MANITOBA	**Order No. 135/05**
THE PUBLIC UTILITIES BOARD ACT	**October 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

CENTRA GAS MANITOBA INC.
AN ORDER ARISING OUT OF ORDERS 103/05 and 115/05

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1.0 EXECUTIVE SUMMARY

The Public Utilities Board (the Board) regulates Centra Gas Manitoba Ltd. (Centra), a subsidiary of Manitoba Hydro, a Crown Corporation (MH). Centra provides natural gas to approximately 250,000 residential, commercial, industrial and not-for-profit customers through a gas pipeline distribution system that serves Winnipeg, Brandon, and some rural Manitoba communities. Natural gas is used primarily for space and water heating, as well as manufacturing processes.

The Board determines just and reasonable rates for Manitoba's natural gas, electrical and municipal water and sewer utilities taking into consideration the public interest. The Board meets its responsibility by assuring as best as possible the well-being of both regulated utilities and consumers, within the context of the underlying times and circumstances.

By Board Orders 103/05 and 115/05 issued in July 2005, the Board provided Centra with general non-primary gas cost related rate increases and other direction. In this Order, which does not change rates, the Board provides its direction and/or views on the following other matters raised and/or addressed at the Centra General Rate Application (GRA) held this summer:

(a) regulatory approach alternatives – the Board confirms its intention to use both the *Rate Base Rate of Return* and *Cost of Service* methodologies, with *Rate Base Rate of Return* to be a test of the maximum allowable return to MH;

(b) MH's allowable return on its investment in Centra (the Board confirms its earlier conclusion that an annual return by way of a combination of a charge by MH to Centra and Centra's annual net income, is fair to both MH and consumers);

(c) an evaluation of MH's acquisition of Centra (the Board concludes that enough time and experience has occurred to allow a judgment to be formed that the acquisition has not harmed the ratepayers of either MH or Centra, and that at future regulatory hearings the further assessment of the acquisition, including synergy benefits there from, should cease or be very limited);

(d) Centra's corporate structure, debt:equity ratio and retained earnings (the Board concludes that Centra’s capital structure, debt:equity ratio and retained earnings should be determined separate from the circumstances of its parent, MH, and that short of an amalgamation of Centra and MH, Centra should be considered a “stand-alone” entity with respect to its capital structure);

(e) gas broker issues (the Board recommends Centra make an application to the Board to enter the retail fixed-price gas supply contract market; an application would be followed by a hearing to allow for a full testing of Centra’s application and an assessment of the appropriateness of such a move from the perspective of the public interest);

(f) Centra’s present hedging approach (the Board directs Centra to consider enhancing the current objective for hedging by including the goal of reducing future primary gas costs, as opposed to the now-singular focus of reducing volatility);

(g) customer class structure (the Board proposes the formation of a separate residential customer class, as residential concerns and circumstances differ in part from those of the other customers within the present SGS class);

(h) rate structure issues (the Board concludes that with commodity prices at all-time highs, useful environmentally-driven rate structure options such as inverted rates, Marginal Gas Variable Cost (MGVC), de-coupling and pricing in cost estimates of environmental externalities should be deferred for later consideration);

(i) Demand Side Management (DSM) - the Board concludes that Centra should be more aggressive with respect to bringing about enhanced space heat retention and heating efficiency for environmental, consumer cost and gas system viability reasons; and

(j) residential and low-income customers (the Board expresses its concern with respect to bill affordability and the ability of residential and low-income customer to invest in DSM measures, and looks to Centra and others to propose initiatives to improve the current situation).

This Order is issued at a time of high natural gas commodity prices. Over the last month October and November 2005 future contracts for natural gas have fairly regularly exceeded $13/GJ, USD (American dollars), or $15/GJ CDN, and have even exceeded $14/GJ USD ($16/GJ CDN).

These prices represent a new high for a commodity that sold for approximately $3/GJ CDN in 1999 when MH acquired Centra. Only a year ago, the cost for an October gas contract in September was approximately $7/GJ CDN. While the recent highs may prove unsustainable in the longer-term, these prices will affect future consumer rates, particularly in 2006 as hedges placed earlier expire. With a primary cost of gas of $7.96/GJ CDN built-in to current Centra rates, the Board is concerned with the effects for consumers of the recent commodity price developments.

While Centra's past hedging and natural gas storage are expected to moderate the immediate impact for consumers on the upcoming November 1, 2005 primary gas quarterly rate setting, rate shock is a real possibility for the February 1, 2006 rate setting.

A basic regulatory principle employed whenever practical is the avoidance of rate shock. The usual means to avoid rate shock is to "smooth" rates by deferring some portion of underlying cost increases to later periods. The objective is to provide time for consumers to adjust to higher rates, and to allow for the possibility of either a future decrease in the underlying costs or other developments reducing rate pressure.

There are risks associated with smoothing, as it is possible that commodity prices will not fall and future rates then would have to take into account the new sustained higher commodity cost level as well as the amortization of deferred costs from previous rate smoothing. Smoothing provides “rough justice” - customers who leave the system avoid costs and new customers may assume costs for periods they were not present. Finally, smoothing may be more desirable for residential customers than for Centra’s other customer classes.

The Board recommends that Centra consider proposing “smoothing” when it brings forward its November 1 and February 1 primary gas quarterly rate applications to the Board. All other parties should also provide their views on this issue prior to the November 1, 2005 and February 1, 2006 primary gas rate adjustments.

2.0 INTRODUCTION

In June and July of this year, the Board held a public hearing into a general rate application by Centra for revised natural gas rates with respect to non-primary gas costs. By Board Orders 103/05 and 115/05 issued following the hearing, Centra was granted general rate increases of 2% as of February 1, 2005 and 1% effective May 1, 2006. Centra applied for 2.5% and 2%, as of February 1, 2005 and May 1, 2006, respectively. The 2% general rate increase as of February 1, 2005 replaced a 2.5% general rate increase as of that date provided previously by way of an interim ex parte Order.

Board Order 115/05 also provided the August 1 quarterly Primary Gas rate increase. The next quarterly rate change will occur as of November 1, 2005. While this Order does not alter rates, it outlines and further explains the Board's directions and concerns, as called for in Order 103/05.

Among the matters herein addressed are regulatory approach alternatives; MH's annual Corporate Allocation against Centra; an assessment of MH's 1999 acquisition of Centra; corporate structure matters such as debt:equity ratio and retained earnings; retail gas supply competition; rate structure including customer classification; environmentally-driven proposals including inverted rates, MGVC and rate de-coupling; DSM; and low-income customers.

Centra's rates comprise commodity, transportation and distribution elements. The commodity cost element includes both primary and supplementary gas. The cost of the primary gas supply is factored into rates four times a year, at quarterly settings of November 1, February 1, May 1 and August 1 of each year.

Centra hedges a significant portion of its primary gas supply costs, and each quarter it hedges out a further quarter, meaning that the costs of primary gas for system-gas customers are partially assured out one year. The practice, while undertaken to reduce volatility not absolute costs, has reduced costs over the last several years because natural gas prices have been increasing. Supplementary gas is not hedged and purchases are at then-market prices.

The cost of natural gas, the commodity, comprises approximately 80% of Centra's overall costs. Since the issuance of Orders 103/05 and 115/05, natural gas commodity prices have increased sharply posing substantial affordability risks. From the date of MH's acquisition of Centra in 1999, natural gas commodity spot prices have risen from in the range of $3/GJ CDN to a recent peak on the futures market in excess of $16/GJ CDN. (AECO prices, the Canadian benchmark, are following the market. Recent prices have approached $14/GJ. The highest price the AECO CGPR index had ever settled at previously was just below $13/GJ.)

The impact of this hyper-inflationary increase is not reflected in Centra's current primary gas rates. And, if not for the significant increase in the Canadian dollar relative to the American dollar (from 62.02 cents on January 18, 2002 to 85 cents), the price situation for space heating and other energy and energy-based costs in Manitoba would be even more problematic.

Significant problems are currently being experienced with respect to residential account delinquency and service disconnections. Annually, thousands of homes are disconnected for non-payment of Centra bills (the vast majority later re-connected when payment arrangements are made), and rising delinquency and bad debts affect administrative costs and overall rates. These problems may accelerate as new higher commodity costs are incorporated within rates. With gas supply costs of only $7.96/GJ CDN reflected in current rates, consumers face significant rate increases in 2006 (as previously indicated, the Board anticipates that the November 1 primary gas quarterly rate setting will be beneficially impacted by Centra's hedging and storage actions).

For new and recently renewed customers of natural gas brokers serving the retail residential market with fixed-price contracts of three and five years duration, the steeply higher prices are already a reality. It is the Board's understanding that recent broker contracts factor in significantly higher primary gas prices than are reflected in Centra's current rates.

The causal factors behind the rapid natural gas price increase are both systemic and extraordinary: The North American Free Trade Agreement; the continental energy market (Canada is a major exporter, two-thirds of annual production flows south); increased costs for exploration and production; American demand for natural gas for electricity generation; a general tightening of the supply/demand situation; and, most recently, hurricanes that damaged production platforms in the Gulf of Mexico and onshore infrastructure, resulting in the loss of large quantities of supply going into the heating season.

Prior to this past summer, continental gas in storage was considered more than adequate, so much so that there was speculation that prices, then-higher than expected, particularly in comparison with the prior year's level heading into the summer, would decline. However, very warm weather in heavily populated areas of the United States led to increased use of natural gas by electricity utilities. The electricity powered air conditioners, and the increased use resulted in lower storage levels ahead of the heating season. Then the hurricanes and the resulting substantial damage took about 200 bcf of gas production out of the supply mix. Production losses continue into October, with predictions that production in the Gulf may not be fully recovered even by the end of this year.

Leaving aside hurricane Katrina and its immediate and direct effect on gas production, and the long-term support for recent price peaks becomes questionable. The production and other direct and indirect costs of oil, natural gas, propane, diesel, coal, gasoline and uranium are not the drivers of current selling prices, as they have not increased proportionate to current price advances. The current volatility of energy prices and, with respect to natural gas, the uncertainty as to when production will return to normal, has created a speculator's heaven and a users' dilemma. In the case of a "bubble," if this is one, the argument for rate smoothing and a reconsideration of the hedging approach is strong. And, for gas users, whether to lock-in to longer-term pricing becomes an important question.

Pursuant to the North American Free Trade Agreement, Canadian natural gas commodity prices compete in the North American market. Canadian users do not get preferential pricing, notwithstanding that demand for natural gas has not risen in Canada.

Part of the reason that natural gas prices have steadily climbed is the growing inter-relationship between energy sources and prices in a free trade/inter-linked continental market. U.S. utilities are increasingly reliant upon natural gas from western Canada for feedstock for electrical generation, as well as for space heating. In this market, oil and gasoline price increases are matched or exceeded by increases in natural gas, fuel oil, propane, coal and uranium.

A crisis such as Katrina illustrates the delicate balance of supply and demand in a continental and world energy market where a strong price response follows even the threat of disruption. Fortunately in this case, Centra hedged a significant portion of its primary gas supply needs prior to the current price spike, and this will, as it has for several years, benefit its system gas customers. However, as the hedges are placed to smooth rate volatility regardless of the direction of prices, under the current approach neither the utility nor its customers may expect savings in the long-term from the current hedging approach. In this Order, the Board comments on hedging practices and suggests consideration of a different approach. (Centra's primary gas costs were $30 million lower in aggregate over the past three fiscal years as a result of its hedging),

While Centra provides rate protection against price volatility through hedging out one-year with an approach providing cost savings in a rising price market, private natural gas brokers operating in Manitoba offer primary gas supply to their customers at fixed prices going out as far as five years. Centra has not sought Board approval to provide a fixed-price contract option to its customers; in this Order, the Board recommends an application be considered to determine whether it is now in the public interest for the local distribution company to offer a fixed price option. The Board also recommends that Centra reconsider its approach to hedging given the cost implications in a falling price market.

The Board notes that the price increases for natural gas have affected the relative benefit of natural gas compared to electricity for space and water heating. When MH purchased Centra, space heating by natural gas in Centra-serviced areas was considerably more economical than by electricity.

And, complementing the cost benefit of using natural gas for consumers, natural gas space heating had a secondary benefit for MH in that the use of natural gas rather than electricity reduces Manitoba-load for electricity generation allowing higher levels of electricity exports to the United States. And, excepting for drought conditions, these exports create net income for MH, a major contributing factor to Manitoba's low electricity rates.

More recently, natural gas price increases have brought another potential benefit to MH's electricity operations, and again this is with respect to export prices. With American utilities using natural gas for electricity generation, higher natural gas prices lead to increases in wholesale electricity prices. However, with MH's export sales contracts being largely long term in nature, recent price increases for natural gas, if they hold, will take time to fully work into MH's wholesale electricity export prices and revenues.

The expected positive affect on MH's electricity export revenues arising from increases in natural gas prices is also muted by the fact that MH's export destinations in the United States rely heavily on coal as well as natural gas as feedstock for electrical generation.
During off-peak hours and days coal-fired generation may meet their requirements allowing an avoidance of natural gas generation. And, if natural gas prices stay high, natural gas will become less desirable relative to other sources of energy for American utilities.

Despite environmental concerns with respect to coal, it will become increasingly attractive to utilities now utilizing "cleaner" natural gas generation. In the regions of the United States where coal-fired generation is less, the effect of natural gas price increases on electricity prices is thought to be more immediate and significant.

Nonetheless, to some degree MH's electricity business can be expected to profit from high natural gas commodity prices as long as those prices do not dissuade Centra customers from staying with natural gas.

Customers leaving natural gas for electricity, as a primary source of energy, increases domestic electricity load for MH, reducing export sale potential. The inter-link between the prospects and circumstances of natural gas and electricity is such that there may well be a business case for MH to invest "electricity" earnings in natural gas DSM.

Reducing consumption is a major way by which natural gas consumers can reduce the impact of rising natural gas prices and make staying with natural gas for heating an acceptable strategy. Over the past five years, residential natural gas demand has fallen by 13%, evidence that DSM is already a known strategy for cost-containment. Achieving additional gas efficiency improvements, i.e. reduced consumption, through DSM has been and should continue to be the long-term strategy for making natural gas affordable.

There are many "winners and losers" in the case of the current energy price spike, and MH's long-term electricity export potential is but one and a relatively small winner at that. Producing provinces are enjoying massive lease sales, royalty and corporate tax revenue increases, and corporations and their investors are earning large before and after-tax gains.

The federal government is also prospering from the situation, creating additional and unexpected revenues that could be a source for the federal government's indications of coming assistance for low-income consumers. So, there are many winners as a result of the situation, including Canada's oil and gas producing provinces and the federal government. And, "producing" provinces and the federal government have been provided a ready source of new revenue to contemplate offering assistance to consumers.

On the other hand, net importing provinces such as Manitoba have experienced major rate shocks for one commodity after another, and, as a result, the loss of internally generated provincial gross product to the producing provinces. Families note a reduction in truly disposable income, and, with wages unable to keep up with the hyperinflation of energy costs, along with the ramifications arising out of higher energy costs for a host of goods and services, choices are made that are particularly difficult for low-income consumers.

For the Province of Manitoba, municipal governments, health care authorities and school boards, the recent energy price explosion will lead to increased costs. These costs will come in heating hospitals, nursing homes, schools, colleges, universities, other institutions and government offices; and to meet rising social assistance costs while incurring, potentially, reduced retail sales tax and corporate income taxes due to the effects of increased utility bills. In the private sector, the cost of natural gas for both space heating and manufacturing processes will become a larger factor. And, the price increases for gasoline and diesel will only compound the problem with an impact on everything from consumer budgets to the fuel costs for transit.

At the same time as Albertans receive a “dividend” of $400 (in 2006) and price rebates of heating costs tied to the largess of the Alberta treasury derived from rising energy prices, Manitoba families are at risk of much higher natural gas heating costs. Equalization is occurring, but not the way generally understood, in this case from “have not” low-income families to the “have”.

As previously indicated, if the recent explosion in natural gas prices is maintained, electricity will increasingly be more economical relative to natural gas for space and water heating with negative implications for the Manitoba electrical load and electricity export potential.

If it were not for the cost of conversion from natural gas to electricity, it is possible that natural gas customers with conventional and mid-efficiency furnaces, at least, would consider switching to electricity. For new construction, heating by electricity is already a feasible option.

As suggested, the Board has reflected on the situation, including the nexus of residential natural gas customers of Centra, high natural gas prices and MH’s net export revenue potential from electricity sales. The Board observes that there may be a business case that could support the integrated natural gas – electricity DSM program previously called for by the Board.

There are earnings prospects for MH’s electricity operation that are clearly linked to high natural gas prices, and it is MH’s interests from an electricity net export perspective to further natural gas DSM to reduce consumption and thus make natural gas service more economical for Centra's customers.

In considering the overall situation and in developing the options, the Board notes that cross-subsidization based on both social and business case support is an ongoing reality with respect to many matters. Legislation and policy subsidizes rural and northern electricity customers by universal grid rates. Four northern First Nations communities served by diesel-generation are subsidized by residential electricity service at grid prices and government subsidies assisting not-for-profit, residential and commercial services.

Oil companies sell their gasoline at similar prices throughout much of the Province, though volumes suggest prices in the major urban settings could be lower than in rural Manitoba. Centra's system-gas customers and its entire customer base with respect to transportation and distribution rates are "one pool". Economy-of-scale principles are trumped by a societal desire to afford fair treatment to rural customers.

With MH fully integrated from an employee and functional perspective, operating synergy savings are accruing to both electricity and natural gas customers. Centra borrowings are through MH, and MH's rates are supported by a government guarantee. Telephone services are provided to all areas at similar pricing, despite obvious cost of service differences. Similar actions occur with respect to bus service, air travel and a host of other services. And, progressive tax systems are in place, not flat-rate approaches.

Private gas brokers are able to operate in Manitoba because of services provided by Centra through MH, services provided not on a full cost recovery basis. Centra back-stops the private brokers; if for any reason they were unable to meet their contract commitments to their customers Centra would step in and meet the supply commitment, albeit customers would pay all the attendant costs incurred by Centra. What could be described as the subsidization of the brokers, albeit modest, has been done to assure consumers a choice in their primary gas supplier.

There are innumerable other examples of cross-subsidy between geographic areas, different services and customer classes, as well as other examples of less than full cost recovery for services provided to competing firms by others. Yet, from the date MH bought Centra, the operating assumption has been there would not be any use of the revenue from one service to fund the costs of the other service.

The Board stated this as an underlying principle in approving MH's acquisition of Centra. But, times have changed and this principle requires discussion. Natural gas price increases have provided a business case for the apparent linkages between natural gas and electricity providing opportunities not contemplated at the time of the acquisition.

In any case, it is important for Centra's customers to prepare for higher prices by ensuring their natural gas heated residences and businesses are insulated effectively and have efficient furnaces. MH offers a loan program and other DSM programs to help customers retrofit and improve the efficiency of gas use. As well, the federal government provides financial assistance for residential DSM measures. MH and Centra are further developing their DSM programs. A discussion of the availability and importance of DSM measures is included within this Order.

In this Order the Board directs Centra to revisit its approaches to DSM and low-income customers.

3.0 BACKGROUND

As outlined in Order 103/05, the five components of the natural gas sales rate billed to customers of Centra are:

- Primary Gas Rates (applies only to customers using Centra-purchased gas);
- Supplemental Gas Rates *;
- Transportation (to Centra) Rates *;
- Distribution (to Customer) Rates *; and
- Basic Monthly Charge (BMC)*.

* Applies to all customers.

Primary Gas Rates are adjusted quarterly on February 1, May 1, August l, and November 1 of each year in accordance with a Rate Setting Methodology (RSM) and process approved by the Board.

The remaining components of Centra's rates are reviewed and approved by the Board in the context of either an annual cost of gas hearing or GRA. The recent GRA provided a forum for the annual cost of gas hearing as well as the rate application.

Centra's most recent applications to the Board were:

- On December 9, 2005, Centra applied for an interim rate increase of 2.5% of overall annual revenue to be effective February 1, 2005. Subsequently, the Board approved the request by Order 13/05 dated January 21, 2005, though the Board subsequently brought the increase down to 2% retroactive to February 1, 2005, with the refund to begin as of August 1, 2005;
- Centra filed a GRA on January 10, 2005 seeking, among other things: confirmation of the 2.5% interim increase sought for February 1, 2005; final approval of the regular

quarterly Primary Gas rate changes provided on an interim basis; a further 2.5% increase in overall revenue to be effective May l, 2006 (the Board confirmed 2% as of February 1, 2005 and approved 1% rather than the 2.5% sought as of May 1, 2006.); and

- On June 25, 2005, Centra sought interim ex-parte approval by the Board of revised Primary Gas Rates and a Primary Gas Rate Rider to be effective as of August 1, 2005.

Prior to these applications, Centra implemented quarterly rate increases approximating a net of 10% for residential customers (February 1, May 1 and August 1, 2005). With those quarterly increases, to be experienced in bills this coming winter heating season, some would argue rate shock has already occurred.

Board Order 13/05 was appealed to the Court of Queen's Bench by CAC/MSOS on the basis that the Board should have provided Interveners with notice of its receipt of an interim ex parte application from Centra. Subsequently, the Court of Queen's Bench quashed the interim ex parte order, but there were no rate effects arising from this action. The Board issued Orders 103/05 and 115/05 reducing the interim rate increase as a result of new evidence heard at the GRA, and making the reduced increase final.

The Board has filed an appeal of the Queen's Bench ruling, being particularly concerned about the Board's jurisdiction and ability to utilize the ex parte process, which the Board employs when it concludes the public interest is served by the approach.

In accordance with the Board's findings in Order 103/05, Centra reduced its proposed revenue requirement for its 2006/07 Test Year by approximately $11.4 million. The adjustment was incorporated into Revenue Requirement by reducing projected Net Income from 2006/07 from $14.4 million to $3.0 million. This has resulted in a Board-approved 2006/07 Revenue Requirement of approximately $564.1 million, including forecast Primary

Gas costs using the March 15, 2005 price strip. Primary gas prices have risen sharply since, and variances between the costs reflected in rates will be carried in the Purchased Gas Variance Accounts, for future disposition in subsequent quarterly or other rate settings.

Also in accordance with the Board's direction in Order 103/05, Centra has updated the Rate Base Rate of Return calculations both for the 2005/06 and 2006/07 test years. The adjustments to Rate Base and the resulting Revenue Requirement under the Rate Base Rate of Return methodology are summarized as follows:

a) Gas Plant in Service was reduced by approximately $0.3 million in the 2005/06 Test Year and $1.9 million in the 2006/07 Test Year, so as to remove forecast expenditures related to the AMR project from Rate Base; these costs will be tracked in a separate account; and
b) Accumulated Deprecation, Working Capital Allowance, Depreciation and Amortization Expense and Return on Rate Base were reduced related to the adjustment for AMR expenditures.

3.1 Interveners

Interveners assist the Board in the Board's assessment and determination of the public interest, and are involved in all stages of the Board's public hearing process. The Board retains discretion as to whether it awards costs, and often assists non-profit Interveners by approving funding, in whole or in part, to facilitate their involvement. Interveners with commercial interests meet their own costs.

Interveners participating in the 2005 GRA public hearing were:

- Consumers' Association of Canada (Manitoba) Inc. and Manitoba Society of Seniors (CAC/MSOS) – CAC and MSOS are not-for-profit associations representing consumers (CAC) and seniors (MSOS);

- Direct Energy Marketing Ltd. and Municipal Gas (Municipal) – Direct Energy is the parent company of Municipal. Municipal is a private broker offering fixed price term gas supply contracts to Manitoba consumers;
- The Communications, Energy and Paperworkers Union Local 681 (CEPU) – CEPU represents a number of MH staff (MH operates Centra);
- Energy Savings Manitoba Corporation (ESMC) – ESMC is a private broker offering fixed-price term gas supply contracts to Manitoba consumers; and
- Time to Respect Earth's Ecosystems and Resource Conservation Manitoba (TREE/RCM) – TREE and RCM are both not-for-profit associations interested in environmental and economic sustainability matters.

Interveners' positions were set out in detail in Order 103/05, and are reviewed again briefly in this Order.

4.0 BOARD ORDERS 103/05 AND 115/05

In Order 103/05, besides providing rate and other direction to Centra, the Board stated:

> "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."

As previously indicated and/ or discussed either above or in Order 103/05:

a) MH acquired Centra in 1999; and
b) through Board-approved rates, Centra recovers:
   i) costs incurred to acquire, transport and distribute natural gas; and
   ii) sufficient revenue to generate a reasonable return on shareholder's equity.

Included in costs since Centra's 2002/03 fiscal year has been an annual Corporate Allocation made against Centra by MH; the allocation provides MH with funds to cover its amortization and financing costs associated with its purchase of Centra. As noted below, the Board considers the Corporate Allocation to be a form of return on shareholder investment, reducing the amount that otherwise may be allowed to Centra as net income.

On a *Cost of Service* basis, the Board determines what represents a reasonable revenue requirement to both meet Centra's allowable costs and provide a reasonable return on Centra's shareholder's equity. The Board has determined that MH is entitled on a normalized weather basis to an annual return on shareholder equity of no more than $15.1 million for Centra's fiscal years 2005/06 and 2006/07.

Accepting an annual Corporate Allocation of $12 million by MH against Centra as one form of "return to MH" left the maximum allowable annual net income allowance provided in rates at no more than $3.1 million. Whether a dividend is declared and paid by Centra or not, the net income of Centra forms a part of MH's consolidated net income and is a component of MH's return on its investment in Centra.

- Also in Order 103/05, the Board, as previously indicated, reduced a previously approved interim general rate increase effective February 1, 2005 by 0.5% to 2.0%, and reduced Centra's requested 2.5% general rate increase effective May 1, 2006 to 1.0%;
- directed that the refund arising out of the reduced rate increase (2% rather than 2.5% from February 1, 2005) be provided to Centra's customers through a rate rider over the two quarters beginning August 1, 2005;
- approved rate riders with respect to non-Primary and other gas cost deferral account balances at March 31, 2005, with carrying costs to July 31, 2005 (deferral accounts arise

when actual costs differ from costs projected to be incurred as represented in approved rates);

- gave final approval of the cost of gas for the 2004/05 fiscal year;
- encouraged Centra to place safety issues before financial considerations and reiterated that Centra bore the main responsibility for safety of natural gas delivery;
- required Centra to continue to justify all plant expenditures to the Board in future applications (the Board's legislation provides it oversight over utility plant expenditures);
- directed that Centra cease all pipe line installations using the four-party trench method as of December 31, 2005, unless or until Centra satisfies the Board that savings could be realized by the approach without any greater risk to public safety;
- directed that Centra not include any expenditures for the automated meter reading (AMR) pilot project in its Rate Base until a business case has been placed before and approved by the Board indicating the proposed project is prudent;
- accepted Centra's proposal neither to include broker logos nor space for broker messages on the intended future "single bill" (charges for electricity and gas are to be billed to MH and Centra customers through a single bill);
- required Centra to conduct additional consultations with CAC/MSOS on the issue of customer designation of partial payments (with a single bill a customer might pay less than the total charges for gas and electricity), and to file a report and the final version of the single proposed bill and related educational materials at least 30 days prior to its implementation;
- rejected an immediate adoption of inverted rates and deferred further consideration until Centra had further developed a) its natural gas DSM program, and b) a new approach to low-income customers;
- required Centra to file a detailed consideration of the impact of inverted rates on low-income and fixed-income residential and commercial customers;

- provided the Board's view regarding the applicability of the Sustainable Development Act (the Board has determined that both Centra and the Board are subject to the Act), and sought the implications for Centra of being subject to the provisions of the Act;
- directed Centra to provide the Board with reports on the following DSM matters by August 8, 2005:
  (a) costs and revenues associated with the customer loan program;
  (b) consideration of the current interest rate of 6.5% and amortization period of five years;
  (c) the pros and cons of targeting federal DSM funding of $2.4 million to projects related to energy efficiency with respect to low-income customers;
- directed Centra to file a report on costs attributed to broker activities and Centra's proposal for recovery of broker support costs, prior to the next non-Primary Cost of Gas Application; and
- requested further comment from interveners with respect to Centra's requirements pursuant to the Sustainable Development Act.

By Order 115/05 dated July 27, 2005, the Board found Centra's June 28, 2005 application for a Primary Gas Rate change to be in accordance with the Board approved RSM. Accordingly, the Board approved changes in Primary Gas Base Rates effective August 1, 2005.

Centra calculated the BMC and rates for Supplemental Gas, Transportation and Distribution pursuant to Board directions, and the Board set new rates arising from the GRA and the interim quarterly Primary Gas Rate application through Board Order 115/05. Also in Order 103/05, the Board stated its intentions for its second Order arising out of the GRA, this being that Order.

The following topics were to be elaborated on:

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

(b) MH’s Corporate Allocation;

(c) MH’s acquisition of Centra;

(d) Centra's corporate structure;

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

(f) gas broker issues: retail gas supply competition: multiple service offerings, fixed price contracts; cost and details of WTS service, etc.;

(g) rate structure; and

(h) DSM, low-income customer and environmental issues.

This Order deals with these matters, and should be read in conjunction with Orders 103/05 and 115/05. While this Order does not change Centra’s current rates, it speaks to upcoming changes to Centra’s rates, that being from the November 1, 2005 and February 1, 2006 quarterly Primary Gas rate settings.

5.0 ENVIRONMENTAL MATTERS

5.1 Background

At the hearing, TREE/RCM advanced the argument that the Sustainable Development Act (SDA) applied to Centra, a position Centra initially rejected. Following the hearing, in Order 103/05 the Board expressed its preliminary view that the SDA applied to all government agencies, including MH, Centra and the Board.

With respect to the SDA and the Board, the Board expressed "(the) 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."

The Board then requested further comment from the parties involved in the GRA as to the relationship of the Sustainable Development Act with regards to MH, Centra and the Board.

A BMC which differs by customer class, is applied to all customer bills, and represents both an environmental and customer equity issue. In Order 103/05 the Board requested Centra to prepare and file a report on the adequacy of BMC. Centra complied on August 1, 2005, drawing the following conclusions:

1. SGS class – the current BMC of $10 per month should be retained despite the fact that the low current level contributes to a cross-subsidy within the class and does not provide an effective price signal;
2. LGS class – finding it difficult to define the amount of cross subsidy that may exist between small volume users and large volume users within the LGS Class, Centra suggested that a study modeling the creation of two customer classes out of the present LGS based on annual consumption might prove useful;
3. LVC - Centra recommended that the BMC for High Volume Firm, Interruptible, Main line, Co-op, power stations (which currently recovers 100% of the customer related costs) be maintained. As well, Centra recommended that capacity costs should continue to be administered by way of demand charges; and
4. Special Contract Class - Centra recommended that the BMC for Special Contract class continue to be calculated as it is, with 100% recovery of the fixed costs of the class currently comprised of a single customer.

In evaluating the appropriateness of the level of the BMC, Centra reported it considered the following:

a) the relationship between the BMC and the allocated costs;
b) the resulting cross-subsidy between customers in each rate class;
c) the willingness of customers to understand and accept the level of charge;
d) the impact of the BMC on the overall demand for natural gas service; and
e) the ability of the BMC to communicate the appropriate price and consumption signal to customers.

Centra also indicated that in conducting its study it had obtained information from other Canadian utilities, to check for comparability to its practices.

Following the hearing, Centra revised its position vis-à-vis the SDA, and indicated that there were no practical implications arising from applying the SDA to Centra. In short, Centra accepted that, in its policies and practices, it could be held accountable for compliance with the SDA, just as is its parent company, MH.

5.2 Intervener Positions and Centra’s Response

As reported within Order 103/05, CAC/MSOS opined at the hearing that the SDA binds the Crowns, including MH and its agents, and imposes a requirement on Crown corporations to develop guidelines for sustainable development, financial management and procurement.

CAC/MSOS stated that given MH’s corporate structure, where all control over Centra resides with MH, Centra along with MH should be considered subject to the SDA.

TREE/RCM agreed with CAC/MSOS and adopted the evidence of its witness, Steven Weiss, which was detailed in Order 103/05. Mr. Weiss and TREE/RCM urged the Board to move Centra towards sustainability pursuant to the SDA, and suggested that Centra:

1. design rates based on utilizing MVGC for all customer classes. For TREE/RCM, a customer's decision to increase or decrease use, whether by investments into energy efficiency or fuel switching, should be done on the basis of the cost to society, including pecuniary opportunities;
2. adopt inverted rates and price the base consumption volume at a lower rate than the marginal rate to correct for the fact that pricing full volumes at the MVGC would produce revenues greater than Centra's revenue requirement;
3. adopt MVGC in its planning and evaluation of DSM program choices and investment levels, and adapt the Total Resource Cost Test to a Societal Cost Test including externality costs;
4. use MVGC in designing its main extension and connection policies, so as to encourage the construction of energy efficient housing (MVGC takes into account direct costs, elements of external costs related to environmental, land use, resource depletion, avoided plant costs, and price elasticity and indirect economic benefits to Manitoba Consumers. Mr. Weiss estimated that external costs represent approximately \$2.50 per GJ, or 9.3¢ per cubic metre (this about 1/3rd of the current rate for primary gas);
5. implement tiered rates using MVGC as the marginal rate, for residential rates, the base volume to equal about 80 percent of the average use of an R-2000 home;
6. implement a rate decoupling mechanism, by which volume variations from the norm due to weather would result in ongoing rate amendments not changing revenue requirement, so as to increase the stability of customer costs and Centra's revenues while recognizing sustainability objectives (an inverted rate structure would increase the variability of revenues because marginal use volumes would be priced at a higher rate, thus short-term weather related changes would impact

more on revenues than currently is the case; a “decoupling” mechanism would adjust rates monthly to prevent over or under collection of revenues due to primarily weather variability and conservation effort factors; the monthly rate change variability would be in the range of plus or minus 1% to 2%); and

7. leave the SGS class’ basic monthly charge (BMC) at the current level to provide maximum incentives to reduce consumption; regarding non-residential customers, there are no uniform allocation methods that would be efficient and fair.

CAC/MSOS joined TREE/RCM on the issue of the BMC, and stated it was opposed to any increase in the BMC. CAC/MSOS suggested that an increase would be contrary to conservation efforts, as with a higher BMC consumers would not be able to generate savings by reducing gas consumption.

Mr. Weiss opined that full adoption of sustainability objectives would have significant rate implications while furthering the goals of conservation and sustainability. Mr. Weiss proposed a lengthy period of adjustment with respect to implementing his recommended measures, so as to avoid the rate shock that would accompany a sudden pricing in externalities and the adoption of MVGC. Mr. Weiss proposed that to allow time and circumstances to permit proper SDA-orientated price signals to be put in place without causing consumer rate shock, rates should gradually approach MVGC over a period of 20-25 years.

Centra advised that it was not convinced that inverted rates are justified in the case of natural gas prices. For Centra, unlike electricity natural gas commodity prices fully reflect the commodity’s value in what is a mature and functioning markets.
Centra indicated that TREE/RCM’s evidence didn’t convincingly demonstrate the existence and/or value of the externalities it claimed provided the basis for its contention that natural gas’ marginal cost is higher than the market rate.

Centra also opined that that implementation of TREE/RCM's suggestions would increase direct costs in administration, due to changes in billing routines and administration of decoupling accounts. Centra forecast that there would be adverse impacts on customers with larger than average gas consumption needs.

Overall, Centra lacked confidence in the forecasted outcomes of an implementation of TREE/RCM's suggestions, and opined that it would be not be prudent to proceed with the recommendations at the present time.

Further, Centra reported that it was unaware of any Canadian utilities using inverted natural gas rates. Centra advised that although inverted rates have been used by some electrical utilities, though not MH, there is no indication that the externalities cited by TREE/RCM were taken into account.

Centra concluded that TREE/RCM's proposed adoption of inverted rates, MVGC and decoupling should not be considered at this time. CAC/MSOS joined with Centra in opposing TREE/RCM's proposal to implement an inverted rate structure.

5.3 Board Findings

As previously stated, in setting rates for Centra, the Board is empowered by Section 126(1) of The Public Utilities Board Act to consider any criteria "that the Board in its discretion may deem appropriate." This wide discretion permits the Board to consider and adopt the principles and guidelines of the SDA as part of the rate setting process for Centra.

The Board sees merit in the concept of inverted rates, as has Centra though its support was conceptual in nature. In Order 103/05, the Board indicated its then-view that the adoption of an inverted rate structure was premature. The Board notes that a proper inverted rate structure must factor in detailed DSM plans and expenditures, and an approach to rates for low-income consumers. As to TREE/RCM's rate decoupling mechanism, while the Board understands and is appreciative of the concept, it will delay further consideration of implementation until such time as inverted rates are introduced.

The Board notes that putting into practice the principles and guidelines of the SDA would have significant implications for Centra and its ratepayers. The Board agrees with Centra that the full implications of TREE/RCM's proposals are not fully understood or quantified to an adequate degree to allow for implementation in the particular circumstances of the time.
At this time, natural gas rates are high enough to send a clear message to consumers that the conservation and efficiency of use of natural gas is important.

Nonetheless, the Board accepts and supports the premise that it is bound by the same SDA interests and objectives as are MH and Centra. The Board observes that Centra has accepted the Board's direction to develop and implement natural gas DSM strategies consistent with the intent of MH's DSM approach for electricity, which while limited is consistent with the SDA.

With respect to the BMC, the Board notes and accepts the approach followed by Centra in considering the appropriateness of current BMC levels. The Board observes that, while the current residential BMC does not reflect the fixed costs of Centra associated with the customer class, a fact that suggests the BMC should be increased sharply, the Board will not direct a change.

The Board considers the current level of the BMC to be a form of subsidy to low-income consumers and, as CAC/MSOS and TREE/RCM point out, more conducive to the goals of conservation than would be the case with a much higher BMC. At this time of high natural gas prices, it would be unwise to adjust the BMC for residential customers.

With respect to the LGS class, the Board will direct Centra to conduct the research it has suggested might lead to improvements in customer equity.

The Board has directed Centra to submit a copy of its report on the BMC to Interveners, and the Board requests that interested parties submit their views on the report by November 15, 2005. The Board will then determine the type of regulatory process, if any, to put into place in order to deal with this issue at this time.

The Board will direct Centra to consider the SDA as applying to Centra. Accordingly, Centra will be directed to consider the goals and objectives of the SDA in future developments of DSM and related plans.

6.0 DEMAND SIDE MANAGEMENT

6.1 Background

In this Order, the Board addresses the topic of DSM in two sections, the first being a general review, the second within the context of the Board's concerns related to the nexus of low-income customers and high natural gas prices. DSM is the term used to denote initiatives intended to reduce consumption of energy and improve the efficiency of use. The reasons supporting DSM relate to the environment, conservation, consumer affordability and general economic matters.

Historically, Centra's expenditures on DSM have been modest. However, in response to Order 131/04 and the Board's urgings that DSM be expanded, integrated with the approach to electricity DSM and focused on low-income consumers, Centra filed a more expansive natural gas DSM plan during the recent GRA process.

Centra accepted the Board's direction that the natural gas DSM program be fully integrated with MH's electricity DSM program. The plan, overall $100 million, proposes $13 million of expenditures over 2006/07 and 2007/08 – this excludes the $2.4 million of funding to be provided by the federal government- with all DSM expenditures to be amortized over 15 years. Given the 15-year amortization period, the forecast impact on revenue requirement related to DSM will be a modest $166,000 in the first two years beginning 2006/07.

Centra also advised that in addition to the $100 million overall plan, it would receive federal funding of $2.4 million over the next two years for DSM initiatives.

6.2 Intervener Positions

CAC/MSOS expressed concern with Centra's proposed DSM program, noting that Centra's plans lacked specificity and did not include specific programs for low-income consumers. CAC/MSOS noted that low-income consumers face financial barriers to their participation in energy efficiency measures.

CAC/MSOS also claimed that Centra's plan:

a) fails to outline how DSM costs are to be allocated between gas and electric operations;
b) fails to meet the "rate impact measurement" test used to determine DSM value; and

c) given the plan to expend $100 million, may push consumer rates higher.

TREE/RCM commented that Centra's DSM program plan costs represent resource costs similar to wholesale gas purchases, and should be allocated between customer classes on a volumetric basis so as to ensure fairness of cost allocation and an awareness by customers of the importance of DSM. TREE/RCM also recommended more attention be paid to low-income customers and that industrial and commercial customers should be allowed to "self-direct" a portion of DSM funds.

6.3 Board Findings

The Board is disappointed with the lack of specificity in Centra's first major DSM plan. To plan to spend $100 million overall including $15.4 million – this including the federal funding - over the next two years signals considerable interest and commitment, and that needs to be followed up with specific plans. The Board agrees with CAC/MSOS that the expenditure plans may well drive up future rates.

Although the Board understands that DSM is intended to reduce consumption such that the overall cost to consumers is lower than otherwise would be the case, rates will be influenced by the expenditures and the Board is concerned that the 15-year amortization period may mask ineffective spending. The Board seeks more specificity.

With respect to the Board's previous direction to Centra to prepare an integrated DSM plan, one involving electricity and gas initiatives within common objectives and parameters, the Board believes Centra has not gone far enough. The Board observes that it may be that Centra is unduly affected by past understandings that:

a) electricity and gas operations are to be "stand-alone", no cross-subsidization; and

b) cost allocations should be to the "user" customer class and should determine customer class rates (one customer class should not subsidize another).

The Board notes that the circumstances supporting these prior understandings may have changed. With MH an integrated energy company, with natural gas and electricity prices inter-related and current natural gas prices over twice that of a year ago, conservation and efficiency are clearly in everyone's interest.

Though the current high commodity price is not fully reflected in customer billing rates, and probably will not begin to be until the February 1, 2006 primary gas quarterly rate setting, affordability difficulties are already present for many customers. As well, environmental issues are now at the forefront, embedded in legislation and policy and driving a publicly supported need to improve energy efficiency and conservation.

The relationship between natural gas and electricity (convergence) is better understood. MH operates both natural gas and electricity systems with a customer base marked by commonality.

And, there are other issues requiring innovative solutions:

a) Recognition of differing interests within a customer base served by both Centra and private brokers with respect to primary gas supplies; and
b) Renters, particularly of houses, are held fully responsible for gas consumed within the rented residences, and landlords (the owners) are not held responsible. Not being the property owner, renters have more difficulty implementing DSM. For residences owned by Family Services and Housing, the Province pays the price if there is a lack of necessary improvements to heat retention and heating efficiency. Private landlords may avoid responsibility under the current approach.

With respect to these two latter particular issues, the Board seeks the input of Centra, Interveners and other interested parties.

As a general comment, the Board understands that there are often conflicts between the various interests of consumers (and between consumer groups), objectives of sustainability, effective DSM strategies and practices, affordable natural gas bills, and customer class and system equity.

Nonetheless, if DSM is to be employed in an optimal manner with respect to natural gas, conflicts between past policies and practices and current circumstances require compromise and resolution if progress is to occur and gas wastage reduced.

In conclusion, the Board finds Centra's DSM plan lacking in specificity and overly bound by convention. The Board will await further detailing of Centra's $100 million plan, which should include the additional $2.4 million federal grant program, before forming a firm view on the efficacy of the plan.

Efficacy will be assessed from the twin perspectives of successfully meeting the goals of DSM generally (reduce consumption, conservation and heating efficiency) and integrating the effort of both the electricity and natural gas components of MH's overall operations for the good of all consumers and the integrated utility.

As previously indicated, the Board will comment further on DSM in the section following addressing concerns as to the affordability of natural gas service for low-income consumers.

7.0 LOW-INCOME CUSTOMERS

7.1 Background

In the 2004 Cost of Gas hearing, and as reported in Order 131/04, CAC/MSOS called for Centra to offer specific programs to assist-low income customers by allowing for affordable financing of high efficiency furnaces and programs to renovate homes to increase energy efficiency. The Board joined CAC/MSOS, noting that low-income consumers were unable for either financial or control issues (house renters lack property ownership rights) to undertake DSM measures required for environmental and affordability reasons.

The Board believes there is considerable wastage of natural gas as a result of poorly insulated properties with inefficient furnaces.

Driven by both affordability and environmental concerns, the Board requested Centra to file an expanded natural gas DSM program, integrated with electricity operation plans, with the view of expanding gas programs and making them more accessible to low-income customers.

As previously indicated, the DSM program filed by Centra during the recent GRA lacked specificity and did not meet the Board's expectations with respect to integration and attention to low-income consumers.

At the GRA, Centra advised that it would employ a new low-income program coordinator to research best practices for low-income programs, and further advised its intent to develop targeted programs for low-income consumers. In response and by Order 103/05, the Board observed that

> "… not all (Centra DSM) programs have yet been identified in any substantive detail, especially those that would be tailored to meet the needs of low-income consumers."

As well, the Board directed Centra to provide its positions on:

a) allocating the $2.4 million of new federal DSM money to projects targeted specifically for low-income customers; and
b) reducing the interest rate and lengthening the amortization period for loans related to heating retention and efficiency upgrades.

Centra rejected the suggestion to allocate the federal grant to low-income DSM, stating that the federal grants were conditional on being used in Centra's *Home Insulation* and *High Efficiency Natural Gas Furnace* programs, and could not be targeted to the benefit of low-income customers. Centra also stated an unwillingness to reduce the interest rate or lengthen the amortization period on its DSM-orientated customer loan program.

Currently, Centra offers DSM loans at 6.5% with a repayment schedule of five years. The current prime lending rate is 4.5%, and Centra amortizes its DSM expenditures over fifteen years. Centra indicated that while its residential loan program is targeted to low-income consumers it is designed to recover costs.

In respect to the Board's suggestion to extend the amortization term of the loan program, Centra stated the five-year term offers a reasonable balance involving the size of the monthly payments and the economic advantages accruing to customers through the lower interest costs of financing over a shorter period.

Centra advised that extending the loan amortization period from 5 years to 15 years, as suggested by the Board, would require an increase in the interest rate to 8.5% to reflect its cost of long-term financing. Centra noted that this would result in a significant increase in the interest costs for consumers.

The Board notes that MH offers up to $15,000 in fifteen-year term loans at 6.5% interest for installations of geothermal heat pumps, and, as previously indicated, both Centra and MH amortize their DSM costs over 15-years. The Board suggests that for residential customers, a rate reduction with the option of also extending the repayment schedule may make DSM more affordable and implemented.

In prior Orders, the Board has joined with CAC/MSOS and TREE/RCM in indicating concern as to the ability of low-income customers to absorb natural gas cost increases. In its role as appeal body with respect to gas service disconnections, the Board has informed itself as to customer delinquency and service disconnections issues and related matters. The Board has noted annual increases in delinquency, Centra's provision for bad debt and disconnection activity.

The Board observes that space heating in Manitoba involves more than service and financial issues, but has health and welfare elements. Disconnected properties that are not reconnected experience significant damage, and customers facing disconnection often have and make difficult choices with respect to other necessities to "keep the heat on." Some properties are not re-connected, even at current and prior natural gas rates.

North American demand-supply tightness, energy price and use convergence and, most recently Katrina has led to a spike in natural gas prices yet to be reflected in rates. As gas supply costs are reflected in rates, consumers are going to experience even more difficult affordability issues.

7.2 Intervener Positions

At the recent GRA, CAC/MSOS sought additional Centra attention to low-income issues, and TREE/RCM proposed that Centra immediately commit to develop an adequate bill payment assistance program to assist low-income customers, and that a more robust DSM program targeted to low income customers should be implemented.

7.3 Board Findings

The Board is concerned with the public interest, and the Board defines that as assuring the well being of both the regulated utility and consumers within the context of the times and circumstances. Sometimes achieving the wellbeing of the utility and consumers simultaneously is difficult, and this may be such a time.

In past Board hearings in other fields, rate shock has been defined as being as a rate increase in excess of 10%. On that test, the shock has already occurred – residential rates for system-gas customers rose 10% including the net effect of the February, May and August 1 quarterly rate settings. Yet, natural gas is a commodity and commodity prices have fluctuated significantly over time. The Board is unsure whether considering a 10% increase threshold for a commodity price to be rate shock is appropriate. The usual means to avoid rate shock is to “smooth” rates by restricting increases to affordable levels at any one rate setting. As indicated previously, the risk of smoothing is that commodity prices do not fall.

If underlying costs continue to increase, with smoothing having been implemented future rates have to take into account not only the new higher cost levels but needed amortization of deferred costs from previous rate smoothing actions. While the Board cannot be certain that further price rises will not occur, the Board is mindful of the implications for consumers, particularly low-income consumers, if rate shock occurs this upcoming heating season.

As well, the Board notes repeated comments of federal government authorities as to interest in assisting low-income consumers facing large cost increases to heat their homes. The Board anticipates that Centra, MH and the provincial government share concerns with respect to consumers during this period of higher gas prices.

While most residential customers will have difficulty meeting the billing rates that would accompany the present market natural gas commodity prices, low-income families have difficulty meeting utility costs at current rates. They are often unable to invest in heat retention and efficiency measures even when programs are available to finance or reimburse all or a portion of such measures. Yet, absent direct financial assistance, only enhanced residential heat retention and efficiency will provide some relief from the rate increases that lie ahead with current market prices. The reality surrounding low-income consumers with residential heating by natural gas includes:

- low-income consumers often occupy older and less efficient housing stock;
- low-income consumers are more likely to occupy rental premises, where the responsibility for investments in heat retention and efficiency rests with the landlord while the utility bill is the tenant's responsibility (landlords are less interested in improving heat retention and efficiency when renters are responsible for utility bills);
- low-income consumers lack the up-front financial means to make large loan payments related to DSM measures aiming to achieve reductions in gas consumption through increased insulation, window and other retrofits and higher efficiency furnaces (low-income consumers find even relatively low-interest loans with five-year amortization periods difficult to service);
- while average annual residential natural gas consumption has decreased by 13% since 1999, this is an overall average; low-income consumers living in older houses may

not have been able to achieve consumption reductions in their dwellings, lacking the means to implement DSM; and

- space heating by electricity is now less costly than natural gas with a conventional furnace, and the gap may rise considerably this winter (for the winter season, November through March, consumption is 70% of annual consumption).

The Board is not certain how to define "low income" when non-discretionary material costs such as space heating is concerned. If the full current spot market price was reflected in Centra's rates, the Board suspects that almost all residential customers and many commercial and institutional customers would experience difficulty in meeting space and water heating bills.

To address these pressing issues, the Board suggests Centra and its parent and operator of the electricity utility, MH, consider reflecting in Centra's upcoming November 1 and February 1 primary gas quarterly rate setting application measures to provide residential consumers short-term (rate) and long-term (cost) relief.

Long-term relief is largely dependent upon the market and an expanded and active DSM program. Short-term relief can come from deferral of a portion of current increased supply costs, albeit this action comes with the risk that commodity prices may not drop.

If deferral is contemplated, Centra may want to establish a new residential class from the current combined residential-commercial SGS class. And, given the convergence of pricing and interests with respect to electricity and natural gas, MH may want to consider whether the apportionment of a portion of net electricity export revenues to help fund an integrated electricity/natural gas DSM effort would be fair and reasonable.

MH, through Centra, has a unique responsibility as well as opportunities with respect to its natural gas consumers. MH provides both electricity and gas, while the majority of the gas customers can be found in urban settings and the majority of electricity space-heat customers in rural areas. Electric space heating, already cheaper than natural gas with a conventional furnace, would be much cheaper when and if full current market prices for natural gas are priced in billing rates.

To protect the potential for electricity export sales, gas usage needs to be made efficient and effective, DSM is required, insulation has to be upgraded and heating plans modernized.

The current spot commodity price of natural gas represents a level at least 40% more than is built in to current rates. As the new market level is brought into customer rates (not expected at the upcoming November 1 primary gas rate setting due to Centra's hedging and storage programs) in the absence of more effective DSM, the average annual heating cost by natural gas will increase by over $400. This, after an earlier 2005 increase of over $100 annually that is yet to be experienced through the upcoming heating season. Few households can afford this without making adjustments to other spending, some may not be able to afford and maintain other necessary spending requirements.

When and if this new price level is reached, it may be expected that:

a) further expansions of natural gas service for residential heating purposes will be unlikely;
b) residential customers, in rented residences heated by natural gas, will experience cost increases far in excess of increases in family disposable income;
c) delinquency, bad debts and service disconnections (already an increasing problem) will increase further;
d) consumers will agitate for assistance;

e) government will experience higher social assistance and other costs; and
f) reduced disposable income of consumers will lead to lower corporate income and therefore lower tax revenue.

The Board cannot express more strongly its concerns for the plight of residential, particularly those of low-income, in these times of extraordinarily high natural gas prices, and the urgency for Centra to devise and implement a full range of DSM programs concentrating on residential and low-income consumers.

The Board further suggests that Centra revisit its positions with respect to:
a) allocation of the $2.4 million in federal grants; the home heating problem has come to national attention, perhaps the federal government would relax its restriction on Centra's allocation of these funds; if not, the grant funds could provide Centra the opportunity to reallocate other funds to develop programs for low-income consumers; and
b) the Board's suggestion that the loan interest rate for low-income customers' DSM initiatives be reduced and the amortization period for repayment be lengthened; the Board notes that Centra itself amortizes DSM project costs over fifteen years and borrows at rates ranging down to and below chartered bank prime, and that MH offers geothermal loans of up to $15,000 with a fifteen-year term at 6.5%.

While the Board appreciates Centra's reluctance to amend loan program terms for gas customers, when its program is a component of its parent's (MH) overall loan program, the Board notes that the situation for residential space heating natural gas customers is considerably different than for electricity space heating customers. Electricity prices are low, and cost-based, not at all like the situation for the primary supply of natural gas.

The Board acknowledges that reducing the loan program's interest rate and extending the amortization for low-income consumers may have, at least initially, a negative impact on Centra's results. Yet, the Board also notes that encouraging low-income DSM may contribute to more customer-initiated DSM projects, less wasted gas, lower delinquency, less bad debts and fewer service disconnections. Encouragement is required to assist low-income customers to upgrade space heat retention and furnace efficiency. Heat is a necessity in the Manitoba climate, and low-income customers may not be in a position to improve the heat efficacy of their homes at current interest rates and amortization schedules.

Given natural gas market prices, looming rate increases, MH's ownership of Centra, and the likely future difficulties of residential customers, the Board urges Centra to explore options and bring forward remedies as soon as possible. In any case, the Board will expect Centra to report to the Board by November 30, 2005 and outline the results of its further review of DSM and loan programs details.

8.0 FIXED-PRICE RETAIL PRIMARY GAS SUPPLY COMPETITION

8.1 Background

Consumers in areas fully served by natural gas brokers have a choice as to the provider of their primary gas supply; the choice being between Centra, a fully regulated utility, or a broker.

Centra offers "system gas," purchased and utilized by Centra in accordance with the terms of its supply, storage and transportation arrangements. As previously indicated, system gas is priced in accordance with Centra's costs, with, depending on weather, approximately 40% of that cost being market at time of delivery to Centra and 60% affected by hedges placed by Centra by month out to one year. Centra's price to consumers is assured only one quarter out and hedged to some degree no more than one year out.

Contrarily, and with respect to residential customers, brokers offer three and five year fixed price primary gas supply, with the price fixed based on estimates of future costs, current market to five years out, plus a mark-up to provide for operating costs and profit. Some consumers prefer the certainty of a fixed price for their primary gas supply.

ESMC and Municipal presently offer fixed price options to consumers in Manitoba, and a larger number of brokers compete in the commercial and industrial field. Brokers' arrangements with their commercial and industrial customers may vary.

Centra had approximately 231,000 residential customers as of March 31, 2005, and approximately 20% of these customers contract with private brokers for their primary gas supply. While the brokers operate pursuant to a Board-established Code of Conduct, the pricing of their contracts is not regulated. Only customers receiving primary gas from Centra are directly affected by the quarterly setting of primary gas rates. The other 20% of residential customers are bound by the terms of their contracts with private brokers. These contracts provide "rate certainty" for the primary gas component of overall billings for periods up to five years, the pricing different from that to be experienced by system-gas customers subject to quarterly price amendments.

Centra considers itself prohibited from entering the competitive fixed-price contract market. There are some grounds for Centra's position. By Order 15/98 issued in 1998 prior to MH's acquisition of Centra, the Board stated, in part, that a variety of service offerings by Centra could be an impediment to the development of a competitive retail market, such a market being considered desirable.

The Board then required Centra to maintain the status quo, i.e. offer only its regulated gas supply option and price and not offer fixed price contracts in competition with private brokers. However, the Board advised that its decision was based on then-current circumstances, and that if circumstances should change fundamentally in the future, the Board was prepared to reconsider whether Centra should offer fixed-price gas supply contracts in competition with the brokers. The rapid recent price escalation of natural gas that has resulted in a significant gap between new broker prices and regulated Centra prices represents a change in circumstances.

The test for a change in approach, as then indicated, was whether Centra's entering the competitive gas supply market would provide economic benefits for Manitoba consumers, benefits with limited risks.

As previously indicated, much has changed over the past seven years; natural gas prices have risen to very high levels and DSM has become a greater focus, recognized as a means by which customer costs can be restrained.

And, the Board, in its Orders arising out of the 2004 Cost of Gas hearing and the 2005 GRA, invited Centra to bring an application forward, an invitation that Centra has yet to accept. Thus, from the Board's perspective, the current limitation on Centra is partially self-imposed; although invited to bring an application by the Board, Centra has not applied for Board approval for it to enter the retail fixed price market.

In Order 131/04 arising out of the 2004 Cost of Gas hearing, the Board directed Centra to provide a report listing the advantages and disadvantages of Centra offering fixed price primary gas arrangements to its customers. The report was to include a discussion on how alternative service offers would be delivered.

During the recent GRA, Centra filed a report on the advantages and disadvantages of Centra offering fixed price arrangements to customers. Unfortunately, the report lacked detail and did not contain any specific recommendations. Cross-examination of Centra at the hearing revealed apparent deficiencies in Centra's awareness of competitive market circumstances nationally, and a lack of any detailed plan with respect to entering the retail fixed price market. Centra suggested that if the Board wants Centra to pursue this option more vigorously, it could lift the prohibition against Centra competing for fixed price contracts.

Centra stated that providing a fixed price primary gas supply option to consumers in competition with private brokers was not its priority, and advised that its attention to the matter would increase if there was price gouging in the market, a condition not then-found. At the time of the GRA, while primary system-gas rates were 12% higher than before the February 1, 2005 primary gas quarterly rate setting, the gap between the primary gas rate billed system-gas customers and the fixed price offered by retail brokers was a relatively modest three to five cents.

Currently, with the recent price spike, the difference has risen substantially, and the Board understands that current broker fixed-price contracts are now in the range of 10-15 cents per cubic meter, or 35-50% over the current regulated system-gas primary rate. The difference rests with the price certainty of a fixed price longer-term contract in contrast with the variable nature of the regulated price.

8.2 Intervener Positions

Intervener positions at the recent GRA were set out in detail in Order 103/05.

CAC/MSOS was in support of Centra entering the retail fixed-price market, to compete directly with the private brokers by offering fixed price gas supply options, and suggested the Board direct Centra to offer fixed price contracts on a trial basis. TREE/RCM did not take a position.

As reported in Order 103/05, Municipal opposes Centra competing with private brokers in the retail market with fixed-price gas supply contracts. Municipal noted Centra has neither made recommendations with respect to fixed price offerings nor sought Board approval to make such an offering. Municipal stated there had been inadequate opportunity for Interveners to file any evidence on the issue, and opined that the Board lacked enough evidence to properly assess the pros and cons of Centra offering fixed price long-term supply contracts.

Municipal indicated that if Centra seeks approval for it to offer a fixed-price option, the Board should conduct a full hearing into the matter and examine potential competitive impacts, which it suggested would be serious.

Municipal opined that with Centra in the fixed price market there was a risk that present competition for gas supply arrangements would be negatively impacted to the detriment of consumers, presumably by withdrawal from the market.

ESMC also opposed Centra competing in the fixed-price retail residential gas supply market. ESMC opined that MH's brand recognition, financial strength and existing customer relations with distribution customers (while 20% of residential customers secure primary gas through brokers, all customers including broker-supplied customers rely on Centra's transportation, distribution and operating system) provide MH with an unfair advantage over private brokers. ESMC opined that given these advantages Centra should not enter into competition with the brokers by offering fixed price offerings.

ESMC echoed Municipal view that if Centra were to seek Board approval to enter the retail competitive market with fixed price contract offerings, Centra should be subject to a public application process before the Board.

ESMC held and Municipal inferred that allowing Centra to offer a fixed price service would not be in the public interest, and would impede price and rate transparency, and increase the likelihood of cross-subsidization. This would, in both brokers' view, unduly affect competition in the natural gas market.

8.3 Board Findings

The Board is interested in receiving an application from Centra to enter the fixed-price retail residential gas supply market. This would permit a full review, in the circumstances of the current marketplace, as to whether it is in the public interest for the local distribution company to offer fixed price contracts.

In its Order arising out of the 2004 Cost of Gas hearing, the Board made it clear that it would entertain an application by Centra to enter the competitive retail fixed price market.

That application did not follow, and in Order 103/05 the Board stated:

> "The Board further notes that Municipal and ESMC want a full public process if Centra … requests Board permission to offer fixed prices. On its part, Centra

> indicated that if the Board suggests 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."

The Board stands by its earlier position. It will not approve Centra entering into primary gas supply competition with the brokers in the absence of Centra making an application to enter the fixed price market and without a public hearing.

In a hearing following an application by Centra to enter the fixed price market, the Board would seek more evidence as to whether the public interest is being served by Centra's absence from the fixed price retail residential market.

While all residences served by Centra's distribution system have access to the private broker offerings, the brokers generally market on a door-to-door basis concentrating on the larger communities. With broker activity concentrated in Winnipeg, the Board is not currently assured that all of Centra's 231,000 residential customers have a full opportunity to choose the fixed price contract option. In the absence of Centra in the field, the consumers' opportunity to select based on price and other factors may be limited.

In the past, price spikes have been followed by declines, though the Board notes that the overall trend in natural gas prices has been "up" since 1999. Those locking in to five-year contracts at primary gas pricing reflective of the current highs may not benefit if this current "high" was followed by a decline. And, if Centra were to smooth rate increases, i.e. defer the inclusion of a portion of its primary gas supply costs in primary gas rates, this would not benefit the customers of the private brokers.

In short, the choice between the variable system-gas option of Centra and the brokers' three and five year fixed price contracts may have serious ramifications. The pricing of current broker offerings are at rates reflective of futures prices, but may prove higher than system-gas variable rates and costs over the full term of the contracts.

As previously indicated, the Board is concerned with the potential for downward price movements in the market, movements that may leave broker-supplied gas through recent contracts at considerably higher price than system-gas through Centra. The Board observes that in fairly recent past history "weather" driven price increases did not hold. While history may be a good teacher, the Board cannot be assured that prices will not rise further. If prices were to rise further and hold, contracts recently signed contracts with brokers would prove cost-effective.

The cost to consumers of natural gas arises not only with the rate but also with consumption volumes. The Board has stated its concern that fixed price contracts mean that any actions taken by Centra to lessen the impact of prices on system-gas customers will not benefit broker-supplied primary gas consumers. Another concern relates to DSM measures.

Reduced natural gas consumption means lower costs for consumers, reduced demands on the environment and less funds leaving the Province. Brokers are understandably focused on shareholder value, and profits come with higher volumes. The Board is therefore uncertain as to the brokers' commitment to DSM. That being said, there is no reason why broker supplied primary gas customers cannot undertake DSM measures. The general concern of the Board with respect to the universality of DSM initiatives needs to be explored at a hearing focused on retail competition.

Centra is owned by a Crown corporation where both the objectives of the owner and the premise supporting its acquisition of Centra are to advance consumer interests. The Board is uncertain as to whether Centra's current level of interest in fixed price offerings is consistent with its consumer-orientated philosophy.

Centra does not mark-up its commodity supply and transportation costs, is non-taxable and has achieved synergy savings as a result of its large size and twin-energy nature. With a "service at cost" philosophy and strong presence in the market, it may be able to offer consumers attractive fixed-price contract terms in competition with the private brokers.

The Board's focus is the public interest, and the Board is of the view that the public interest involves the sorting out of competing objectives. While there usually is tension between diverse goals, the Board's priority is the achievement of the best service at the most economical pricing for consumers. The Board is also subject to the SDA, and environmental health includes reduced energy consumption. That would come with DSM, and Centra and MH are the known vehicles by which DSM is pursued and sustained.

At the GRA, CAC/MSOS proposed that the Board direct Centra to offer fixed-price contracts in competition with the private brokers. The Board is not prepared to do this, particularly in advance of an application by Centra.

Given that an impediment to Centra advancing a proposal to offer fixed price contracts may be the question of how profits or losses related to fixed price contracts would be dealt with, the Board provides one perspective.

Conceptually, the Board notes that any gains or losses enjoyed or incurred by Centra as a result of such a venture could be to the account of Centra's non-fixed price consumers. Consistent with the concept of avoiding rate shock and dependent upon risk mitigation measures to be employed to reduce loss potential, the Board suggests that Centra could propose being allowed to amortize any gains or losses on fixed price gas supply contracts over five years. And, in any application it might bring, Centra could suggest that any costs incurred related to forward purchasing of commodity supply to reduce risk be included as a cost of any fixed-price program, similar to the approach to reasonable administrative and operating costs.

The Board assumes that Centra would enter the competitive retail market with the same capabilities as brokers with respect to hedging or forward purchasing of gas supplies to reduce the risk of losses on fixed price contracts. And, of course, if Centra were to enter that market it would be subject to a Code of Conduct similar to that the Board now ensures broker adherence to. Fixed-price contracts bring administrative difficulties and risks. Centra would have to be prepared to undertake the role effectively. The Board would examine Centra on this requirement upon it making an application.

Evidence at the hearing suggested that one possibility for a regulated utility offering fixed-price offerings would be for the competitive products to be separated from the regulated supply offering by means of the creation and operation of a subsidiary. The Board is not convinced, in advance of the testing of positions that would occur at a future hearing, that Centra would necessarily need to establish a separate subsidiary to administer a fixed price contract offering.

Overall, the Board is uncertain as to whether a fixed-price offering or offerings by Centra would be in the public interest. If Centra were to bring forward an application , the Board would, as suggested by Municipal, hold a public hearing at which Interveners and interested parties will be invited to participate. Given existing market circumstances, the Board encourages Centra to act in a timely fashion with respect to a decision to bring forward an application.

9.0 HEDGING PRIMARY GAS

9.1 Background

Centra's primary gas purchases are priced at wholesale market, or index prices. Centra also leases seasonal storage facilities towards optimizing its firm transportation contracts on the Trans-Canada pipeline system. The use of storage assists in managing rate volatility, with gas stored over a seven-month "summer" season, purchased at seven distinct market prices, only to be withdrawn to meet supply requirements during the five month "winter" season.

Centra's Derivatives Hedging Program for primary gas has the goal of reducing consumer rate volatility. The approach has been consistently applied since 2001. The parameters of the current program are based in part on research into customer preferences carried out in 1998 and 2004

Prior to this Order, Centra's hedging activities were confined to up to 90% of its primary gas supply requirements (taking into account that 20% of the residential market is supplied by brokers) out by month to one year, with supply requirement estimates based on the "warmest year." Total volume hedged is below 90% when the average temperature, as determined by the use of degree-days, is lower than the warmest year on record. Applying the current 90%-approach to the volumes in a "normal" year results in approximately 60% of Centra's primary gas requirements now being hedged. Primary gas accounts for approximately 99% of all natural gas consumed within Centra's distribution footprint in a normal weather year.

Centra limits its hedged volumes to reduce the likelihood that it will hedge more volumes that it requires for actual supply. Because it places its hedges, with prior hedging having secured months through to 9, for months 10, 11 and 12, it relies on estimates of requirements for primary gas up to twelve months forward.

Centra's hedging approach assures only that, for the supply hedged, the supply cost will fall within a narrow price range; it does not seek to reduce overall gas costs for the long-term. The current objective is to reduce volatility, not long-term prices.

In Order 131/04, the Board directed Centra to review alternatives to its current hedging approach. The review was to consider goals with respect to achieving and/or maintaining reductions in volatility <u>and</u> costs, the current approach targets reductions in volatility alone, and Centra was to test alternative approaches on a retrospective basis.

While a Revised Derivatives Hedging Policy was filed in the recent GRA, the requested report, entitled *Retrospective Review of Derivative Hedging Program for Primary Gas*, which includes retrospective modeling, was not filed with the Board until after the hearing.

At the recent GRA, Centra proposed to revise its derivative hedging policies and procedures to incorporate a level of discretion. Centra would hedge up to 100% of eligible volumes, up from 90%. At 100% rather than 90%, Centra would hedge approximately 70% of its primary gas supply needs in a normal degree-day weather year, rather than the current 60%.

Conceptually the revised policy would also provide Centra, with the approval of its Executive Committee, the authority to hedge less than 100%, in fact to go so far as not to hedge. However, that is not the understanding of the Board as to Centra's intentions.

The Board observes that if Centra were to hedge less than 90% of eligible volumes under either the current or the proposed revised policy, the Board would expect not only that Centra's Executive Committee had pre-approved the change but also that the Board would be notified. Though such a move might be appropriate in certain circumstances, and considered actively with a policy change and assured adequate expertise, hedging less than 90% of eligible volumes is, for the Board, outside the parameters of the current hedging program..

Centra plans to continue to use its present hedging instrument (an approach assuring a price for the volumes hedged within a narrow $0.50 range). However, under the proposed revised policy Centra would not only be able to hedge less than 90% of eligible volumes but would discretion with respect to the hedge instrument, the price range secured, and the percentage of volumes hedged. Discretionary actions would require the prior approval of its Executive Committee, and be subject to the understanding outlined above.

Centra once again confirmed that its hedging approach was intended to mitigate volatility, and could not be expected to produce actual gas supply cost savings over the long-term. In fact, over the long-term, when the operating costs of the program are taken into account, Centra reported that its mechanistic hedging program could be expected to result in net costs (i.e. higher costs and rates) than would have been the case if no hedges had been placed.

9.2 Intervener Positions

Noting that Centra's approach had the objective of reducing volatility and not supply costs and rates, CAC/MSOS recommended Centra cease its mechanistic hedging approach because of the placement and administrative costs involved in the process.

CAC/MSOS advised that consumers preferred the achievement of reduced costs rather that reduced volatility, and that volatility was adequately constrained through the monthly budget plan and variance accounts.

CAC/MSOS noted that actual primary gas supply costs had been secured through the mechanistic hedging approach now in place, but only because prices had risen through the period. Its position can be summed up and paraphrased as "we have won in the past, so let's stop the practice before it goes the other way and leads to higher than necessary gas supply costs in a future period."

9.3 Board Findings

The Board notes that the report containing the retrospective modeling was filed after the completion of the hearing, meaning Interveners have not had the opportunity to provide their comments to the Board. The Board observes that the retrospective modeling did not test the hypothesis of a falling commodity price market. The Board will welcome comments from Interveners and/or other interested parties. and though planning to review the report at the next Cost of Gas hearing, the Board is unsure if such a delay is acceptable to Interveners and in the public interest in the current circumstances.

The market has more or less continually climbed from 1999 to September 2005; will it continue to climb? If it does not and actually declines, mechanistic hedging to reduce volatility will result in higher primary gas costs than would be the case if no hedging took place.

The Board seeks the views of Interveners on this point, and on the report itself.

Nonetheless, and given the importance of the issues involved and recent commodity price volatility, the Board provides tentative and preliminary comments below. The Board would not leave a Centra recommendation to amend its hedging practices unanswered when commodity price fluctuations are rapid, price movement strong and the current mechanistic approach remains in place.

Firstly, the Board notes that Centra's revised hedging policy provides for management discretion, and extends the potential hedging coverage to 100% of eligible volumes. This change may increase volatility protection but does, at least conceptually, introduce a significant factor of management judgement.

In advance of further review subsequent to receiving Intervener comments, the Board will approve the revisions to the Derivative Hedging Policies and Procedure *on the basis that the intent is to provide discretion within a range of 90% to 100% of eligible volumes*. As well, the Board will study the report filed and direct further questions to Centra.

The Board appreciates CAC/MSOS' concerns with the current mechanistic approach and its focus on reducing volatility rather than the reduction of overall supply costs. And, while the Board understands the value of reducing volatility, it notes that even in the discretion provided under the new policy within the range of 90% and 100% of eligible volumes the "mechanistic" nature of the current approach has been varied and a degree of management discretion added.

While the Board appreciates Centra's understandable desire, particularly given a past negative hedging experience that occurred prior to MH's acquisition of Centra, to avoid "market timing", the Board is unsure as to whether the avoidance of risk is always in the public interest.

Under the current approach, commodity price movements are followed "mechanically" whether price movements are up or down. The present approach has produced $30 million in aggregate gas supply savings for Centra's primary gas customers over the last three fiscal years. These savings have arisen only because the direction of the commodity price has been steadily "up". What happens if prices move down?

The Board suggests that the extended experience of steady price increases may not necessarily continue. The Board is unsure as to whether sound judgement during a period of very high prices might include <u>not</u> placing mechanistic hedges, or reducing the volumes hedged to below the current policy range, to allow for falling prices to benefit consumers.

Centra doesn't mark up its commodity costs. While this represents a benefit for consumers if gas supply costs are prudent and economical, it may also lessen Centra's incentive to achieve as low net costs as possible. Centra is a monopoly, and within Centra resides the local gas market expertise. So, the question is whether that market position and expertise is best utilized for the long-term benefit of consumers through the mechanism of mechanistic hedging practiced only to reduce volatility?

The Board is not certain that mechanistic hedging of up to 100% of eligible volumes (weather normalized, about 70% of primary gas would be hedged with 30% of normalized volumes left to the vagaries of the market) for the sole purpose of reducing volatility represents best practice. The nature of business is risk, and managing risk is a critical skill for all enterprises. There is no fully management of risk in following a mechanistic approach. The Board has noted differing practices at other natural gas distributors.

Faced with exceptionally high prices during last fall's hurricane season, another utility took on risk and did not place the hedge its policies require it to do. The utility determined it was in its customers' best interest not to place the hedge, and to await "normalized" pricing. When that condition developed to its reasonable satisfaction, the hedge was placed. That strategy may have backfired.

Was this practice *risky?* Yes, but it did demonstrate an over-riding desire of the utility to utilize their expertise in the making of judgment calls in their perspective of what was in their customers best interest. In this case, the Board accepted the utility's action, with the realization that the delay may prove costly. Fortunately, it did not.

The Board considers the most current price spike in the market, and is concerned that prices may drift down while Centra's mechanistic hedging approach will lock in the high prices meaning no benefit to consumers for the period of the hedge if prices do drift down.

If current prices were considerably lower, say in the $5-6/GJ range, the range of only a year ago, it is unlikely the Board would raise this issue at this time. But with futures prices having recently exceeded $14/GJ USD, driven by hurricanes (Katrina and Rita) and continuing American production concerns ahead of the heating season, the Board is uneasy with the prospects of hedging out mechanistically at the time of a possible "bubble." Any possible change in approach requires an assessment of the experience and training of MH employees available to handle the responsibilities.

Hyperinflation has been followed by periods of disinflation, lower prices, in the past, particular when the underlying cost of production and transportation are so much lower than the current price. As previously noted, the Board understands that past weather-induced price crisis have ended with quickly reducing prices once the supply-demand balance was restored. And, with alternative fuels available to some major natural gas consumers, prices at current levels could lead to fuel switching and conservation measures assisting price reductions.

Again, the Board seeks the views of Interveners, Centra, and other interested parties, and is prepared to open up the hedging question and policy for review now, rather than wait until 2006 and the next Cost of Gas hearing.

10.0 REGULATORY METHODOLOGY –RATE BASE RATE OF RETURN VS. COST OF SERVICE

10.1 Background

Centra’s rates include recognition of costs incurred to provide gas and service and a return on Centra’s shareholder’s equity for the benefit of MH, its parent corporation. Establishing rates begins with the determination of revenue requirement (i.e. the revenues required by the utility to meet its costs and provide a return on the investment in it by its owner). There are two methodologies generally utilized by regulators for determining a regulated utility’s revenue requirement.

The *Rate Base Rate of Return* methodology is generally applied and has been in use with respect to Centra both before and since MH’s acquisition of Centra. The other methodology in use is the *Cost of Service* approach, an approach employed with respect to MH and electricity rates and also with respect to Centra’s natural gas rates.

10.2 Rate Base Rate of Return Methodology

Under the *Rate Base Rate of Return* regulatory model, the major determinants of revenue requirement and customer rates are the investment in assets (investment in plant net of accumulated depreciation plus a working capital allowance), forecasted gas and other costs, shareholder's equity and the allowed rate of return on equity.

The regulator determines the allowable rate base, and may disallow a component of the utility's assets and/or incurred costs. Since MH's acquisition of Centra, neither assets nor costs have been disallowed by the Board, though assets and costs related to a smart metering project, as indicated below, have not been allowed to be included within the Rate Base or costs at this time.

As previously indicated, revenue requirement includes allowances for both forecasted gas and other costs and an overall allowed rate of return on allowed rate base (assets). This rate is a combination of an allowable rate of return on shareholder's equity as well as an allowable recovery of interest on the debt component of a utility's capital structure.

As to the allowable interest rate on debt, the regulator looks to the utility's costs as well as to market conditions. The regulator also looks to the utility's debt:equity mix, and may determine that the mix is inappropriate and establish an imputed debt:equity mix that is different than that actually in place.

In summary, the rate of return on rate base takes into account four factors: debt and shareholder equity, interest rate on debt, and the allowable rate of return on shareholder equity. In the end, under the *Rate Base Rate of Return* method rates are established by consumer class taking into account costs plus the allowed rate of return on rate base (rate base times the allowable rate of return).

In short, revenue requirement and rates are developed to take into account costs incurred by the utility that are acceptable to the regulator plus an allowable return on rate base reflective of financing related costs and a return on shareholder's equity.

The approach is most successfully employed when dealing with private owned utilities, where the rate of return allowed to the utility and its shareholders has to be within a range acceptable to the general investment market so as to motivate investments in utilities.

Generally speaking, private utilities are interested in maximizing shareholder value, whereas Crown corporations or utilities owned by Crown corporations are focused on recovering costs (not only of the utility but also of its parent) and having sufficient retained earnings to limit the risk of customer rate shock.

10.3 Cost of Service Methodology

The *Cost of Service* regulatory model for determining revenue requirement and rates is similar to the *Rate Base Rate of Return* model in many respects.

Revenue requirement under a *Cost of Service* methodology takes into account forecasts of finance expense and net income by management based on management judgment as opposed to a formulaic approach. The forecasts have to be acceptable to the regulator; if not, the regulator amends the forecasts in establishing revenue requirement and rates.

The focus under the *Cost of Service* model is allowable incurred costs and adequate retained earnings. Allowable costs, including allowable net income, form the basis for determining revenue requirement.

With respect to the level of net income allowable by the regulator in establishing revenue requirement, the regulatory test is not based on a rate of return allowed on rate base but the net income deemed by the regulator to be prudent with respect to the utility's financial health.

The Board's perspective on utility financial health views deficits negatively and assumes a prudent level of retained earnings to serve as a buffer against the risk of future untoward developments that, in the absence of retained earnings, would generate a requirement for a sharp rise in consumer rates.

In this case, Centra filed its rate application based on the *Cost of Service* methodology, which is consistent with the approach taken both by its parent and internal management reporting processes. As well and in accordance with the Board's direction, Centra filed information on revenue requirement prepared on the basis of the *Rate Base Rate of Return* model.

Centra's revenue requirement on a *Cost of Service* basis, the approach used in Centra's revenue requirement and rate proposal, was less than that developed using the *Rate Base Rate of Return* methodology.

Centra opined that, given this, the Board had sufficient grounds for supporting Centra's proposed rates, as those rates were less than would have resulted in the *Rate Base Rate of Return methodology* was applied.

10.4 Intervener Positions

Intervener positions taken at this summer's public GRA hearing were discussed in detail in Order 103/05. A brief summary of those positions follows below:

Interveners suggested that if the Board accepted the use of the *Cost of Service* regulatory model this would infer a harmonization of regulatory oversight between the regulatory approach taken to Centra and MH. The Board jurisdiction over Centra's operations is considerable more extensive than is the case with MH's electricity operations.

With respect to Centra, the Board has statutory authority for an oversight that extends beyond revenue requirement and rates and includes the approval of capital expenditures, expansions and operating matters; this is not the case with respect to MH.

Concerned that the Board's more extensive regulatory oversight of Centra would be jeopardized with the adoption of the *Cost of Service* regulatory model, CEPU recommended there be no change to the regulatory environment. CEPU held that the level of Board oversight now exercised over Centra activities was appropriate and had ensured safe and reliable natural gas delivery, a situation CEPU wants to continue.

From CEPU's perspective, the *Rate Base Rate Base Rate or Return* regulatory approach better supports a continued Board testing of Centra management's judgment, which CEPU holds has the effect of motivating better management decisions. In CEPU's opinion, under a *Cost of Service* regulatory model this level of regulatory oversight would be lost.

CAC/MSOS cited past Board decisions, The Public Utilities Board Act (the Act) and case law in joining CEPU in support of the continuation of the *Rate Base Rate of Return* regulatory framework as opposed to *Cost of Service*. As discussed in Order 103/05, CAC/MSOS adopted the evidence of its witness Mr. Matwichuk. He strongly recommended the continuation of the *Rate Base Rate of Return* approach on the basis that it would provide a) historic consistency, b) continuity and c) transparency.

Mr. Matwichuk also opined that the *Rate Base Rate of Return* regulatory approach provides an implicit incentive for utility management to improve efficiencies, exceed financial forecasts, and improve utility financial integrity. Mr. Matwichuk suggested that the *Cost of Service* approach did not offer such benefits.

Mr. Matwichuk cited an example from British Columbia as support for his contention, claiming that the methodology was preferable even when the utility is a Crown corporation.

He reported that subsequent to the nationalization of a number of electric utilities to form BC Hydro that BC Hydro, a Crown corporation, continues to be regulated using *Rate Base Rate of Return* methodology.

10.5 Board Findings

The Board notes the position taken by Centra and MH that *Cost of Service* is an appropriate method of regulation for Crown-owned entities. According to Centra, applying the model to Centra will be consistent with the regulatory model applied to MH and the way in which both Centra and MH are managed. MH has integrated Centra operations and MH's employees perform the required functions and services of Centra. As well, the members of MH's Board of Directors are also the members of Centra's board. Absent MH's involvement, Centra cannot be operated.

The Board notes the assurances provided at the hearing by Mr. Warden, MH's Vice-President and Chief Financial Officer that MH seeks only the return of its costs related to Centra together with such reasonable net income as the Board determines to ensure Centra's financial position is adequate for consumer protection. Rather than maximizing shareholder value, the expectation for private shareholder-owned companies, MH reports seeking safe operations and reasonable customer rates.

Given the commitments of the operator of Centra, MH, the Board disagrees with CAC/MSOS and CEPU that *Rate Base Rate of Return* methodology is required for MH management to have a sufficient incentive to operate Centra in a cost-effective manner to the benefit of Centra's ratepayers.

The Board is comfortable with the *Cost of Service* methodology and has lengthy experience with the approach in its regulation of MH, Manitoba Public Insurance and municipal water and sewer utilities. The Board notes the published goals and objectives of MH, Centra's parent, and that these include references to cost-effectiveness and reasonable rates.

The Board's public hearing processes provides the Board and interveners adequate opportunities to review Centra operating decisions and results and test the results and forecasts against both experience and expectations.

Notwithstanding the Board's acceptance of the *Cost of Service* as an appropriate model for the regulation of Crown and municipal corporations, in this case the Board is also guided by its legislative requirements. While legislation requires that revenue requirement be determined on the *Rate Base Rate of Return* methodology, it also appears to provide the Board latitude to regulate Centra on a *Cost of Service* basis. However, to be prudent and given that Centra was acquired by MH in 1999 under the understanding that Centra ratepayers would not be negatively impacted by the acquisition, the Board intends to apply both regulatory approaches to ensure Centra's revenue requirement is fairly and properly determined.

And, notwithstanding acceptance of *Cost of Service* as the primary model for determining revenue requirement and rates, the Board accepts the argument that it is vitally important to maintain the current level of regulatory oversight over Centra, a legislatively based oversight that differs markedly from the Board's oversight of MH. This oversight extends to capital expansions, the delivery of safe and reliable natural gas service, and other operating matters. The Board notes that one of the factors leading to its approval of the acquisition of Centra by MH was the higher level of regulatory oversight provided by the Act to the Board with respect to Centra and natural gas operations.

The Board sees every reason why the *Cost of Service* approach, supplemented and tested with continued *Rate Base Rate of Return* comparisons of revenue requirement should be accompanied by a continuance of the current Board oversight of capital expenditures and other gas operating matters. Experience with the regulation of MH's electricity operations, where that same breadth of regulatory oversight is not provided for, has indicated to the Board the difficulties associated with establishing rates without specific oversight over the capital expenditures that play a large role in the determination of net income and rates.

In the case of MH and electricity rates, the Board can disallow the recognition of certain capital or other expenditures in the determination of revenue requirement. While this provides for a certain level of comparable oversight to the Board's jurisdiction with respect to natural gas and Centra, the Board is cognizant that the effects of disallowance with respect to MH and electricity have implications that devalue the option. This is particularly the case with respect to the ability to approve or disapprove of capital expenditures before they are made.

MH and Centra are Crown-owned; there is no external shareholder that can be held accountable and penalized for imprudent expenditures without impact on Manitoba ratepayers one way or another.

When Centra incurred heavy losses from derivatives trading prior to MH's acquisition, the Board disallowed a major portion of the losses in rates and, by so doing, penalized Centra's private owner by reducing the dividend potential of Centra. With MH now the owner, disallowance after the fact is not harmless for Manitobans.

Accordingly, the Board will direct that future General Rate Applications by Centra continue to be filed using *Cost of Service* to calculate revenue requirement and *Rate Base Rate of Return* to test that result, and continue broad oversight over Centra's operations. As well, the Board will, if legislative amendments are proposed in future prescribing *Cost of Service*, recommend that the Board's oversight of gas operations remain as is.

In Order 103/05, the Board stated that the return to MH as determined under *Rate Base Rate of Return* is to be the absolute limit for shareholder returns. That return may take the form of an annual corporate allocation by MH against Centra and/or Centra's annual net income result. Regardless of the division between corporate allocation and net income, it is the Board's determination that the *Rate Base Rate of Return* methodology is to be used as a test of maximum revenue requirement.

The Board accepts and approves the adjusted Rate Bases filed by Centra for the 2005/06 and 2006/07 test years respectively, once amended to reflect the Board's position on the AMR project.

In Order 103/05, the Board approved certain non-commodity based rate increases to be effective August 1, 2005 and May 1, 2006. The rate increases were determined using evidence put forward by Centra based on a C*ost of Service* approach tested against the *Rate Base Rate of Return* test.

Again, the Board intends that rate increases approved by the Board will not produce revenue requirements in excess of the annual revenue requirement determined by the Board under *Rate Base Rate of Return* over the long term. Through reliance on both regulatory approaches, the Board's regulatory objective of fixing just and reasonable rates in the public interest will be furthered.

At the GRA, the issue of a potential amalgamation of Centra with MH was briefly raised. As previously indicated and also as discussed in some detail in Order 103/05, MH has integrated the functions and services of Centra within its overall organization. One staff, one management and one Board of Directors manage and operate MH and Centra, within MH's organizational structure.

MH employs a complex cost accounting approach by which the direct and indirect costs attributable to natural gas operations are allocated to Centra. As well, MH is now making a $12 million annual allocation against Centra. The allocation together with administrative and operating savings enjoyed by MH arising out of the integration of Centra, meet the annual costs incurred by MH to amortize and finance the acquisition. Thus and to-date, neither electricity nor gas ratepayers have been negatively impacted by the acquisition.

Despite the operational integration, Centra is an incorporated company that is regulated separately from MH by the Board. Direct and indirect regulatory costs ensue as a result of separate Centra and MH applications for rates and other direction.

Since its 1999 acquisition, Centra rate hearings have included considerable discussion and review related to ongoing assessments of the cost-effectiveness and value of the acquisition from the perspective of Centra and MH ratepayers. Concerns have been raised and tested, and commitments of mutual benefit for MH and Centra customers made and reiterated by MH.

The Board is satisfied that the acquisition of Centra by MH has not damaged the interests of either Centra's or MH's customers. While it is possible that major future events could change this assessment, the most notable event perhaps being the allocation of costs and benefits arising out of the construction of a new MH head office, whether or not Centra remains separately incorporated and regulated does not necessarily affect the Board's ability to make an assessment of value.

In the past and at the most recent GRA hearings, the potential for the legal amalgamation of Centra and MH has been raised. The Board notes that current legislation allows for the Centra to apply to the Board if an amalgamation with MH is sought. Regardless of the potential for a future amalgamation, a requirement for separate records to support future rate applications related to electricity and natural gas service will remain.

The Board notes that there may be a business case to be made for an amalgamation, perhaps to seek further operational and regulatory process savings, that that case would require testing in an application. And, it is increasingly clear that natural gas and electricity are linked with a) electricity being used as feedstock by the export customers of MH (affecting electricity net income), and b) with Manitoba natural gas usage providing for higher levels of electricity export sales.

As discussed previously and similar to the Board's position with respect to the use of the *Cost of Service* and *Rate Base Rate of Return* regulatory mechanisms, the Board concludes that regardless of corporate structure the current regulatory oversight provisions related to natural gas should be continued. From the Board's perspective, the continuance of its oversight provisions with respect to natural gas is in the public interest. Provided that the Board's conclusions on regulatory oversight, future segmented accounting, and a continuation of commitments made at the time of Centra's acquisition remain operative, if MH wishes to amalgamate Centra within MH to achieve savings and productivity improvements, the Board would consider an application.

Such an application should include the full details of the amalgamation proposal along with a listing of advantages and disadvantages, if any and from the perspective of the Board and ratepayers as well as MH. If an amalgamation were to be proposed, and there is no current indication that this will occur, the Board would establish a process in which Interveners and other interested parties would be provided an opportunity to participate.

In any case, whether amalgamation is proposed or not, the Board is of the view that future natural gas GRA hearings should take a very economical approach with respect to further assessments of ratepayer value arising out of the acquisition. Now, six years after the acquisition took place, and with functions, staff and responsibilities fully merged, the degree of difficulty associated with evaluations of the acquisition from the perspective of Centra and MH ratepayers separately is such that the exercise will be of questionable merit. In Order 103/05, the Board accepted that neither the interests of MH's electricity or Centra's natural gas customers have been harmed by MH's acquisition, and that the commitments made by MH at the time of acquisition have been honoured. That being said, if specific issues arise in future hearings that have implications as to the relative well being of either set of customers as compared to the other, the Board will review the matters and encourage interveners to do the same. In fact, the Board will raise one such matter in this Order, the question of the potential for electricity operations subsidizing natural gas, as discussed in a later section below.

11.0 CORPORATE ALLOCATION AND ACQUISITION ISSUES

11.1 Background

MH acquired Centra in 1999 for $241.9 million, and the price included a premium of $121 million over book value which was comprised of $65 million in goodwill and $56 million in net asset write-ups (revaluation of fixed asset values). MH also incurred acquisition and integration costs of $11.9 million, bringing its total cost of acquiring Centra to $253.8 million.

In Order 208/02, the Board stated:

> "The shareholders of Hydro initiated the purchase of Centra. The ratepayers of Hydro and Centra should be held harmless as a consequence of the Transaction. Therefore, the risks and benefits associated with the Transaction and the Integration should accrue to the shareholders of Hydro."

The Board did not accept MH's recommendation that all costs associated with the acquisition and integration be recorded in the financial statements of Centra, and directed MH to account for the Acquisition Transaction and the Integration Costs in the books and records of MH for regulatory purposes. This directive had no impact on MH's consolidated financial reporting, but resulted in appropriate financial reporting for each separate utility for regulatory purposes.

In the GRA of 2002 (Order 208/02), MH's electricity customers were assured that synergy savings and a return to MH representative of the return on Centra's shareholder's equity granted Centra's former owner would offset MH's acquisition related financing costs.

Neither electricity nor natural gas consumers were to suffer from the acquisition.

In Order 208/02, the Board noted that Centra's then-rates included a component for rate of return on shareholder's equity. The Board held that the continuation of an allowable return on shareholder's equity plus realized synergistic savings would be sufficient to allow MH to recover its acquisition and related costs. The Board still holds this to be the case.

In the recent GRA, MH revised downwards its estimate for the annual costs of amortizing and financing its acquisition of Centra to $19 million. MH advised that with the revision and good synergy savings being realized MH, Centra would be held responsible for $12 million annually, an amount that would be further reduced if costs incurred by MH in integrating Centra were fully amortized.

Prior to the acquisition and under the former private ownership, Centra produced average annual after tax profits of between $14-16 million. Together with savings arising out of operational synergies, the assumption was initially and still is that MH would (and had) acquire(d) 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.

MH provided estimates of Centra's interest and operating savings arising out of and following its acquisition of Centra, and suggested that the aggregate annual savings approached or equaled the annual Corporate Allocation, further supporting the contention that Centra ratepayers had gained as a result of the acquisition by MH.

As reiterated in Order 103/05, Centra opined that it was essential to have a clear and transparent means of sharing acquisition costs between gas and the electric operations. Centra suggested that an annual Corporate Allocation is easy to understand, and represents a fair apportionment between gas and electric ratepayers of the costs MH incurs with respect to its acquisition of Centra.

By the annual Corporate Allocation, annual synergy and other savings arising out of and following the acquisition, MH reiterated its belief that neither electricity (MH) nor natural gas (Centra's) customers have or will suffer as a result of the acquisition.

11.2 Intervener Positions

Intervener positions regarding the Corporate Allocation and acquisition Issues were discussed in detail in Order 103/05.

CAC/MSOS opposed the combination of a Corporate Allocation and Centra's proposed allowable annual net income in revenue requirement. CAC/MSOS noted that in Order 118/03 the Board had established that an annual after-tax return on Centra's equity of between $14-$16 million would be available to MH.

CAC/MSOS argued that the $14.4 million net income Centra would include in 2006/07 revenue requirement, when combined with a $12 million Corporate Allocation, would provide an excessive return to MH. CAC/MSOS suggested that by providing access to

MH of Centra annual net income in the range of $14-$16 million would, together with expected synergy savings to be realized by MH, be sufficient to meet MH's ongoing costs associated with its purchase of Centra. For CAC/MSOS the Corporate Allocation was neither required nor warranted.

11.3 Board Findings

Centra had proposed that revenue requirement be established to include both the Corporate Allocation and an annual net income for Centra in the range of $14-16 million. This position supported Centra's application for a 2.5% rate increase as of May 1, 2006; as previously indicated, the Board approved only a 1% increase.

The Board agrees with CAC/MSOS that providing in Centra's revenue requirement annual net income of $14-16 million along with a Corporate Allocation by MH of $12 million would amount to an excessive return to MH. The Board agrees with CAC/MSOS that a total return to MH in the range of $14-16 million is adequate and, together with synergy savings, should allow MH to meet the annual costs of amortizing and financing its acquisition costs. For the Board, providing for a return of that nature requires only a rate increase of 1% as of May 1, 2006, and this was provided by Board Order 103/05.

In Order 103/05, the Board accepted the inclusion in revenue requirement of a $12.0 million annual corporate allocation. In that Order, the Board also found that the allowed return on Rate Base determined by the *Rate Base Rate of Return* methodology represented the absolute limit for a return to Centra's parent company. That limit applies whether that return be by way of net income (and, potentially, subsequent dividend) or by Corporate Allocation.

The Board remains of the view that the *Return on Rate Base* should, as long as the current legislation remains in place, continue to be used as a guideline over time to ensure reasonable rates are in place. The Board also continues to hold the view that it is important that the ratepayers of both MH and Centra are held harmless from MH's acquisition of Centra.

The Board remains of the view stated in Order 208/02 that the risks and benefits associated with the acquisition and integration of Centra by MH should accrue to the shareholders of MH, and that the acquisition should not result in any increase to Centra's ratepayers. This position is consistent with the commitment by MH at the time of the acquisition and continued through the recent GRA hearing.

The Board further notes that the Centra customers have realized significant benefits as a result of the acquisition transaction. Many of those benefits, both monetary and non-monetary, are discussed in detail in Order 103/05. And, the Board also expects that further benefits will accrue to Centra customers over time.

It would be unfair to MH customers if Centra rates did not include an allowed return to MH for its investment in Centra, just as the former private owner received a return.

With respect to regulatory efficiency and costs, as suggested previously, given the passage of time the Board agrees with the positions put forward by Centra and many interveners that it is increasingly difficult to quantify specific synergistic benefits realized by Centra as a result of the acquisition. In saying this, the Board notes that it should be recognized that significant benefits have accrued to Centra customers.

As a result, the Board approved the corporate allocation of $12.0 million for the 2005/06 and 2006/07 test years as requested by Centra. The Corporate Allocation, when combined with the allowed net income for each of the test years of no more than $3.1 million, is in the range of the total after tax net income allowed to Centra and its former private owner by the Board prior to the acquisition. This approach is consistent with the original intent of the transaction, the Board position enunciated in Order 208/03, and the position put forward by some Interveners at the most recent GRA and earlier hearings.

The Board expects that the appropriate net income level will be revisited in future Centra GRA applications if current circumstances change materially. However, the Board believes that there is no merit in pursuing the elusive issue of estimating realized synergistic benefits and projecting what would have been Centra's operating costs if the former private ownership had continued in future applications.

The passage of time and the continuing full integration of the gas and electric operations make it increasingly difficult if not impossible to track and isolate synergistic benefits from normal productivity gains and other factors.

The Board also notes the change evidenced in Centra and MH's assessment of MH's annual costs associated with the acquisition. In prior proceedings, Centra had determined the annual cost of the acquisition to be $20.9 million, calculated to eventually retire the $253.8 million debt related to MH's acquisition of Centra, with interest. The Board notes that MH now plans not to retire the debt, a decision that the Board accepts as Centra's business is assumed to have a continuing value. This reduces MH's annual amortization and financing costs related to the acquisition to $19 million ($17 million being annual financing costs related to the acquisition amount).

12.0 FINANCIAL TARGETS – DEBT EQUITY: RATIO AND RETAINED EARNINGS LEVEL

12.1 Background

The corporate structure of Centra for rate-setting purposes is identical to the actual capital structure based on Board approved methodology. The capital structure of Centra as reflected in the GRA was as follows:

	2005/06		2006/07	
	($millions)	**%**	**($millions)**	**%**
Long-term debt	250.1	56.3%	225.7	50.2%
Short-term debt	50.7	11.4%	73.7	16.4%
Equity	143.7	32.3%	150.3	33.4%
Total	444.5	100.0%	449.7	100.0%

Note: Centra's debt is due to MH, its parent corporation. As well, Centra's capital structure differs from MH's investment in Centra, which was entirely of debt.

Centra derived the capital structure weightings shown above by using Board-approved methodology, as follows:

1. total capitalization is calculated by averaging forecast year-end balances of the various types of capital;
2. equity is calculated based on the average of the forecast year-end equity balances;
3. long-term debt is calculated based on the 13-month average of Centra's debt issues; and

4. short-term debt is calculated by subtracting equity and long term debt from total capitalization.

In the rate application, Centra reported its consolidated capital structure from a MH perspective, with that including debt MH incurred to purchase Centra. Thus, Centra considered its consolidated debt:equity ratio to be 86:14, not the 68:32 ratio indicated above calculated on a stand-alone basis. Centra contended that it was appropriate to exclude Centra’s actual $121 million of share capital in determining the debt: equity ratio as the full acquisition price was financed by debt. Centra further opined that the appropriate debt:equity target ratio was that of MH, 75:25, and that as Centra now had a 86:14 ratio, as calculated on a consolidated basis, considerably more net income was required through revenue requirement and rates to allow Centra to reduce its debt:equity ratio from 86:14 to 75:25.

12.2 Intervener Positions

Intervener positions are discussed in detail in Order 103/05.

For discussion purposes only, CAC/MSOS accepted MH’s perspective on Centra’s debt:equity ratio to begin with, then questioned Centra’s need to meet a 75:25 debt:equity target, the same target as MH, given that Centra’s debt is guaranteed by the Province.

CAC/MSOS also questioned Centra’s adoption of a more “aggressive” time frame to meet the 75:25 debt:equity financial target than was in place for MH. The more aggressive time frame equated to the higher revenue requirement sought by Centra, than was approved by the Board.

CAC/MSOS adopted the evidence of its witness, Mr. Matwichuk, who disagreed with the manner by which Centra calculated its debt:equity ratio. CAC/MSOS stated that at acquisition Centra had $121 million in shareholders equity, of which $82 million represented retained earnings converted into stock. CAC/MSOS stated that the debt MH assumed to acquire Centra was the debt of MH, not Centra.

CAC/MSOS claimed the "Stand Alone Principle" was a long-standing regulatory principle, and that the financial circumstances of the owner should not be considered when determining the level of the equity within a subsidiary utility. Mr. Matwichuk stated the method used by Centra to calculate the equity component of its debt:equity ratio was not consistent with the approach of other utilities in Canada, the financial community or credit rating agencies. CAC/MSOS supported its position by filing several examples from other jurisdictions.

CAC/MSOS urged the Board not to abandon the "Stand-Alone Principle" in assessing Centra's financial structure, debt:equity ratio and rates.

Based on Centra's filed Integrated Financial Forecast, Mr. Matwichuk calculated Centra's forecast debt:equity ratio on a stand alone basis for the two test years to be 63:37, and noted that the ratio was in excess of MH's 75:25 debt: equity target, and thus Centra's revenue requirement as sought was not required.

12.3 Board Findings

The Board accepts Mr. Matwichuk's opinion and CAC/MSOS' position, and rejects the arguments put forward by Centra that $121 million of its share capital should be excluded from Centra's debt:equity ratio. The Board understands the stand-alone principle advanced by CAC/MSOS' witness, and agrees it is supported by decisions in other regulatory jurisdictions and the Board's judgement.

The Board also notes that Centra's position with respect to the $121 million and its proposed exclusion from the debt:equity calculation is not consistent with Centra's own calculation for purposes of determining revenue requirement on the *Rate Base Rate of Return* methodology, where the equity component as reported by Centra included $121 million of share capital. The Board notes CAC/MSOS' calculation indicating a debt:equity ratio of 63:37 for the two test years.

At any rate, the debt equity discussion is only relevant in determining the need for and appropriate level of any required rate increase.

The Board notes that Centra incurred annual losses after taking into account MH's Corporate Allocation in fiscal years 2002/03, 2003/04 and 2004/05. These losses have reduced Centra's retained earnings to approximately $20 million, a level significantly less than was present prior to acquisition and insufficient for a corporation the size and complexity of Centra.

The Board observes that if MH had begun with annual Corporate Allocation charges against Centra from the first year of its ownership, Centra would be in an accumulated deficit position. The retained earnings that developed between the acquisition and March 31, 2002 arose because MH did not make the charge in the initial years of its ownership. (When MH acquired Centra, a financial reorganization took place. Fixed assets were written-up in value, and retained earnings were converted to share capital to begin the MH ownership with Centra having no retained earnings.)

Although the Board rejects the debt:equity calculation proposed by Centra, the Board has approved revenue requirements and rate increases in Order 103/05 that should lead to marginally improved Centra's retained earnings. Any risk to Centra customers from possible future rate instability was mitigated by the rate increases, the Board's acceptance of Centra's incurred costs, and confirmation of a stand-alone debt:equity ratio for Centra.

Centra incurred losses in 2002/03 and 2003/04, so the only "return" to its owner, MH, was through the Corporate Allocation, which did not exceed the $14 – 16 million range accepted previously. With respect to the period from the date of acquisition through to the start of the 2002/03 fiscal year, MH did not directly benefit financially from its acquisition of Centra. And, Centra's revenue requirements and rates for that period were lower than might have been acceptable to the Board if a rate application had been made.

That being said, the now-regular annual Corporate Allocation, an expected return to annual profitability for Centra, and increased annual synergy savings arising for MH as a result of the integration of Centra are sufficient to allow the claim that MH customers have not been financially disadvantaged from the acquisition.

13.0 NATURAL GAS STORAGE

13.1 Background

On August 1, 2005, following the GRA hearing, and in response to Order 103/05, Centra filed a report on the development of salt cavern storage based on the conclusions of an earlier IGC study. ICG is a respected American gas and energy consultant that was engaged by Centra on the Board's direction to review Centra's gas supply issues.

Centra has periodically reviewed the potential of adding salt cavern storage in Saskatchewan to its gas supply portfolio mix, its current storage facility is in Michigan. The two areas of potential benefit that have been the focus of study are the enhancement of Centra's security of supply and the potential achievement of lower overall gas supply costs.

ICG submitted a report that was filed with the Board and discussed at the 2004 Cost of Gas hearing. The report contained recommendations related to supply purchasing and contracting, transportation and storage. At that hearing, Centra indicated that it was not prepared to act on ICG's recommendations, but would await further and future market developments before taking on a longer-term stance on many of the issues raised.

In its most recent internal review, shared with the Board and Interveners, Centra again submitted that the potential benefits of salt cavern storage, a major ICG recommendation, were enhanced security of supply and annual gas cost savings. However, given current uncertainties in the market place and the estimated cost of the development ($76.6 million), Centra concluded that it would not pursue salt cavern storage at this time.

Centra has indicated that it has an under-contracted capacity of approximately 44,000 GJ per day given a peak day winter requirement of approximately 465,000 GJ, with the supply risk confined to no more than 28 non-consecutive days. That being said, Centra does not consider itself at risk to acquire its gas requirements, this due to surplus capacity on the TransCanada pipeline – capacity that Centra does not anticipate will disappear. In short, Centra reports an ability to manage the under-contracted situation, though with some price risk.

Centra indicated that it would continue to monitor future developments in the natural gas industry to ensure a safe and reliable supply of natural gas to Manitoba.

With respect to its gas supply purchases, consistent with its view as expressed at the Cost of Gas hearing, Centra did not act on ICG's recommendation to purchase gas from more than one supplier. ICG has also recommended the purchase be for varied terms. However, following a tender, Centra chose a single supplier for a two-year supply contract. At the recent GRA hearing, Centra indicated that it had renewed that arrangement, and was still reluctant to implement ICG's recommendations on gas supply in uncertain market times when it remained unconcerned as to supply capability.

13.2 Intervener Positions

Stating that it was disappointed that Centra had not filed its internal review of the IGC Report for the GRA hearing to allow for a examination, Municipal urged a public review of Centra's internal report be undertaken once it was filed (it was filed on August 1, 2005).

ESMC submitted that Centra's internal review of the IGC Report should be shared with the Interveners and reviewed in a public process.

13.3 Board Findings

The Board requests that interested parties submit their views on the internal review report filed by Centra no later than October 31, 2005. The Board will then determine the type of regulatory process to put into place in order to deal with this issue.

The Board notes recent market developments and commodity price volatility, and believes that comments on the report from Interveners will be helpful to the Board as it assesses its process options and timing.

14.0 OTHER MATTERS

In Order 103/05, dated July 12, 2005, the Board dealt with a number of Centra's responses to other Board Directives from previous Orders. The Board reached decisions on several matters, determined further discussion was warranted on others, and directed Centra to file material related to certain of its other previous directives.

For some of these matters, the Board provides additional comments.

14.1 Integrated Natural Gas and Electricity Bills

In Order 103/05 the Board stated:

"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 Board prior to such information being released to the public."

The Board concluded on the requests of ESMC and Municipal that their logos be on the bills and space be provided for broker advice, denying both. The Board directed Centra to file for Board approval the final draft of the one-bill format along with draft notices to the public thirty days prior to such information being released to the public.

The Board will review the information along with any comments from Interveners and may provide final approval.

14.2 Connection Fees and Extensions

With respect to Centra's practice of requiring up-front connection fees prior to undertaking a major system expansion, Centra proposed to end the practice and, in Order 103/05, the Board stated:

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

Accordingly, the Board approved Centra's proposal to phase-out the connection fees in accordance with Centra's proposed timetable. The Board has the view that the substantial natural gas commodity price increases since MH's acquisition of Centra have substantially impaired major expansion prospects for Centra's natural gas distribution network.

Whether the situation will improve in the future is unclear, but, for now, requiring connection fees to pre-fund major system expansions, as previously approved by the Board, is not conducive to the prospects of acquiring new Centra customers.

As well, during the GRA hearing Centra filed feasibility tests for main extensions in excess of 500 meters constructed since the 2003/04 GRA. The Board has reviewed these tests and, being of the view that all expansion cost and revenue parameters were properly met, will approve the results as filed by Centra.

The Board continues to expect Centra to file feasibility tests, even in the absence of a GRA.

14.3 Schedule of Hourly Rates (Service Charge Amendments)

In Order 103/05 the Board stated that it was satisfied with Centra's proposed approach to customer service charges as submitted in the GRA. The Board approved Centra's proposed amendments to its customer service charges attached as a Schedule to Centra's Terms and Conditions of Service and considers this matter need not be further discussed at this time.

14.4 Capacity Management

At the recent GRA, Centra responded to the Board's concern with Centra's approach to including Capacity Management revenues in the determination of rates. Centra proposed to include estimated Capacity Management revenues in the cost of gas forecast and have them embedded in the Base Rates, and to distribute the revenue to the various customer classes through cost allocation model.

Centra also proposed to maintain a deferral account to capture the difference between forecast and actual Capacity Management revenues, any balance to be distributed on an annual basis in conjunction with the annual Cost of Gas proceeding.

The Board approved Centra's proposal and plans to review the first year results of the new approach at the next Cost of Gas hearing. Just as future gas costs are embedded in rates, the Board believes Capacity Management revenue estimates should be so included to the benefit of consumers.

14.5 Four-Party Trench System

In Order 103/05 the Board stated:

"The Board considers costs of the Four Party Trench installation, which 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."

Accordingly, the Board directed Centra to cease all gas pipe line installations using the four party trench method as of December 31, 2005, unless and/or until Centra can satisfy the Board that savings can be realized without incurring greater risk to public safety.

Given the potentially explosive nature of natural gas, safety is to take precedent over an objective to achieve operating savings unless there is clear evidence that estimated savings are significant and demonstrably achievable and that safety is not compromised.

14.6 System Safety

The Board made a number of observations with respect to Centra's responsibilities for system safety and integrity, pursuant to *The Gas Pipe Line Act.* Notwithstanding the Board's statutorily based oversight role with respect to pipeline safety and its ongoing assessment of and involvement with Centra pipeline construction and maintenance matters, the Board noted that the prime responsibility for safety rests with Centra. Centra is the operator of an extensive and complex gas distribution system and is directly responsible for arrangements with and supervision of employees and contracted agents involved in construction and repair.

The Board noted past deficiencies with respect to:

a) Centra's inspections of third party installations;
b) line-staking;

c) meeting cathodic protection targets; and
d) butt fusion pipeline experience.

That being said, the Board is encouraged by Centra's efforts to enhance safety and damage control, including its introduction of a formal Quality Assessment Process to be fully implemented in 2005. With respect to the latter, the Board notes Centra's assurances that the process will involve the continual testing, maintaining and updating of Standards and Procedures. The Board also noted Centra's citing of its Integrity Management System, another means by which future system safety and integrity may be better assured.

The Board encourages Centra to take action to minimize line-staking errors, to improve its inspection processes, and to recognize that safety targets are more important than net income forecasts. The Board notes that it is considering some devolution of Board oversight actions to Centra, but that regardless of this possible future transfer, Centra will retain the obligation to justify as safe any and all future proposed plant expansions to the Board's satisfaction.

The Board reaffirms its view that safety is of paramount importance, and that system integrity and safety expenditures, both operating and capital, are to remain one of Centra's top priorities. Natural gas is a dangerous commodity improperly handled, and requires careful operations and assessment.

The Board will continue to monitor system operations from the perspective of safety and system integrity.

14.7 Automated Meter Reading (AMR)

In Order 103/05, the Board stated, in part:

> "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 cost incurred for 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 noted the evidence presented at the hearing that meter reader activities extend beyond meter reading and include activities enhancing and supporting system safety. Given the importance of safety, the Board directed that the safety-related functions of meter readers be factored into the analysis of the value of the AMR approach.

Notwithstanding the Board's reservations about AMR, these concerning primarily the potential loss of safety assessments, the Board is concerned with the evidence presented at the hearing suggesting Centra's difficulties in entering system-served residences for the purpose of reading meters. Centra reported ongoing difficulties in gaining access to residences for meter reading. If actual readings cannot be taken, risks develop related to fair billings and collections as well as safety. For certain, billing integrity is jeopardized.

The Board understands from Centra's evidence that access problems are being encountered both with respect to owner-occupied and rented quarters, and urges Centra to develop approaches to counter and address the situation regardless of whether AMR is proceeded with.

Natural gas prices are very high and many households are experiencing difficulty in meeting their payment obligations. Regardless, preventing or failing to facilitate Centra access for meter reading purposes is contrary to the public interest and represents financial and operational risks for Centra and its other customers. The problems have to be addressed and resolved.

The Board encourages Centra to develop new means to address the problem, including the potential of increasing estimates when access is denied, developing recommendations related to landlord responsibility, and establishing more "outside" meters.

The Board will direct Centra to provide the Board with an update on the access issue by December 31, 2005, as well as an update on is AMR project.

14.8 Customer Education

14.8.1 Background

In Order 131/04, the Board directed Centra to consult with the private gas brokers and CAC/MSOS with respect to the content of its customer education material as related to customer primary gas purchase options. MH reported on a conference call it held with interested parties on January 21, 2005 and on a subsequent meeting with representatives from CAC/MSOS to discuss customer education. Centra indicated that a further meeting would be arranged, and undertook to provide the Board with a report on the results of the discussion.

In Order 103/05 the Board stated that

> "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."

14.8.2 Intervener Positions

Intervener positions were set out in detail in Order 103/05. CAC/MSOS expressed concern that customers are not aware of either their options or the consequences of signing up with a broker. CAC/MSOS urged the Board to direct Centra to put resources towards consumer education respecting the retail gas marketplace.

Municipal took issue with Centra's position that it should be permitted to promote its primary gas supply option to consumers. 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 should decide to embark upon a promotional campaign, the Board should require Centra to first apply to the Board for approval. Municipal wanted to involve the Board to ensure issues regarding the appropriateness of the campaign could be fully considered by all interested parties and, in the end, be determined by the Board.

ESMC disagreed that Centra has the authority to promote its regulated primary gas supply service, contending that a regulated Crown utility should be unbiased and financially indifferent with respect to which company supplies primary natural gas to consumers.

ESMC contended that it is important that customers be educated 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 be a one-time event. TREE/RCM proposed that Centra provide its customers with information and, perhaps, incentives towards making a choice of the most cost effective energy source.

14.8.3 Board Findings

Regardless of the product or products Centra offers or may offer, the Board is of the view that its customer education material should fairly list and outline all gas supply options available to consumers (fixed price as well as Centra’s product). Customer educational material should be comprehensive and factual, and provide consumers an informed opportunity to choose between the options for their gas supply based on full information.

References to Centra’s supply option in its educational material should clearly state that a consumer is also able to purchase primary gas from registered broker, and that while brokers operate pursuant to a Board-set Code of Conduct, the pricing of broker supply contracts is not regulated. Concurrent with these directions to Centra, the Board advises brokers that information they provide to consumers while promoting their service offerings should fairly indicate and report upon Centra’s system-supply option, and that consumers may remain with their firm or switch to “system-gas” at their convenience (subject to contract provisions).

Centra and the brokers should consult with each other and CAC/MSOS with respect to educational and/or marketing material intended for distribution in Manitoba, and copies of all material to be used for these purposes are to be provided to the Board at least fifteen days prior to use. The Board may choose to comment or provide direction with respect to such material.

In market conditions involving large and rapid commodity price changes, consumers require fair and full disclosure of the advantages, disadvantages and risks associated with Centra and broker offerings, and this information shall be provided in a factual and objective manner.

The Board endorses TREE/RCM's suggestion that Centra provide consumers with information related to consumer energy choices.

The Board notes that electricity is now the cheaper energy source for space heating when compared to conventional gas furnaces, and with limited exceptions is available off the grid throughout Manitoba. The current price of heating by natural gas may pose particular problems for Centra and brokers, when promoting or reporting on natural gas and their gas supply product.

14.9 WTS Service Report

14.9.1 Background

Centra provides Western Transportation Service (WTS) which allows customers to select private brokers as their supplier of primary gas. Customers selecting brokers no longer require Centra-supplied primary gas. Centra has a provision in its gas supply contract to allow for sufficient reductions from supply requirements to provide for broker replacement gas. The terms of Centra's supply contract with Nexen Gas Marketing Inc. were reviewed at the 2004 Cost of Gas hearing. At that hearing, Municipal expressed concern with the terms of Centra's contract and opined that Centra had not consulted sufficiently with the brokers to identify areas of concern prior to acting.

In Order 103/05 the Board directed Centra to review and file a report detailing possible changes to the Western Transportation Service (WTS). Centra was requested to indicate the benefits and costs of alternatives to Centra establishing the Maximum Daily Quota (MDQ), controlling daily nominations and reductions of daily nominations of direct purchase gas, and to list any options related to enrolling WTS customers more frequently than quarterly. Centra filed the "Report on Potential Changes to WTS on August 1, 2005.

Centra advised that it operates the WTS service to, as best as possible, mirror its activities related to the acquisition and operation of its system-supply gas approach. Centra advised that the Manitoba market has a low load factor, and the load is temperature sensitive. Centra reported that given its lack of local storage and given the market characteristics and weather particularities, re-nominations were required to ensure load balancing to avoid TCPL balancing fees. Centra suggested that the brokers' preferences were derived from experiences in the eastern market, which is notable for ample storage.

Centra concluded that the current WTS arrangements with respect to Centra establishing the MDQ, controlling daily nominations and reductions of daily nominations of direct purchase gas were in the best overall interests of Manitoba consumers, and should not be amended. Centra reported that it was necessary that it calculate broker related MDQ at 1.25 times customers' normalized average daily load, rather than closer to 1 time.

Centra also suggested that more frequent than monthly enrollment periods were possible but would result in significant incremental costs that should be borne by Brokers. Centra also indicated that the changes sought by the brokers would inappropriately affect the "level playing field" concept for the transportation of all gas supplies to Manitoba.

14.9.2 Intervener Positions

At the recent GRA, Municipal stated disappointment that Centra had not filed the report dealing with possible changes to WTS and urged a public review of report to be undertaken once filed. The report has now been filed.

ESMC stated that once filed the report should be vetted by all interested parties, and noted that limited information was provided prior to and during the GRA hearing. ESMC also held that interested parties should be encouraged to make submissions to the Board on this issue.

14.9.3 Board Findings

The Board appreciates that the report was filed after the completion of the GRA process and has not been reviewed by all interested parties.

The Board wants input from Interveners and, in the absence of direct request from Centra or an indication by a broker supporting a more timely review, will hold over the report for examination in conjunction with the 2006 Cost of Gas hearing.

15.0 IT IS THEREFORE RECOMMENDED THAT CENTRA:

1. consider enhancing the current objective for hedging by including a goal of reducing future primary gas costs and report to the Board by December 31, 2005;
2. amend the customer class structure to form a separate residential customer class out of the present SGS class;
3. be more aggressive with its DSM program with respect to the objective of bringing about enhanced space heat retention and heating efficiency for environmental, consumer cost and gas system viability reasons;
4. enhance its DSM measures with a focus on low-income residential consumers, revisit with the Federal government its positions with respect to the allocation of the $2.4 million in federal grants; and reconsider the loan interest rate and amortization period for DSM initiatives;
5. consider proposing “smoothing” when it brings forward its November 1 and February 1 primary gas quarterly rate applications to the Board; and
6. make an application to the Board for determination, through public hearing, as to whether it is now in the public interest for it to enter the retail residential fixed-price gas supply market.

16.0 IT IS THEREFORE ORDERED THAT

1. For purposes of rate determination, rate bases of $394.374 million and $405.494 million for the 2005/06 and 2006/07 test years, respectively, BE AND ARE HEREBY APPROVED;

2. For purposes of rate determination, revenue requirements of $554.947 million and $564.104 million for the 2005/06 and 2006/07 test years, respectively, BE AND ARE HEREBY APPROVED;

3. Centra provide copies of all responses to Board directives in Board Orders 131/04 and 103/05 to Interveners on record, with interested parties to provide comments and positions to the Board no later than November 15 or at such other date as is indicated herein;

4. Centra file future General Rate Applications using both the *Rate Base Rate of Return* and *Cost of Service* methodologies, the former to be used as a test of the maximum revenue requirement;

5. Centra report on its low- income and DSM proposals by November 30, 2005, including consideration of revising its DSM loan program terms and rates.

6. The revised Derivative Hedging Policies and Procedures as filed, BE AND ARE HEREBY APPROVED;

7. Centra bring forward an application for the November 1, 2005 primary gas rate setting after considering the Board's comments and concerns as expressed within this Order, the application is to be provided to the Board no later than October 20; 2005;

8. Centra provide the Board with its intentions with respect to a potential filing of an application to enter the fixed-price retail primary gas market, on or before November 15, 2005;

9 Centra complete its research concerning BMC for the LGS customer class, and file same with the Board by December 31, 2005;

10. Centra complete its research on 4-party trenches and submit a study with final conclusions by December 31, 2005;

11. Centra study and report on the concept of inverted rates within the context of its now-confirmed requirement to consider and support sustainable development goals and objectives, and include that report within its next General Rate application;

12. Future rate applications to be prepared with Centra's debt:equity calculation based on a stand-alone methodology;

13. Interested parties submit their views on Centra's Gas Storage situation, considering the internal review report that has been filed by Centra, no later than December 31, 2005;

14. Centra consider alternate means to address its problem of accessing meters for reading and safety purposes, update the AMR project, and report to the Board with findings and plans by December 31, 2005;15. Centra and the brokers consult with each other and CAC/MSOS with respect to educational and/or marketing material intended for distribution in Manitoba, and provide copies of all proposed distribution material to the Board at least fifteen days prior to use; and

15. The WTS report filed by Centra be held over for examination by the Board and interested parties in conjunction with the 2006 Cost of Gas hearing.

THE PUBLIC UTILITIES BOARD

"GRAHAM F. J. LANE, B.A., C.A."
Chairman

"G. GAUDREAU"
Secretary

Certified a true copy of Order No. 135/05
issued by The Public Utilities Board

Secretary