MANITOBA	**Order No. 103/05**
THE PUBLIC UTILITIES BOARD ACT	**July 12, 2005**

Before: Graham F. J. Lane, B.A., C.A., Chairman
Monica Girouard, C.G.A., Member
Mario J. Santos, B.A., LL.B., Member

AN APPLICATION BY CENTRA GAS MANITOBA INC. FOR APPROVAL OF RATE INCREASES OF APPROXIMATELY 2.5% OF OVERALL REVENUE EFFECTIVE FEBRUARY 1, 2005 AND MAY 1, 2006, AND ADJUSTMENTS TO RATES EFFECTIVE AUGUST 1, 2005 TO REFLECT CHANGES IN SUPPLEMENTAL GAS, TRANSPORTATION (TO CENTRA)AND DISTRIBUTION (TO CUSTOMER) , AND OTHER MATTERS

Table of Contents

Page

1.0 Introduction

Centra Gas Manitoba Inc. ("Centra") is Manitoba's largest natural gas distributor, and is a wholly-owned subsidiary of Manitoba Hydro ("MH"). MH acquired Centra in 1999. The prices charged ("rates") for sales of natural gas are subject to the review and approval of The Public Utilities Board ("the Board"), pursuant to the provisions of The Public Utilities Board Act.

Centra's General Rate Application ("GRA") hearing for the 2005/06 and 2006/07 Test Years concluded with closing submissions on June 27, 2005. The GRA addressed numerous and complex issues, and while some of the matters will require more time for a review of the evidence and deliberation before the Board will be in a position to provide its determinations, there are issues the Board is able to deal with at this time.

Accordingly, the Board has decided to issue two Orders arising out of this GRA. This preliminary Order will be followed by two additional Orders, these being:

1. A Rate Order by late July 2005 with respect to the August 1, 2005 Quarterly Primary Gas rate, which will also incorporate the rate impacts of matters dealt with in this Order; and

2. A further GRA Order to be issued later this summer or early fall will deal with matters either not addressed or only partially addressed in this Order. The matters reserved for the second GRA Order are listed herein.

The Board intends that the Rate Order, to be effective August 1, 2005, will provide an integrated and comprehensive understanding of rates for customers.

Prior to this Order, and with the exception of the interim 2.5% rate increase granted by Order 13/05 effective February 1, 2005, the Board last amended Supplemental Gas, Transportation (to Centra)and Distribution (to Customer) rates effective November 1, 2004. That increase of 0.4% included the first non-gas cost increase since MH acquired Centra.

Transportation (to Centra) and Distribution (to Customer) rates generate revenue to recover costs that account for less than 25% of Centra's overall costs. Basically, a 1% increase in overall revenue represents an increase in non-gas costs of approximately 4%.

Centra's GRA sought approval for rates to recover costs and provide for a reasonable level of retained earnings. Retained earnings serve as a buffer against untoward future events that could otherwise potentially result in rate shock to customers

Pursuant to the longstanding ratemaking process, the GRA process approves a revenue requirement determined sufficient to meet utility costs and provide reasonable net income (which could contribute to growth in retained earnings), and is distributed amongst, and recovered in rates charged to, Centra's customer classes on the basis of a Board-approved cost allocation methodology.

There are two generally accepted methodologies for determining a regulated utility's annual revenue requirement. One approach is the Rate Base/Rate of Return approach, which has been in use with respect to Centra for decades. The other approach is denoted as the Cost of Service approach, and this methodology is favoured by some, including MH and Centra, for regulating public sector utility monopolies.

Under the Rate Base/Rate of Return regulatory model, the major determinants of revenue requirement and rates are rate base (basically, allowable investment in plant net of accumulated depreciation and working capital allowance), depreciation and amortization, debt, shareholders' equity and allowable costs. The regulator determines the allowable rate base (assets can be disallowed), allowable costs (costs can be disallowed) and determines an overall allowed rate of return on rate base. The rate of return on rate base is comprised of four factors: debt and shareholder equity, interest rate on debt, and the allowable rate of return on shareholder equity.

Generally, for a privately-owned utility the Capital Structure consists of approximately 60% debt, with the other 40% funded by shareholder equity. The rate of return allowed by the regulator on shareholder equity is higher than the interest rate on debt, as a risk premium is provided for shareholder equity.

The Cost of Service regulatory model for determining revenue requirement and rates is different than the Rate Base/Rate of Return model in several areas, but the ability to declare certain costs not to be allowable remains unchanged. The focus under the Cost of Service model is allowed costs. Allowed costs, including net income, form the basis for determining revenue requirement, and a level of net income is also provided for. With respect to the level of net income allowed within revenue requirement, the regulatory test is not the rate of return on rate base but the net income deemed to be prudent for the utility's financial health.

A brief discussion of the two regulatory models is contained within this Order, with more to follow in the second GRA Order planned for late summer/early fall.

With respect to the approved level of net income provided for in revenue requirement and rates, Centra's actual net income in any one year generally does not match the weather normalized net income forecast made in establishing the revenue requirement because of weather and other variable factors.

Centra's costs include gas related costs and non-gas related costs, the latter including Operating and Administrative expenses ("O&A"), depreciation and amortization, financing costs, capital and other taxes, return on equity, and since 2002/03, a Corporate Allocation. The Corporate Allocation is an annual charge levied by MH to allow it to recover from Centra a share of MH's on-going costs related to its acquisition of Centra.

Prior to the acquisition, Centra produced average annual after tax profits of between $14-16 million. Together with savings arising out of operational synergies, the strategy was that MH could acquire Centra without any negative rate implications for either Centra or MH customers. MH has not taken any dividends from Centra since acquisition and the Corporate Allocation is the only transfer from Centra to MH now in place.

Gas commodity costs represent by far the largest cost component for Centra's revenue requirement, and include Primary Gas and Non-Primary Gas. Primary Gas commodity rates apply to customers purchasing gas directly from Centra; commodity costs are approved by the Board through the means of an annual Cost of Gas hearing.

Transportation (to Centra) and Distribution (to Customer) rates are normally established following an annual Cost of Gas hearing or a GRA which is filed on a periodic basis.

Natural gas brokers also purchase and sell gas to a significant number of residential, commercial and industrial customers; Centra provides the intra-Manitoba distribution network to deliver both gas supplied by both brokers and Centra. Accordingly, charges for Supplemental Gas, (which is used by Centra to supply a portion of the required gas, even to customers that have a Broker supply their Primary Gas), Transportation and Distribution rates affect all customers served by Centra's distribution system, except for Transportation Service customers that are only impacted by Distribution costs.

2.0 Centra's Rates

Centra's rates consist of five different components, namely, Primary Gas, Supplemental Gas, Transportation (to Centra), Distribution (to Customers), and a Basic Monthly Charge ("BMC").

The Primary Gas component of Centra's rates recovers the cost of the natural gas supply received from Western Canadian sources. For 2005/06 Primary Gas supply is forecast to represent approximately 85% of Centra's overall gas supply. Primary Gas rates are set on a quarterly basis in accordance with an established Rate Setting Methodology and process approved by the Board.

At this hearing, Centra sought final approval of all gas costs for 2004/05, inclusive of costs approved through interim Primary Gas Orders since the 2004/05 Cost of Gas Application. This GRA also sought approval of new Supplemental Gas, Transportation (to Centra), and Distribution (to Customer) rates. Supplemental Gas rates are established to primarily recover the cost of gas purchases from U.S. sources, as these sources are required to meet cold Manitoba winter weather conditions.

Transportation (to Centra) is the component of rates that recovers the costs associated with transporting gas supplies from Alberta to Manitoba, and for injection of storage gas during the summer months for delivery to Manitoba in the high-use winter period.

The Distribution (to Customer) component of rates recovers the costs associated with operating Centra as well as the cost related to Unaccounted for Gas ("UFG"). A portion of operating costs, such as for meter reading and customer billing, are recovered in the BMC. Presently, the BMC does not recover all of Centra's fixed costs. Centra is to file with the Board by August 2005 a report considering the approach to be taken with respect to the BMC.

The billed rates charged to Centra's customers are made up of two components, these being base rates and rate riders. Each of the Primary Gas, Supplemental Gas, Transportation (to Centra) and Distribution (to Customer) rates has both a base rate and a rate rider component. Base rates reflect an estimate of future gas costs and non-gas costs, while rate riders adjust for differences that arise between gas cost estimates and actual gas costs incurred.

The annual cost of gas is by far the most significant cost that Centra incurs in providing service to its customers, and is in excess of 75% of Centra's overall costs. Centra passes on these costs to its customers without any mark-up, either for overheads or profit.

To ensure that only the exact cost of gas is passed on to customers, Centra maintains a number of Purchased Gas Variance Accounts ("PGVA"). These accounts record the difference between the cost of gas embedded in sales rates and the actual cost incurred. The differences are periodically either refunded to, or collected from, customers by way of temporary rate riders. These rate riders either decrease (refund) or add to (collect) the base sales rates, and form a separate and identified part of the billed rates to customers. The Primary Gas rate rider is set as part of the Quarterly Rate Setting Methodology.

In this Application, Centra sought the disposition of the non-Primary PGVA and other gas cost deferral accounts to customers based on the balances as at March 31, 2005, plus carrying costs to July 31, 2005. Rate riders established by prior Orders expire on July 31, 2005, and will also impact billed rates to customers. A subsequent July 2005 Order, dealing with the regular Primary Gas Quarterly rate setting, will also combine and incorporate the effects of this Order, including rates and rate riders, with the August 1, 2005 Primary Gas Rate.

3.0 Background

The last final determination by the Board of the non-gas components of Centra's rates occurred by way of Orders 118/03 and 125/03, which were with respect to Centra's 2003/04 fiscal year. The last determination by the Board of the gas costs included in Centra's Supplemental Gas, Transportation (to Centra), and the UFG component of Distribution (to Customer) rates occurred by way of Orders 131/04, 132/04 and 146/04.

On December 9, 2004, Centra applied and subsequently received approval (Order 13/05, effective February 1, 2005) for an interim 2.5% increase in overall annual revenue requirement. Centra indicated that part of the requested increase in rates was due to volume decreases in gas sold, these occurring due to customer-initiated actions to improve energy efficiency. The other major factor supporting the increase was a projected 2004/05 Corporate Allocation of $15.1 million by MH to Centra.

Centra projected that the 2.5% increase would generate approximately $3 million in incremental revenue for the balance of its 2004/05 fiscal year, and $12 million for 2005/06 and subsequent fiscal years. Centra did not allocate the increased revenue requirement to its various customer classes in accordance with the Board-approved cost allocation methodology, but, with the Board's approval, used a proxy that estimated the proper effect, awaiting this GRA to "true-up" the rate change allocations between customer classes.

The Board granted the interim increase because:

a) Centra was losing money and its year-end of March 31 was approaching. To delay a decision on the increase would have resulted in the loss for 2004/05 being $3 million higher with the prospect of another loss in 2005/06 (whether under a Rate Base/Rate of Return or Cost of Service revenue requirement regulatory framework, rate increases are usually provided to ensure profitable operations);

b) On January 10, 2005 Centra had filed a GRA, and the interim award was to be tested at the GRA hearing scheduled for May, only four months later. This would allow Intervenors an opportunity to review the interim Order, and allow the Board to either confirm or vary the interim award;

c) A projected Primary Gas quarterly rate decrease was due February 1, 2005. To avoid having consumers experience a rate decrease on February 1 followed by a potentially larger increase on August 1, 2005, when existing rate riders refunding PGVA balances to customers expire, the Board decided to provide the interim increase sought by Centra. This netted the 2.5% interim increase against the Primary Gas Rate decrease , thus reducing rate volatility and potential confusion in the minds of consumers as to the direction of rates for natural gas;

d) There are substantial costs associated with a hearing; a GRA had been scheduled and the Board saw no benefit to consumers in having to fund two hearings on the same issue. The Board considered that the GRA hearing would allow all interested parties to test Centa's evidence and make submissions to the Board. The Board would then issue a final Order in respect of the February 1 interim rate; and

e) The Board found special circumstances to exist, and proceeded on an interim ex-parte basis as requested in Centra's Application.

The Board handles many Orders as efficiently as possible, some through exparte processes; to do otherwise would challenge Board and utility budgets and human resource capabilities. The Board recognizes that excess regulatory costs are an issue not only for the Board and the regulated utilities, but also for the customers of the utilities.

Consumers Association of Canada/Manitoba Society of Seniors ("CAC/MSOS"), an intervenor of record, sought judicial review of the Board's Interim Order from the Court of Queen's Bench on the basis that the Board should not have proceeded on an ex parte basis. The matter was heard in early June, and the Court's decision is dated June 27, 2005.

The Court concluded that the Board should not have heard Centra's interim Application on an ex-parte basis. While the Court has found deficiency with the process leading to the interim Order, no deficiency was alleged with respect to the GRA process. In the GRA process, Centra has requested final approval of a rate increase of approximately 2.5% of overall revenue effective February 1, 2005.

4.0 Application

As a result of changes in Centra's non-gas costs, sales volumes, and non-Primary Gas costs, Centra requested revised Distribution (to Customers), Supplemental Gas, and Transportation (to Centra) and Distribution (to Customers), rates. The application was based on Centra's forecasts of costs for its 2005/06 and 2006/07 fiscal years.

Centra's costs change over time for a variety of reasons, including: gas supply contract amendments; gas market pricing changes; weather-related factors; general price inflation; other changes with respect to O&A costs; increases and other changes with respect to customers (location, expansion and new connections etc.); hedging experience; pipeline safety; distribution-related projects; capital and other tax changes; interest rate changes, increases in debt; variation in bad debt provisions; policy and practice changes; amendments to accounting policies; Demand Side Management initiatives and experience, and service amendments.

Centra also requested approval for disposition of amounts accumulated in the non-Primary PGVA and gas cost deferral balances to March 31, 2005, with estimated carrying costs to July 31, 2005, and:

1. Final approval of a rate increase of approximately 2.5% of overall revenue effective February 1, 2005.
2. Adjustments to rates to reflect changes in its Supplemental Gas, Transportation and UFG to be effective August 1, 2005; and
3. Approval of a further rate increase of approximately 2.5% of overall revenue effective May 1, 2006, projected to generate additional revenue of $13 million in Centra's 2006/07 fiscal year.

Centra also requested final approval of 2004/05 gas costs, as well as final approval of a number of interim Orders issued by the Board since the 2004/05 Cost of Gas hearing.

Following a pre-hearing conference, on February 21, 2005 the Board issued Order 22/05 granting Intervenor status to a number of interested parties. Order 22/05 also established a timetable for the orderly exchange of information to assist the process.

The public hearing commenced on May 31, 2005 at the Board's office in Winnipeg, Manitoba, and concluded on June 20, 2005. Final submissions were heard on June 27, 2005.

5.0 Intervenor Positions and Applicant Response

Intervenors assist the Board in its assessment of the public interest, and are involved in all stages of the Board's public hearing process, including the filing of questions; cross-examination of witnesses; and final argument. The Board often assist non-profit organizations granted Intervenor status by approving funding, in whole or in part, for their involvement. Intervenors with commercial interests are required to meet their own costs.

Intervenors in the GRA were:

Consumers Association of Canada (Manitoba) Inc. and Manitoba Society of Seniors Inc. ("CAC/MSOS")

Direct Energy Marketing Ltd. and Municipal Gas ("Municipal")

Communications Energy & Paperworkers Union Local 681 ("CEPU")

Energy Savings Manitoba Corporation ("ESMC")

Time to Respect Earth's Ecosystems and Resource Conservation Manitoba ("TREE/RCM").

Two Intervenors engaged witnesses. CAC/MSOS brought Mr. Matwichuk, C. A. before the Board, while TREE/RCM enlisted the services of Mr. Weiss. These witnesses provided evidence that was the subject of cross-examination by the Board, other Intervenors and Centra.

As well, with the consent of Centra, TREE/RCM provided a report by the Pembina Institute which was placed on the record and partially relied upon by Mr. Weiss in providing his testimony.

As previously indicated, this Order does not address all of the matters arising at the GRA. The GRA Order that will follow will deal with matters not dealt with in this Order, as well as elaborating further on matters addressed herein. In its further elaboration, the subsequent GRA Order will provide a more extensive review of some of the positions and interests of the Intervenors.

Accordingly in this Order, in some cases only a brief summary is provided of the positions and interests of the Intervenors with respect to the matters dealt with in this Order. As well, there is a brief summary of positions taken by Centra in response to the positions of the Intervenors relative to Centra's application.

Communications Energy and Paperworkers Union Local 681 ("CEPU")

CEPU raised two particular issues at the hearing:

a) Centra's plan for a pilot automated meter reading project ("AMR"); and
b) The regulatory model under which the Board regulates Centra.

CEPU recommended that the Board deny Centra's requests for $400,000 in plant additions to conduct an AMR pilot project in the 2005/06 test year, and $3 million in plant additions for 2006/07 test year. The 2005/06 funding would begin a roll-out of an AMR implementation assuming the pilot justifies proceeding. CEPU noted that Centra is seeking Board approval for these expenditures without first providing a business case justifying the expenditures.

CEPU submitted that implementing AMR would not make economic sense given that the present cost to read a residential meter is only $0.88 or $5.28 per customer annually (based on six meter reads a year). CEPU argued that to proceed with AMR would eventually result in millions of dollars of material and installation expense without considering "stranded" costs related to the replacement of the existing meters before the end of their useful lives. CEPU forecast that AMR, if implemented, would result in an eventual tripling of the existing cost to read a customer's meter.

CEPU observed that there were also non-economic reasons supporting the current approach, and that these were primarily related to safety. CEPU reported that meter readers play a safety role in ensuring the reliable and safe delivery of natural gas. CEPU noted that meter readers perform visual inspections and report safety hazards such as gas leaks, excessive piping strain and iced over regulators. CEPU suggested that these safety benefits would be lost with an AMR-based approach, and that the potential loss of effective safety measures should outweigh any hypothetical benefits Centra may forecast for AMR.

CEPU suggested there were other ways by which Centra could achieve improved success in gaining access to meters, and that these included ERTs and the relocating meters outside of residences.

With respect to the regulatory environment, CEPU focus was not on revenue requirement and rates but the oversight facet of the regulatory approach. CEPU believes that the level of Board oversight over Centra activities has ensured safe and reliable natural gas delivery. From CEPU's perspective, the Rate Base/Rate or Return regulatory approach allows for the testing of Centra management's judgment, and CEPU believes this has the effect of motivating the best decisions possible. In CEPU's opinion, under a Cost of Service regulatory model, this level of oversight would be lost.

CEPU suggested that if, the Board decides to rely on a Cost of Service methodology, it would be in the best interests of consumers to continue Board oversight of terms and conditions of service and operating practices and procedures.

Consumers Association of Canada (Manitoba) Inc. and Manitoba Society of Seniors Inc. ("CAC/MSOS")

In stating its overall position on the application, CAC/MSOS submitted that Centra had not met its burden of proof to establish that the Corporate Allocations, net income and cost of operations amounts requested were necessary and would result in just and reasonable rates.

CAC/MSOS submitted that the interim 2.5% increase in revenue requirement granted as of February 1, 2005 together with the 2.5% increase sought for May 1, 2006 were unprecedented in scale.

CAC/MSOS noted that, if finalized and granted, the two increases would in aggregate represent an increase of non-gas cost of greater than 20 % over two years. CAC/MSOS submitted that such an increase would represent the largest two-year non-gas cost increase in Centra's history.

CAC/MSOS indicated a further concern that by granting an interim increase as of February 1, 2005, the Board had allowed Centra to mask its effect by combining the rate impact with a Primary Gas rate reduction which occurred on the same date.

CAC/MSOS observed that Centra's rate proposals were driven by the annual Corporate Allocation, requested net income of $19 million over the two years ending March 31, 2007, and an increase in O&A expenses of approximately $5 million. CAC/MSOS noted that Centra's O&A costs were projected to rise from $49.3 million in 2002/03 to $54.1 million for 2005/06, a 10% increase over the two-year period.

CAC/MSOS cited past Board decisions, The Public Utilities Board Act and case law supporting the Rate Base/Rate of Return regulatory framework.

CAC/MSOS adopted the evidence of Mr. Matwichuk, and the CAC/MSOS witness recommended the continuation of the Rate Base/Rate of Return approach on the basis that it would provide historic consistency as well as transparency. Mr. Matwichuk also stated that the Rate Base/ Rate of Return regulatory approach provides an implicit incentive to improve efficiencies and exceed financial forecasts to improve utility financial integrity, and suggested that the Cost of Service approach would not offer such benefits.

CAC/MSOS also opposed the combination of a Corporate Allocation and a proposed high level of annual Centra net income. CAC/MSOS noted that Order 118/03 had set out the Board's perspective as to how MH could meet the costs arising out of its acquisition of Centra. According to CAC/MSOS, the Board had established that an annual after tax return on Centra's equity of between $14 to $16 million would be available to MH.

CAC/MSOS suggested that net income in that range together with expected synergy savings to be realized by MH should be more than sufficient to meet MH's ongoing costs associated with its purchase of Centra.

CAC/MSOS asserted that MH's portrayal of how its acquisition costs were to be met had changed between this and the previous GRA. CAC/MSOS noted that previously there had been no mention of a Corporate Allocation. CAC/MSOS suggested that there should not be any link between the $7 million synergy transfer requested by Centra at the last hearing, (only a $3 million temporary transfer was approved) and the $12 million annual Corporate Allocation now being levied on Centra by MH. For CAC/MSOS, the Corporate Allocation and the annual net income amounts requested by Centra to be in revenue requirement, are for the exact same purpose and thus amount to double counting.

CAC/MSOS questioned the need for the increase in the amount sought from Centra by MH. CAC/MSOS considered these sums to include the Corporate Allocation, the net income forecast of $14.4 million for 2006/07, and $9 million of synergy savings earned by MH. CAC/MSOS noted that in aggregate, these three items far exceeded the annual amount required by MH to finance its acquisition, which itself had fallen from $20.9 million to $18.5 million.

In commenting on Centra's Cost of Service revenue requirement filing, CAC/MSOS argued that the $14.4 million net income applied for in 2006/07 when combined with a $12 million Corporate Allocation would provide a $26 million return to MH, which would be excessive, in CAC/MSOS' view.

Centra indicated that, pursuant to a request to review its debt:equity ratio target in Order 13/05, Centra had established a financial goal of a 75:25 debt:equity ratio, the same target as MH. CAC/MSOS questioned Centra's need to meet the financial target; given that Centra's debt is guaranteed by the Province. CAC/MSOS opined that the debt:equity ratio could safely be much higher. As well, CAC/MSOS also questioned why Centra had set a more "aggressive" time frame to meet the 75:25 debt:equity financial target than was in place for MH.

With respect to customer service matters, CAC/MSOS expressed concern that the currently proposed single bill (electric and gas services on one bill) would not provide adequate advice to customers as to their option to allocate their partial payments. CAC/MSOS noted that although customers will receive one bill under the plan, there will still be two completely separate services involved.

For CAC/MSOS, customers should have the right to determine to which service their payments will apply. CAC/MSOS recommended that Centra advise its customers of this choice on their natural gas bill by providing a check-off box on the payment return slip to indicate how payments are to be applied.

With respect to Centra's unfinished Demand Side Management ("DSM") plans, CAC/MSOS expressed concern with Centra's plan to spend approximately $13 million over the next two test years on energy efficiency and conservation given the specifics of how that money will be spent remain unclear. CAC/MSOS noted that Centra's plan does not address how DSM costs are to be allocated between gas and electric operations. CAC/MSOS also was concerned that the DSM programs may fail to meet the "rate impact measurement" test, and would create upward pressure on future rates. Nonetheless, CAC/MSOS was encouraged by Centra's DSM initiatives which used incentives for consumption reduction rather than penalties.

CAC/MSOS opposed the proposal of RCM/TREE to implement an inverted rate structure, and further expressed concern that the current DSM program does not include specific programs for low-income individuals facing barriers to participation in the DSM programs.

Centra had reported that the Interlake expansion had failed to connect the number of customers originally forecast, and thus it planned to phase out connection fees in an effort to assist further connections. CAC/MSOS did not oppose the phasing out of Interlake connection fees, but sought assurances that connection fees were not in place in other expansions and would not return as a feature of future expansions. CAC/MSOS recommended that the economic feasibility test established for expansions be maintained and enforced. CAC/MSOS submitted that, if contributions are required outside of normal billing, these should come in the form of up-front contributions rather than be sought subsequently from potential customers.

CAC/MSOS questioned the benefits Centra consumers get from the Derivative Hedging program. CAC/MSOS expressed concerns that the benefits are not justified by the costs and potential risks.

CAC/MSOS urged the Board to reconsider the method of evaluating the results of the Hedging Program, which currently is a measurement of volatility reduction, and that the Board should consider cost savings in gas costs in evaluating the program. CAC/MSOS recommended that Centra reduce its hedging program to one that only protects against dramatic gas price spikes and, at the same time, offer fixed price service offerings to customers.

CAC/MSOS adopted the evidence of its witness, Mr. Matwichuk, who disagreed with the manner by which Centra calculated its debt:equity ratio. Centra excluded $121 million of Centra’s share capital in its calculation of the ratio, and took the perspective of the parent, MH. CAC/MSOS stated that when Centra was acquired by MH there was approximately $121 million in shareholders equity of which $82 million represented retained earnings. CAC/MSOS stated that the debt that was used to acquire Centra was the debt of MH, not Centra.

CAC/MSOS stated that considering MH's debt in the calculation of Centra's debt:equity ratio violates the "Stand-Alone Principle". CAC/MSOS indicated that it was a long-standing regulatory principle not to consider the financial circumstances of the owner in determining the level of the equity within a subsidiary utility. CAC/MSOS urged the Board not to abandon the "Stand-Alone Principle" in determining Centra's rates.

With respect to Multiple Services offerings, the practice of offering a variety of gas supply contracts to consumers, CAC/MSOS suggested the Board consider directing Centra to offer fixed price contracts on a trial basis. CAC/MSOS contested Municipal's claim that Centra offering fixed price contracts, while competing with brokers, would be unfair to brokers. CAC/MSOS claimed that Direct Energy, the parent company of Municipal, is both the regulated default supplier in Alberta and also a competitor in the fixed price contract market.

On the topic of customer education, CAC/MSOS expressed concern that customers are not aware of either their options or the consequences of signing up with a broker. CAC/MSOS cited the Western Opinion Research Survey that found 41 percent of consumers not to be aware of their relationship with a broker. CAC/MSOS stated this level of confusion in the marketplace is not acceptable. CAC/MSOS urged the Board to direct Centra to put resources towards consumer education respecting the gas marketplace.

On the matter of the BMC, CAC/MSOS stated it was opposed to any changes that would increase the BMC to residential consumers. CAC/MSOS opined that any increase would be contrary to conservation efforts since consumers would not be able to generate savings by reducing gas consumption.

With respect to Centra's prior acquisition of the Gladstone Austin Natural Gas Cooperative ("GANG"), CAC/MSOS reiterated its position that only the net book value of GANG's assets, and not any premium paid, should be included in rate base.

With respect to Centra's $20 million plus Customer Information System project, CAC/MSOS doubted the accuracy of Centra's forecast that $1.6 million of additional savings will arise out of the project, with the majority of those savings to accrue to Centra.

CAC/MSOS opined that the Sustainable Development Act ("SDA") binds the Crowns, including MH and its agents, and that it imposes a requirement on Crown corporations to develop guidelines to sustainable development, financial management and procurement.

CAC/MSOS referred to case law and the concept of piercing the corporate veil. CAC/MSOS suggested that in certain cases the courts will pierce the corporate veil to determine that a subsidiary can be considered, for a certain particular purpose, to be one and the same as the parent. CAC/MSOS stated the test used is based on the level of control that one organization has over the other organization

CAC/MSOS stated given the current corporate structure at Hydro, since all control resides with MH, Centra along with MH should be considered subject to the SDA

Municipal Gas ("Municipal")

Municipal stated it was disappointed that Centra had neither completed nor filed the Board-required internal review of the IGC report, or the report dealing with possible changes to WTS. Municipal urged the Board implement a public process to review the two reports, once filed.

Such a review process would allow for the canvassing of issues raised in the reports by interested parties.

Municipal also expressed concern that proposed changes to the customer bill pursuant to the single-bill initiative did not mark a significant improvement over the current format of the WTS bill. Municipal suggested that Centra's new bill include the broker's logo as well space for broker communications to its customers.

Municipal stated that such enhancements to the bill would also improve the level of customer education, and assist in addressing the recent finding that a large minority of broker customers indicated non-awareness of their relationship with a broker.

Municipal took issue with Centra's corporate policy position that it should be permitted to promote its primary gas supply. Municipal submitted that such a position is inconsistent with Centra's role as a default supplier in an unbundled deregulated natural gas retail commodity market. Municipal submitted that if Centra decided to embark upon a promotional campaign, the Board should require Centra to first apply to the Board for approval, so that issues regarding the appropriateness of the campaign could be fully considered by interested parties and determined by the Board.

Municipal raised concerns about the allocation of gas procurement costs, expressing concerns with what was portrayed as a significant increase in costs in major categories allocated to the transportation and distribution functions.

Municipal also expressed concern with changes in the allocation of storage and transportation operation costs between gas and transportation rates, and expressed the concern that this may result in the artificial suppression of the price of Primary Gas. Municipal urged the Board to request specific gas cost information and then review the matter at the next Cost of Gas hearing.

In regards to Centra offering fixed price contracts, Municipal indicated Centra has not made any recommendations with respect to such offerings, nor did it seek Board approval to make such an offering. Municipal further stated that given the late submission of Centra's report during the hearing, there had been inadequate opportunity for intervenors to file any evidence on the issue. Municipal contended that the Board does not have enough evidence to weigh the pros and cons of Centra offering fixed price long-term supply contracts.

Municipal stated that if Centra offers a fixed-price option there is the potential risk to the competitive nature of the retail market in Manitoba, suggesting that current participants could withdraw or curtail services. Municipal suggested that if Centra were to propose to offer a fixed price option, the Board should conduct a full hearing into the potential competitive impacts.

In response to claims by CAC/MSOS that Direct Energy, Municipal's associated company, had service offerings in Alberta that included both the regulated and unregulated market, Municipal indicated that there were strict barriers between the two associated companies involved and that the Alberta regulator provided oversight. The Board sought additional information from Municipal on the topic, and will further discuss fixed price offerings in its next GRA Order.

Energy Savings Manitoba Corporation ("ESMC")

ESMC stated a preference for greater control over the volume nomination process along with a more stable maximum daily quantity ("MDQ"). ESMC proposed that Centra offer a stable nomination volume for the entire year, but indicated a willingness to accept a consistent monthly nomination in the interim.

ESMC further stated it would like the ability to sign up customers under a monthly enrolment process; currently, there can be a wait time of up to four months before a customer begins receiving its gas service from a broker. ESMC stated that this long wait period acts as an impediment to customer mobility and causes confusion and concern for customers.

ESMC stated the MDQ, nomination and customer mobility issues are tied directly to the terms and conditions of the Primary Gas supply contract that Centra entered into with Nexen, and to Centra's gas supply portfolio, and, therefore, the IGC report recommendations. ESMC submitted that the internal review of the IGC report should be vetted by all interested parties, as only limited information on this important subject was provided by Centra prior to and during the GRA.

ESMC requested that its name and logo displayed prominently on the customer bill, with a dedicated place to allow brokers to communicate with their customers. ESMC stated the bill is their primary communication vehicle to their customers and allowing brokers access to the bill would improve customer education. ESMC contends that the bill should be subject to regulatory oversight

ESMC sought assurance that a fixed price natural gas retail offering, signed by one signatory in a household would not be considered void if the customer bill is now invoiced under the name of another signatory in the household.

ESMC contends that it is important to educate customers in an unbiased fashion on the options and products available in the natural gas marketplace in Manitoba. ESMC believes that the joint consultation process for educational efforts should be ongoing, and not a one-time pilot.

ESMC disagrees that Centra has the authority to promote the regulated Utility gas supply service; ESMC strongly contends that a regulated Crown utility should be unbiased and financially indifferent with respect to who supplies the natural gas.

ESMC stated that MH enjoys significant brand recognition as the provincial distribution company for both natural gas and electricity. ESMC suggested that brand recognition, MH's financial strength and existing customer relations with their distribution customers provides MH with an unfair advantage over retail marketers.

On Centra offering fixed price offerings, ESMC's echoed the position brought forward by Municipal, that any multiple service offering by Centra should be subject to a public application process before the Board. ESMC opined that Centra should only be mandated to offer a standard regulated default supply service, one that is reflective of current market pricing.

ESMC stated that allowing Centra to offer a fixed price service would not be in the public interest, would impede price and rate transparency, and increase the likelihood of cross-subsidization, all unduly affecting competition in the natural gas market.

Time To Respect Earth's Ecosystems and Resource Conservation Manitoba ("TREE/RCM")

TREE/RCM adopted the evidence of its witness Steven Weiss, who urged the Board to review policies to move Centra towards sustainability pursuant to the SDA.

Mr Weiss recommended:

1. Centra adopt Marginal Variable Gas Costing ("MVGC") for its planning and evaluation of DSM program choices and investment levels. This would require Centra to switch from the Total Resource Cost Test to a Societal Cost Test which includes externality costs.

2. Centra design a fuel switching program to provide its customers with information and perhaps incentives to choose the most cost effective energy source.

3. Centra use MVGC in designing its main extension and connection policies which would encourage the construction of energy efficient housing.

4. DSM program costs are resource costs similar to wholesale gas purchases and should be allocated accordingly, on a volumetric basis.

5. Industrial and commercial customers should be allowed to "self-direct" a portion of DSM funds as these customers posses the most technical expertise related to their facilities, and can best invest these funds.

6. Implementation of tiered rates using MVGC as the marginal rate. For residential rates, the base volume should be equal to about 80 percent of the average use of a gas heated R-2000 home.

7. That the Board consider directing the implementation of a decoupling mechanism (by which volume variations from the norm due to weather would amend rates) to increase stability of customer costs and Centra's revenues.

8. Setting the BMC for SGS customers at its current level so as to provide maximum incentive to conserve in volumetric rates.

9. Centra immediately commit to develop, by next year, an adequate bill payment assistance program and a robust DSM program targeted to low income customers.

As indicated, TREE/RCM's concerns related to environmental and energy efficiency matters, and these issues and TREE/RCM's positions will be dealt with in further detail in the subsequent GRA Order. However, there is one matter raised by TREE/RCM that is addressed in this Order, and this concerns the question of whether Centra is subject to the provisions of the SDA.

TREE/RCM submits that Centra is subject to those provisions, and the Board, in a preliminary view expressed herein, concurs with TREE/RCM and CAC/MSOS and requests further comments by Centra in advance of the Board issuing the subsequent GRA Order.

Centra's Position

As previously indicated, and with respect to rates, Centra is seeking rate increases effective February 1, 2005 amounting to approximately 2.5% of overall revenue, and a further 2.5% increase to be effective May 1, 2006. The February 1, 2005 increase is expected to generate additional revenue of approximately $3 million in 2004/05 and $12 million in 2005/06 and future years, and the requested May 1, 2006 increase is expected to generate addition revenue of $13 million for 2006/07.

As part of closing argument, Centra filed a document that dealt with various Rate Base/Rate of Return issues. Because Centra filed its Application based primarily on a Cost of Service methodology, Centra did not speak to this document but requested that it form part of the transcript.

Centra opined that one of the most significant issues to be considered arising out of this hearing is what is the most appropriate regulatory methodology to apply in determining Centra's non-gas portion of revenue requirement (Rate Base/Rate of Return, or Cost of Service). Centra observed that this issue has been under consideration since MH acquired Centra in 1999.

Centra strongly favours the Cost of Service methodology, considering it to be more applicable to Centra's new status as a subsidiary of a Crown corporation.

Centra's view was the Cost of Service methodology provides more flexibility with respect to achieving financial targets, and noted that the approach is routinely used by senior management and the Board of Directors in managing the utility.

Centra argued that the existing legislation is permissive, and that its Cost of Service based application meets the Board's requirements, while furthering its corporate plan to achieve a 75:25 debt:equity ratio as suggested in Board Order 13/05.

On the matter of the Corporate Allocation, Centra argued that it is essential to have a clear and transparent means of sharing acquisition costs between the gas and the electric utilities. Centra argued that the Corporate Allocation is easy to understand, and represents a fair apportionment between gas and electric rate payers of the costs MH incurs with respect to its acquisition of Centra.

Centra noted that the Corporate Allocation is the only allocation of costs between MH and Centra, and claimed there was no "double counting" as alleged by CAC/MSOS. From Centra's perspective, the apportionment is based on an estimate of benefits achieved in each utility, and is intended to preserve the "no harm" principle for the benefit of both electricity and gas customers.

In responding to CAC/MSOS's claim that Centra had failed to meet the onus placed on it to prove its revenue and rate requirements, Centra opined that by its evidence it had demonstrated the financial requirements sought.

Centra's closing arguments also addressed a wide range of other matters with respect to their Application. These arguments will be addressed in more detail in an Order to follow, but are also considered to some extent within the following Board Findings section.

6.0 Two Board Decisions

The hearing concluded with closing statements heard on June 27, 2005. The GRA dealt with a considerable number of issues, some quite complex, and the volume of evidence supporting all the matters discussed was substantial.

The regular issues of a GRA, namely revenue requirement, costs incurred and projected, expansion and capital project plans, and service amendment proposals, rate schedules and proposals, were again before the Board. However, there were a host of other matters discussed, and these ranged from hedging practices, post-acquisition evaluation, retail primary gas supply competition, demand side management activities and an automated meter reading pilot project, to environmental concerns, inverted rate proposals, and the plight of low-income customers facing high natural gas bills.

The Quarterly Primary Gas Order for rates to be effective August 1, 2005 is expected to be released in mid to late July 2005. That Order will reflect the rate decisions and directions provided in this Order including the expiration of certain rate riders scheduled to conclude on July 31, 2005, and implementation of new rate riders, along with the normal quarterly amendments related to commodity market price changes in Primary Gas and implementation of other rate riders.

By issuing this Order, which contains rate directions effective August 1, 2005 to be implemented concurrent with August 1 quarterly Primary Gas rates, the Board further supports the concept of providing appropriate and timely price signals while restraining undue rate volatility.

With respect to the second GRA Order to arise out of these proceedings, the Board plans to elaborate further on matters referred to in this Order and will also address:

(a) The regulatory approach alternatives of Rate Base/Rate of Return and Cost of Service;

(b) MH's annual Corporate Allocation;

(c) An assessment of MH's acquisition of Centra;

(d) Centra's corporate structure vis a vis that of its parent, MH;

(e) The debt:equity ratio and appropriate retained earnings level;

(f) Retail gas supply competition: multiple service offerings, fixed price contracts;

(g) Costs and details of WTS service, etc.

(h) Rate structure, the BMC and volumetric charge schedule

(i) TREE/RCM's proposal for rate de-coupling mechanisms and related matters;

(j) Demand Side Management, and the problems of low-income and tenant customers with related delinquency, bad debts and administrative cost issues ;

(k) Environmental issues and related matters; and

(l) Other matters arising out of the GRA.

7.0 Board Findings

By this Order, the Board will:

(a) reduce the interim general rate increase of 2.5% implemented February 1, 2005 to 2.0%;

(b) vary and reduce Centra's application for a 2.5% general rate increase effective May 1, 2006, and grant an increase of 1.0% effective May 1, 2006;

(c) direct a refund arising out of the reduced rate increase be provided to Centra customers by way of a rate rider over the two quarters beginning August 1, 2005;

(d) approve the rate riders applied for by Centra in its GRA, with respect to non-primary gas cost PGVA and other deferral account balances as at March 31, 2005 with carrying costs to July 31, 2005;

(e) confirm quarterly primary gas rate amendments previously provided by way of interim ex parte Orders up to May 1, 2005, on the basis that price management will be dealt with in the context of the PGVA at Cost of Gas hearings;

(f) give final approval of the cost of gas reflected in the accounts of Centra for the 2004/05 fiscal year;

(g) approve Centra's request to increase the overhead component of the Primary Gas Rate to $\$1.73/10^3M^3$ on August 1, 2005 and to $\$1.84/10^3M^3$ on May 1, 2006;

(h) accept in revenue requirement MH's Corporate Allocation against Centra, for 2005/06 and 2006/07, of $12 million ;

(i) approve the phase-out system for connection fees with respect to the Interlake expansion;

(j) approve Centra's service charge amendments as set out in its application;

(k) require Centra to file a full business case with respect to its intended pilot of automated meters in advance of proceeding to implementation, the business case to consider options, costs, and implications to customers;

(l) accept Centra's proposal not to include broker logos and space for broker messages on the "single bill", and require Centra to conduct additional consultations with CAC/MSOS on the issue of customer designation of partial payments and provide a report on those consultations and the final proposed version of the single bill and educational materials to the Board at least thirty days prior to its implementation;

(m) encourage Centra to place safety issues before financial considerations and remind Centra that it bears primary responsibility for the safety of natural gas delivery;

(n) reject the adoption of inverted rates and defer further consideration until such time as Centra's DSM plans have been further developed, its new approach to low-income customers developed and a more detailed consideration of the implications of an inverted rate schedule for low-income and fixed-income residential and commercial customers is undertaken (TREE/RCM proposed an inverted rate schedule whereby the price of the commodity rises with the volume used, so as to motivate property owners to improve gas use efficiency and thus reduce bills and environmental damage.); and

(o) provide and expand upon the Board's view on the question whether Centra and/or the Board are/is subject to the *Sustainable Development Act*. This issue is important because of the potential implications for Centra and/or the Board if either or both of the parties are subject to the Act;

2.5% Interim Rate Increase

With respect to the 2.5% interim overall revenue requirement increase of February 1, 2005, the Board will vary the increase and reduce it to 2% as of February 1, 2005. The Board will also direct that rates be amended as of August 1, 2005 to reflect the February 1, 2005 rate increase as being 2% rather than 2.5%.

The Board will further direct that a rate rider be implemented August 1, 2005 to distribute the excess charges collected to July 31, 2005 to customers over six months beginning August 1, 2005.

With respect to the February 1, 2005 increase of 2%, the Board will direct that its application to customer classes be adjusted to distribute the appropriate amounts to the various customer classes and customers in accordance with the Board-approved cost allocation methodology.

Since MH acquired Centra on July 30, 1999, and prior to the February 1, 2005 interim increase Centra sought a general increase for non-gas costs (i.e. the costs of operating the utility and providing a reasonable return on the owner's investment) only once. With respect to that Application, by Board Orders 118/03 and 125/03 the Board approved a general rate increase of 0.4%, effective April 1, 2003. This GRA was Centra's second since the acquisition by MH six years ago.

In its application for the 2.5% interim rate increase effective February 1, 2005, Centra reported:

1. Actual losses of $2 million and $8 million in 2002/03 and 2003/04, respectively;
2. Forecasts of further losses of $8 million and $10 million for 2004/05 and 2005/06, respectively, without the requested 2.5% revenue increase;
3. Projected annual Corporate Allocations of $15.1 million to Centra from MH;
4. Projected that a 2.5% overall revenue requirement rate increase as of February 1, 2005 would generate incremental revenues of $3 million in 2004/05 and $12 million in 2005/06 and thereafter; and
5. Projected that with the 2.5% increase as of February 1, 2005, the expected loss for 2004/05 would decline to $5 million and the expected loss of $10 million for 2005/06 would become a forecast of a $2 million net income.

At this hearing Centra updated its application and advised that it had recorded a Corporate Allocation charge from MH of $12 million in 2004/05, down from the $15.1 million previously projected. With the reduction in costs, Centra revised its projected loss for 2004/05 to $2 million from $5 million, and increased its net income projection for 2005/06 from $2 million to approximately $5 million.

The Board finds the reduction in Corporate Allocation from the projected amount to be material, and considers that $3.1 million of costs and revenue requirement provisionally provided Centra by the Board through February 1, 2005 interim rates were in excess of actual requirements. Therefore, the Board has determined that the approximate rate equivalent of that sum, $3.1 million, being approximately 0.5% of overall revenue should be removed from the interim 2.5% rate increase and the funds collected through to July 31, 2005 related to the 0.5% refunded to customers.

Proposed May 1, 2006 General Rate Increase

Centra filed its GRA on a Cost of Service approach for determining revenue requirement, but, as directed by the Board in 131/04, it also filed a comparison based on Rate Base/Rate of Return methodology. In schedule 3.0.0 to the application, Centra submitted a revenue requirement of $558 million and $575 million for 2005/06 and 2006/07, on the basis of Cost of Service. Centra also provided a revenue requirement of $569 million and $577 million for the two years based on a Rate Base/Rate of Return Methodology.

While Centra reduced the Corporate Allocation provision by $3.1 million for each year under both approaches, reducing Corporate Allocation from $15.1 million to $12 million from 2004/05, it did not reduce its revenue requirement application. Centra amended its application to reflect the decreased Corporate Allocation by simply increasing the applied for net income upwards by the $3.1 million in each year under both the Cost of Service and Rate Base/Rate of Return regulatory models.

Centra indicated at the hearing that Cost of Service was the method used by its Board of Directors and senior management, to determine the revenue requirement of Centra and MH.

Accordingly, Centra indicated and argued that Cost of Service was its preferred approach to setting revenue requirement and rates and should be the way by which it is regulated. Centra supported its position by reviewing the law as it perceived it, and argued that the Board has the jurisdiction to adopt Cost of Service as the only methodology for use in determining Centra's revenue requirement and rates.

In support of that position, it was pledged at the hearing that MH will never seek a return on its investment in Centra other than:

(a) full recovery of its costs, including the sharing with Centra of financing and other costs associated with the acquisition of Centra; and
(b) the development of sufficient retained earnings in Centra from natural gas distribution operations to provide for a prudent financial foundation for natural gas operations.

Centra further argued that its proposed revenue requirement for rates was justified on a Rate Base/Rate of Return methodology as well under the Cost of Service approach.

Centra suggested that when the two test years, 2005/06 and 2006/07, were taken into account there was ample justification for the Board to accept both the Corporate Allocation of $12 million in each year and a combined two-year net income of $19.3 million. However, Centra acknowledged that on a single-year only basis, 2006/07, the now revised net income of $14.4 million (Cost of Service approach) was slightly in excess of what would be allowed under the Rate Base/Rate of Return methodology for that one year.

It should be noted that since MH acquired Centra in 1999 the aggregate amount of funds projected to be transferred to MH through the Corporate Allocation mechanism, through and including the test year 2007/08, is approximately $66 million. It could be argued, assuming applications were filed and approved, that even at the previously accepted level of $14-16 million of annual Centra net income, subject to utilization by MH, MH could have sought to withdraw an aggregate of $140-160 million over the same period of time.

Granted, the "no harm" test would have come into play and likely prevented the full $140-160 million being transferred. The Board does not find that MH customers suffered from the acquisition as a result of this discrepancy of $74-94 million over ten years, because during this period of time MH customers have and may be expected to benefit from savings arising out of synergies.

With respect to Centra's customers, there may not have been sufficient synergy and avoided cost savings to have allowed the additional $74-94 million to be transferred to MH. In any case, these additional sums were not transferred.

It is clear that from the date of acquisition through to the year of introduction of the Corporate Allocation, MH drew no funds from Centra (neither dividend nor Corporate Allocation). The net income earned during that period in Centra was left in Centra, and formed the basis of its current retained earnings, which have helped to reduce borrowing requirements and interest costs.

CAC/MSOS' position is diametrically opposed to the position adopted by MH and Centra on the preferred method of regulation. CAC/MSOS takes the position that Rate Base/Rate of Return is the method to be followed by the Board. CAC/MSOS does not share Centra's interpretation of the law.

The Board was undecided on whether Rate Base/Rate of Return should be the only methodology in use when determining Centra's revenue requirement, and, accordingly, asked Centra to file on both bases. While Centra has raised several problems with Rate Base/Rate of Return with respect to its use in the case of a utility owned by a Crown Corporation that operates the subsidiary with its own staff, it raises one particular issue.

The Board must consider whether the Cost of Service approach provides for just and reasonable rates that are lower for consumers. Given the experience since MH's acquisition and MH's indicated intentions at this hearing, the Board notes that this may well be the case. The Board considers its primary regulatory objective is to fix just and reasonable rates that are in the public interest. If Rate Base/Rate of Return provides for a higher revenue requirement and return to the owner, that may not be in the best interests of consumers.

In this Order, the Board considers Rate Base/Rate of Return as the absolute limit for a return to Centra whether that return be by way of net income and dividend or by Corporate Allocation. On a Cost of Service basis, the return to Centra for the years under review is lower, and that is all that is provided by this Order.

The Board can assume that if Centra was still under the ownership of a private investor, additional rate applications would have been filed during the 1999-2005 period, and that the owner would likely have sought the full available rate of return on equity through its rate applications.

In any case, Centra has indicated it has not sought revenue requirements under a Rate Base/Rate of Return methodology. Rather it has developed its rate applications pursuant to the Cost of Service approach. On a Cost of Service basis, the Board considered what would represent a reasonable revenue requirement including the allowable return.

Accepting the Corporate Allocation of $12 million as one form of return to the owner, that would leave net income up to approximately $3 million as the other means to provide a benefit to the owner. Earnings in Centra form a part of MH's consolidated net income, so whether or not MH takes those earnings in the form of a dividend, the earnings are reflected in the corporate "bottom line." That being said, retained earnings developed and left in Centra contribute to improving the financial strength of Centra.

As was demonstrated during the hearing, there are two perspectives as to what constitutes Centra's debt:equity ratio. MH holds that in the calculation of Centra's debt:equity ratio, the MH perspective has to be taken into account. MH borrowed the funds to acquire Centra and paid a premium over net book value.

While the Board will explore this area of interest in more depth in its second GRA Order, suffice it to say at this point that MH considers Centra's consolidated debt:equity ratio to be 86:14. Given that MH's financial target of a 75:25 debt:equity ratio also is in place for Centra, this would, in the view of MH, leave Centra with considerably more retained earnings to be developed before that ratio is achieved. As long as the Corporate Allocation is in place, progress towards that perspective of Centra's debt:equity ratio will be on a very limited pace. Net income sought in revenue requirement by Centra for the 2006/07 test year will not be allowed by the Board.

Related to this matter, is another question that arose at the hearing, this being the pace at which the 75:25 financial target should be approached. MH, Centra's owner, proposed a fairly quick progression to that ratio, and this lies behind its application for a Net Income of $14.4 million for 2006/07 to be included in revenue requirement. CAC/MSOS submit that even if MH's perspective on Centra's debt:equity ratio is accepted, the pace to reach that level should not be any quicker than MH's pursuit of that target for its electricity operations.

The Board concludes that Centra ratepayers should not be required to contribute through rates to the development of retained earnings at a pace quicker than is being projected for MH's electricity operations. The Board notes that MH's projected progress towards achievement of the 75:25 ratio by 2014/15 is predicated upon the assumption of 2.5% annual rate increases, and numerous other factors.

The Board observes that Centra's longer-term forecast, the Integrated Financial Forecast ("IFF"), includes projections of future rate increases. Although those rate increases appear relatively modest compared to its current application, being for 1% every two years, it should be taken into account that the 1% is based on overall revenue requirement not just non-commodity costs. When reduced to non-commodity costs, the rate of increases projected are more similar to MH's electricity expectations.

The Board concludes that, considering the $12 million Corporate Allocation, the rate increase to be effective May 1, 2006 should derive a net income not to exceed $3 million. The Board notes that the funds "allocated for or to the benefit of the owner" arising out of the Board's direction for 2006/07 will be the "Corporate Allocation" of $12 million and a net income no higher than $3 million, aggregating approximately $15 million. This is based on, and consistent with the net income previously enjoyed by the former private owner and is within the range contemplated by the Board in Order 118/03.

The Board defers the discussion over which regulatory model should be utilized in the future to its next Order. For now, the Board notes that the 1.00% rate increase effective May 1, 2006 combined with the reduction of the 2.5% interim rate increase awarded as of February 1, 2005 to 2%, means that, under either regulatory model, the rate increases now varied and directed are fair, reasonable and justifiable.

In short, for the two test years of 2005/06 and 2006/07, the net income provided Centra , is below the net income allowable under Rate Base/Rate of Return and, as well, justified as required and fair under the Cost of Service methodology.

PGVA and Deferral Accounts

The Primary Gas PGVA balances will be distributed to customers through the normal quarterly Primary Gas rates adjustments. Non-primary gas PGVA and deferral balances will be distributed to customers in accordance with this Order, with adjustments made at the time of the August 1, 2005 Primary Gas rate adjustment.

System Expansion Interim Order

Centra requested confirmation of Order 54/05 that gave interim approval to an amendment to an existing franchise agreement with the Rural Municipality of Rosser, and also approved the feasibility test related to the extension of Centra's distribution system to serve one additional customer.

The Board is satisfied that all conditions applicable to date as stipulated in Order 54/05 have been met, with the exception of the required future "true-up" calculation, and will confirm Order 54/05 as being final.

Quarterly Primary Gas Interim Orders

The Board is satisfied that the quarterly primary gas interim rate changes previously provided by way of interim ex-parte Orders were properly prepared and will give final approval to the following Orders: 73/03, 129/04, 12/05 and 57/05. Any issues with derivative hedging will be addressed in the review of the PGVA at the annual Cost of Gas hearing.

Cost of Gas, Fiscal 2004/05

The Board is satisfied that Centra's cost of gas for fiscal 2004/05 was incurred for the benefit of its customers, and that those costs were reasonable and passed on to the customers through rates without markup; accordingly, the Board will approve the cost of gas as per the Application.

Hedging activities were in accordance with Centra policies reviewed at the GRA hearing, and were mechanistic in nature and did reduce rate volatility. The Board will comment further on Centra's hedging strategy as well as its change in hedging policy, as discussed at the hearing, in its subsequent GRA Order.

Corporate Allocation

In Order 118/03, the Board discussed the source of funds available to MH from Centra to fund the acquisition of Centra's shares and integrate the operations.

In that Order, the Board stated:

"The Board believes the no-harm principle is paramount, and that both Centra and MH ratepayers should, to the extent possible, be held harmless as a result of the decision by MH to acquire Centra. The Board also recognizes that since MH initiated the transaction, it should bear some risk relative to the transaction, particularly since MH's size relative to Centra makes it better able to manage any negative cost implications resulting from the acquisition."

In the 2002/03 fiscal year MH and Centra began to utilize an annual Corporate Allocation charge to Centra, initially set at $15.1 million, as the mechanism by which Centra would make its "required" contribution to the costs arising from MH's acquisition of Centra. Centra indicated at this hearing that the mechanism of the Corporate Allocation was selected by MH to make transparent Centra's contribution to MH's acquisition.

At this hearing, Centra confirmed that approximately $19 million was required annually to meet its financing and amortization of acquisition costs arising out of its acquisition of Centra. Centra further indicated that MH itself would meet $7 million of the $19 million, leaving Centra to absorb the remaining $12 million by way of an annual Corporate Allocation, as long as it could be assured that Centra's customers were not harmed by the charge.

Centra shares, with CAC/MSOS and the Board, the understanding that MH's acquisition of Centra is not to result in higher rates for Centra customers than would otherwise have been the case under Centra's management by its former private owner.

At this hearing, Centra confirmed that its first priority was to ensure that pledge was sustained. From the date of acquisition in 1999, the only cost to Centra arising out of its acquisition by MH has been the Corporate Allocation. MH has not taken any dividends out of Centra's retained earnings.

With respect to the allocation of O&A expenses, the evidence suggests that the allocation made against Centra does not include a mark-up of costs incurred by Centra. To confirm Centra's customers have not been economically harmed by the acquisition requires an assessment of O&A expenses. It also requires an assessment of net income and revenue requirement levels.

Starting first with O&A, an ability to offset the annual Corporate Allocation with “savings” would facilitate the assurance that the “no harm” pledge is being kept. This would leave only net income as the remaining test. The allowed net income would not exceed the allowed return on equity under the Rate Base/Rate of Return methodology.

At this hearing, Centra reported that annual savings from synergies and avoided costs, the latter being costs previously incurred under private ownership that are no longer incurred, had reached approximately $8 million per year. While the Board accepts CAC/MSOS’ contention that synergy savings are estimated, it finds the methodology by which Centra arrived at its estimate to be reasonable.

The Board notes that for the 2005/06 test year the $12 million Corporate Allocation charge, combined with the Board allowed net income, approximates the total net income range that the Board said was available to partially fund the acquisition in Order 118/03. This is before considering:

1. once the one-time tax payment is fully amortized, (it is now being amortized over a thirty-year period,) increased tax savings will arise for Centra;
2. further synergy savings are anticipated (single-bill initiative, four-way trench); and
3. non-monetary advantages to Centra customers arise from MH’s ownership.

Centra’s estimates of avoided cost and synergy savings were extensively examined and tested at the hearing. There are several supporting factors for the estimate, these include a reference to O&A cost levels relative to customer numbers and inflation and the methodology used by MH to allocate costs between Centra and itself. The Board considers that on-going general price inflation, decreased average volume of gas usage per residence due to customer-initiated DSM, a significant and sustained growth in MH’s consolidated O&A, additions and improvements to Centra services to customers, and growth in the customer base including expansion outside of Winnipeg all would have tended to increase the O&A costs per customer further than has been the case.

It is worthy of note that Manitoba went through a significant period of extreme cost suppression during the 1993-1998 period, when government expenditures were being significantly restrained and pressure placed on holding down wage costs in all segments of the provincial economy. A days-off-without pay program was in place, and several years passed without any recognition of the loss of purchasing power being reflected in wage increases.

This period ended at or about the same time as Centra's acquisition by MH, and Centra, similar to many other organizations, soon returned to "normal" collective bargaining and the reflection of general inflation in wage settlements if not an element of "catch-up." If Centra had remained under private ownership, it is doubtful that the change in the bargaining environment would have passed it by.

While CAC/MSOS called into question Centra's estimates of synergy and avoided cost savings, and cited the actual 1999 level of O&A expenses as being too low to justify the current claims of savings, the Board finds Centra's restating of the 1999 cost level to be acceptable. Centra advised that 1999 O&A expenses should be adjusted to take into account the realities of operations in the year of sale. From that restated higher level of 1999 costs, the adjustment of that cost level to take into account customer growth and general price inflation is reasonable, and arrives at the view that synergies and avoided costs are as Centra holds them to be. The Board also notes that Centra provided specific examples of savings arising out of the acquisition and later integration of Centra operating functions and staff into MH; these include a reduction in executive costs and steps to make construction initiatives more productive.

The Board is satisfied MH has taken the necessary care to ensure its allocation of O&A costs to Centra is fair. The Board finds that Centra customers are not being held responsible through rates for excessive charges that should be met by electricity customers.

Centra is allocated operating, maintenance and administrative charges by MH; the invoices and payroll costs that are represented in the allocation are paid by MH. The portion of MH's aggregate expenses that pertain to Centra operations is allocated to Centra in accordance with various cost drivers. Some of the costs allocated to Centra pertain only to matters that involve gas operations, some arise out of costs that are incurred on a shared basis – such as general overheads.

Centra reviewed the discreet processes utilized to determine the allocation of O&A costs from MH , which include time sheets and other specific measures. The Board assured itself of the fairness of the allocation through this hearing with a review of reports and information requests filed, and the cross- examination of Centra's witnesses.

The Board notes both MH and Centra are audited by an independent external auditor and subject to the overview of the Auditor General of Manitoba. With no qualification indicated in the auditors' reports; the Board accepts that as additional indicators that the allocation of costs to Centra have been fairly done to-date.

Nonetheless, the Board reminds Centra of its intention to continue to review the allocation carefully during future rate applications, and suggests that MH and Centra continue to treat the allocation seriously, with MH having the prime responsibility to avoid cross-subsidization.

The Board notes CAC/MSOS' concerns with respect to the costs that may arise for Centra as a result of the construction of the new MH head office. The Board respectfully reminds Centra and MH of the requirement to ensure that the head office facility will not prove unduly harmful from a rate perspective for Centra's customers. The Board will follow up on this item at the appropriate time. The Board expects that the costs allocated to Centra subsequent to the completion and occupancy of the new head office building will not increase disproportionate to the benefits of centralization.

Again, at this hearing Centra advised that further synergy savings may develop in future, from such initiatives as the "one bill" and construction productivity measures such as the "four way trench" project.

When considering the question as to whether Centra's customers are better off, or at least have not been harmed by the acquisition, the Board accepts that benefits not easily measured in quantifiable terms should also be considered. Non-monetary benefits arising out of the acquisition and integration, as reported by Centra include:

a) reduced duplication of functions with respect to such matters as line locating
b) enhanced system integrity and reliability (formalized evaluation of "at risk" facilities and networks, increased pipeline assessment activities to evaluate coating and corrosion issues)
c) energy bills for electricity and natural gas within one envelope; soon one bill
d) web information and electronic newsletter services provide electricity and natural gas customers a single site for a range of useful information with respect to heating efficiency measures and energy source selection
e) automated customer notification system for interruptible customers
f) the availability of internet banking and e-business resources now available to gas customers provide greater access to alternative technologies for payment and service transactions
g) an integrated voice response system to shorten wait time for customer telephone inquiries
h) expanded hours of operation and increased staffing in the customer service area
i) increasingly integrated Power Smart programs
j) environmental stewardship has been enhanced by the integration
k) extension of professional services
l) enhanced staff and service depth

There may be other "non-monetary" benefits that have arisen from the acquisition and integration, and these include:

1. decision-making centered in Manitoba, with senior officials located in Manitoba;
2. increased attention being paid to public interest issues – no longer as driven solely by financial objectives (approach to low-income customers, demand side management, etc.);
3. improved borrowing power;

Returns to MH

Centra indicated that MH will not seek a return on its investment in Centra other than the full recovery of its costs, including financing and other costs associated with the acquisition of Centra, achievable through the Corporate Allocation and savings as the result of synergies.

Centra also indicated that with respect to net income and the development of sufficient retained earnings from natural gas distribution operations to provide for a prudent foundation, MH sought only to gradually bring Centra's debt:equity ratio, calculated in accordance with MH's perspective, to 75:25.

The Board accepts that the costs to be recovered from Centra include a share of the costs associated with the acquisition. The Board reminds MH and Centra that this sharing will be satisfactory and fair only as long as those costs do not exceed the lesser of what is required for MH's full recovery of acquisition costs or $12 million per year. As well, the final test to be applied is that any combination of net income and charges to Centra by MH do not result in higher rates for Centra customers than would have been the case under private ownership.

The Board understands MH's rationale for the Corporate Allocations. That said, the Board notes that the first priority is the position of Centra customers, and any risk of under-recovery must fall to MH's customers, regardless of the fact that all of Centra's customers are included within MH's customer list for electricity.

For the principle of "no harm" to be honoured, Centra and MH will have to be/continue to be successful in the efforts to achieve and maintain synergy savings and higher productivity. The Board anticipates that ensuring "no harm" to electricity and natural gas customers will be less difficult in time, particularly upon the eventual full amortization of the one-time income tax payment and integration costs.

The Board concurs with MH's decision not to take dividends from Centra. As long as dividends are not declared and taken from Centra's retained earnings, and the annual Corporate Allocation remains at the current level, the Board will have a level of assurance that Centra's customers have not been "harmed" by MH's acquisition of Centra. The other major issue to be considered in this regard is net income, which is discussed subsequently.

The "no harm" principle is of a paramount importance with respect to the dealings between Centra and its parent, MH.

Cost of Service/Rate Base, Rate of Return

There are two accepted mechanisms by which revenue requirement for a utility may be determined. One is from the use of the Rate Base/Rate of Return model, the other is the employ of a Cost of Service model. Centra and its owner MH have indicated a desire to be regulated on the basis of the Cost of Service methodology.

CAC/MSOS objected to the approach, particularly because of its effect for the test year 2006/07, where CAC/MSOS opposes the provision of a Corporate Allocation to MH at the same time as revenue requirement was proposed to include a $14.4 million net income provision.

CAC/MSOS suggested that the combination of both Corporate Allocation and $14.4 million of net income would represent a "double count" and a return based on rates in excess of what would arise from the continued use of the Rate Base/Rate of Return model.

In Order 131/04 the Board noted that the existing legislation allowed the Board to review Centra's rates on a Rate Base, Rate of Return basis. The Board also noted, in Order 131/04, that the legislation may also permit other forms of regulation of the gas utility.

The Board requested Centra to file its next GRA on the basis of both Rate Base, Rate of Return and revenue requirement, Cost of Service.

The Board was of the view, in Order 131/04, that such a dual filing would enable the Board to reach its determination taking into account revenue requirement, Cost of Service and compare such approach with the Rate Base, Rate of Return methodology.

While Centra and CAC/MSOS have differing views on the preferred and/or applicable regulatory methodology, both should agree that the Board is to fix just and reasonable rates that are in the public interest.

In this Application, the Board has considered Centra's rate base and the formulaic calculation of the return on the equity component that finances the rate base. In this Order, and the GRA Order that will follow, the Board discusses various rate base items.

The Board has also had the benefit of considering Centra's revenue requirements, on a Cost of Service basis. It is noteworthy that Centra's revenue requirements for the 2005/06 fiscal year, prior to the adjustments required by the Board's variance of the interim February 1, 2005 rate increase, were $10 million less under a Cost of Service methodology compared to the pro-forma Rate Base/Rate of Return approach, primarily because of a lower requested net income .

The Board is mindful of Centra's requests to only recover its approved costs and expenses plus a reasonable amount that provides a contribution to retained earnings.

Based on all of this information, the Board has been able to assess Centra's costs and expenses that are proper to include in what the Board has determined to be just and reasonable rates. Centra will be required to recalculate the Board approved costs and expenses and refile for Board approval the resulting rates and supporting schedules, including the resultant return on equity.

In its subsequent Order, the Board will further review the use of a Cost of Service model or a Rate Base/Rate of Return approach. In its deliberations, the Board will take under advisement all the evidence presented at the hearing in this regard.

Contract Tendering

Centra tenders all new construction work to third parties with potential bidders being invited to pre-qualify respecting expertise and equipment adequacy, most recently under a closed bid system. In this system, bidders are not aware of prices of other bidders. Successful contractors are required to guarantee their work for a two-year period. The current contract awarded in the spring of 2005 has a three-year term. Two bids were received for works within the metro Winnipeg areas and one for the rural area of Manitoba. Both contracts were awarded to the same bidder. The Board notes that eight bidders responded to Centra's request in 2000, while only one responded for the 2003 contract and only two responded to the 2005 work contracts. The Board further notes Centra's position that multi-year contracts can lead to better prices.

The Board encourages Centra to review its bidding practices to determine if some other bid system could result in a more competitive environment resulting in lower prices. As well, the Board recommends that Centra insert the option of canceling the contract if a contractor consistently breaches any aspect of the Gas Pipe Line Act in respect of safety related and other issues.

System Safety and Integrity

In addition to the following observations, the Board will address other aspects of Centra's requested additions to plant in its subsequent GRA Order.

The Board emphasizes that regardless of the regulatory model used, Centra has the obligation to justify all proposed future plant expenditures to the Board's satisfaction, prior to installing any plant.

In this regard, the regulation of Centra will continue to differ from that of MH. The Board is mindful of the position taken by Intervenors in previous hearings where the Board was urged to maintain a continued and even more vigorous regulatory oversight in such matters.

At the time of the acquisition of Centra, MH stated that it would not compromise safe and reliable service. Parties and Interveners involved in that process submitted that a high level of supervision by the Board be maintained, and even enhanced.

Centra has substantial responsibilities pursuant to the Gas Pipe Line Act, and these have not been diminished as a result of the acquisition. Centra continues to bear the prime responsibility for the installation, maintenance and operation of its plant in a manner so as to ensure public safety.

The Board notes that although Centra has confirmed that safety has not been compromised, Centra believes that more attention will be necessary in the future to address system integrity concerns because of aging infrastructure. The Board is encouraged that Centra has taken initiatives to address this issue through the development of an Integrity Management System ("IMS").

This management system program will be designed to predict the consequence of high-risk areas of the pipeline plant and to prioritize integrity issues through a proactive approach. Centra uses tools such as risk software, leak surveys, and cathodic protection monitoring to support the objectives of the program. Centra's risk assessment software is designed for transmission pipelines only, but it is considering applying risk software to its distribution system.

Centra's IMS program will be the driver for the system betterment and integrity improvement capital programs for transmission lines.

The Board notes that Centra has a history of repeated deficiencies with respect to inspecting the quality of workmanship by third party installation crews. Centra acknowledges that it has experienced some difficulties in this regard but states that it is not related to the acquisition. However, the Board is encouraged by Centra's acknowledgement of these past problems and its recent attempts to inspect a greater number of third party installations during the construction, rather than after the fact when remedial action would be reactive and costly.

Line Staking Errors

In the prior year, a large number of line staking errors occurred. Gas line locates are now predominantly performed by MH employees with electrical backgrounds. Centra acknowledged that although there are fewer employees with a natural gas background, than an electrical background, conducting line locates in Winnipeg, there is no correlation between this shift in personnel and the number of line staking errors. Centra also stated that the costs associated with third party pipeline damages where Centra is found to be at fault are recovered in the rate base.

Failing to Meet Cathodic Targets

Centra utilizes a cathodic protection program for steel pipelines to retard corrosion. Centra's target is to achieve a 95% cathodic protection level at any given moment in time. As well, Centra's goal is to resolve any problems with the protection system within 30 days, and no longer than 90 days. Centra acknowledged that these targets have not yet been met but indicated an effort to meet the targets. The Board reminds Centra that these safety targets are more important than net income forecasts, and that safety will over-ride other matters in the Board's considerations.

Inspection Failures

Inspection failures on capital projects can result in significant costs to rate payers and pose risks to public safety. Centra provides personnel to inspect the work of third-party contractor crews to ensure compliance with Centra's Standards. Work conducted by Centra's internal construction and maintenance crews is not inspected by either internal or external inspectors.

Not all projects receive full inspection because inspectors have other duties including record keeping and tracking contract payments. Centra has had system failures because of poor quality work by third party contractors, and this may have been avoided with higher levels of inspection or better trained inspectors on site. Centra reported an ongoing effort to improve the situation and the Board encourages Centra to maintain its focus on these problems.

As well, poor workmanship resulted in a number of leaks on the welded joints of the pipeline located in the R.M's of Hanover and La Broquerie. In addition to the safety risks and reliability issues, remediation costs were approximately $150,000. Similarly, poor workmanship and inadequate inspection resulted in damage to the protective coating of the Southwest Transmission pipeline during installation. This combined with inadequate cathodic protection resulted in premature corrosion leaks. The costs of remediation in this case was approximately $766,000.

Polyethylene ("PE") Butt Fusions

PE butt fusions required remediation and repair commencing in 1989 because of poor workmanship that had resulted in numerous incorrectly installed mains being put into service. In addition to serious risks to public safety and reliability, the cost for remediation is now estimated to be $1.3 million.

Damage Prevention

The Board is encouraged by the extent of Centra's involvement in numerous initiatives related to damage prevention. These initiatives were reported to include fulfilling responsibilities pursuant to the Gas Pipe Line Act that require the utility to locate gas pipelines when requested to do so by a third party. Centra continues to conduct training sessions for all personnel to enable all to keep current on the newest developments and equipment utilized..

Centra also administers a "Call Before You Dig Program" specifically designed towards gas pipelines and contributes to a similar program administered by the Inter-Utility Committee within the City of Winnipeg. Centra provides consumer education through information booths at conferences, mailers to customers and follow-ups with excavators through direct meetings and/or letters.

Centra also attempts to recover costs from third parties who cause pipeline damages. Centra indicates they are actively working with Workplace Safety and Health to help decrease problem excavators.

With respect to damage prevention, the Board takes a zero tolerance view when it comes to adherence to Manitoba Regulation 140/92 and the safety requirements of the Gas Pipe Line Act. The Board continues to hold the firm view that safety is of paramount importance, and that system integrity and safety expenditures, both capital and operating, must be the top priority at all times.

The Board does not contest Centra's view that safety with regard to pipeline damages since the acquisition of Centra by MH has not been compromised in any manner, including the shift in line staking duties to personnel with electrical backgrounds. However, the Board is of the view that line staking errors are unacceptable not only from the perspective of conformance to legislative requirements, but also from a safety perspective.

Centra must continue in its efforts to reduce line staking errors. The Board further encourages efforts by Centra to prevent damages to plant.

Quality Control

The Board notes that since the mid 1990's Centra has engaged in a high priority initiative to develop operating standards and procedures effecting safety and utility operations. These standards and procedures are to be tested using a proposed internal quality assurance program. A comprehensive formal Quality Assessment Process is to be implemented in 2005 to continually test, maintain and update Standards and Procedures.

Four Party Trench Installation

Four Party Trench installation currently is a pilot project in which Centra will share a common trench with electrical and communication cables. However, Centra acknowledged that to date direct costs for Centra and its customers are, on average, 180% to 200% greater for each main extension project installed in the four party trench, compared to installation under the traditional single party method.

Centra and MH are currently conducting an optimization process in hopes of achieving savings of approximately 25% over both the electrical and gas single party installation costs. Centra has indicated that the portion of savings will not be known until the optimization process is complete. Centra has committed to evaluating the merits of the Four Party Trench pilot project by the end of 2005.

The Board considers costs of the Four Party Trench installation, that are nearly double the traditional installation methodology, are unacceptable. Additionally, the Board is of the view that Centra has not provided sufficient evidence to suggest that overall savings of 25% or more can be achieved through the optimization process.

By the end of 2005 construction season more than 40 Four Party Trench installations will have been completed and these should be ample to enable Centra to properly assess this pilot project. It is the Board’s view that the Four Party Trench initiative must fully demonstrate financial or other tangible benefits.

Additionally, the Board must be satisfied that there will be no increased risk to safety or increased costs in the event of third party damages to any of the four services located within the common trench.

Accordingly, the Board will order Centra to cease all gas pipeline installations through the Four Party Trench program as of December 31, 2005. Thereafter Centra is to carry on using the traditional means of gas pipeline installation, unless or until such time as Centra can satisfy the Board that anticipated savings can be realized and there is no greater risk to public safety.

Automatic Meter Reading ("AMR")

Centra proposed a pilot project, at a cost of approximately $400,000 to establish a business case for a comprehensive AMR program (previously entitled the Off Site Meter Reading Program ("OMR"). Centra indicated the benefits of an AMR program include obtaining meter readings where access to the meter is difficult and to provide improved accuracy in readings during off-cycle reads and move-ins or outs.

Centra reported that it would take many years and millions of dollars to complete full implementation of AMR, and that AMR was being considered as a way to capture accurate meter readings and other corporate objectives. Centra indicated that it experiences difficulties in gaining access to many customer residences over the course of a year, and that a few customers had not had their meter read for up to 71 months.

AMR would also assist with Centra's load forecasts and load management activities. Unit costs for AMR installation are approximately $200 while the cost to move a meter from inside to outside is approximately $195. These costs would be factored into the business case.

Centra indicated that the business case would form the basis for Centra's choice of technology, the scope of the program and, ultimately, project costs. Centra has committed to filing the business case with the Board and assured the Board that there will not be any further significant expenditures on this project until such time as the business case proves the project to be viable.

In two previous rulings, the Board denied Centra's OMR/AMR request for inclusion of funding of approximately $800,000 into rate base citing that the project did not meet the prudence test. However, the changes that have been implemented since Order 79/98 are:

1. The original program specifically focused on inside meters. Centra has indicated that this new program scope focuses on difficult to access meters with inside and outside locations.
2. The technology available for AMR has improved and now includes many different types and suppliers. One of the concerns that contributed to the Board's denial of AMR in the past was that the technology was relatively new in the late 90's and subject to rapid change.
3. Joint meter reading benefits between MH and Centra have now been fully realized which will help to assess the business case of AMR. When the Board denied AMR in Order 8/97, joint meter reading was only being investigated and that was another reason to deny AMR at the time.
4. Load management was not considered as a possible benefit to AMR in 1997; the original program was intended only to address inside meters that were difficult to read.
5. According to Centra the problem of difficult to read meters has magnified and is on the rise.

Given that the AMR is a pilot project, the Board considers that associated costs should not be included in rate base at this time. The Board expects Centra to separately track and record all costs related to this project. The balance in the account at year-end will be amortized at Centra's long term borrowing rate over a five year period, or until the business case analysis demonstrates that the project is prudent, at which time the account balance may be considered for transfer into rate base.

The Board considers, as submitted by CEPU, that meter reader activities go beyond reading of the meters, and include visual inspections of the meter, calling in gas leaks and iced over regulators, and reporting apparent excessive pipe strain. These important safety steps would be lost if AMR is implemented.

The Board also agrees with CEPU that the business case must recognize these safety steps and factor this element into the business case, especially when considering what Centra deems to be the non-economic benefits of the project.

Cost Allocation

Centra's cost allocation methodology is a three-step process that firstly assigns all Revenue Requirement components into one of six functional areas. Step two classifies all of the functionalized costs as being energy, customer or demand related. The final step then allocates the functionally classified cost to each of Centra's customer classes.

The Board notes that the cost allocation methodology is consistent with that last approved by the Board in Orders 118/03 and 131/04. The Board also notes that Centra has complied with the Board's direction with respect to the allocation of UFG as ordered in Order 131/04.

Additionally, the Board will approve Centra's proposal to dispose of the balance in the Supplemental Gas PGVA through the Distribution (to Customer) rate rider for all classes, except the Interruptible Class. For that class, for reasons of a potential negative billed rate, the balance will de treated as a separate line item on the customer's bill.

The Board will also approve the cost allocation insofar as it applies to the 2006/07 test-year, as there is no change from the allocation for the 2005/06-test year.

The Board has considered and finds Centra's request to increase the Primary Gas overheads to $\$1.73/10^3M^3$ in 2005/06 and $\$1.84/10^3M^3$ in 2006/07 to be justified at this time, and consistent with prior methodology.

The Board will request that prior to the next Cost of Gas hearing, Centra review and report on its internal accounting to isolate costs that can be attributed directly to broker activities and customers. Upon receipt of a report and in conjunction with the next Cost of Gas hearing, the Board will determine if a separate fee, specific to brokers should be utilized in lieu of the current allocation methodology.

As previously indicated, the Board will approve Centra's request for final 2004/05 gas costs, 2005/06 forecast gas costs, and the proposed treatment for the disposal of the non-Primary gas and other gas cost deferral account balances as projected to March 31, 2005, plus carrying costs to July 31, 2004 (as revised in the April 29, 2005 update).

Because the Board will order that the 2.5% increase granted effective February 1, 2005 be reduced to 2.0%, it will be necessary for Centra to recalculate the appropriate August 1, 2005 base rates to reflect this change.

Additionally, as previously indicated, the Board will require Centra to refund this excess revenue through a rate rider and to ensure that the approved cost allocation methodology is employed to properly refund the incremental revenue to each customer class.

The Board will require that this rider be implemented on August 1, 2005 and continue until January 31, 2006, at which time it will be discontinued, to coincide with the February 1, 2005 quarterly Primary Gas Rate change.

Integrated Electric/Gas Bills

In developing the integrated single-bill format, Centra held discussions with interested stakeholders including Municipal and CAC/MSOS. Although many of the points of contention were resolved, two matters were not.

These are the inclusion of a Broker's logo and a message line, as requested by the Brokers, and a check-off box to indicate the customers preference with respect to partial bill payments, as suggested by CAC/MSOS.

In respect of the Broker logo and message line, the Board concurs with Centra's position that the bill is not the place for any Broker messages or further identification, beyond what currently is contemplated. It would further clutter the bill and lead to further customer confusion. The Board endorses Centra's perspective that brokers are able to communicate with customers in any number of ways; direct action by the brokers not involving Centra is the Board's preference.

With respect to the manner by which a customer is notified that any partial bill payment may be assigned to either gas or electric or pro-rated, the Board is of the view that the single bill is not the appropriate manner to accomplish notification. The Board notes that approximately 85% of all customers pay all bills within the allotted period and another 10% or so pay within 30 days.

This leaves a relatively small portion that may utilize the partial payment provision. Centra's Terms and Conditions of Service provide for the allocation of partial payments, in the absence of a stated customer's preference, to the oldest component in the first instance. The Board considers that the appropriate manner by which to inform and educate customers on this matter is as part of the campaign currently proposed by Centra with regard to the implementation of the single bill slated for November 2005.

The Board encourages Centra to communicate with stakeholders in developing such a notice, in accordance with the protocol proposed for the consumer education process in this hearing. The Board will expect Centra to file the final bill format and notices to the public prior to such information being released to the public.

Demand Side Management ("DSM")

The Board notes that Centra's final natural gas DSM plan was received rather late in this GRA process, and allowed little time for a thorough review at the hearing. The Board notes that not all programs have yet been identified in any substantive detail, especially those that would be tailored to meet the needs of low-income consumers.

While the impact on revenue requirement related to DSM will initially be minimal being amortized at approximately $166,000 in 2006/07, the total expenditure of approximately $13 million over two years and $100 million in total is significant. Amortization of these amounts is proposed to be over a 15-year period. As well, Centra advised that it had received a federal funding commitment of $2.4 million over two years, and that this sum would also be available for DSM initiatives.

The Board notes Centra's commitment to engage a full time individual that will be responsible for researching and developing DSM programs for low-income consumers.

The Board remains concerned about the effect of rising natural gas prices, up 300% over five years, on low-income customers, and cites the rise in service disconnections and bad debts as evidence of increasing difficulties. The Board is hopeful that Centra will be able to devise a DSM program that will focus, at least in part, on the plight of the low-income customer.

The Board will have further comment on DSM in the subsequent Order.

Connection Fees and Expansion

The Board will approve Centra's plan to end the requirement for customer connection fees with respect to the Interlake project, and accepts Centra's proposal that the new approach be phased in over a period of time.

The economics of space heating by natural gas has changed since the expansion took place, and for some residential customers heating by electricity may be a more economical choice. The Board accepts that removing the connection fee may assist in building the gas customer base overtime, and, at minimum, it will encourage an efficient choice of energy sources by customers.

The Board notes that Centra anticipated approximately 500 residential customers to arise out of the Interlake expansion, while fewer than 100 have materialized to-date. The Board accepts Centra's argument that while the curtailment of connection fees will reduce revenue in the immediate term, it may provide additional customers in time to contribute to overhead expenses.

Service Charge Amendments

The Board is satisfied with Centra's proposed approach to customer service charges, and will approve the amendments proposed in the GRA.

Sustainable Development Act, the Environment

The intent of the Sustainable Development Act ("SDA") is, in the view of the Board, to promote a framework through which sustainable development will be implemented in the provincial public sector and promoted in private industry and in society generally.

With respect to the question of whether Centra and/or the Board are/is subject to the provisions of the SDA, the Board is of the preliminary view that the SDA has never been expressly made applicable to Centra or the Board.

However, the SDA does apply to Crown Corporations, and while Centra is not legally a Crown Corporation it is also fully functionally and operationally integrated into MH, a Crown Corporation. By extension, the policies of sustainable development followed by MH would also be followed by the wholly-owned subsidiary, Centra. The oral evidence of Centra's, and MH's, Chief Financial Officer at this hearing reinforces this view.

While the SDA does not expressly apply to the Board, it is the Board's preliminary view that in setting rates for Centra, the Board is empowered by legislation (Subsection 126(1) of The Public Utilities Board Act) to consider any criteria "that the Board in its discretion may deem appropriate."

This wide discretion may permit the Board to consider and/or adopt principles and/or guidelines of sustainable development as part of the rate setting process for Centra.

The Board would appreciate further comments from the parties to this proceeding with respect to the Board's jurisdiction and the intent of the SDA with respect to Centra, prior to completing its deliberations and issuing the second GRA Order to arise out of this proceeding.

Reports to be Filed by Centra

In prior Orders, the Board has directed Centra to provide various reports. In this Application, Centra updated the Board with respect to the reports now indicated:

1 Natural Gas DSM Program:

Centra filed a preliminary plan with its GRA materials. Prior to the public hearings, Centra filed copies of its Natural Gas Supplement to the 2004 Power Smart Plan. Also prior to the public hearing of this GRA, Centra filed its DSM – Potential Scoping Study.

2 Fixed Price Offerings

During the public hearing of the GRA, Centra filed its report on the advantages and disadvantages of Centra offering fixed price arrangements to gas customers. This report did not contain any specific requests by Centra. The Board notes CAC/MSOS' expression of disappointment that Centra did not seek the authority to enter the competitive-side of the retail gas market. The Board further notes that Municipal and ESMC want a full public process if Centra subsequently requests Board permission to offer fixed prices. On its part, Centra indicated that if the Board desires that Centra pursue this option more vigorously, it could lift the prohibition against Centra competing for fixed price contracts that was established in Order 15/98.

3 Customer Education

Centra has consulted with brokers and CAC/MSOS, and filed a report in these proceedings. From the Board's perspective, there appeared to be a consensus as to the process for rolling out Centra's next Primary Gas Customer Education Program, which may be later this year or early 2006. That being said, Municipal and ESMC seek Board direction on whether Centra should promote its present primary gas offering. The Board will reserve a discussion on this matter for its second Order.

4. Integrated Natural Gas and Electricity Bills

On May 12/05, Centra filed as part of the GRA proceedings, updated information with respect to its proposed integrated natural gas/electric bill. The information included the new Communication Plan; Delinquency Bill Messages and Notices; Sample Letters and Notices; New Bill Format Status and Sample Bills. Centra indicated its intention to begin to roll out this initiative in November 2005. Centra filed revised Terms and Conditions of Service to reflect a clarification of the allocation of partial payments and processes.

5. Rural Expansion Financial True-Up Calculations.

Centra has completed final true up calculations for Hanover (Central)/LaBroquerie; Phase 1 Rural Infrastructure Program; and Interlake and BiFrost – Woodlands
The following projects are scheduled for true-up with an effective date of December 31, 2004: RM of Portage – la Prairie (East Portage), RM of Grey, RM of Rosser

6. Main Extensions in Excess of 500 Meters

Centra has filed a summary of all main extensions in excess of 500 meters, since the 2003/04 GRA, for the years 2002 to 2004.

7. Internal Review of IGC Report

Centra is to file a report on its internal review of the IGC recommendations, including conclusions and recommendations regarding Centra's further course of action. Centra advised that it expects to be in a position to file this report with the Board no later than August 1/05. Municipal sought a a public review of portfolio plans by June 2006, prior to Centra considering an extension of current Nexen arrangements.

8. WTS Service Report

Centra was directed to review possible changes to the WTS Service, including the benefits and costs of alternatives to Centra establishing the MDQ, controlling daily nominations, controlling reductions of daily nominations of direct purchase gas, and the ability to enroll WTS customers more frequently than quarterly. The report will require Centra reconsidering related "philosophical issues." The report is expected in conjunction with Centra's report on its internal review of the IGC Report and recommendations.

9. Derivatives Hedging Policy

Centra was directed to review alternatives to the mechanistic hedging approach with respect to achieving and/or maintaining reductions in volatility and costs, and refine its research efforts to test alternative approaches on a retrospective basis. While a Revised Derivatives Hedging Policy was filed in this GRA, the requested report is to be filed with the Board on or before August 1, 2005. CAC/MSOS recommended Centra cease its mechanistic hedging approach because of the costs involved in the process.

10. Capacity Management

Centra has, responded to the Board's concern with Centra's practice of including Forecast Capacity Management revenues with PGVA and gas cost deferral account balances that include only historic data. Centra proposes to include the forecast of

Capacity Management revenues as part of the calculation of base rates and to allocate these revenues to the various customer classes through the cost allocation model. Centra would also maintain a deferral account to capture the difference between forecast and actual Capacity Management revenues. The Board finds Centra's proposal acceptable and will review the first year results at the next Cost of Gas hearing.

11. Level of Basic Monthly Charge (BMC)

The Board is expecting a report on Centra's review of adequacy of the BMC by Aug 1, 2005. CAC/MSOS does not want the BMC to increase due to the implications for low income customers and conservation.

12. Schedule of Hourly Rates

As part of these proceedings Centra has filed labour authority rates that would be adjusted annually. The Board has reviewed the rates and will approve them as filed.

Other Matters

The Board will direct Centra to provide the Board with more information with respect to Centra's loan program that is related to energy efficiency and natural gas.

In particular, the Board would appreciate Centra's advice with respect to the actual costs and revenues associated with the loan program, particularly with respect to the sufficiency of its current loan interest rate of 6.5%. The rate appears relatively high, given the history of lower market short-term rates, and the Board seeks Centra's advice as to whether the rate could be lowered further for low-income customers.

Furthermore, the Board would appreciate Centra's advice with respect to the amortization period for these loans. As the Board understands the current plan, the amortization period for these loans is shorter than Centra's own fifteen year amortization period for Demand Side Management expenses. A longer amortization period with fixed rates, if this were possible, would assist low-income customers in achieving energy efficiency upgrades.

The Board will also direct Centra to provide its position on Centra allocating the $2.4 million of new federal DSM money to projects targeted specifically at low-income customers.

Centra mentioned in closing submissions, that the hearing process could be improved by earlier disclosure of the parties' positions on issues. Additionally, Centra would appreciate an opportunity to hear the closing submissions of other parties on one day, and then provide Centra's closing submissions the following day.

The Board is always interested in improving its hearing process and will have Board Staff and/or Advisors contact all parties to this hearing to obtain information that may lead to process improvements in subsequent hearings.

8.0 It Is Therfore Ordered That:

1. The interim general rate increase of 2.5% effective February 1, 2005 BE AND IS HEREBY reduced to 2.0%, effective February 1, 2005;

2. A rate rider be implemented over the two quarters commencing August 1, 2005, to distribute to customers the refund required with respect to the reduction of the 2.5% rate increase to 2.0%;

3. The rate riders with respect to non-primary gas cost PGVA and other deferral account balances as at March 31, 2005, with carrying costs to July 31, 2005, BE AND ARE HEREBY APPROVED;

4. The cost of gas reflected in the accounts of Centra for the 2004/05 fiscal year BE AND IS HEREBY APPROVED;

5. The proposed 2.5% general rate increase effective May 1, 2006 BE AND IS HEREBY REDUCED to 1.0%;

6. Centra's proposal to phase-out system connection fees with respect to the Interlake expansion BE AND IS HEREBY APPROVED;

7. Centra's proposed amendments to its customer service charges, as set out in its Application, BE AND ARE HEREBY APPROVED;

8. Centra to continue to justify all plant expenditures to the Board;

9. Centra review its capital program tendering practices to determine if some other system would enhance the competitive environment leading to lower construction costs, and to report to the Board by no later than December 31, 2006;

10. Centra continue to inspect a greater portion of third-party installations during construction, rather than conducting after-the-fact assessments, and eliminate line staking errors to the extent possible;

11. Centra cease all gas pipe line installations using the four party trench method as of December 31, 2005, unless and until Centra can satisfy the Board that anticipated savings can be realized and that there is no greater risk to public safety;

12. Any expenditures for the AMR pilot project not be allowed into Rate Base until Centra submits a business case satisfying the Board that the proposed project is prudent;

13. Centra's requests to increase its Overhead Primary Gas rate to $\$1.73/10^3M^3$ on August 1, 2005 and then to $\$1.84/10^3M^3$ on May 1, 2006 BE AND ARE HEREBY APPROVED;

14. Centra provide the Board reports on the following matters, by August 8, 2005:

    (a) the actual costs and revenues associated with the loan program, particularly with respect to the sufficiency of its current loan interest rate of 6.5%;

    (b) information on the current amortization period provided in the loan program, and Centra's opinion as to whether that period should be extended;

    (c) an opinion and position on the advantages and disadvantages of targeting the new federal DSM funding, of $2.4 million over two years, to projects related to energy efficiency and low-income customers; and

    (d) its perspective on the implications, if any, for Centra being subject to the provisions of the *Sustainable Development Act*.

15. Interim Orders 73/03; 129/04; 12/05; 54/05 and 57/05 BE AND ARE HEREBY CONFIRMED AS FINAL;

16. Prior to the next Non Primary Cost of Gas Application, Centra is to file its report on costs attributed to Broker activities and Centra's proposal for recovery of such costs;

17. Centra file, for Board approval, the final one-bill format and notices to the public, thirty days prior to such information being released to the public;

18. Centra file, as soon as possible, for Board approval, revised rates, to be effective August 1, 2005, taking into account rate directives provided herein as well as the quarterly Primary Gas Rate adjustments proposed for August 1, 2005;

The Public Utilities Board

____
Chairman

____
Acting Secretary

18. Centra file, as soon as possible, for Board approval, revised rates, to be effective August 1, 2005, taking into account rate directives provided herein as well as the quarterly Primary Gas Rate adjustments proposed for August 1, 2005;

THE PUBLIC UTILITIES BOARD

"Graham F. J. Lane, C.A."
Chairman

"H. M. Singh"
Acting Secretary

Certified a true copy of
Board Order 103/05 issued by
The Public Utilities Board

Acting Secretary

Appendix A

Appearances

R. F. Peters	Counsel for The Public Utilities Board (“the Board”)
M. Murphy	Counsel for Centra Gas Manitoba Inc. (“Centra”)
B. Czarnecki	Counsel for Centra
S. Boyd	Representing Communications, Energy and Paper Works Union Local 681 (“CEPU”)
K. Saxberg	Counsel for the Consumers’ Association of Canada (Manitoba) and the Manitoba Society of Seniors (“CAC/MSOS”)
D. Brown	Counsel for Direct Energy Marketing Ltd./Municipal Gas
K. Melnychuk	Representing Municipal Gas
N. Ruzycki	Representing Energy Savings Manitoba Corporations (“ESMC”)
P. Miller R. McQuaker	Representing Time to Respect Earth’s Ecosystems (“TREE”) and Resource Conservation Manitoba (“RCM”) (“RCM/TREE”)

Appendix B

Witnesses for Centra

A. Aziz	Manager, Gas Distribution, Planning and Design
D. Case	Manager, Customer Service Operations
K. Derksen	Senior Analyst of Gas Rates
W. Derksen	Manager, Management Accounting and Budgeting
L. Kuczek	Divisions Manager, Consumer Marketing and Sales
D. Rainkie	Manager, Regulatory Affairs
B. Sanderson	Senior Gas Cost and Hedging Analyst
H. Stephens	Manager, Gas Supply, Transportation and Storage Department
L. Stewart	Manager, Gas Supply, Pricing and Administration
V. Warden	Vice-President, Finance & Administration, and Chief Financial Officer
R. Wiens	Divisional Manager, Rates and Regulatory Affairs

Witnesses for Intervenors

M. G. Matwichuk	Partner, Steven Johnson, Chartered Accountants
S. Weiss	Senior Policy Analyst, NW Energy Coalition
M. McCulloch* A. Taylor*	The Pembina Institute

* (Presented written evidence but did not testify.)

Appendix C

Intervenors

Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors Inc. ("CAC/MSOS")

Direct Energy Marketing Ltd./Municipal Gas ("Municipal")

Communications Energy & Paper Workers Union Local 681 ("CEPU")

Energy Savings Manitoba Corporation ("ESMC")

Time to Respect Earth's Ecosystems ("TREE")

Resource Conservation Manitoba ("RCM")