CENTRA GAS MANITOBA INC.
2013/14 GENERAL RATE APPLICATION

VOLUME II

FIXED RATE PRIMARY GAS SERVICE

INDEX

Appendices

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13.0 Overview of Tab 13

The purpose of this Tab is to provide an update on the status of Centra Gas Manitoba Inc.'s ("Centra") Fixed Rate Primary Gas Service ("FRPGS") and to provide materials on the proposed changes to the FRPGS Rate Setting Mechanism.

13.1 Program Results to Date

FRPGS provides customers with the opportunity to contract with Centra for a fixed Primary Gas rate for a contract period of either one, three or five years. Residential and commercial customers in the Small General Service ("SGS") and Large General Service ("LGS") customer classes who are not currently under contract with a registered gas marketer are eligible to apply for this service during the marketing period established for each offering.

During fiscal years 2011/12 and 2012/13 there were seven separate enrolment periods:

- May 16 to June 9, 2011 (deliveries commencing August 1, 2011)
- August 25 to September 13, 2011 (deliveries commencing November 1, 2011)
- February 8 to March 13, 2012 (deliveries commencing May 1, 2012)
- May 8 to June 12, 2012 (deliveries commencing August 1, 2012)
- August 8 to September 11, 2012 (deliveries commencing November 1, 2012)

- November 13 to December 14, 2012 (deliveries commencing February 1, 2013)
- February 8 to March 11, 2013 (deliveries commencing May 1, 2013)

The following table shows the rates associated with each FRPGS offering noted above and Centra's quarterly Primary Gas rate in effect during each enrolment period.

FRPGS Enrolment Period & Flow Date	**Centra Fixed Rate ($/m^3)**	**Centra Quarterly Rate ($/m^3)**
May 16 - June 9, 2011 *(August 1, 2011 flow)*	1-Year N/A 3-Year $0.1975 5-Year $0.2095	$0.1548 (May 1 - July 31)
Aug. 25 – Sept. 13, 2011 *(November 1, 2011 flow)*	1-Year N/A 3-Year $0.1960 5-Year $0.2067	$0.1468 (Aug. 1 – Oct. 31)
Feb. 8 – March 13, 2012 *(May 1, 2012 flow)*	1-Year $0.1500 3-Year $0.1661 5-Year N/A	$0.1105 (Feb. 1 – Apr. 30)
May 8 – June 12, 2012 *(August 1, 2012 flow)*	1-Year $0.1342 3-Year $0.1537 5-Year $0.1649	$0.0880 (May 1 – July 31)
Aug. 8 – Sept. 11, 2012 *(November 1, 2012 flow)*	1-Year $0.1523 3-Year $0.1694 5-Year $0.1807	$0.0967 (Aug. 1 – Nov 30)
Nov. 13 – Dec. 14, 2012 *(February 1, 2013 flow)*	1-Year $0.1706 3-Year $0.1815 5-Year $0.1912	$0.0967 (Nov. 1 – Jan. 31)
Feb. 8 – Mar. 11, 2012 *(May 1, 2013 flow)*	1-Year $0.1690 3-Year $0.1804 5-Year $0.1900	$0.0967 (Feb. 1 – Apr. 31)

13.1.1 Marketing

Centra currently provides FRPGS offerings once each quarter, with each marketing period to commence shortly after the implementation of the quarterly Primary Gas rate change. An offering was not available in November/December 2011 with a February 1, 2012 flow because of Centra's inability to execute hedge transactions as discussed in Section 13.2.

The marketing strategy for the FRPGS is to offer customers a choice in their Primary Gas product. The marketing message does not attempt to influence a customer's decision and is indifferent to which product a customer chooses, including the default product. Marketing efforts only promote products offered by Centra.

Centra markets FRPGS primarily through messaging on the Manitoba Hydro website, and may supplement this with the use of mass media communication and sales options, including the use of newspaper ads, brochures and voluntary direct mail and e-mail communication (i.e. the customer must sign up or subscribe to receive mail or e-mail notifications). Centra does not use door-to-door sales or telemarketing.

13.1.2 Results

Centra reports the results of the FRPGS program on an annual basis to The Public Utilities Board ("PUB"). In compliance with Directive 7 in Order 156/08, Centra submitted the 2010/11 & 2011/12 Annual Report on FRPGS on August 26, 2011 and December 13, 2012, respectively. These reports are provided in Appendix 13.1 and 13.2.

The enrolment results for the enrolment periods in fiscal 2011/12 and 2012/13 are shown in Appendix 13.3 to this Tab. Appendix 13.3 indicates the number of contracts projected and accepted for SGS Residential, SGS Commercial and LGS customers for the 1, 3 and 5 year offerings for August 1, 2011 flows. The volumes hedged and subscribed are also provided in aggregate for each of the 1, 3 and 5 year offerings. Hedges were not placed for flow dates after August 1, 2011, therefore, only contracts scheduled for activation are shown. A further offering for May 1, 2013 flows is currently underway, however, no results are available as of the date of this filing.

Centra is also providing, as Appendix 13.4, the settled results and marked-to-market projections as at December 31, 2012 for all hedging instruments placed in support of the FRPGS offerings since the inception of the program.

13.2 Proposed Changes to the FRPGS Rate Setting Methodology

13.2.1 Background

On July 11, 2008, Centra applied to the PUB for approval to offer fixed rate and fixed term Primary Gas contracts to Manitoba customers. In that Application, Centra sought approval for a standardized Rate Setting Mechanism (“RSM”) to determine the rates to be charged for each offering that reflected the hedged cost of Primary Gas plus a Volumetric Risk Premium (“VRP”) and a Program Cost Rate (“PCR”). The PUB issued Order 156/08 on December 2, 2008 which approved the utilization of the pricing formula for FRPGS, and approved a VRP to be set at 5%.

Centra utilized financial derivatives to manage market price risk for its FRPGS products from the inception of the program until August, 2011. The principles and procedures that have been followed in placing derivative transactions for FRPGS are as follows:

- Derivatives will be used for the purpose of fixing the Primary Gas commodity cost for forecast customer volumes under normal weather conditions;

- Derivatives will not be used for the purpose of speculation. There must be a reasonable expectation of an underlying physical requirement for the gas that is being hedged;
- Only Over-The-Counter ("OTC") derivative instruments will be utilized for placing hedge transactions;
- As a matter of course, the derivative instruments that will be used are fixed price swaps;
- Hedges will be placed prior to offering and selling fixed rate contracts to customers;
- Quotes will be solicited from a minimum of three counterparties;
- Fixed rate hedges will be based on the best available market price at the time of each transaction;
- Once a derivative contract is put in place, that contract will not be sold or otherwise dealt with (i.e., unwound) except in extraordinary circumstances; and
- Derivative positions may be placed for up to a five year duration.

Generally, Centra has offered FRPGS products on a quarterly basis, ensuring that the marketing periods do not overlap with the change in quarterly Primary Gas rates on February 1, May 1, August 1 and November 1. Since the inception of FRPGS in 2009, Centra has brought forth FRPGS contract offerings on fifteen separate occasions. Centra's forecast customer uptake for the various offerings has ranged from the consumption equivalent of approximately 30 residences to the consumption equivalent of approximately 1,100 residences.

13.2.2 Financial Counterparty Participation

In the summer of 2011, Centra was informed by participating financial counterparties of their refusal to continue to engage in derivatives transactions on the relatively small scale that has been characteristic of the FRPGS program since its inception. On August 9, 2011, Centra sought price quotations on financial derivatives for 3 and 5 year FRPGS offerings for a gas flow date of November 1, 2011. However, only one financial counterparty was willing to participate. Centra's derivatives policy requires that a minimum of three price quotations be obtained and therefore, Centra did not place these derivatives.

Centra subsequently notified the PUB and sought approval to apply a proxy Primary Gas commodity price determined as the 3 and 5 year volume weighted average strip of future prices at AECO (based on August 9, 2011 market close prices), plus the average dealer premium experienced for the nine previous FRPGS offering to that date. Centra's request was approved in a letter from the PUB dated August 24, 2011[1].

On January 31, 2012, Centra submitted a letter to the PUB advising of its intention to file an application for a modified FRPGS risk management and rate setting methodology at or near the time of the filing of its next General Rate Application. As Centra was still unable to engage in derivative transactions for the very small forecast customer consumption volumes associated with the FRPGS, Centra requested that the PUB

[1] In a subsequent letter dated August 31, 2011, the PUB further clarified that approval for the departure from the approved RSM for the FRPGS applied to the November 1, 2011 offering only, and should Centra wish to use this or any other methodology other than the approved RSM for the FRPGS, the PUB will require Centra to file a formal application seeking approval to employ that methodology.

approve Centra's continued use of the proxy RSM described above for the FRPGS offering with flows commencing on May 1, 2012, and for subsequent FRPGS offerings until such time as a revised FRPGS methodology has been reviewed and approved by the PUB. On February 6, 2012, the PUB issued a letter approving Centra's request.

Since 2011 it became apparent that financial counterparties are reluctant to engage in derivatives transactions on the scale that has been characteristic of the FRPGS offerings to date.

In addition, the under-subscription of the majority of FRPGS offerings has resulted in unsubscribed hedged volumes that are generating financial losses on both a settled and forecast basis due to the general decline in the wholesale natural gas market that has occurred since the inception of the FRPGS program The financial impact of these excess hedged instruments is forecast to be approximately $900,000 at market prices as of December 31, 2012.

13.2.3 Proposal to Manage Market Price Risk through Self-Insurance

In order to facilitate the regular offering of FRPGS products and to broaden the scope of term offerings to 1, 2, 3, 4 and 5-years, Centra is proposing to modify the RSM to utilize a Self-insurance Risk Premium ("SRP") to manage both market price risk and customer consumption variance risk for all subsequent contract offerings.

In place of the hedged commodity price and the 5% VRP, Centra proposes to calculate a forecast Weighted Average Cost of Primary Gas ("WACOG") for each contract term, including the forecast impacts of storage on Centra's average cost, pipeline transportation costs from the AECO 'C' delivery hub to the Empress custody transfer point, and compressor fuel on the TransCanada Mainline. Centra would then add an SRP of 8% to determine the commodity price for the RSM calculation. The approved PCR will then be incorporated to determine the billed rate to be charged to customers for each contract term.

13.2.4 Determination of the Self-insurance Risk Premium

The proposed SRP is intended to compensate for the risk exposure that is created by selling Primary Gas to a customer at a fixed rate, while purchasing that natural gas at variable wholesale market prices throughout the contract term, as well as customer consumption variance risk.

Centra conducted randomized market simulation studies in order to determine the estimated ranges of financial results that would have been experienced historically under a range of SRPs.

These studies were based upon data for the period from May 2000 through March 2011. This period is particularly well-suited for testing the effectiveness of a self-insurance approach for a number of reasons. Retail customers in Manitoba first gained access to fixed-rate, fixed term contracts for their Primary Gas supply in May 2000. This also marked the commencement of an eight-year period of unprecedented upward price volatility. In addition, this period demonstrated significant weather variation, along with its corresponding effects on customers' Primary Gas consumption.

Centra's randomized market simulation modeling generated the scenarios required to estimate the range of financial results that may have been experienced under a range of various SRP's during the time period. These trials employed FRPGS customer usage parameters that generated a mean model result that replicated Centra's long-term base case customer demand forecast for the FRPGS.

The overall results of all simulation studies indicate that an SRP of 8% would be appropriate. It resulted in a realized cumulative monthly FRPGS risk margin (the total FRPGS program revenue less WACOG costs and PCR revenue) greater than $0.00 in approximately 51% of months during the time period studied. Cumulative overall settled risk margin results would have resulted in gains ranging from $8.1 million to $10.6 million by the end of the period, although cumulative settled risk margin results would have reached a worst case interim loss position of between $1.1 million and $2.1 million in January 2006. In addition, when averaged across all simulation trials, the unsettled forward mark-to-market risk margin loss position could have reached a mean value of approximately $3.9 million in July 2008.

A chart depicting chronological settled risk margin results during the historical period studied with an 8% SRP is provided in Appendix 13.5.

13.2.5 Measures to Manage the Risks Associated with Self-insurance

In order to further manage and mitigate the risks associated with the adoption of FRPGS self-insurance with an 8% SRP, Centra intends to review the FRPGS program when any of the following thresholds are reached:

- When net customer migration to the FRPGS in any one gas quarter reaches 0.5%[2] of overall annual sales volumes. Limiting customer migration to this level will moderate Centra's term risk exposure whereby customer subscriptions could potentially cluster in time periods where adverse market and weather conditions generate net risk margin losses on those periods' offerings.
- When volumes associated with active FRPGS customers under contract reach 2.5% of Centra's overall annual sales volumes. This measure is intended to prevent the overall scale of Centra's financial and customer consumption variance risk from growing to unacceptable levels. While Centra will undertake a review of the program once this level is reached, it is Centra's view that active FRPGS customers under contract should be limited to 5% of overall annual sales volumes, which would amount to approximately half of the actual average small volume fixed rate Primary Gas product demand experienced between May 2000 and March 2011.[3]
- When cumulative settled risk margin losses (calculated from the inception of Self-insurance) exceed $1 million. Restricting realized risk margin losses to $1 million would limit potential deterioration of Centra's retained earnings. As noted previously, Centra's market simulation studies indicated that in the absence of such a limit, cumulative total realized risk margin losses under self-insurance could have reached nearly $2.1 million in early 2006 on an interim basis with an 8% SRP.

[2] Average quarterly net migration to fixed price natural gas products (including both marketer and Centra supplied) in Manitoba over the May 2000 through March 2011 period studied was approximately 0.52% of overall annual sales volumes.
[3] During the eleven year period studied in support of the development of FRPGS Self-Insurance, total small volume customers under a fixed rate Primary Gas supply contract, whether provided by a marketer or Centra, averaged approximately 9% of overall annual sales volumes.

- When unsettled forward mark-to-market risk margin losses (again calculated from the inception of self-insurance) exceed $1 million. Restricting unsettled forward risk margin losses to $1 million would limit potential deterioration of Centra's retained earnings from offering the FRPGS to customers. Centra's historical market simulations of FRPGS Self-insurance indicate that during periods of significant adverse market price movements, its unsettled forward mark-to-market risk margin loss could have reached an estimated $3.9 million during the summer of 2008. It is important to note however, that little of this unsettled mark-to-market loss would have ultimately been realized as market index prices commenced a sustained downward trajectory shortly thereafter.

13.2.6 Conclusion

Centra plans to maintain the routine quarterly offering of FRPGS products to Manitoba natural gas customers. Faced with the reluctance of financial counterparties to transact financial derivatives for the amount of customer interest shown in the product offerings and the financial risk associated with unsubscribed hedge instruments, Centra requests that the PUB approve the revisions to the RSM to adopt self-insurance to address the market price risk inherent with acquiring commodity at market prices while selling to customers at fixed rates for a given contract duration.

Self-insurance allows the continuous availability of FRPGS options for customers and offers additional benefits in terms of providing the flexibility to increase the FRPGS product offerings to include 1, 2, 3, 4 and 5 year offerings should customer interest warrant it.