M A N I T O B A	**)**	**Order No. 175/06**
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THE PUBLIC UTILITIES BOARD ACT	**)**	**December 21, 2006**

BEFORE: Graham Lane, B.A., C.A., Chairman
Monica Girouard, C.G.A., Member
Alain Molgat, B.Comm, C.M.A., Member

DETERMINATIONS AND BOARD COMMENTS ARISING OUT OF CENTRA GAS MANITOBA INC. COST OF GAS PROCEEDINGS BEFORE THE PUBLIC UTILITIES BOARD

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1.0 EXECUTIVE SUMMARY

This Order arises out of a Public Utilities Board hearing held this November that mainly concerned Centra Gas Manitoba Inc.'s (Centra) natural gas commodity costs and related matters. While this Order does not change existing Centra rates, last established November 1, 2006, it does establish the parameters for a General Rate Application proceeding (GRA) which will address rates and other important topics.

By this Order, the Board:

a) approves Centra's gas costs for the 2005/06 fiscal year and confirms rates established by previous interim rate decisions;
b) directs Centra to file a General Rate Application (GRA) by February 28, 2007;
c) indicates that the GRA proceeding will consider:
   i) rate adequacy;
   ii) rate schedule and classification design;
   iii) the competitive natural gas landscape;
   iv) demand side management and low-income residential customers;
   v) environmental matters;
   vi) experience, single-bill initiative;
   vii) adequacy of the allowable annual return permitted to Centra and Manitoba Hydro;
   viii) gas safety; and
   ix) such other matters as may arise through the proceedings.
d) directs Centra to:
   i) continue with hedging employing "cashless collar" derivatives, but with a wider band;

ii) file draft amendments to the hedging policy, defining and elaborating on the special circumstances providing for a variance from “mechanistic” application of the hedging approach;

iii) improve the record keeping of Gas Supply Risk Management Committee and Executive Management Committee discussions related to gas supply;

iv) undertake additional research into consumer preferences with respect to hedging, the Equal Monthly Payment Plan (EPP), fixed-price fixed-term primary gas options, market competition, and, for high volume customers, the provision of lump sum refunds when balances owing to such customers develop;

v) file an estimate of annual costs related to Centra’s enabling of participation by retail natural gas brokers in the Manitoba market;

vi) file a business plan for Centra’s Capacity Management Program; and

vii) refrain from extending the commodity supply contract beyond October 31, 2009, to facilitate a review of requirements and options ahead of a long-term commitment.

The review of the natural gas landscape to occur within the upcoming GRA proceeding will consider a wide range of issues and options, including:

a) the business relationship between Centra and the natural gas brokers, and ways and means of improving that relationship to the benefit of consumers;

b) potential discontinuance of Centra hedging of primary gas supply costs and possible amendments to the quarterly Rate Setting Methodology (RSM) towards depressing rate volatility;

c) Centra offering fixed-price fixed-term primary gas supply contracts to consumers;

d) establishing the EPP as the “starting” or default condition for residential natural gas customers;

e) charging retail gas brokers for Centra’s costs associated with enabling broker competition; and

f) amending the existing regulatory cost assessment approach to include brokers.

2.0 APPLICATION

In September 2006, Centra filed the application that led to the November Cost of Gas hearing, which sought final Board approval for:

a) Supplemental Gas, Transportation (to Centra), and Distribution (to Customers) sales rates, effective August 1, 2006, which were, as previously indicated, approved on an interim basis in Order 116/06;

b) gas costs incurred by Centra for the period April 1, 2005 to March 31, 2006 of $389.7 million; a reduction in Non-Primary Gas base rates of $6.6 million, also approved on an interim basis in Order 116/06;

c) the balances and disposition of the various Non-Primary Gas Purchased Gas Variance Accounts ("PGVA") and gas cost deferral account balances accumulated to March 31, 2006 (with carrying costs to July 31, 2006) of approximately $13.2 million – also approved on an interim basis in Order 116/06;

d) Supplemental Gas, Transportation (to Centra) and Distribution (to Customers) sales rates effective November 1, 2004, approved on an interim basis by Orders 131/04, 132/04 and 146/04;

e) Supplemental Gas, Transportation (to Centra) and Distribution (to Customers) rates effective August 1, 2005, approved on an interim basis in Order 115/05;

f) Orders 115/05, 142/05 and 148/05, 13/06 and 17/06, 64/06, and 116/06, which provided interim approval of Primary Gas sales rates effective August 1, 2005, November 1, 2005, February 1, 2006, May 1, 2006 and August 1, 2006, respectively;

g) Orders 132/05 and 102/06, 157/05, and 28/06 which granted interim approval of new or amended franchise agreements and related feasibility tests for the extension of gas service to customers in the Rural Municipalities of Rockwood, Ste. Anne, and North Cypress; and

h) Order 144/06, which provided interim approval of Primary Gas sales rates effective November 1, 2006.

Interveners to the November proceeding were Direct Energy Manitoba Limited (DEML), the parent company of the retail broker Municipal Gas; Energy Savings Manitoba Corp.(Energy Savings) and Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors (CAC/MSOS).

While the interveners understood in advance that the hearing would not focus on the competitive natural gas market landscape/environment in Manitoba, at the hearing the parties advanced the following preferences:

a) retail brokers – a continuation of Centra refraining from entering into direct residential fixed price fixed term primary gas contract competition with the brokers, and Centra ceasing to hedge primary gas costs; and

b) CAC/MSOS – Centra offering residential fixed-price fixed-term primary gas supply contracts; offering "system supply" customers a choice not to be involved in hedging; and amendments to the hedging approach to allow for increased consumer participation in downward market price movements. CAC/MSOS also recommended that hedging occur only on a mechanistic basis.

Interveners criticized Centra's reliance on past consumer surveys to support mechanistic hedging for the purpose of restraining rate volatility. Other topics canvassed at the November hearing included:

a) Centra's gas supply operations and arrangements;
b) the impact of energy efficiency measures on commodity purchase requirements;
c) system-gas customer projections;
d) pricing structures , cost allocation and rate design;
e) base rates, billed rates and historical annual bill impacts; and

f) Centra's arrangements with the brokers.

3.0 BACKGROUND AND DISCUSSION

3.1 Preamble

Transcripts of the November 2006 Cost of Gas hearing leading to this Order may be accessed through the Board's website (www.pub.gov.mb.ca) or at the Board's Office. Supporting evidence including responses to interrogatories filed during the hearing and other general information related thereto is also publicly accessible, and may be reviewed through the Board's Office.

Readers wishing to better understand the market and the roles of Centra and natural gas brokers; the design of the customer classification and rate schedules; the timing and process related to rate changes; and the regulatory processes, may wish to review past Orders 131/04, 115/05, and 135/05, all of which may be found on the Board's website, and/or contact the Board's Executive Director at 945-2644.

This Background and Discussion section does not review the full scope of the proceedings that lead to this Order, but rather focuses on matters deemed significant with respect to matters requiring further consideration in future proceedings.

3.2 Introduction

Centra and retail and other gas brokers supply Centra's franchise markets with natural gas, all of which is imported. In aggregate, including both Centra and broker supplied gas, approximately 250,000 residences and businesses (this representing approximately 50% of addresses receiving electricity) expend approximately $700 million annually for natural gas.

Centra's monopoly is limited to the transportation and distribution of natural gas within its franchise areas. Centra system gas customers are provided primary gas at a variable price without a fixed-term contract. Retail and other natural gas brokers, dependent upon Centra for transportation, distribution, billing and collection, offer fixed-price fixed-term and other primary gas supply contracts to residential, commercial, industrial and institutional customers.

Centra is the default supplier, in the absence of contracting for gas supply from a supplier other than Centra, Centra provides the gas. Unlike the retail natural gas brokers, which offer fixed-price fixed-term contracts, Centra offers no price certainty to its customers. Yet, through the use of storage and financial derivatives, Centra provides limited "rate protection" for system gas customers for up to one year.

Centra's primary gas costs are determined through a combination of its commodity supply agreement with Nexen, transportation charges to Manitoba (from Alberta and Michigan), the costs of gas drawn from Centra's storage facilities in Michigan, and the results of hedging activities. Primary gas, whether bought from a broker or from Centra, represents approximately 70% of the average residential customer's annual natural gas bill, the other bill components relate to Centra's transportation, distribution and operating costs.

3.3 Manitoba's Natural Gas Landscape

The current natural gas landscape in Manitoba has its origins in the decisions of Board Order 15/98, which suggested:

a) Security of supply is Centra's responsibility;
b) Centra should charge brokers for Centra's billing of broker customers;
c) Centra is responsible for storage, related transportation and load balancing; and, importantly
d) Centra is responsible for enabling brokers to operate in Manitoba; and
e) Centra shall recover downstream storage and transportation costs through rates applied to all customers, including those of gas brokers.

In Order 15/98, the Board provided broad objectives for the Manitoba market:

"… the individual interests of the utility and other market participants in preventing each other from offering competitive alternatives to their own services must not overshadow the real objective in moving towards a fully competitive market. That objective is to provide the consumer with meaningful customer choices, service offerings, and economic benefits. Ultimately, the consumer must benefit and that must be the rationale for any industry or regulatory change", and

"… customer wishes must be paramount … In making its decisions the Board must determine whether the interests of the consumers are advanced through the various proposals," and

"The Board is of the belief that consumers may benefit with more, rather than fewer, competitive options. The Board further accepts that … Centra ha(s) a presence in any new competitive environment. Given a structure that meets all the necessary characteristics of a free and open competitive market, customers should have the ability to make choices based upon price and various service offerings… consumers may benefit with more, rather than fewer, competitive options."

Much has changed since 1998, not only with respect to commodity prices, which have increased by a factor of two, but also as to the viability and operations of the brokers.

3.4 Events Preceding the November Hearing

The November hearing was preceded by a number of events relevant to the directions and commentary provided herein, these include:

a) a natural gas commodity price spike following gas supply and transportation damage caused by Hurricane Katrina and Rita in the summer of 2005;

b) a spring, summer and fall 2006 reversal of commodity price direction, prices moved sharply down following the repair of gas supply and transportation infrastructure in the United States and the experience of warm weather in the winter of 2005/06;

c) in reaction to the rapid and severe commodity price movements, Centra varied its application of its hedging policy in the fall of 2005 and, again, in 2006;
d) also in reaction to severe commodity price movements, the Board varied its quarterly rate setting methodology (RSM) on November 1, 2005;
e) following Centra's filing of a 2006/07 Interim Non-Primary gas rate application, approved by Order 116/06, the Board called a November Cost of Gas hearing, the subject of this Order;
f) in August 2006, the Board issued a discussion paper related to Centra's hedging policy and practices;
g) also in August 2006, Centra provided brokers and other interveners an opportunity to advise Centra with respect to Centra's future gas supply arrangements (the current gas supply contract with Nexen expires October 31, 2007); and
h) in September 2006, Centra filed its Cost of Gas application, the basis for the November hearing.

Centra's 2006/07 Interim Non-Primary gas rate application, approved by the Board by Order 116/06 and confirmed herein, provides:

(i) $6.6 million in refunds to customers through rates with respect to projected 2006/07 Non-Primary Gas Costs (i.e. Supplemental Gas, Transportation to Centra, and, Unaccounted for Gas Costs); and

(ii) $13.2 million in refunds to customers through rates related to various Non-Primary Gas (PGVA) and gas cost deferral account balances as of March 31, 2006, with carrying costs to July 31, 2006. Centra's rates are based in part on forecasted gas supply and transportation costs, the difference between actual costs and the forecast costs represented in rates are recorded in variance accounts, and the balances of those accounts are regularly distributed to customers by means of rate riders).

The aggregate $19.8 million of refunds now being provided to customers through rate riders implemented August 1, 2006 arose as a result of the winter of 2005/06 being the warmest winter on record in Manitoba. The unexpected and unprecedented warm weather resulted in the virtual elimination of a requirement for supplementary gas supply and, as well, brought about reduced transportation costs due to reductions in primary and supplementary gas supply needs. As well, the credits to customers being currently provided through rate riders include the rate effect associated with forecast Centra Capacity Management (CM) revenues of approximately $4.5 million.

CM arises out of Centra's efforts to employ excess transportation and/or storage capacity/inventory to generate sales to other parties offsetting in part Centra costs.

3.5 Preparing for the November Hearing

With the co-operation of interveners, and recognizing other Centra and Manitoba Hydro (all of Centra's responsibilities are carried out by Manitoba Hydro) workload requirements, the Board restricted the scope of the November hearing. Major gas "landscape" issues were deferred to the now-anticipated GRA.

However, and in responding to Centra's application for an agenda-restricted November hearing, DEML commented not only on matters slated for the agenda of the Cost of Gas hearing, such as Centra's hedging, but also on "landscape" issues, proposing various alternate market structure scenarios. The Board, sharing Centra's view that broader natural gas landscape issues would best be addressed in the context of a separate process, confirmed the restricted agenda but advised all parties that a future proceeding would specifically revisit the natural gas marketplace.

Also ahead of the November hearing, Centra advised that the Gas Supply Contract Review, assisted by its consultant Energy and Environmental Analysis (EEA), would not be completed until February 2007. Centra's gas supply contract with Nexen concludes October 31, 2007, unless a new arrangement has been negotiated by March 31, 2007. The gas supply contract, together with Centra's transportation and storage arrangements, underlie the terms and conditions by which Centra meets market supply demands, including the requirements of the natural gas brokers.

Centra advised that while it would take into account the views of interveners and the directions of the Board with respect to gas supply arrangements, it did not plan to seek the Board's approval of a new gas supply contract, only of costs consequences to arise out of such a contract.

3.6 Hedging

Centra's hedging, which is intended to reduce rate volatility for system gas customers, develops net gains or losses that fall to the consumers to enjoy or meet.

Recently, and following Hurricanes Katrina and Rita in the summer of 2005, natural gas supply prices soared. Centra reported paying in excess of $17/GJ, eight times the price level of the 1980s and 1990s, and basically twice the pre-hurricane price. Centra's hedging ahead of the hurricanes reduced gas supply costs substantially, and helped restrain primary gas rates for system gas customers during the period of very high gas supply prices.

However, Centra's continuation of hedging out one year during the period of record high prices resulted in a subsequent experience of gas supply costs exceeding market prices as commodity prices fell below the floor price of Centra's hedges from spring of 2006 on. The downside risk with the use of cashless collars involving a narrow band separating the upper and floor price is hedging losses when commodity market prices fall below the floor price.

When this occurs, Centra has to pay its hedging counter-party, with the payment offsetting the "gains" arising in the "real" market as its commodity costs fall with the market price. What this means is that system gas consumers are levied rates that exceed then-present commodity prices. This happened from the spring through to October of 2006, with the risk at the time of the

November hearing being that the situation would continue to develop further hedging losses as outstanding hedges concluded.

The concept of mechanistic hedging is that over the long term, if hedges are placed without regard to then-market prices, a break-even result is expected. However, as prices rose in the fall of 2005 and stayed high into the spring of 2006, Centra shared a Board's concern enunciated in Order 135/05 that a commodity price bubble was present. And, acting contrarily to the approach it had taken since employing "mechanistic hedging," Centra took a market view and did not uniformly apply its mechanistic hedging approach at all times.

Centra exercised executive management judgement, though minutes from Centra's Gas Supply Committee and Executive Committee meetings wherein actions and decisions were considered were not sufficiently detailed to provide a full and transparent understanding of Centra's decision-making process.

At the November hearing, Centra advised that primary gas costs for 2006/07 could be as much as $98 million in excess actual primary gas purchase costs, 20% or more higher than would be the case without hedging. Centra forecasting a net hedging cost for 2006/07 in the range of $75 million, with $40 million already realized, though advising that if market prices turned upwards the additional costs related to hedging could be as low as under $20 million for 2006/07.

Ahead of the November hearing, the Board issued a discussion paper to Centra and registered interveners, providing observations as well as options to Centra's hedging policy and practices. In its August 2006 discussion paper, the Board expressed its understandings concerning Centra's hedging approach, these including:

a) based on past consumer surveys, Centra considers consumers to be supportive of hedging with the objective of reduced rate volatility;
b) Centra's "mechanistic" hedging approach involves management judgement, from the design of the rate setting mechanism, the decision to hedge, the selection of the derivative

mechanism and counter-parties, the percentage of eligible volumes hedged, and timing of the hedge, to subsequent decisions not to offset initial hedges; and

c) Alternatives to the derivative mechanism employed by Centra (cashless collars), are available;
d) some other gas distributors do not hedge; others employ different hedging mechanisms, and some take market views on an ongoing basis.

The Board's paper suggested that CAC/MSOS opposed Centra hedging was conducted; and noted that hedging was but one of several mechanisms by which primary gas rate volatility was reduced. At the Cost of Gas hearing, with respect to Centra's hedging practices, discussion centred on three questions, these being whether consumers:

a) are prepared to accept the risk of volatility that would arise upon Centra ceasing hedging;
b) would prefer more explicit guidelines being placed on Centra's hedging practices; and/or
c) prefer a different hedging instrument, perhaps accepting up-front costs.

Discussion took place as to whether Centra should either widen the band of the cashless collars or, instead of employing cashless collars, place caps on the market price. Wider cashless collar bands and caps protect consumers against price spikes while allowing increased participation in falling prices. Centra noted that caps would involve up-front premium costs whereas cashless collars have no up-front premium and include only dealer margins. Centra suggested that the annual cost of dealer margins was approximately $400,000, with administrative costs a further $200,000.

Hearing participants discussed the use of hedging strategies involving the taking of a market view, i.e. projecting future market prices and acting on those forecasts in hedging actions. One such strategy involves restraining, limiting or cancelling hedging during a period of expected price decrease. Strategies based on having a directional view of the market were considered the riskiest strategies, and markets with significant volatility such as gas markets as ones exacerbating the risks. Abandoning hedging entirely removes protection from catastrophic spikes.

With respect to Centra's current use of cashless collars with a narrow price band, interveners observed that Centra's approach was established five years ago, when natural gas commodity prices were considerably lower than current levels. CAC/MSOS' expert, agreeing with an observation contained in the Board's August 2006 discussion paper, suggested the parameters of the approach should be reviewed to ensure that volatility protection is appropriate to current consumer risk appetite.

According to Centra, and based on past customer surveys, residential consumers prefer restrained rate volatility consistent with the narrow cashless collar band. CAC/MSOS suggested a wider band, to allow for more participation by consumers in decreasing market conditions while retaining protection against major price spikes.

CAC/MSOS also suggested that system gas customers should be provided a choice, and that some may not want the "insurance" provided by hedging. As well, CAC/MSOS suggested that if Centra were to enter into competition with the retail gas brokers and offer fixed-price fixed-term primary gas contracts, many system gas customers may prefer such contracts over the uncertainty offered by the present system gas offering.

3.7 Alternatives to Hedging/Current Approach

With Centra's objective for hedging being the reduction of rate volatility for system gas customers, it is important to understand that hedging is but one of several mechanisms available or in place to reduce rate volatility. As such, in its August discussion paper, the Board noted the availability of the following options:

a) no hedging (which while likely to drive increased rate volatility, can also be expected to reduce the cost of primary gas on a long-term basis - the hedging approach employed by

Centra was reported by Centra to incur average annual dealer margin costs of $400,000 as well as administrative costs in the order of $200,000);

b) no hedging, coincident with an adjustment to the primary gas purchasing agreement to provide rate assurance out to one year (currently, Centra's Nexen supply contract ties commodity prices to a spot market index);
c) no hedging, concurrent with the introduction of Centra fixed-price fixed-term primary gas offerings in competition with the retail natural gas brokers;
d) no hedging, with the introduction of a Centra fixed-price fixed-term offering coincident with an adjustment to the primary gas purchase agreement to provide rate assurance out to one year;
e) varying the "mechanistic" approach, to explicitly allow for the taking of market views during periods of large commodity price changes;
f) purchase of options limiting the commodity price ceiling, but not downward price movements (i.e. "caps");
g) retention of the current derivative mechanism, cashless collars, but with wider collar bands allowing for increased participation in price declines; and/or
h) increased consumer migration from system gas supply to retail gas broker fixed-price fixed-term primary gas contracts.

3.8 Means to Secure Reduced/Restrained Rate Volatility

Hedging has produced restrained rate volatility, but, as observed in the Board's August 2006 discussion paper, it is but one of several mechanisms in place or available to restrain volatility. Other mechanisms available to or regularly bringing about reduced volatility include:

a) natural gas storage: natural gas bought after the winter heating season in advance of the next heating season and stored in a Michigan facility is withdrawn in the winter; (Centra consultant IGC earlier recommended the expansion of Centra's storage capacity, but Centra deferred action pending further developments. Stored gas may have a considerable value in the case of a commodity price spike, such as occurred in 2005.)

b) the RSM for quarterly primary gas rate settings establishes firm rates out one quarter;
c) as previously discussed hedging (which is not expected to produce either long-term savings or costs, the latter excluding dealer margins and administrative expenses);
d) EPP, whereby gas customers, upon election and whether system gas or broker customers, are billed a flat monthly charge, adjusted in accordance with an established process;
e) consumer based conservation, that is measures undertaken to improve heat retention and/or efficiency (Manitoba Hydro's Power Smart programs address both natural gas and electricity usage);
f) fixed-price fixed-term primary gas supply contracts with brokers;
g) Board action differing from the RSM, this has occurred during periods of extreme commodity price fluctuation; and
h) an ever-present potential for legislative action to restrain rates.

3.9 Board/Government Intervention in Rate Movement

With the acceptance of interveners and Centra, the November 1, 2005 quarterly primary gas rate setting involved the recognition in residential rates of only half of the increase warranted by virtue of then-market conditions and forecasts. Having apprehended the presence of a commodity price bubble, the Board acted to restrain residential rates out of concern for residential consumers following Hurricane Katrina and Rita. The February 1, 2006 primary gas rate setting restored the RSM.

Shortly after the Board's November 1, 2005 intervention, the government introduced a bill that provided government the ability to restrict rate increases during the winters of 2005/06 and 2006/07. While these provisions were not proclaimed, the tabling of the bill and its passage through the legislature suggest a willingness of government to act in extraordinary circumstances.

3.10 Ultimate Responsibility for Costs

Overall primary gas costs, comprised of, as previously indicated, costs arising out of stored gas and transportation costs, purchased gas and hedging, flow through rates to system gas customers without mark-up or discount.

To-date, regardless of actions of and cost experience incurred by Centra as a result of market conditions, contractual arrangements, administrative decisions, operating circumstances and hedging, and with only one exception, the overall cost of primary gas has been reflected in the rates charged system gas customers.

The one experience when consumers were not held fully accountable for Centra's primary gas costs occurred prior to Manitoba Hydro's acquisition of Centra in 1999. Centra then-acted on its then-view of the direction of the natural gas commodity price market and hedged volumes in excess of eligible volumes in an effort to reduce overall primary gas costs. The market turned against Centra, and it incurred substantial losses. The losses were considered by the Board to have partially arisen out of speculative activity, a significant portion was disallowed and was not reflected in customer rates, resulting in a major loss for Centra's then-private owner.

4.0 Board Findings

The Board accepts the support provided for Centra's rate-related application and will approve its 2005/06 gas supply costs and confirm all interim Orders issued related to rates through to and including the November 1 quarterly primary gas Order.

The Cost of Gas hearing, restricted though the agenda was, provided an opportunity to consider many matters of considerable importance to Centra, consumers, the natural gas brokers and the Board. The Board's mandate is to determine the public interest, and the Board finds the public interest to be represented by a market landscape that provides fair and equitable rates, reasonable consumer choice, and a sound natural gas distributor, Centra.

Centra is not to have to rely upon its parent Manitoba Hydro for financial sustenance, as to do would require the systemic subsidy of natural gas customers by Manitoba Hydro's electricity customers. Though Manitoba Hydro and its owner, the Province, have a natural hedge against rising natural gas prices in that wholesale electricity prices are tied in part to natural gas prices, and increases in natural gas prices benefit Manitoba Hydro's electricity export revenues, the same is not the case for consumers.

With natural gas commodity costs, including transportation, storage and the net result of hedging, passed on to consumers through rates, the Board finds that a landscape that addresses consumer requirements and, when such can reasonably be met, preferences, represents the public interest. With respect to the composition of the Manitoba natural gas market, and ahead of an intended review of that landscape, the Board understands consumers (whether residential, commercial, industrial or institutional) want:

a) security of supply (space heat is a necessity of life in Manitoba, and if an investment has been made in the infrastructure required to heat by natural gas, there must be assurance of the supply of that gas);
b) safe distribution (natural gas is a dangerous commodity, requiring proper infrastructure, maintenance and safety oversight);
c) affordable rates; and
d) choice.

With respect to choice, and, the Board is presently unsure as to whether the natural gas brokers require Centra's abstinence from the fixed-price fixed-term primary gas supply market to survive, and whether Manitoba consumers would benefit from Centra's entry into that segment of the market.

Regardless of whether Centra enters the fixed-price fixed-term market or not, questions remaining to be adequately answered include whether Centra's servicing of broker requirements is consistent with the objective of providing consumers choice, and whether the financial terms of the relationship between Centra and the brokers are reasonable. The Board is also unsure as to whether the presence of only two retail gas brokers in Manitoba, and their offerings of three and five year fixed-price primary gas contracts, are sufficient to ensure adequate retail residential competitiveness.

4.1 Review of Natural Gas Landscape

Towards the Board being in a position to reach a conclusion on these and other matters related to natural gas supply in Manitoba, the Board will direct that a review of the natural gas competitive landscape occur in 2007. The Board does not accept that situation requires a major separate hearing to do this, and will direct that the review be conducted within the confines of a GRA hearing, to be held in April 2007. One of the Board's preoccupations is to ensure a cost effective regulatory process, and the Board is not of the view that a separate process for a gas landscape review would be consistent with that goal.

Ahead of that hearing, and to facilitate the opportunity to change, the Board will direct that Centra's arrangements with its supplier(s) of natural gas not be set in stone for an undue length of time, ahead of a review of the implications of those arrangements for the competitive landscape.

Accordingly, while this Order will not amend Centra's rates, it does provide other substantive directions.

4.2 General Rate Application (GRA), by February 28, 2007

At the hearing Centra indicated its plan to bring forward an application seeking Board approval for a general rate increase of 2% effective May 1, 2007 and 1% effective May 1, 2008. The basis for such an application may include increasing administrative and operating costs, and Centra's desire to continue to contribute to the retirement of the debt assumed by its parent, Manitoba Hydro, arising out of the 1999 acquisition of Centra.

4.3 Gas Supply Contract

As indicated above, the Board is mindful of a pressing need to examine the overall natural gas landscape and related issues. And, while this would best occur prior to Centra extending its gas supply arrangements, the Board recognizes that with the termination date for the Nexen gas supply contract being October 31, 2007, with notice required before March 31, 2007, this may not be fully possible.

The gas supply contract assures Centra's customers, whether supplied primary gas by Centra or through brokers, of security of supply. Security of supply in a cold climate is a higher priority than optimizing consumer choice and/or providing gas brokers market opportunities.

Accordingly, Centra may find it necessary to extend its gas supply arrangements ahead of the anticipated April 2007 GRA hearing. Taking into account the contrasting views of Centra and the broker interveners at this hearing with respect to the need for a gas landscape review ahead of gas supply arrangements being re-established, the Board will direct that gas supply contractual arrangements not extend beyond October 31, 2009. That is, unless sufficient flexibility is built into the arrangements to allow changes with respect to the competitive natural gas landscape in Manitoba. The Board notes that Centra is aware of the requests of the brokers for changes to the present arrangement and, of the Board's interest in reviewing the costs associated with Centra's servicing of broker requirements and customers. Accordingly, this will also be a topic for review at the GRA.

The gas supply contract provides for and drives the lion's share of Centra's annual costs, which are passed on to customers through rates, and assists in the determination of the nature and magnitude of storage requirements, Centra's hedging activities and the operations of the natural gas brokers.

With Centra and interveners to the Board's Centra-centric proceedings in agreement that the gas landscape needs to be reviewed, a major question to be answered is as to the process to be followed and the likely duration of the resultant proceeding. Centra has suggested that the review will require up to two years to complete, the Board is not of that view. While the Board accepts that the review may extend beyond the upcoming GRA, the Board anticipates that considerable progress can be accomplished at the GRA, and decisions amending the landscape can be arrived at. This is not the mid-1990s, the competitive market place in Manitoba has already been defined and has been in operation for some time. Consumer requirements and preferences are reasonably well known.

At the upcoming GRA with respect to the natural gas landscape, among other things the Board will revisit Board Order 15/98's conclusions that:

a) all aspects of Centra's merchant function including natural gas supply procurement functions should remain within the regulated utility;
b) Centra should determine an appropriate tariff for the billing and collection of broker customers (the tariff was developed, twenty-five cents per account per month – the Board will require Centra to determine its full costs associated with its services to brokers, including costs associated with billing and collection with respect to broker customers);
c) Centra should continue to be responsible for storage, related transportation and load balancing;
d) Centra should continue to be responsible for nominations and backstopping; and
e) Centra shall recover downstream storage and transportation costs through rates applied for all customers, including those of gas brokers.

As well, through the proceeding the Board will consider whether it is in the public interest that Centra:

i) amend its gas supply pricing arrangements to place less reliance on indexed gas prices; and/or
ii) abandon hedging for "system supply" customers; and/or
iii) offer fixed-price fixed-term contracts in competition with retail natural gas brokers.

While the review will most likely also touch on gas storage and transportation matters, until Centra's further research and plans are before the Board, it will be difficult to contemplate changes to current arrangements. Centra current contract with ANR for Michigan storage expires in 2013, well before that date proposals for replacement or other amendments to current structural issues need to reviewed and determined.

4.4 Cashless Collar Band

The reasonable assumption is that an efficient market (as the AECO market has been portrayed) should result in mechanistic hedging producing long-term "zero" results.

That is, savings associated with actual prices higher than Centra's band are expected to be offset by periods when actual prices fall below Centra's band, creating additional cost. And, there are "built-in" costs associated with hedging. Dealer margins are understood to be built in to the quotes received from Centra's counter parties, and dealer margin costs were estimated to be in the range of $400,000 per year (perhaps higher in the case of volatile prices). As well, there are administrative costs, estimated from $200,000 a year.

Thus, if no hedging was done, Centra's customers could expect to enjoy through lower average long-term rates the equivalent of $600,000 a year in savings, about 1.5% of annual primary gas supply costs. That said, clearly there would be increased volatility, rates would fluctuate more than has been and could be expected to occur with the existing hedging approach. As well, there would likely be future major commodity price shocks from time to time, shocks low-income customers may be unable to absorb.

To protect against the risk of rate shock, the Board will neither direct nor even suggest an end to mechanistic hedging, at least at this time. Ahead of considering the natural gas landscape in Manitoba, and the roles of Centra and the private brokers, particularly with respect to their offerings to consumers, the Board is not prepared to direct an end to hedging, nor is it prepared to end the use of cashless collars.

The main advantage of cashless collars is that there is no up-front cost for entering into them, unlike the situation with caps where the premium can be very substantial. Even though the long-term experience with cashless collars and caps is expected to be similar, assuming both approaches were consistently applied, it has been argued that being required to make major up-front payments to secure caps represent a psychological barrier or risk to consistent practice.

That said, the Board agrees with Mr. Pringle that the width of the band of Centra's cashless collar hedges needs to be greater. A 50-cent out-of-the-money upper strike price with a bottom price of approximately 80 cents less may have been adequate to protect against the immediate effects to arise from unforeseen and large increases in natural gas commodity prices when average annual natural gas prices were below $3/GJ. However, at current market prices, the Board, as did Mr. Pringle, considers the band to be too narrow.

What once was protection against volatility in the range of 20% of the average price per GJ, is now reflective of protection more in the range of 6%. The Board does not share Centra's current view that today's consumers require or expect protection against price movements to that narrow level. The Board does not agree with Centra that consumers require protection from $60 annual price swings.

The Board notes the experience since the recent GJ spike maximum of $17/GJ, as prices have fallen to as low as a spot price of slightly under $4/GJ (at date of publication of this Order, the spot price was approximately $7/GJ). While Centra's primary gas customers were saved from the degree of volatility represented by these commodity price swings, through the operations of the RSM, the EPP, storage and hedging, that relief has been short-lived. Market prices determine costs and rates: the anti-volatility measures have only delayed and spread out the impact. For Centra primary gas customers, the delay is no more than one year; for the customer of brokers, the delay has been as much as five years, though in that case a premium has been paid in the initial rate setting of the broker.

As a result of the narrow band of the hedges placed, Centra's primary gas customers did not immediately enjoy the advantages of the price declines of the winter, spring and summer of 2005/06. At least, to the degree that would otherwise have taken place during the price decline that followed the peaks associated with the aftermath of Hurricanes Katrina and Rita. If hedging by means of cashless collars is to remain one of Centra's means of effecting restraint in rate volatility, then the hedging should involve a wider band.

4.5 Special Circumstances and Minutes

Over the last decade, Centra, once under private ownership and twice under public ownership, has experienced difficulty applying its approach to hedging. In each previous case, the difficulty arose when management judgement was involved.

In the first instance, prior to Manitoba Hydro's acquisition of Centra, the Utility speculated on price movements and incurred a net loss approaching $50 million, a significant proportion of which was not allowed to be reflected in rates by the Board. In 2001, under Manitoba Hydro ownership, Centra did not invoke its policy and left unhedged large volumes of primary gas requirements during a period of large and unexpected commodity price increases, the result included higher costs and rates for consumers and considerable criticism of Centra by interveners and the Board.

In the recent case, following an opinion expressed by the Board (Order 135/05) that a natural gas commodity “price bubble” was in place following Hurricanes Katrina and Rita, Centra, on two occasions, initially held off from hedging the normal volumes. When it did hedge, it was months later than past practice suggested. Centra held that its actions, which were directed by its Executive Management Committee, apparently in opposition to the advice of the Gas Supply Risk Management Committee, were in compliance with its policy. The Board agrees, the policy provides for “up to 100%” of volume required and allows for exceptions in special circumstances, not defined.

The Board considers the situation that followed Hurricanes Katrina and Rita as “special circumstances” and not solely rated to a market view. The hurricanes devastated production and other natural gas infrastructure, reducing North American supply following a hot summer that had driven down supplies ahead of what was feared to be cold winter. The unknown leads to fear and prices peaked at levels that if continued would have likely led to consumer rates that, in the absence of Board and/or government intervention, would have driven up account delinquency, service disconnection and bad debts.

The actions of counter-parties and futures markets are not influenced by Manitoba concerns, and can be volatile in certain circumstances. After Hurricanes Katrina and Rita, Centra did not cease hedging, but twice reduced the volumes hedged below the eligible volumes, delaying the placement of the hedges until the market “cooled.” If prices had not fallen, the failure to fully hedge may have had a negative impact on consumers, but nothing like the overall effect arising from rates being sustained at the record peak of late fall 2005.

The financial result of Centra’s recent deviating from policy was beneficial for consumers, though not nearly as beneficial as would have been the case if the “missed” hedges had not been replaced, and others reduced or placed. The Board empathizes with the situation faced by Centra through this period. As it turned out, it was a price bubble and prices did fall back, and quickly.

However, if the summer had been warmer or last winter colder, natural gas inventories would not have recovered and prices may well have stayed high. Centra's hesitation and partial recognition of "the bubble" are understandable, particularly given the clear understanding of "mechanistic" hedging and aversion to taking a market position.

From the Board's perspective, the overall experience indicates that the advice received both from Risk Advisory (2001) and Mr. Pringle (at this recent hearing) is correct. If Centra continues to hedge, and if it cannot define when exceptions to the general rule are permissible, there is a strong argument for staying with a purely mechanistic approach. Ahead of future "special circumstances" arising, an effort to delineate what is meant by special circumstances would be helpful.

The Board agrees with Centra that it will be difficult to define "special circumstances" in an optimally effective way, if an optimally effective way can be known. As well, the Board disagrees with CAC/MSOS and accepts there is a role for Centra's Executive Management Committee, perhaps even for its Board of Directors or the Executive Committee of the Board when it comes to matters as important as deviations from the purely mechanistic approach.

Hedging can have and has had major impacts on gas costs and rates. Centra should not cease hedging, awaiting the Board's conclusions to follow a review of the gas landscape issue. But, it should, as previously indicated, widen the bands of the cashless collars. Centra should advise the Board as to its determination of the degree of widening, upon implementing same.

With respect to the documentation of the deliberations and decisions of its Gas Supply Committee and Executive Management Committee on hedging matters, the Board finds the record keeping inadequate. While the Board accepts that Centra's executive, and staff on the Gas Supply Risk Management Committee and within the Gas Supply division, were monitoring market developments closely from the advent of the hurricanes, and that the actions taken reflected concern for consumer rates, better documentation of the deliberations is required.

Consumers paid the full cost associated with primary gas supply, including the results of hedging, and Centra's deliberations related to hedging need to be more fully documented so as to better facilitate acceptance of the parties to these proceedings that due care and diligence is taking place. There is a need for a clear paper trail, for transparent accountability, particularly when the mechanistic approach is not fully employed.

4.6 Hedging Advice

Provision for outlined exceptions should be provided within the hedging policy, it is not good enough to simply provide for exceptions. The basis for exceptions need to be carefully defined, and assistance from expert external advice would prove helpful, if not to Centra, at least for the parties to these proceedings. Centra has sought external advice related to hedging in the past, and should do so again.

The occasional outcome of a hedge, if exceptions are not allowed, may be, as Mr. Pringle opined, that Centra "walks off the cliff." The Board's understands Mr. Pringle to mean there are occasions where special circumstances support either not hedging or placing a hedge on a reduced volume. If Centra is restricted in its ability to act where a prudent person with expertise and interest would, because of an inability to exercise judgement, then "walking off the cliff" may be the outcome.

When natural gas prices exceeded $17/GJ last winter, it was a time when the warm weather to come that winter was not expected, before the production and transportation infrastructure in the Gulf of Mexico had been repaired, and before natural gas inventories soared to record levels in North America. In short, it was the "perfect storm." Mechanistic actions are just that, mechanistic, sometimes, rarely as those times will hopefully be, exceptions to the rule do occur.

While Centra does not financially gain from natural gas supply price movements, as it does not mark up its costs for the natural gas it distributes, it is a public sector firm owned by a parent company owned in turn by the Province. As such, it is vitally interested in the welfare of its customers, and does not blithely ignore market actions that have or are expected to harm Manitoba consumers. In short, the Board believes the situation of the summer, fall and winter of 2005/06 was truly exceptional. Given the broader context of Centra's interests and the interests of its parent and parent's "owner", Centra acted understandably by employing judgement and briefly leaving "mechanistic hedging."

The problem was that it had no provision for the exception, nor any written policy to guide its actions in an exceptional time. It is not surprising that it did not maximize the financial benefits obtainable when prices turned down, but if an effort is made to define special circumstances, if the situation occurs again the opportunity to avoid costs and obtain savings may have a better chance of being realized.

Centra should engage advice with respect to improving the existing hedging policy.

4.7 Research Consumer Preferences

The Board supports Centra seeking to understand the preferences of its customers, and encourages Centra's employing expert advice in preparing, conducting and, subsequently, reviewing surveys and survey results. However, to expect the average consumer to be able to adequately understand the approaches that are available and/or employed, and the options, is, perhaps, too much to expect, particularly with the complex approach Centra now takes to restraining rate volatility.

In undertaking further research into consumer attitudes and preferences with respect to hedging, the Equal Monthly Payment Plan (EPP), and fixed price fixed term offerings, Centra should consult widely in advance of proceeding. Parties to consult with include CAC/MSOS. The Board understands Centra's reservations about involving the gas brokers in Centra's customer surveys, since, in a sense the two parties are in competition with each other. The parties also have differing requirements and preferences. This does not mean Centra should refrain from making an effort to understand the perspectives of brokers.

The customer surveys of 1998 and 2004 are dated, coming ahead of increasing experience with natural gas brokers, large commodity price increases, and the experience of several price shocks and subsequent declines. The experience of the recent commodity price shock and the interest recently shown in Centra possibly entering the fixed price fixed term gas supply competition needs to be reflected in the surveys of consumers.

In undertaking the development of a plan for consumer surveys, which is to be filed with the Board ahead of the GRA, Centra is also to file a report with the Board providing its considered views with respect to:

a) making the EPP the "starting" or default condition for all customers, whether system-gas or broker served;
b) providing lump sum refunds to large volume customers, upon material credit balances developing in PGVA accounts with respect to such customers. While the Board is interested in further Centra's views with respect to employing lump sum refunds for customer classes other than large volume customers, the Board is inclined to agree with Centra that providing lump sums to such customers will result in substantial incremental costs and operating difficulties.

4.8 Centra's Costs, Brokers

When the current natural gas broker arrangements were developed, the direction from the Board was to facilitate competition. The understanding was that costs incurred by Centra through the exercise would fairly be shared amongst all of Centra's customers, as it was deemed to be in the public interest that competition be enabled and fostered. This, whether or not a particular group of customers availed themselves of the choice offered by the brokers.

For the Board, one question that needs discussion and answering is whether the current level and nature of competition justifies the current arrangement. The Board understands that there are only two retail gas broker/marketers, and that this has been the case for some time. The Board further understands that the brokers do not currently offer one and two year fixed price contracts, and have restricted their offerings to three and five year terms for the residential market. The Board also understands that the brokers have generally offered similar prices for similar terms, and that those prices are substantially in excess of current market prices. The Board does not find this surprising, given that the brokers commit to a price for three or five years and the market has shown itself to be increasingly volatile.

The Board notes the administrative and general infrastructure of Centra that is devoted to maintaining broker operations, and wants to know what the annual cost of the effort is, including bad debt provisions with respect to broker customers. While the initial decision was for Centra to absorb such costs as a price required to enable a competitive landscape, with the brokers well established, the question is should system gas customers pay costs attributable to serving broker primary gas customers?

If the Board is to consider the possibility of allowing Centra to enter the fixed price fixed term market in competition with the brokers, the Board wants to better understand all of the implications before making a decision. These implications range from the accounting to be maintained by Centra, to the expense loads to be priced into a Centra fixed-price fixed-term offering, to the operating code of conduct Centra would operate under, and to the risk that brokers may depart the market.

4.9 Scope of GRA

The Board anticipates that the GRA will consider a wide range of possible changes to the natural gas competitive landscape in Manitoba, including:

a) the potential abandonment by Centra of hedging for its current system gas offering, with possible amendments to the RSM to mitigate the effect of leaving hedging;
b) the establishment of the EPP as the default condition with respect to system gas customers;
c) Centra entering the fixed price fixed term market in competition with the natural gas brokers;

d) amendments to Centra’s supply arrangements to facilitate improved broker service;
e) the allocation of Centra costs associated with the operations of natural gas brokers to those brokers; and
f) forecast implications of changes to the competitive gas landscape in Manitoba.

At the GRA, the Board will also review its own costs, present and forecast, with respect to supporting and enabling the presence of retail natural gas brokers. The Board has noted an increasing dedication of Board and Board staff time, and hence costs, to matters related to the regulation of brokers, and on the basis of “user pay” is considering amending broker licensing and processing fees.

The GRA proceeding is expected to consider May 1, 2007 and 2008 rate increases for all customer classes, to address projected net income shortfalls. As well, the Board anticipates a comprehensive review of non-primary gas supply matters including:

a) Centra’s low-income demand side management initiatives (the Board will seek an update as to plans of MH with respect to the fund that may be established from export electricity revenues to address low-income and northern DSM requirements);
b) environmental concerns;
c) rate schedule design;
d) return to Centra’s parent (Manitoba Hydro);
e) gas safety – including proposed changes to the Board’s oversight mechanism;
f) automated meter reading; and
g) any implications arising out of directions flowing from the special hearing, and other matters.

The Board anticipates that Resource Conservation Manitoba and Time to Respect Earth’s Ecosystem , and perhaps other interested parties, will join the interveners to the recent hearing in the examination of issues and options at the GRA proceeding.

4.10 Centra's Capacity Management Program

Centra supply, transportation and storage arrangements involve capacities that often exceed Manitoba market supply requirements, particularly outside of the winter months. By utilizing its contacts and market opportunities related to its particular infrastructure and contract term circumstances, Centra seeks to earn revenues towards reducing overall gas costs.

Recently, and based on prior years' results, Centra projects Capacity Management Revenue results for each prospective year ahead of each year, and develops its revenue requirement and rate proposals based on those estimates.

While the Board and interveners to annual Centra proceedings have been pleased with the contribution being realized, there are differences in the understandings as to the situation and opportunities amongst Centra, the interveners and the Board.

Towards narrowing that gap in the understanding, the Board will direct Centra to prepare, possibly with external assistance, a business plan for the Capacity Management Program, the plan to define the parameters, outline the contributing elements and project future results, optimal, best case and worst case.

5.0 IT IS THEREFORE ORDERED THAT:

1. Centra Gas Manitoba Inc.'s Cost of Gas application seeking the Public Utilities Board's approval of Centra's gas costs for its fiscal year 2005/06 and confirming rates established by previous interim rate decisions through to and including those set on November 1, 2006, is hereby approved;

2. Centra Gas Manitoba Inc. file a two-year General Rate Application (GRA) by February 15, 2007;

3. Centra Gas Manitoba Inc. include within its GRA matters related to the natural gas landscape; and

4. In advance of the GRA, Centra Gas Manitoba Inc.:

   a) continue with "mechanistic" hedging to restrain primary gas rate volatility with a wider band for the application of the "cashless collar" mechanism;

   b) file with the Board Centra's determination of revised band width;

   c) file with the Board draft amendments to its existing hedging policy to provide for exceptions to "mechanistically" applying the approach;

   d) improve its record keeping of discussions and decisions of its Gas Supply Committee and its Executive Management Committee with respect to hedging;

   e) file a business plan with respect to the Capacity Management Program;

   f) develop plans to conduct additional research into consumer understandings and preferences with respect to hedging, the Equal Monthly Payment Plan (EPP), fixed price fixed term offerings and market competition, and file those plans with the Board;

g) file a report with the Board on the implications associated with employing lump sum refunds to high volume customers, rather than rate riders;

h) file an estimate of the annual cost to Centra of its current enabling of participation by retail natural gas brokers in the Manitoba market (operational, administrative, and bad debts); and

i) refrain from extending or replacing the existing gas supply contract beyond October 31, 2009, and file with the Board any extension to the existing contract.

THE PUBLIC UTILITIES BOARD

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

"G.O. BARRON, C.G.A."
Acting Secretary

Certified a true copy of Order No. 175/06
issued by The Public Utilities Board

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Acting Secretary