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Message from the President: A response to whistleblower allegations October 26, 2009

I want to assure all staff that recent media reports about the risk of electricity blackouts and Manitoba Hydro being on the verge of bankruptcy are completely misguided and without any substance whatsoever. The highly publicized whistleblower allegations are the subject of an independent review by the Auditor General or her designate and this review will be conducted as soon as possible. Manitoba Hydro will also be engaging KPMG to conduct an in-depth and independent review of the Corporation's risk management practices. In the meantime, I would like to provide you with my comments on each of the allegations made against Manitoba Hydro:

Electricity Blackouts

Security of energy supply is fundamental to the mandate of Manitoba Hydro and has always been one of our top priorities. Our record of system reliability ranks among the very best of all energy utilities in Canada. Not only does Manitoba Hydro have the lowest domestic electricity rates in Canada, we also have very close to the highest system reliability. It's a record we're proud of and we will never, under any circumstances, allow the reliability of our system to be compromised.

To further enhance system reliability, a major new high voltage direct current transmission line, Bipole III, is planned for construction with a 2017 in service date. Bipole III will provide for a separation from the existing high voltage transmission line from northern Manitoba and will reduce the risk of power outages due to major storms or other uncontrollable events. Bipole III will also provide additional capacity to transmit power from planned new generation facilities in the north.

There has also been some suggestion that Manitoba Hydro has oversold future energy supplies in export markets which will lead to energy shortages in Manitoba. In fact, export contracts put Manitoba load first and Manitoba Hydro has the right to curtail exports in the event of unforeseen circumstances in Manitoba. Furthermore, our planned export contracts will result in additional interconnections with our neighbouring utilities and will result in enhanced security of supply for all Manitoba Hydro customers.

Financial Bankruptcy

Negative statements made about Manitoba Hydro's financial position are totally incorrect. In fact, Manitoba Hydro is currently in the strongest financial position than at any time in the history of the corporation. This is evidenced by the achievement last year of the corporation's long time target for the debt/equity ratio. The debt/equity ratio is recognized by rating agencies and financial institutions as one of the primary indicators of a corporation's financial strength. Back in 2002, the Board of Manitoba Hydro set a target to achieve a debt/equity ratio of 75:25 by 2011/12. That target was achieved last year — three full years ahead of schedule.

Some media reports have also suggested that Hydro's own financial forecasts show gloom and doom ahead. This is simply not true. While Manitoba Hydro, like any other business, is not immune from the financial impacts of the world economic downturn, we are especially well-positioned to prosper in the years ahead. Our financial forecasts clearly indicate that Manitoba Hydro's financial position will continue to be strong and that investments made in new generation and transmission today will pay huge dividends to future generations of Manitobans.

Secretive Organization

Another very misleading statement is that Manitoba Hydro has somehow become a secretive organization. I can't think of any organization that comes under more scrutiny than does Manitoba Hydro. We hold three well-publicized Public Accountability meetings in different parts of the province each year, I personally appear before a Crown Corporations Committee of the Legislature each year, we are subject to regular mandate and performance reviews by the Crown Corporations Council, our financial records are scrutinized regularly by internal and external auditors, the Auditor General provides additional oversight on Manitoba Hydro's financial accountability, we obtain Treasury Board approval on all capital and borrowing requirements, and our rates are subject to continuous review and approval by The Public Utilities Board (PUB).

With respect to PUB, there has been some suggestion that we are withholding information that the PUB needs to effectively do its job. Manitoba Hydro is more than willing to provide whatever information is necessary for the PUB to fulfill its important rates approval mandate. However, Manitoba Hydro operates in a very competitive export power marketplace and it is necessary to provide the PUB with information in such a way that does not put Manitoba Hydro at a competitive disadvantage. Manitoba Hydro has always had a cooperative working relationship with the PUB and this is expected to continue.

Drought Losses Avoidable

In fiscal year 2003/04, Manitoba Hydro incurred the largest financial loss in its history — a total loss of \$436 million. Was this loss avoidable? Absolutely not.

Because perfect foreknowledge is not possible (with respect to future precipitation and extreme weather), when low water conditions were experienced in 2003, Manitoba Hydro prepared for the worst drought on record and made certain Manitobans would be provided with sufficient power in a worst case scenario. Fortunately, the winter of 2003/04 ended up being warmer than normal and water supplies were slightly better than the worst case scenario (the drought ended up being the third worst on record as opposed to being equal to the worst on record). Had Manitoba Hydro known this in advance, which was not possible, the cost of the drought could have been reduced to some extent. However, it is important to note that because reservoirs were not fully drained in 2003/04, incremental revenue was generated in the following years through the deferred sale of electricity out of these reservoirs.

Following the drought, Manitoba Hydro engaged RiskAdvisory, an independent consultant to review Manitoba Hydro's drought operations. Their January 2005 report concluded the following:

a) "Overall, the Company did an outstanding job in managing the drought."

- b) "Manitoba Hydro managed the drought in a very commendable and prudent manner."
- c) "While the Company did incur incremental costs to avoid draining reservoirs, it did so for the sole purpose of protecting the Manitoba consumer from potential outages in the future."
- d) "The Company may not have been perfect in the development and implementation of their drought strategy, but the risk-reducing benefits of the hedging strategy far outweighed the implementation cost of the strategy."
- e) "The losses that the Company experienced could have been over \$1 billion if the exposures had not been managed properly."

The Public Utilities Board reviewed Manitoba Hydro's drought management operations. In Order 143/04 the PUB stated that "The Board is satisfied that MH took reasonable steps to mitigate its loss during the drought, including its actions in the futures market to reduce its export delivery obligations. The Board notes that no Intervener indicated concern with MH's actions related to export activities during the drought period."

Optimistic Export Forecasts

Manitoba Hydro designs its system so that there will always be sufficient dependable energy to supply the Manitoba and firm export loads. Dependable energy is defined as the amount of energy available from the hydraulic and thermal systems as well as contractual imports assuming the lowest river flows on record. Because flow records are maintained as far back as 100 years, Manitoba Hydro has a high degree of confidence that it can supply the firm loads even in the most extreme drought. However, should water conditions be worse than the extreme planned for drought, firm export sales can be curtailed to the extent necessary to meet the needs of Manitoba. To that extent, firm exports improve the reliability of supply to Manitobans. Further, this means that whenever water flows are above dependable levels, Manitoba Hydro will have surplus energy available to sell on export markets.

In addition to the energy surpluses that result from higher than dependable water flows, large blocks of surplus energy and capacity exist whenever Manitoba Hydro brings new generation into service. For example, when Limestone Generating Station was placed into service, approximately 1,300 megawatts were added to the system. Because Manitoba Hydro's domestic load grows by only about 60 megawatts per year, Manitoba Hydro was able to sell large amounts of surplus power into the export market on a firm or guaranteed basis. Without such firm surplus sales, it would not be financially possible to construct such large generation and transmission facilities. The financial risk would be far too great. However, with willing purchasers of Manitoba Hydro's surplus power, largely in the USA, Manitoba Hydro has been able to mitigate the financial impacts of such large construction projects and return the financial benefits to Manitoba consumers in the form of very low rates. Without sales of surplus energy into export markets, electricity rates in Manitoba would be at least 30 percent higher than they are today. In addition to low electricity rates, Manitoba Hydro has been able to make substantial annual payments to the province, currently in excess of \$200 million per year, to improve the quality of life in Manitoba.

Just as it did with Limestone Generating Station, Manitoba Hydro is negotiating with counterparties to secure long-term sales from the proposed Keeyask and Conawapa Generating Stations. While much has been stated about the significant capital dollars required to construct these new facilities, construction will not commence until firm sales are in place. The firm sales will largely offset the capital construction costs resulting in minimal residual risks to Manitoba ratepayers. Constructing Keeyask and Conawapa

Generating Stations along with associated transmission represents a sound business investment for Manitoba Hydro and will yield benefits to the province for many years to come.

Mismanagement

Probably the most hurtful comments directed at Manitoba Hydro recently are allegations of mismanagement. Nothing could be further from the truth.

When I became President & CEO of Manitoba Hydro almost 20 years ago, I set a vision that Manitoba Hydro would be the best utility in North America. By virtually every measure, that vision has been achieved. We have the lowest electricity rates in North America, the highest customer satisfaction, high system reliability, a greatly improved and still improving safety record, we are financially strong, we have the highest aboriginal representation in our workforce of any Canadian company, our Power Smart energy conservation program is one of the best in North America and our record of environmental responsibility is second to none. All of this was made possible by the best and most dedicated management team anywhere. I am extremely proud of all employees of Manitoba Hydro and for any of them to be unfairly criticized is especially distressing.

I strongly support the right of any individual to express his or her legitimate concerns in a discreet and confidential way without fear of reprisal. This is the essence of the Province's whistleblower legislation. At some point, however, Manitoba Hydro needs to have the opportunity to defend itself once the allegations are known. We have stated previously that we fully support an investigation by the Office of the Auditor General because we are very confident that such an independent review will vindicate Manitoba Hydro and demonstrate that the corporation is managing its risks in the most prudent and responsible manner.

In addition to the review of the Auditor General, Manitoba Hydro has also engaged the services of ICF International and KPMG to provide independent assessments in the areas of drought risk management, long-term contracts, hydrologic modeling, specific power trading issues and the governance structure for power trading. The findings of ICF International were provided to Manitoba Hydro in a report dated September 11, 2009. In summary, the findings of ICF International were as follows:

- 1) Manitoba Hydro should be in the power export business based on the benefits provided to the ratepayers and the Province.
- 2) Manitoba Hydro has been in the export power business for many years and has developed sophisticated structures and capabilities to manage exports and hydro variability; these structures continue to develop and improve.
- 3) Manitoba Hydro has the lowest domestic electricity rates in Canada and North America in part because of exports. Export prices greatly exceed Manitoba Hydro's embedded generation costs, and the revenues are used to decrease domestic rates and/or to provide the financial wherewithal to withstand droughts without rate shocks.
- 4) Proposed new long-term contracts are expected to provide several types of benefits including lower Manitoba Hydro rates than would otherwise be the case without the contracts.
- 5) United States utilities are undertaking new transmission construction to facilitate Manitoba Hydro exports. The buying utilities are expending up to \$2 billion for expanded

transmission between the utilities and the Canadian border. This export driven addition in new transmission construction can be used to support imports in the case of a drought worse than the worst-on-record.

6) Hydroelectric development, combined with long-term firm contracts, is preferred for Manitoba as it avoids the risks involved in developing fossil power plants.

7) Manitoba Hydro has a reasonable and adequate risk mitigation plan. Even in the event of a five-year drought, the Company has plans to achieve an equity cushion sufficient to accommodate the reduced cash flow due to drought without having to raise rates.

8) ICF concludes that it is appropriate for Manitoba Hydro to enter into long-term firm commitments for 20-30 years in the future in the manner in which the corporation is proposing.

9) The prices proposed for long-term firm contracts appear reasonable and adequate, and Manitoba Hydro pricing processes appear adequate.

10) The models used by the corporation (hydrological forecasting models) are similar to models used by other hydro-electric dependent companies.

11) ICF considers Manitoba Hydro's quantification of risk exposure to drought to be reasonable.

12) ICF concludes that Manitoba Hydro's risk mitigation strategy related to an extended drought is adequate, and helps meet a key goal of avoiding rate shocks.

The findings of the KPMG review will be provided in a report to be presented on or before December 31, 2009.

I am very proud of the employees of Manitoba Hydro as well as the status the corporation has achieved as one of the largest integrated electricity and natural gas utilities in Canada.

Thank you for your support and confidence during these challenging times.

Sincerely,



Bob Brennan, FCA
President & Chief Executive Officer

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