap it
- Auditor General must undertake long-needed key reviews

- Benchmark Hydro operations, and evaluate capital assets
- Write-down intangible, uneconomic and deferred assets
- Re-establish true transparency and openness

- Conflict of interest - financial incentives for govt. with current plan
- PST and City sales tax on a necessity in a cold climate?
A Worst Case Scenario

- Hydro builds Bipole III and commits to long-term exports
- FN partnerships left as is or worse
- Hydro builds Keeyask, Conawapa, Pointe de Bois
- Rates soar, 20 cents per kWhr
- Increases 'feathered in', assisted by accounting
- Hydro bills take $2.5 to $3 billion a year out of Manitoba's economy
- Massive subsidy of government through levies and rates
- Crisis for lower income and industrial customers

Spin - Before the build, claim new dams for domestic purposes
Spin - After the 'build', focus on export revenue, but leave out cost
Ratepayers (not government) take the 'hit'
QUESTIONS?

Consider the Take-Home Points:

- Hydro and government, innumerable costly mistakes
- Openness and Transparency absent
- Motivations - financial, political and ideological
- Rates, capital spending and government revenues soar
- Government records levies on Hydro, Hydro defers the cost
- Watch out for server farms - EIIR needed now
- Protection for ratepayers, absent

- Better development options are available (cheaper, less risky)
- Government's finances out-of-control
- Major reform is necessary - now!