MANITOBA PUBLIC UTILITIES BOARD

Re: CENTRA GAS MANITOBA INC.
2007 COMPETITIVE LANDSCAPE PROCEEDING

Before Board Panel:
Graham Lane - Board Chairman
Len Evans - Board Member
Eric Jorgensen - Board Member

HELD AT:
Public Utilities Board
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APPEARANCES

R.F. Peters		)Board Counsel
Marla Murphy		)Centra Gas
Brent Czarnecki		
Paul Kerr	(np)	)Coral Energy
Sandy Boyd	(np)	)Communications, Energy)and Paper Workers)Local 681
Kris Saxberg		)CAC/MSOS
Ivan Holloway		)
Eric Hoaken		)Direct Energy
Nola Ruzycki		)Marketing Limited)& Energy Savings)(Manitoba) L.P.
Dave Hill	(np)	)Koch Fertilizer
Nick Gretner	(np)	)J.R. Simplot

APPEARANCES (CONT)

William Gange	(np)	)TREE and Resource)Conservation Manitoba

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--- Upon commencing at 9:03 a.m.

THE CHAIRPERSON: Good morning, everyone. Ready to begin.

CAC/MSOS PANEL, Resumed:

MARK STAUFT, Resumed

MARC VAN AUDENRODE, Resumed

CONTINUED CROSS-EXAMINATION BY MR. BOB PETERS:

MR. BOB PETERS: Yes, thank you. Good morning. Dr. Van Audenrode, yesterday you told me that -- and you told the Board more accurately -- that in terms of the hypothetical of allowing Centra Gas to offer a fixed price offering, your preference and recommendation was that it be allowed to offer that within the regulated utility.

Is that correct?

DR. MARC VAN AUDENRODE: Yes, that's correct.

MR. BOB PETERS: And am I also correct that the only reason you suggested that was for ease of management? That is, if both activities were being regulated, it would make the job of the Public Utilities Board much easier to figure out whether there was cross-subsidization happening.

DR. MARC VAN AUDENRODE: That's the main reason, yes.

MR. BOB PETERS: Were there any other reasons that you can offer the Board?

DR. MARC VAN AUDENRODE: Well essentially -- I mean, it fits in the whole picture of, you know, how do -- how can we make sure that the price that are being offered for this product, which is -- which I believe is fundamentally different from the product that Centra is currently offering, how can we make sure that the price for this product -- meaning the long-term contract -- is as close as possible to a competition price; as close as possible to the lowest possible price.

And I believe that allowing Centra to offer that rate -- you know, regulate an environment, is the simplest, most efficient, and most cost effective way to do that, and to achieve that.

MR. BOB PETERS: Dr. Van Audenrode, if there was an ability of the Utility, or of Manitoba Hydro to offer a fixed price offering outside of the Utility, that could work if there was an affiliate transaction, or affiliate relationship code. Do you agree?

DR. MARC VAN AUDENRODE: That -- I mean, technically yes. The issue is how would we make sure --

I mean, how would we make sure that by having three (3) players in this long term market, rather than two (2), we would be getting closer -- much closer or at competitive price.

MR. BOB PETERS: Wouldn't the market dictate that, and not the Public Utilities Board?

DR. MARC VAN AUDENRODE: Well, the market would dictate it as long as three (3) is enough players to get to competitive price. Sometimes it is enough; sometimes it wouldn't be enough.

MR. BOB PETERS: Well, if three (3) players aren't enough, what's the solution then?

DR. MARC VAN AUDENRODE: Allow Centra to give a regulated -- a regulated rate in that market.

MR. BOB PETERS: So offer a fourth option inside the regulated utility, is your --

DR. MARC VAN AUDENRODE: I lost -- I lost you there.

MR. BOB PETERS: Well, I'm sorry. I -- when you said,"three (3) isn't enough," I was assuming one (1) of those would have been Manitoba Hydro's unregulated affiliate.

DR. MARC VAN AUDENRODE: Yes. And I'm saying, if you had an unregulated affiliate competing with two (2) other players in that very specific market, I'm not sure that we would get necessarily two (2) competitive price. Clearly there would be more chance to get the competitive price with three (3) players, rather than two (2), but I'm not sure.

So what I'm saying is, the solution is allow Centra to afford this rate within the regulated -- the regulated framework, and that will give you a very good benchmark for a price for such long-term contracts.

MR. BOB PETERS: How would you know if there was a competitive price if there was two (2) retailers plus an affiliate of Manitoba Hydro that was not regulated? How would you know if that price was competitive?

DR. MARC VAN AUDENRODE: Well there are many techniques, but it's complex. It requires a lot of -- a lot of research and a lot of work, and I mean, you can do it. I mean, obviously it -- it would be possible but I -- but I would think that this would be a much more complex way to get at it than simply allowing Centra to offer it within the regulated framework.

MR. BOB PETERS: And I take from your answers, that the offering within the regulated framework is your best recommendation for the -- for the checks and balances to ensure that there is at least one competitive price out there?

DR. MARC VAN AUDENRODE: In the long run fixed price market, yes.

MR. BOB PETERS: Do you agree, Dr. Van Audenrode, that whether the hypothetical offering of the Utility was inside the Utility or in an unregulated affiliate, you would want to ensure that there was a level playing field amongst the retailers selling the fixed price offerings?

DR. MARC VAN AUDENRODE: I agree.

MR. BOB PETERS: And when you say, "level playing field" I took from your yesterday's transcript that that really means to you, primarily no cross-subsidization of any kind by the default customers to any Centra fixed price offering customers?

DR. MARC VAN AUDENRODE: Yes.

MR. BOB PETERS: And that's the role of the Public Utilities Board to ensure that doesn't happen?

DR. MARC VAN AUDENRODE: Yes.

MR. BOB PETERS: And when you say no cross-subsidization, you're saying that all of the costs for the Utility's optional fixed price offering are to be charged through to the customers who subscribe for that offering?

DR. MARC VAN AUDENRODE: Yea.

MR. BOB PETERS: And when you say all of

the costs are to be charged through, those would include charges for any of Centra's personnel who were involved in the fixed price offering?

DR. MARC VAN AUDENRODE: Yes.

MR. BOB PETERS: It would include any of the assets of the regulated utility that were used to offer the fixed price offering?

DR. MARC VAN AUDENRODE: Yes.

MR. BOB PETERS: It would include any additional regulatory costs as a result of having the Board review the fixed price offering?

DR. MARC VAN AUDENRODE: I think you asked me that yesterday, I said yes, and said I would believe these would be minimal.

MR. BOB PETERS: And in -- you can't quantify them but you --

DR. MARC VAN AUDENRODE: No.

MR. BOB PETERS: Okay.

DR. MARC VAN AUDENRODE: I don't see how they could be huge.

MR. BOB PETERS: And any additional and attendant risks that the fixed price offering brings to bear have to also be borne by the customers who subscribe for Centra's fixed price offering, to avoid cross-subsidization.

DR. MARC VAN AUDENRODE: Very, very clearly, yes. And if I may qualify some of -- of my previous answers, all the other costs that you listed before are -- I mean, I don't see why these costs would be any different from -- for any customers subscribing to the long-term fixed price contracts, different from those subscribing to a short-term contracts.

So this is relatively trivial and simple to do. The last cost that you just raised and talked about is really the key and that -- that cost which is the risk associated with Centra getting into this type deal, should clearly borne by those customers who are going to subscribe to these contracts.

MR. BOB PETERS: And those risks would include hedging risks that the company may have on their fixed price offering?

DR. MARC VAN AUDENRODE: I -- I mean, can get into too technical terms there. But I mean I -- I don't know how Centra would manage that but I would imagine that if they sell five (5) years contract, they would somehow cover themselves for -- for these contracts.

MR. BOB PETERS: But if they -- if there were any risks associated with the hedging, that would also have to flow to the fixed price contract customers?

DR. MARC VAN AUDENRODE: It would. But -- but keep in mind though this is fundamentally different from the hedging that we talked yesterday about -- and Mr. Stauft talked about yesterday in great deal. This is not taking a position, it's closing a position. It's not opening yourself to new risks or different risk, it is recognizing that because you sold five (5) years contract on the one hand, you have opened yourself to some risk, and you need to find a financial position that will somehow compensate you and -- and make that risk go away.

MR. BOB PETERS: One of the costs yesterday that you suggested did not have to be charged through to the fixed price customers of this hypothetical Centra fixed price offering, was for use of the Centra name or any of the monopoly power that the existing incumbent Utility has?

DR. MARC VAN AUDENRODE: Well -- and I guess I -- not sure I really understood where you were going with that but I -- you know, I -- you know, there would be Centra customers that would -- you know, be Centra customers.

Why would they be any different from any other Centra customers?

MR. BOB PETERS: And then -- and just so the Board is complete with the list then, the -- the suggestion that Centra would have to embed a profit into their hypothetical fixed price offering, you disagree with that and say there is no need to do that?

DR. MARC VAN AUDENRODE: Well, again, I'm not sure as to how the formula currently works to set up the prices for Centra customers, but from what I understand is that there is -- part of the formula allows for some net revenue to flow to Centra. And I wouldn't see why this should be any different for customers getting into these long term contracts and for other consumers.

MR. BOB PETERS: Put another way, Centra is getting their return from another rate so they don't have to add a profit into their primary gas rate?

DR. MARC VAN AUDENRODE: No, but I -- you know, to generate the profit for Centra there is to -- there has to be some, you know, nominal amount added to the cost of a cubic metre of gas that is being bought by Centra customers. And that amount should be added to the price that short-term customers pay and equality to those -- to the price that long-term customers pay.

MR. BOB PETERS: When we add up all of the costs, I wasn't clear yesterday, from Mr. Stauft's answer or yours, whether or not the hypothetical Centra's fixed price offering would be less expensive than that offered by the retailers at any given point in time.

DR. MARC VAN AUDENRODE: I don't know. I mean, at any given point in time, I don't know and nobody knows.

MR. BOB PETERS: To protect Centra's utility from any risks related to fixed price offerings, would there be a need or an option to segregate some of the retained earnings for that purpose?

DR. MARC VAN AUDENRODE: I'm not sure I understand your question. I don't -- you know, to the extent that risks are passed on to the customers who are asking for Centra to take on that risk, I don't see where the risk is for Centra.

MR. BOB PETERS: Mr. Stauft, yesterday, did I understand you to tell the Board that you didn't consider yourself to be an expert in the consumer marketing field?

MR. MARK STAUFT: I think so, yes.

MR. BOB PETERS: All right. And Dr. Van Audenrode, have you any consumer marketing expertise that you profess?

DR. MARC VAN AUDENRODE: I'm clearly not an expert in marketing. I know consumer theory, which is at the heart of economics.

MR. BOB PETERS: All right. Let's talk

then about -- from a theoretical aspect. One of the criticisms that Mr. Stauft has raised is the current door-to-door marketing by retailers.

Have I got that right, Mr. Stauft?

MR. MARK STAUFT: Yes.

MR. BOB PETERS: And your concern is problems can arise from that method of marketing and there is no way of knowing whether the information being disseminated at the door is factually accurate or at least unbiased, is that your concern?

MR. MARK STAUFT: I think so. That's a fair summary, yes.

MR. BOB PETERS: Do you also agree that door-to-door marketing is one of the more expensive forms of marketing?

MR. MARK STAUFT: That seems reasonable, yes.

MR. BOB PETERS: And as a result of that form of marketing, that would inflate the costs that retailers incur in their marketing efforts to attract customers?

MR. MARK STAUFT: That would seem to follow, yes.

MR. BOB PETERS: All right. Is it your view, Mr. Stauft, that whatever marketing avenues Centra

Gas has for its -- as we called it, their hypothetical fixed term contract -- whatever marketing avenues they have, the same avenues should be available to the retailers?

(BRIEF PAUSE)

MR. MARK STAUFT: I guess subject to thinking a little bit more about what that might include, I would think that they already are. So, yes, obvi -- I don't see why Centra should have exclusive access to any particular channel, but I would doubt that they would anyway.

MR. BOB PETERS: Well, what about inserting a -- a little flyer or brochure into the -- the bill doc -- the bill envelope? Should that be open to all, or should that be exclusively the domain of Centra Gas?

MR. MARK STAUFT: That's an interesting question actually, and I have to say I have not thought that through, and I -- it probably would not be a good idea for me to speculate about that on this spot.

MR. BOB PETERS: Dr. Van Audenrode, any comments about whether the marketing available to retailers should be exactly the same as the marketing available to the Utility?

DR. MARC VAN AUDENRODE: That would be consistent with what I said, that should have a playing level -- level field, yeah.

MR. BOB PETERS: And in that regard, if -- should the retailers then have access to Centra's database?

DR. MARC VAN AUDENRODE: I would say yes.

MR. BOB PETERS: And that's because there should be a level playing field?

DR. MARC VAN AUDENRODE: Yeah. And -- I mean, I'm saying "yes" as an economic expert. I don't know whether there are legal or -- or other issues related to that, but you know, that goes with my principle that it should be a playing level field.

MR. BOB PETES: Okay. Well that's a fair qualification, and we'll leave the -- the legal issues for those who -- who want to tackle those problems.

But let's also deal with the form of arrangement. Should -- should customers who want long term contracts, be allowed to enter into those contracts on the internet?

DR. MARC VAN AUDENRODE: I have to say I haven't thought about that.

MR. BOB PETERS: No -- no view?

DR. MARC VAN AUDENRODE: I don't see why not, but again I haven't thought about that, so.

MR. BOB PETERS: Mr. Stauft, if you have anything to pipe in, you're welcome to.

MR. MARK STAUFT: No, I don't.

MR. BOB PETERS: All right. What about telemarketing? Can they sign a customer up over the phone? Is that gonna be something that -- that should be recognized as a binding arrangement with a customer who receives a phone call and decides they want a fixed price offering, whether it's from Centra or a retailer? Should -- should they be allowed to enter into the arrangement over the phone?

DR. MARC VAN AUDENRODE: Same answer with the additional qualification that you're slipping in there some legal concept for which I have no expertise.

MR. BOB PETERS: All right. Fair enough. Mr. Stauft, is it -- is it to be taken from your evidence that your recommendation to the Board is that the door-to-door marketing practices of retailers should be discontinued?

MR. MARK STAUFT: I was asked that in an IR, and I -- my response, I believe, was "yes," without offering any opinion about whether the Board has jurisdiction to do that.

I also have to say that, to me it seems like a pretty hypothetical question. I certainly, when I was preparing my evidence, wasn't thinking of that as a -- as a realistic option, but since the question was put to me, I answered it that way. So I certainly haven't argued for that in my evidence.

MR. BOB PETERS: And you thought -- and you thought it was unrealistic because you -- you would expect that would be an avenue open to, not only retailers, but to Centra should they choose and be permitted to allo -- to offer fixed price contracts?

MR. MARK STAUFT: I would suppose so, sure. I -- I -- yeah, that's fine.

MR. BOB PETERS: Mr. Chairman, I'd like to thank Mr. Stauft and Dr. Van Audenrode for their answers to my questions. I'm finished. Thank you.

THE CHAIRPERSON: For now, Mr. Peters.

MR. BOB PETERS: Thank you.

THE CHAIRPERSON: Thank you, Mr. Peters.

Ms. Murphy...?

CROSS-EXAMINATION BY MS. MARLA MURPHY

MS. MARLA MURPHY: Thank you. Good morning panel. I guess I'll start with the same sort of outline that Mr. Peters did, and that is while I might pose a question to one or the other of you, you're both certainly welcome to -- to contribute any thoughts that you have with respect to the response.

I'd like to start with a fairly finite issues, I think, which one -- it's one, Mr. Stauft, you indicated you didn't feel terribly strongly about, and that was the equal payment program being made default for customers.

And your evidence, as I heard you yesterday, was that for customers who do nothing, they should be put on the budget plan, is that right?

MR. MARK STAUFT: That -- that's my understanding of what being the default means, yes.

MS. MARLA MURPHY: And I just wanted to clarify what you meant by customers who do nothing. Centra's evidence indicates that for new customers that contact the service centre to commence service, they're asked at the time of sign up whether or not they want to participate in the budget program. And at that point, depending on the response, they're either enrolled or not.

Now, would you consider that to be an adequate election on the customer's part or is there something further required?

MR. MARK STAUFT: I would think that's an adequate election. In that situation, they are sort of asked, I gather, from your description of it, point blank, yes or no. So they have to make a choice and whatever choice they make, good for them.

MS. MARLA MURPHY: And as I understood your evidence yesterday -- well first of all, you don't think there's anything different that needs to be done in that process?

MR. MARK STAUFT: I don't believe so, no.

MS. MARLA MURPHY: And for existing customers already on Centra's service, I understood your evidence yesterday to be that you didn't necessarily need to do anything with those customers. That changed a bit from what you had written earlier, is that fair?

MR. MARK STAUFT: That's right. I mean, my discussion -- well, you heard my discussion with Mr. Peters, and I think that's where we got to. I said, Well, if there are -- contrary to what I expected, strong customer resistance to the plan that I described in my evidence, well, that's something that has to be taken into account.

And he suggested to me that maybe an alternative that's less extreme would be just deal with it in the context of new customers, and I agreed that that would probably be a reasonable approach.

MS. MARLA MURPHY: If I could address the issue that you dealt with on page 10 of your evidence. You suggested that competition should make customers better off. And I think you said, perhaps because unregulated markers -- marketers are unab -- are able to provide delivered service at a lower price than the Utility.

And what I wanted to get clarified from you is over what period of time should we determine whether or not a customer is better off?

(BRIEF PAUSE)

MS. MARLA MURPHY: This -- the passage that you're referring to is a response or a description of this sort of general rationale for introducing competition into markets, in general. I think the reference implicitly is to the long run, however you define that. It's not just a month-to-month, or -- it's on average in the long run.

MS. MARLA MURPHY: And I was interested in your definition of what the long run would be. Is that over the term of a contract? Or is it some different period?

MR. MARK STAUFT: Well, I would think

over, you know, sort of several contracting cycles, over several years kind of thing. That's what I had in mind.

MS. MARLA MURPHY: So it will become difficult to determine that for -- given that are three (3), four (4), and five (5) year contracts? If you have several terms, it's going to take a number of years before you determine that?

MR. MARK STAUFT: Oh sure. Of course it is, yes.

MS. MARLA MURPHY: The other potential benefit that you refer to in your evidence is for marketers to offer services valued by customers but not offered by the Utility. Are you referring there to services in addition to primary gas supply?

MR. MARK STAUFT: No. I mean, applying this general observation in the context of Centra, I was thinking more of different term products.

MS. MARLA MURPHY: And what potential value do you see different term products having for customers?

MR. MARK STAUFT: Well, the point I was making, I think, is that just that individual customers may have preferences for different term products. I talked about that a little bit yesterday with Mr. Peters, where some people have expressed a preference for one (1) year contracts, two (2) year contracts, variable rate contracts, five (5) year contracts.

Just it's -- the simple point is that if people want those and they're made available, that makes them happy. That makes them better off than they would be if they couldn't get them, that's all.

MS. MARLA MURPHY: And from your perspective is there an inherent value in having different terms?

MR. MARK STAUFT: If, in fact, there are different preferences amongst customers for different terms, then I would say yes.

MS. MARLA MURPHY: What I was getting at is that you made some comments in your evidence then, yesterday, to Mr. Peters, that in effect, the market takes into account all of the different expectations of prices, so that whether you buy short-term or long-term gas, ultimately the price should be the same.

So do you see a value in customers choosing a different term, if the ultimate price should be the same at the end of the day?

MR. MARK STAUFT: Right. You're talking different context. When I was talking about the expected prices, that's wholesale trading activity in Alberta, right? What we're talking about now is just individualized preferences that customers have for the term of the commitment that they make.

And this is an individualistic thing; some people are more risk adverse than others; just all kinds of things can come into that. It's a much more random thing and it's not really, in my mind, connected with the observations about how the wholesale gas market functions.

MS. MARLA MURPHY: Is it fair to conclude that it's not connected to price then, when you say it's not connected to wholesale markets?

MR. MARK STAUFT: No, I mean, price would obviously enter into it, right? I mean, even people who have a sort of initial preference for a one (1) year contract, will -- may say that but then if you tell them that the one (1) year contract costs three (3) times as much as a five (5) year contract, they may say, Oh, never mind.

It's just part of the -- their preferences with respect to the product, kind of interact with their preferences about price, which is for the lowest price, and they'll kind of combine all of that, I assume, and make a judgment in any particular case which product they want.

MS. MARLA MURPHY: Thank you.

Dr. Van Audenrode, do you agree with Mr. Stauft's comments on page 9 of his evidence, that competition should maximize consumer benefits by ensuring goods and services that consumers want, are produced at the lowest cost and sold at the lowest possible price?

DR. MARC VAN AUDENRODE: That's a fair description, yes.

MS. MARLA MURPHY: And with respect to Manitoba's natural gas market, how does competition affect production at the lowest possible cost, in terms of affecting the market price?

DR. MARC VAN AUDENRODE: I'm not sure I understand your question.

MS. MARLA MURPHY: Well, I'll put it another way. Competition or the absence of competition in Manitoba won't affect the market price or the production cost of gas, will it?

DR. MARC VAN AUDENRODE: I would have to disagree with that. I mean, your ability to be good at purchasing gas under good circumstances and, you know, using the right financial tool could, at some point, give you some advantages.

What I have said yesterday repeatedly, is that I doubt that anybody could claim that it would be better on average, systematically, always than everybody else.

MS. MARLA MURPHY: I think I'm asking you a different question, though. There's nothing that we do in Manitoba that affects the market price of gas, in terms of whether or not we have one (1) or two (2) or three (3) price offerings or product offerings? The market is the market, regardless of what Manitoba does?

DR. MARC VAN AUDENRODE: Well, then -- no, I have to qualify that. You know, there is no such thing as one (1) single market price. There are many, many, many prices for gas delivered today, for gas delivered next week, for gas delivered in one (1) year or two (2) years, three (3) or five (5) years. And how you are able to play with these different prices and how you are able to play with the price of gas in Alberta versus the price in Texas is part of your ability to manage your cost of delivering gas to your customers at the lowest possible cost.

And, again, as I said, I doubt that anybody can claim that they can systematically always, forever be better than the rest of the market.

MR. MARK STAUFT: If -- I think maybe you're talking at cross-purposes, a little bit. If your question is: Does the competitive structure in Manitoba affect the NIT price in Alberta, I would say no, it's just way -- it's just not big enough to do that.

At the -- at a sort of more general level, the way the market is organized in Ontario and how it's operated may affect the cost of producing retail sales service, if you think of it that way. If you think of, you know, delivered -- gas delivered to somebody's house as the product then obviously the way the market is organized and operated in Manitoba affects that, but it certainly doesn't affect what happens at NIT or AECO.

MS. MARLA MURPHY: Thank you. That's my point, is that when we look at analysing the success or otherwise of competition in Manitoba, what we need to be focussed on is not the production at a low cost but rather the sale at the lowest possible cost in Manitoba.

MR. MARK STAUFT: Right. Yeah. And just the way I expressed it maybe is confusing a little bit. I do think of it as a production process to create a sales service at somebody's house.

I agree that's a bit of an odd way to talk about it but that's what I meant.

MS. MARLA MURPHY: And activities such as hedging and storage and the right management tools that are available, will impact the price the supplier is able to offer, correct?

MR. MARK STAUFT: I agree, yes.

MS. MARLA MURPHY: Are there other tools that are available to a supplier to impact price?

MR. MARK STAUFT: Sorry, what -- what was your list again?

MS. MARLA MURPHY: Hedging, storage and rate management tools.

MR. MARK STAUFT: I mean, those would be the major categories. Just -- in principle if you sort of abstract from the factual circumstances around Centra right now; transportation, management, people in principle can buy gas in the Gulf Coast and -- and get it delivered to Manitoba. Things like that.

There's a lot of different factors but generally I think your list is -- is reasonable.

MS. MARLA MURPHY: If the current market structure was to continue, do you have any view on whether the broker's market share would increase, decrease of remain the same?

MR. MARK STAUFT: I don't know. I mean, apart from the fact that I gather from Centra's evidence, that it has been stable for a considerable period, so there's no particular reason to expect it to go up or down. Although I suppose it could.

MS. MARLA MURPHY: Are you aware of how the participation rates in Manitoba compare with those of other jurisdictions?

MR. MARK STAUFT: My general understanding is that they are lower than in Ontario. Ontario, as I recall, it's typically 40 to 45 percent, and I think it's probably similar to what's seen in Alberta.

MS. MARLA MURPHY: And outside of those jurisdictions, what other jurisdictions are you aware of those?

MR. MARK STAUFT: I -- I don't know, no.

MS. MARLA MURPHY: Dr. Van Audenrode, do you have view on whether or not there's any indication, that given the current market structure that the participation rates in Manitoba would change?

DR. MARC VAN AUDENRODE: I don't -- haven't looked at this.

MS. MARLA MURPHY: Mr. Stauft, on page 21 of your evidence you suggest that in signing a long term fixed price contract, customers are betting that the floating price will average out to be higher over the term than a fixed price, is that right?

MR. MARK STAUFT: Yes.

MS. MARLA MURPHY: And you suggest that the customer's more likely to lose than to win in the current conditions?

MR. MARK STAUFT: Yes, for the reasons explained in my testimony.

MS. MARLA MURPHY: Part of the difference in the price between the system price and the broker offerings, represents a premium that's paid to shed some of the risk of moving from a floating price, is that right?

(BRIEF PAUSE)

MR. MARK STAUFT: As I was saying -- I think I said to Mr. Peters yesterday -- I don't know how the retailers set their price. We -- in a forum like this we -- I think we'd naturally like to think of it as some kind of cost of service buildup, the way a utility's rate is derived.

But I'm guessing that that's probably not it. What -- what in principle unregulated sellers do is just maximize -- set the price to maximize their -- their profit.

And so I'm reluctant to get into what I think is ultimately speculation about how exactly these prices are -- are constructed, or how you would break them out in a sort of theoretical sense if you wanted to try to analyse that out.

I mean, it might be possible to do that but I haven't made that attempt and I think it's very difficult, and I doubt that I can help you very much with that.

MS. MARLA MURPHY: You'd agree with me that at least notionally, when people shed risk they pay a premium associated with that?

MR. MARK STAUFT: In general terms, I think that's true, yeah.

MS. MARLA MURPHY: And you don't take issue with there being a premium for that shedding of risk, do you?

MR. MARK STAUFT: No. I mean, in general terms that's true. But again in any specific fact situation you have to think about what is the no-risk situation and what is the risky situation and people may have different perceptions of that. Different markets may have different levels of premiums and so on. So in general terms I agree with you but it's -- as I say, difficult to analyse quantitatively, sitting here.

MS. MARLA MURPHY: Are you able to give any indication, in terms of the natural gas market?

You've talked about there being different risks in different markets; is the natural gas market one or does it depend on the type of market that you're in, in a more stratified sense?

MR. MARK STAUFT: Again, without having sort of dug up data on this, my understanding is that in the natural gas market, the premiums or otherwise, for long term -- talking -- speaking about the wholesale -- the market at NIT, for example, the very large liquid market, my understanding is that there's probably -- again, it's difficult to even measure, because you can't really find the data to measure this for sure, but I don't get the impression from my discussions with people in the industry that there's a huge premium for either long or short term; it's sort of an expected value basis right across the board.

Now, there may be one way or the other, but I really don't know. And I don't think it's a significant factor, particularly in the shorter time horizons, in the NIT market. Like, the one (1) year price is pretty much the same as the expected average of the one (1) month prices, for example, at NIT.

MS. MARLA MURPHY: And does five (5) year fall within your short term or is that long --

MR. MARK STAUFT: It's sort of --

MS. MARLA MURPHY: -- term?

MR. MARK STAUFT: -- at the outer edge of it, I think. Yeah.

There's not -- public information on five (5) year market prices in Alberta is not readily available. You -- you can get it if you sort of have a channel of communication into the some of the brokers -- or the, sorry, the marketers but it's not in newspaper or on the news services or anything like that.

MS. MARLA MURPHY: You discuss in your evidence, a scenario where there's a -- if there is an overwhelming likelihood of consumers in the aggregate suffering a net loss, that at that point there's a greater argument for regulatory intervention or other competitive discipline on unregulated brokers.

And I want to understand what would be a net loss, as you've termed it.

MR. MARK STAUFT: Okay. Sorry, do you have a reference, just so that I can --

MS. MARLA MURPHY: Page 26, according to --

MR. MARK STAUFT: -- the context?

(BRIEF PAUSE)

MS. MARLA MURPHY: Starting at line 5, if that helps you.

MR. MARK STAUFT: Right. Right. Yeah.

And the situation -- the context there is if you find that there's just some market imperfection going on, that's harming customers, then that's an argument for regulatory intervention.

Sorry, your question, though, was about how I --

MS. MARLA MURPHY: How do you know --

MR. MARK STAUFT: -- how you decide.

MS. MARLA MURPHY: -- there's a net loss, yes?

MR. MARK STAUFT: Yeah. Again, the level of discussion here, I certainly didn't have any quantitative benchmarks in mind. I mean --

MS. MARLA MURPHY: And from what I understood, you just to tell me about the term over which you'd assess this, it would be a number of years as opposed to a particular contract term?

MR. MARK STAUFT: In principle, in the long -- yeah, right.

MS. MARLA MURPHY: And you're not able to give the Board any direction in terms of what level of premium would be expected and what might be a net loss over and above what that would be?

MR. MARK STAUFT: No. Again, just to back up a little bit -- maybe this will clarify it a little bit -- the -- I don't claim in my testimony to be able to measure any of this with any precision, right, in terms of net losses or net gains; that's all certainly beyond my capabilities, beyond the data that I have, and possibly beyond anyone's capabilities.

The argument is essentially -- in general terms -- is, look, if there are reasons to be concerned about whether there is something wrong in the market, in terms of the way benefits are being generated for customers; if we're nervous about that, if there's sort of clues that that may be going on, and if you have other approaches, like the ones we've talked about here that -- that can make us feel better about that; can lessen that concern, or act as a constraint on whatever may be going wrong in the market, then it seems to me that it would be a good idea to implement those measures.

Assuming, of course, that you can persuade yourself, or satisfy yourself, that you're not causing some other difficulty in the process. If it's -- if the -- the -- the solution, or the sort of prophylactic measures are costless, and reasonably harmless, why not do that if -- if you're nervous about the market not working properly.

MS. MARLA MURPHY: The measures you're talking about in that context are customer education?

MR. MARK STAUFT: Well, I -- well just now, I was thinking more about the proposal that Centra be allowed to offer fixed price products at a regulated rate, which does address, in principle, some of the concerns that we've raised, as we discussed yesterday.

MS. MARLA MURPHY: And when you make your assessments, I appreciate they're not calculations, but what are -- what is it that you're comparing too when you look at the net loss? Is it Centra's system rate that you're comparing it to, or is it the market rate?

MR. MARK STAUFT: Sorry. What do you mean by "market rate," in that context?

MS. MARLA MURPHY: I was thinking more of the market price. Are you talking about a monthly, or a daily, or some other market price as being the standard by which you decide whether or not customers have suffered a net loss, or do you look at what their other offering was, the -- the system offering?

MR. MARK STAUFT: I -- I'm thinking about it, not in terms of in relation to any specific market price. As Dr. Van Audenrode said, and as I think I've said, there is not single market price. There's thousands of market prices for gas across North America.

My -- the comparison that I have in mind is just the comparison with what the outcome would be under competitive conditions if the market was working properly.

MS. MARLA MURPHY: Have you considered whether or not there are differences between Manitoba's market and the market in Alberta and Ontario, such that the economic basis for retail gas competition is perhaps not the same in Manitoba?

MR. MARK STAUFT: I have thought about that. There seems to be -- I think it's possible that that is the case. Certainly as between Ontario and Manitoba, Ontario has a much larger population, a lot bigger market. As I think Dr. Van Audenrode mentioned yesterday, just the scale of the market is a factor in the ability of new entrants to -- to come in and -- and operate profitably.

So that is a -- is a difference. Certainly they have a different history, probably, in terms of how -- how and when unregulated marketers started operating.

There is a difference in the delivery mechanisms as between Ontario and Manitoba, as well. The bundled "T" mechanism that the Ontario utilities operate is a little simpler to use, from a broker perspective. It's a much flatter profile, so that the difficulties that Direct and Energy Savings have with WTS nomination patterns, there's nothing they can do about that, but just the physics of the situation, it's easier with the Ontario services.

So those -- those factors are all relevant, I think.

MS. MARLA MURPHY: Would you consider the load profile in Manitoba to be a relevant factor as well?

MR. MARK STAUFT: In a sense, it is. In -- in combination with the set of assets that Centra has assembled to serve the market, and therefore the WTS service characteristics that -- that fall out of that. I just said that, I think, that that may well be a factor in how well it -- the retail market works.

MS. MARLA MURPHY: And I suppose that weather volatility would factor into that as well, wouldn't it?

MR. MARK STAUFT: Right. I mean, I think that's sort of part of the whole thing. It's just a question of what assets you need. You know, Manitoba, they have to plan for the Utility, the delivery entity has to plan for a much more extreme peaks and valleys than do in Ontario. And just tied up with that, have much less storage available to them.

So, yeah, it's al part of the same issue, I think.

MS. MARLA MURPHY: And does the issue of public versus private ownership play into the economic basis for competition in Manitoba as well?

MR. MARK STAUFT: I have to say that when I have talked -- thought about these issues, I have not seen -- taken that into account in a -- in a major way.

I -- I just sort of assumed that the Utility is a -- is an entity that operates in its own interests and -- just like any other utility.

Now -- I mean, I think in a practical level it -- it may have an effect on the way these things work. I mean, a publicly owned utility like Centra may have a different level of interest in undertaking certain activities than a privately owned one does just because of the nature of its mandate. That -- that may well be the case.

But as I say, it's hard to generalize on that and I -- I'd hate to speculate a lot about what Centra's motives are or aren't, versus the motives of Enbridge or Union or ATCO or somebody like that.

MS. MARLA MURPHY: Dr. Van Audenrode, do you have any discussion or anything to add, with respect to that discussion, of the economic basis for competition here and compared to other jurisdictions?

DR. MARC VAN AUDENRODE: No, I would

defer to Mr. Stauft and that I don't have enough institutional knowledge.

MS. MARLA MURPHY: Thank you. I want to turn to the area of your discussion of the control of marketing practices. Your evidence suggests that even with codes of conduct and dispute resolution mechanisms, that there's still some possibility for what you termed as inappropriate behaviour by individual sales people.

Would you suggest that elimination of door-to-door sales would address that concern from your perspective?

MR. MARK STAUFT: Well sure. If the -- if the inappropriate practices are part and parcel of door-to-door sales, then eliminating door-to-door sales would take care of it.

So in a sort of simplistic sense I suppose, yes the answer is.

MS. MARLA MURPHY: And maybe Mr. Saxberg, you want to pipe in here but I'm wondering if that CAC's recommendation in respect of this issue.

MR. KRIS SAXBERG: I don't think this is the time to -- to communicate that. I'd have to talk to my clients and -- and we'll be making our final submissions at the appropriate time.

CONTINUED BY MS. MARLA MURPHY:

MS. MARLA MURPHY: You --

MR. MARK STAUFT: Sorry. I just -- I can add certainly when I was writing my testimony, I did not, as I said a while ago, I didn't have that option in mind at all.

I mean, I certainly wasn't thinking of that as a recommendation to the Board, so. There's other ways to deal with it; it basic -- basically is what my -- my testimony is -- is discussing.

MS. MARLA MURPHY: And when you say there's other ways of dealing with it, are you thinking of information that's provided to customers at the door or something else?

MR. MARK STAUFT: Yeah. I mean -- well the whole discussion about -- well basically all of the issues that -- that arise. The -- the whole business about Centra offering fixed term contracts which is really kind of an instance of imposing competitive discipline on the unregulated players, achieving appropriate cost allocations; all of these things go into it.

I mean, these -- these practice -- these -- the things that I'm concerned about, again, these were raised by me in my testimony, just as a basis for being concerned about whether the market is really working appropriately.

Not as necessarily something that people need to address or -- or would be capable of addressing in any kind of direct way. I mean, if people go to people's doors and lie to them without their employers knowing about it, okay. There's not much you can do about that.

You can't send somebody around to keep an eye on every conversation that happens at every door. So it's just a matter of organizing the markets in a way that minimizes the effects of any inappropriate behaviour that's going on, as far as I can see.

MS. MARLA MURPHY: And would some of the ways of addressing that include the level of information or the type of information that's provided to customers at the door?

DR. MARC VAN AUDENRODE: Yeah, can I -- maybe I -- I wanted to add something in here. It's -- you know, deciding to buy gas for the next five (5) years is a big decision. I mean, nobody buys anything anymore for five (5) years these days. A new house, that's it. Your cars, you don't even keep it for four (4) years and for five (5) years. You shed it out at fourth year. You don't buy anything for -- for five (5) years.

Second, it's not a trivial amount. You know, it's five (5) times two thousand dollar ($2,000), or fifteen hundred (1,500), it's ten thousand dollar ($10,000); that's more money than most people put in their RRSPs.

And third, it's a financial decision. Your decision to go for a fixed rate or for a floating rate had nothing to do with your need to -- for natural gas. It's a financial decision.

When you advise people on financial decisions, there are very stringent rules. You know, know your customer, make sure that you're offering a product that is suitable. I mean, there are a list of things that -- I mean, this, this -- the decision's a financial decision and I think it should be treated as such. And the level of information that you would expect the consumer to get when they're making this decision is exactly the same as the one you would expect the consumer would get when they decide how to use their RSPs.

(BRIEF PAUSE)

MS. MARLA MURPHY: Thank you. I understood your suggestion to be, I think, twofold, which is the fixed-price offering and better information for customers.

Now, can either of those go on their own? In other words, if Centra determines that it's not prepared to offer a fixed-price product, or if the Board orders that it continue with a single product, in your view is better information at the door enough?

(BRIEF PAUSE)

MR. MARK STAUFT: I wouldn't say that it's necessarily enough and I'm not sure how you would know whether it was enough or not. Clearly it would help. I mean it would be a positive step, I think, if customers were better informed about these matters, for the reasons that Dr. Van Audenrode just gave you.

I mean, it's a -- it's a complex thing, and I -- as I indicated in my testimony, it's a -- really a very complicated issue when you get right down to it. So, directionally, sure, I think it's an improvement. I wouldn't take the position that, No, we can just forget about all of the other potential solutions and rely on that. I don't think that's correct.

MS. MARLA MURPHY: In your view would it be of assistance to customers if they were informed of the current price that they're paying per cubic metre, as well as Centra's offering prices, in addition to the price being offered by the broker at the door?

MR. MARK STAUFT: I suppose directionally that's true. One of the -- I have to say one of the difficulties with this -- the whole notion of providing more information is deciding exactly what information would be appropriate and in what form and so on.

I mean, again, it's easy to say directionally, sure, consumers should be -- it would be nice if they were better informed and they'd probably make smarter decisions if they were. But again, down at the level of detail about -- the arguing about what should or shouldn't be in bill inserts and stuff like that, I'm not sure that it makes sense for me to be speculating about that, or making things up about that on the stand.

I mean -- and one of the difficulties, of course, is that just -- the comparison that, in principle, a customer should be making here is between -- is not really between the five (5) year price that Direct is offering and the three (3) month price that Centra is offering. That's not really the appropriate comparison at all.

The real comparison is the price that the retailers are offering and what the customer would reasonably expect prices for Centra -- Centra's prices to be over the five (5) year horizon.

And as I tried to indicate in my testimony, that's a very difficult number to come up with. I mean, you -- I've made sort of elementary stabs at it, but for a -- your average consumer to even fully grasp the question that is supposed to be being asked, let alone assembling the data and doing the manipulation to figure out what an answer might or might not be, very difficult.

So I'm not -- this is a -- practical level, I'm not sure that enough information could be given to people to enable them to do that. Unfortunately, it's just a very difficult thing to do.

DR. MARC VAN AUDENRODE: If I could maybe add something here.

I think we're mixing two (2) different problems here.

One is making sure that the consumer understands the product that he is buying.

And second, if the consumer chooses to buy a long term product, making sure that he gets the best possible deal on that.

Working on making sure the consumer understands doesn't guarantee that he gets the best deal;

he might still elect to choose it. But if competition in that market can be healthier he could have probably get on an even better deal.

MS. MARLA MURPHY: You had a discussion, both of you, with Mr. Peters a few minutes ago about a level playing field and the suggestion was made that in order for the field to be level, brokers should be permitted to include information in Centra's bill when it's mailed to the customer.

What I'm wondering is, on the same -- by the same token or the reverse of that, should Centra also be able to communicate information to the customers at the door, when the brokers attend at the door?

MR. MARK STAUFT: I can see how Centra would make that argument, yes.

Again, I think -- I think we were speaking in pretty general terms. I -- as I -- for my part anyway, I am reluctant to be sort of arguing about or making recommendations off the top of my head about specific details like that.

I think, just procedurally and practically, it would probably make more sense for -- probably be easier for everyone if rules like that were hashed out in a forum or a setting where the issues are kind of put to everybody to begin with, and the alternatives are on the table, and people can spend a little bit more time thinking about it.

Again, it's one of those things where it can get pretty complicated, pretty fast, probably if you start going down that road, so.

MS. MARLA MURPHY: And I guess that's my -- that's true, I agree with you. But that's also true of suggesting that Centra's bill should be available to brokers to insert items in the envelope. So if one is fair is the other not also fair?

MR. MARK STAUFT: Yeah, I can -- I can see that argument. If I'm Centra, I say, well, hey, it's my bill, you know. So -- you know, local grocery stores can't compel me to put grocery store flyers in my -- the gas bill I send out to people, why should these guys be able to.

Again, I can see that argument and I can see arguments on both sides, and I -- I would suggest that that's probably not the level of detail issue that should or needs to be determined in this case.

MS. MARLA MURPHY: I just wanted to address with you a comment you made on page 43 of your evidence. And you suggest that the Board's approach to what you describe as a lack of effective competition in Manitoba, may depend on policy considerations.

Do you have that? It's right at the bottom --

MR. MARK STAUFT: Yeah. Could I --

MS. MARLA MURPHY: -- of the page.

MR. MARK STAUFT: Right. I'm just going to -- if you'd just give me --

MS. MARLA MURPHY: Sure.

MR. MARK STAUFT: -- five (5) seconds here, I'll look at the context.

(BRIEF PAUSE)

MR. MARK STAUFT: Okay. Sorry.

MS. MARLA MURPHY: What I want to know is what policy considerations you think should be taken into account?

MR. MARK STAUFT: Okay. What I had in mind there was, sort of, almost beyond policy considerations to philosophical considerations, in the sense that different governments and different Boards, different groups of people can have different views about just the -- the general appropriateness of State intervention in people's decision making.

You know, you can -- people can -- some people take the attitude that -- you know, people if want to engage in self-destructive behaviour, they're free to do that. Other people have a more paternalist bent in the way they -- they look at the world. It wasn't really much more than that. A just sort of an acknowledgement that at the very highest level, people may have preferences one way or the other about the extent to which they believe the State should be -- or the Regulatory Board should be examining these things. It wasn't any more complicated than that, or any more profound than that.

MS. MARLA MURPHY: I was hoping to get an understanding of -- of how the steps that the Board might take would vary, depending on their policy perspectives, but based on what -- the answer you've just given me, I don't know if you can provide me any information in that regard.

MR. MARK STAUFT: Probably not. I think that's fair.

MS. MARLA MURPHY: Professor Cyrenne, in his evidence, discussed the role of the competitive sector in regulating the price behaviour of a regulated Utility.

Are you familiar with that -- that evidence?

MR. MARK STAUFT: Yeah. I recall that,

yes.

MS. MARLA MURPHY: And do you, Mr. Stauft and Dr. Van Audenrode, agree that that phenomenon exists?

DR. MARC VAN AUDENRODE: Yes.

MS. MARLA MURPHY: And would you agree that the reverse is also true? That the behaviour of the regulated Utility also regulates the price behaviour of brokers?

DR. MARC VAN AUDENRODE: I wouldn't put it that way. I would say it serve -- it serves as a benchmark for -- for the competitive sector.

MS. MARLA MURPHY: Thank you. I want to turn to the issue of hedging. Mr. Stauft, you refer in your evidence to essentially cost free ways of controlling volatility that are perfectly adequate, and I'm wondering how you define things being, "perfectly adequate."

MR. MARK STAUFT: Perhaps the adjective "perfectly" shouldn't have been in there. Adjectives always get you in trouble, you know. They always do. It's best to do one last edit to get rid of them.

MS. MARLA MURPHY: I'll settle for how you defined "adequate" as long as I --

MR. MARK STAUFT: Right. Well, again it's -- it's a -- there's no hard and fast definition of that, obviously. It does seem to me though, as to -- the subsequent discussion should make -- should make clear, that there are alternatives available that, I believe, address most of the issues that are addressed by the hedging program.

That's without -- when I say -- adequate doesn't mean a -- a perfect substitute. I wouldn't go that far. I mean, there are obviously differences between the effects of the hedging program and the effects of the alternatives that are available. So it's -- it has to be a bit of a general judgement type issue, I think.

MS. MARLA MURPHY: Dr. Van Audenrode, you expressed some opinions yesterday regarding Centra hedging its primary gas purchases, and I wondered how familiar you are with Centra's current hedging program.

DR. MARC VAN AUDENRODE: Well, what I understand is that there is some form of costless collar in place -- in place.

MS. MARLA MURPHY: Are you aware that Centra engages in what's been described as a "mechanist hedging program?"

DR. MARC VAN AUDENRODE: I heard that, yes.

MS. MARLA MURPHY: And you understand

that to mean that they hedge on a specified period for a specified duration?

DR. MARC VAN AUDENRODE: Yes.

MS. MARLA MURPHY: And are you aware that the policies and procedures for hedging have been approved by the Public Utilities Board?

DR. MARC VAN AUDENRODE: Yes.

MS. MARLA MURPHY: Your evidence suggested that you view Centra as hedging on a speculative basis in order to make a profit. Is that your understanding?

DR. MARC VAN AUDENRODE: No.

MS. MARLA MURPHY: When you talked today about an opening position versus a closing position, what did you mean by that?

DR. MARC VAN AUDENRODE: What I meant by that is simple financial terms is -- you know, sometimes because you're selling a product in such a way, you're opening yourself to risk and -- and therefore it is appropriate to go on the financial market and -- and try to cover that risk.

When you don't have that risk and you, on yourself, on your own, take a position, that's opening a position. And if you are a private corporation as far as I know, you're for -- obliged and you're mandated to report that to you shareholders because you are taking some risk.

In this case, from what I understand, you're covering yourself by saying that if the price of natural gas falls at very low level, then you're -- you will pay more than market price, as a way to cover for the upside.

That's what I called opening a risk. That means that during that time you will have to make hard payments to -- to honour the deal.

MS. MARLA MURPHY: And the converse of that is that you're shedding the risk on the other side?

DR. MARC VAN AUDENRODE: Exactly that, yeah. I -- I don't -- I don't -- I don't dispute that, but the fact is that you're opening a risk. I mean, you're not perfectly covered in a financial sense and you're opening a risk.

At some point you'll run the risk of having to pay much more than market price, and of course in the case of Centra it doesn't show up because you just pass it onto the consumer, but if you were a private corporation, you'd be in trouble.

MS. MARLA MURPHY: When you -- when you analyse whether or not Centra is taking on risk, you're not looking at the volume, the issue of the volume of the gas that we're -- we're purchasing?

DR. MARC VAN AUDENRODE: I totally agree with you, that all this is compounded by volume issues, yeah.

MS. MARLA MURPHY: And with respect to the primary gas program, Centra hedges, in its rate management program, only its minimum year volumes, so they don't take that risk on. Do you understand that to be the case?

DR. MARC VAN AUDENRODE: I didn't know that, but I'll accept that.

MS. MARLA MURPHY: And conversely if we were to hedge a fixed price product, Centra would be required to hedge the volume risk as well, correct?

DR. MARC VAN AUDENRODE: That's true, that if you were to have a fixed rate you could cover yourself to some extent, but you still would have to find ways to deal with the volume risk, that's true.

MS. MARLA MURPHY: And in order to have someone else carry that risk, would require a payment of a premium?

DR. MARC VAN AUDENRODE: Well you would have to pass on that cost to the customers who sign up for these -- for these deals, very clearly.

(BRIEF PAUSE)

MS. MARLA MURPHY: You've made the suggestion that hedging is appropriate for private companies who could be punished for the decisions -- I think was the words you used -- but not for public companies, is that right?

DR. MARC VAN AUDENRODE: I don't know if I used these exact words, but yes.

MS. MARLA MURPHY: Are you aware that Centra's hedging activities are subject to a prudence review by the Public Utilities Board?

DR. MARC VAN AUDENRODE: That's what I understand, yes.

MS. MARLA MURPHY: And in the case of Centra being found to have imprudently hedged, there's a risk of disallowance of a portion of their costs?

DR. MARC VAN AUDENRODE: I didn't know that.

MS. MARLA MURPHY: Have you, either of you, undertaken any analysis of the kind of volatility that customers would experience, if Centra were to eliminate its hedging activities?

(BRIEF PAUSE)

MR. MARK STAUFT: I have not gone back and looked at that, no. I know Centra has done a lot of work on it and I've seen it from time to time, but I haven't independently worked on it.

MS. MARLA MURPHY: And do I understand your evidence and CAC's position to be that if Centra is -- that -- that the suggestion that Centra discontinue hedging is predicated upon the assumption that they would offer other products, alternate products to customers?

MR. MARK STAUFT: I can's say what CAC's position will be in argument. I think I had a similar discussion yesterday with Mr. Peters, where I said if it were the case that Centra was able and willing to offer alternative products, that would certainly, in my mind, strengthen the argument for getting rid of the hedging program; just because it would be even less necessary, in the sense that individual customers would then have alternatives available -- an additional alternative available to them to deal with volatility issues.

I don't think I -- when I was discussing that with Mr. Peters, I don't think I went so far as to say that it was an if and only if type of linkage. I mean, the CAC may take that view, I just have not -- it would make sense to me to eliminate the hedging program even if that didn't happen. I think there's a -- there's still an argument for that.

But I think I acknowledged that the -- the argument is stronger and Centra may feel better about that option if in an environment where they were able to offer other alternatives to customers.

MS. MARLA MURPHY: Let's just explore for a minute, the scenario in which Centra maintains one (1) service offering, which is no longer hedged.

And I'm -- I would like your views on the effect of that in terms of what that will do to Centra's price. Would you agree with me that it will increase the volatility of our product?

(BRIEF PAUSE)

MR. MARK STAUFT: Again, without having done the analysis, in general terms it would seem that it would increase the volatility of the primary gas rate.

The -- the point -- I mean, that -- the more general argument about eliminating the hedging program though is, first of all to think about how badly people care about -- how much people care about volatility in the first place.

And also, as I think I said yesterday, consider the availability and adequacy of the options that are available to people to -- to deal with it including the EPP program. I mean, you know --

MS. MARLA MURPHY: Yeah. I'll get to those in a minute but in terms of the product that would be available to customers, if a customer wanted a hedged product at that point, they would have no alternative but to buy a long term fixed price contract. Isn't that right?

MR. MARK STAUFT: That's true. Hedged, in a sense, yeah. One (1) form of hedging, yeah.

MS. MARLA MURPHY: And in your evidence I haven't -- I haven't heard you mention it here -- but in your evidence, you did actually note a benefit to hedging, and that was that it could be used to remove, what you described as temporary price spikes; and you suggested that that was used by brokers to market their product at the door.

Do you recall that? It's in your response to PUB/CAC-17.

MR. MARK STAUFT: I do recall it if you just give me two (2) seconds here, I'll --

MS. MARLA MURPHY: Sure.

MR. MARK STAUFT: PUB-17?

MS. MARLA MURPHY: Yes.

(BRIEF PAUSE)

MR. MARK STAUFT: Right. Yes, I would recall that discussion, I'm sorry. The question?

MS. MARLA MURPHY: That -- will that suggest that the removal of hedging will make Centra's product look less attractive to customers, won't it?

MR. MARK STAUFT: Yeah. It -- it may have that effect, yes. I mean, the -- the observation there is that probably, sort of, random and erratic unexpected price spikes, probably make it easier for door-to-door salesmen, for the retailers, to persuade people to sign up for their product.

And so, yeah, in that senses eliminating those types of spikes is -- would not be good for the brokers, from that perspective. Now whether that's a legitimate marketing tool or not is a separate question. I mean, just as a factual matter it's probably the case that if Centra's rates are bouncing all over the place, it makes it easier for -- it's makes their job a lot easier.

MS. MARLA MURPHY: One of the programs that you've indicated as an alternative to hedging is the equal payment plan and I think I've already heard you say to Mr. Peters that the equal payment plan doesn't effect the underlying cost of gas, is that right?

MR. MARK STAUFT: That's true, yes, it doesn't.

MS. MARLA MURPHY: So it effects the timing over which people pay their bills, but not the amount of the bill?

MR. MARK STAUFT: Right. It doesn't affect the total obligation -- payment obligation to Centra. It just -- it -- what it does affect is the amount that people pay each month --

MS. MARLA MURPHY: Yes.

MR. MARK STAUFT: -- which I would argue is what people are mostly interested in, but...

MS. MARLA MURPHY: The second tool that you cite as an alternative is the rate management, or the use of a primary gas variance -- a Purchase Gas Variance Account, PGVA.

Would you agree with me that also does not affect the underlying cost of gas?

MR. MARK STAUFT: That's true, yes.

MS. MARLA MURPHY: And storage is somewhat different. It's an alternative that -- that does affect the underlying cost of gas, correct?

MR. MARK STAUFT: It may, yes. Yeah. I'm sorry, yes, it does.

MS. MARLA MURPHY: And it obviously comes at a cost. We have to pay for the storage?

MR. MARK STAUFT: Right.

MS. MARLA MURPHY: Fixed price products will also affect the underlying cost of gas, correct?

MR. MARK STAUFT: Sorry? Fixed price products?

MS. MARLA MURPHY: Fixed price products. If a customer buys a fixed price, it will affect their cost of gas rather than just the timing of which they pay it?

MR. MARK STAUFT: Yes. Yes, that's true.

MS. MARLA MURPHY: So when you talk about there being essentially free alternatives to hedging, there's really only two (2), as I understand it -- unless you have others outside of the list you've given us -- and that's the Equal Payment Plan and the Rate Management Program.

Is that right?

MR. MARK STAUFT: I think that's fair, yes. Keep in mind that -- I mean, I'm not sure what distinction you were drawing there, but hedging -- the theory is, hedging does not affect the underlying cost of gas either, right. Again, it's, in principle, a timing issue.

I mean, that's the -- the pitch as I understand it from Centra. In the long run, it's pretty much -- the expected results should be pretty much the same as the market, apart from the administrative and hedging costs. Just so we're --

MS. MARLA MURPHY: That's true over the long term --

MR. MARK STAUFT: In the long term, yeah. Now -- and I think -- but obviously in the short run, you can get significant ups or downs in -- in gas costs within a year as a result of hedging, obviously.

MS. MARLA MURPHY: And the benefit of hedging is that it removes some of those spikes in the prices; the highs and the lows?

MR. MARK STAUFT: Well, yeah. Whether -- although removing the lows isn't necessarily a benefit, right? It's not a benefit, but --

MS. MARLA MURPHY: It is if your goal is --

MR. MARK STAUFT: -- realise --

MS. MARLA MURPHY: It is if your goal is to control volatility.

MR. MARK STAUFT: I suppose, yeah. Well, I think people would much rather have the lows than no volatility, right? It's just the -- the getting rid of the -- the lows is the price of getting rid of the highs, really. It's not -- it's not so much volatility as an abstract objective, I wouldn't think. If people could get rid of the lows, good for them; they'd probably say that was a good idea.

MS. MARLA MURPHY: Did I understand your evidence to suggest that customers prefer rate adjustments, such that their bills remain the same, rather than impacting the price for their gas?

MR. MARK STAUFT: I don't think I said that. I mean -- can you --

MS. MARLA MURPHY: Well -- no, I'm not -- I --

MR. MARK STAUFT: -- where are you --

MS. MARLA MURPHY: -- I think I'm paraphrasing what you said when you said the customers are more -- care more about their bill rather than their rate.

MR. MARK STAUFT: Okay.

MS. MARLA MURPHY: That they don't want hedging.

MR. MARK STAUFT: I don't think I said people don't want hedging. What I said was -- or my -- it seems to me a common sense perception that people, and as well, consistent with the focus group and the results and the -- and the customer survey -- that when people are looking at their gas bills, what they're primarily interested in is how much they have to pay at the end of the day, and not the intricacies of what rate numbers are changing six (6) lines up in the bill, from month to month.

It's not a -- you know, I mean that's not based on customer research, it's not based on any expertise I may claim in how consumers behave; it just seems to me like a common sense observation and one that, as I said, is consistent with the -- the research that -- that Centra has done.

DR. MARC VAN AUDENRODE: Can I -- can I add something, because I heard -- and I heard it on several -- several occasion during this hearing, that -- the claim that the hedging program necessarily, over the long run, has zero cost for the customers, and I don't think that's necess -- necessarily true.

The way the hedging program is set, as I understand, is buy selling on one hand your willingness to pay more if rates are very low, against purchasing the right to pay less if rates are very high.

And the -- you know, the definition of what's very high and very low is -- depends on setting the cost of these two (2) sides of the deal to be equal and make it cost less. Now, from what I understand, and I don't know exactly how you do that but that's a very complex product, which I would think is done over the counter. There is no general market for that.

And banks don't do that over -- on the goodness of their heart. They -- they sell that because they know that on the other hand they have two (2) other customers who are willing to take the opposite position. But in these deals, there's always one (1) deal which is more difficult to sell than the other.

And so I don't think there is any guarantee in the design of the mechanism that tells you you're going to hit the -- the ceiling the same -- the same number of times as you're going to hit the floor, over a long period of time. And I -- I mean, I'm -- I'm not saying it's impossible that this happen, but I'm saying there's nothing in the design, from what I understand of this, the design of that hedge that guarantees it.

(BRIEF PAUSE)

MS. MARLA MURPHY: Mr. Chairman, I don't know if you're ready for a break, if this might be a good time, or if you'd like me to carry on for a little bit further.

THE CHAIRPERSON: I won't say we're always ready for a break, but we'll take the break now. We'll make it a little bit shorter, so we'll be back no later than twenty (20) to 11:00.

--- Upon recessing at 10:25 a.m.
--- Upon resuming at 10:43 a.m.

THE CHAIRPERSON: Anytime you're ready, Ms. Murphy.

CONTINUED BY MS. MARLA MURPHY:

MS. MARLA MURPHY: Thank you. I just want to return to the -- to an understanding of two (2) of your recommendations which appear, at least at first, to be at odds.

The first is that you think that Centra should not hedge it's systems supply offering.

And the second is that Centra should offer a fixed-price offering.

Would you agree with me that inherently a fixed-price offering requirements hedging, or at least practically requires hedging?

MR. MARK STAUFT: It may do as a

practical matter, but I think they're quite different contexts. I don't see them as being inconsistent.

MS. MARLA MURPHY: You suggest that the Utility should refrain from hedging, on the one hand, in respect of its System Supply offering. But on the other hand you advocate that fixed-price offering should be put forward. And I think the expectation is that, certainly on the part of a utility, that product would require that we hedge in order to offer it. Is that fair?

MR. MARK STAUFT: Right. But those are hedges entered into for completely different purposes.

MS. MARLA MURPHY: Perhaps you can explain that for me.

MR. MARK STAUFT: Well, the -- the generic hedging program is aimed at creating a specific price effect for what is otherwise a variable -- variable product. I, at least, think of the whatever hedging or long-term gas purchases may be required to provide a fixed-price product, that's just part of the -- part of what's required to provide that product.

It's just part of producing that product. It's just one of the things that you -- you need to do. Or you may feel like you want to do anyway.

MS. MARLA MURPHY: And in Centra's view, based on the customer research that it's done, we think that that's the appropriate characterization for a default product. So how is it different?

MR. MARK STAUFT: No. But I mean, that's -- there we're talking about different definitions of what the default product is. Right. I mean, when you're talking about a one (1) year fixed-price product, it is what it is. It's a one (1) year fixed-price product and how Centra creates that is one (1) problem.

The -- the question about -- disagreement about whether the default product should be hedged or unhedged is -- goes to the question of what the product should look like or what -- how it's defined.

Just because it's called a default product doesn't mean there's a single thing that we're talking about, in the same sense as we're talking about a one (1) year fixed price product.

MS. MARLA MURPHY: And the fact that it's a -- a default product or the system product, doesn't necessarily require that it be unhedged does it?

MR. MARK STAUFT: No.

MS. MARLA MURPHY: Would you agree with me that when Centra -- assuming Centra is to offer a fixed price product, they would undertake some hedging to do that and that would involve a certain amount of risk?

MR. MARK STAUFT: Go ahead.

MR. MARC VAN AUDENRODE: Yeah, aside from the volume risk which will always be there for any product, I don't see where the risk would be for -- for Centra.

MS. MARLA MURPHY: Do you acknowledge that the volume risk for natural gas in Manitoba is a significant one?

DR. MARC VAN AUDENRODE: Oh yeah, there is a volume risk and you need to manage it.

MS. MARLA MURPHY: Have you undertaken any study to quantify what that risk might be?

DR. MARC VAN AUDENRODE: No, I haven't.

MS. MARLA MURPHY: Mr. Stauft, in your evidence, you suggested that that risk should be spread as -- as evenly as possible over all of Centra's customers, is that right?

MR. MARK STAUFT: Sorry, which risk?

MS. MARLA MURPHY: The risk associated with offering a fixed price product and the -- what I would call the volume risk that's associated with that.

I'm referring to page 70 in line 7 through 20 of your evidence.

MR. MARK STAUFT: Right.

MS. MARLA MURPHY: Sorry, 71.

(BRIEF PAUSE)

MR. MARK STAUFT: Right. And this is in the context of a discussion of how Centra might design and -- and offer a fixed price product.

I'm not sure that I said, as a general principle, that volume risk should be spread over customers, generally. I --

MS. MARLA MURPHY: I'm reading from line 7 and -- through 10 where you say:

"Floating price customers would bear the residual risk associated with minor mismatches between fixed price supply and fixed price sales..."

MR. MARK STAUFT: Right.

MS. MARLA MURPHY: "...through the operation of the PGVA."

MR. MARK STAUFT: Yeah. Under one (1) of the scenarios that I identify here for how Centra could do it. This whole section, as I think I said in my -- my oral direct testimony, is intended to be an analysis of the options and the pros and cons without necessarily involving any recommendations by me.

I mean, it's just an observation more than anything. And the observation is, that if you -- if you fix the price, if you're offering people a fixed price product, you're probably going to end up with either an under or over recovery of costs at the end of the period, and that has to be dealt with somehow.

I mean, I talked about this with Mr. Peters as well. It has to go somewhere. I guess you could try to shift it forward to the next period's fixed price customers or the option that's being talked about here is basically shift it in -- into the general PGVA, which under certain conditions might work fine.

But there's lots of different ways that it could be done.

MS. MARLA MURPHY: Well, the reason I brought it to your attention is that I understood your response to Mr. Peters to be a different one; that is that it -- it should follow the people who buy that particular product rather than being spread over all the customers and I'd like to have an understanding of -- of what your recommendation is in that regard.

(BRIEF PAUSE)

MR. MARK STAUFT: I mean yeah -- I mean at a general sort of rate making principle level, that's the result that you would like to have, right? That risks and costs, follow the customers that -- that cause them to be incurred.

But, you know, in -- in real life, depending on the design of the products that you're talking about and how -- what other constraints you may have in terms of who risk can or can't be shifted to, and how it gets compensated for. There may be practical adjustments that need to be made in -- in that kind of thing, and it's one of the options that's -- well, and that -- the scenario that's being talked about in the paragraph that we're talking about here, would involve Centra putting those variances into its general PGVA.

Again, it's a -- it's a volatility increment to the system sales customers, which may or may not be large. It may or may not be handleable in some other way. It may or may not be compensated for through some increment to the price of the fixed price product. There's all kinds of issue that will have to be thought about and -- and resolved when Centra goes to -- to design these products.

And Centra may come up with, you know, some other alternative, or some better alternative, than the ones that I identify in -- in here that -- that they like better, and that everybody likes better. That's possible.

MS. MARLA MURPHY: Mr. Saxberg, could I ask you to provide PUB/CAC-3 to Dr. Van Audenrode please.

(BRIEF PAUSE)

MS. MARLA MURPHY: Are you familiar with that response, Dr. Van Audenrode?

DR. MARC VAN AUDENRODE: I am not, but -- no, I'm not.

MS. MARLA MURPHY: Maybe I'll just give you a minute to read through it. I have some questions for you.

(BRIEF PAUSE)

MS. MARLA MURPHY: I can probably help your reading a little bit. I want to look at the response to Part B.

(BRIEF PAUSE)

DR. MARC VAN AUDENRODE: Okay.

MS. MARLA MURPHY: In Part B of that response, it's indicated that a market power analysis is undertaken to determine whether there are comp -- there is competition in the market, sufficient to constrain prices to a competitive level.

And I just wanted to address with you how that's tested. I understand when the Competition Bureau considers such a question, that they use what they call a "four-firm concentration ratio" to assist in their determination of whether there is a risk of an exercise of market power.

DR. MARC VAN AUDENRODE: Yes.

MS. MARLA MURPHY: Is that your understanding?

DR. MARC VAN AUDENRODE: Yeah.

MS. MARLA MURPHY: And my understanding of the -- that characterization is that they look at what share of the market the top four (4) firms make up, is that fair?

DR. MARC VAN AUDENRODE: Yes.

MS. MARLA MURPHY: And I understand that if that ratio is above 65 percent that the Competition Bureau then has concerns. Is that your understanding?

DR. MARC VAN AUDENRODE: I'm not sure about the 65 percent number, but I would take your presentation, yeah.

MS. MARLA MURPHY: In the case of Manitoba's Natural Gas Supply, what would the four-firm concentration ratio be?

DR. MARC VAN AUDENRODE: I've no idea; haven't done this. But from what I understand, they aren't four (4) competitors --

MS. MARLA MURPHY: That was my point. Given that there's only two (2) brokers, plus the regulated Utility, that the percentage would have to be 100 percent, wouldn't it?

DR. MARC VAN AUDENRODE: Yeah.

MS. MARLA MURPHY: Absent regulation, would you expect that to cause a concern?

DR. MARC VAN AUDENRODE: Well, "cause a concern" is the right word, and -- you know, because there are cases where two (2) players are sufficient to lead to -- to competition. There are cases where it's way too few. But you know, "cause a concern," I think, is the -- is the right word.

S. MARLA MURPHY: And the availability of a regulated product can act to mitigate that concern?

DR. MARC VAN AUDENRODE: That's what I have been arguing yesterday; saying it would work as a benchmark.

MS. MARLA MURPHY: And from that perspective it's important that the Utility's offering remain viable, is that fair?

DR. MARC VAN AUDENRODE   Yes.

MS. MARLA MURPHY: And would you agree with me that that will continue to be the case as long as there's a small number of participants in the market?

DR. MARC VAN AUDENRODE: I wouldn't know. I mean, I -- I don't really know how many participants in a market you would need or -- or how many participants in a market would be a problem for Centra. I don't know. I haven't done that study.

MS. MARLA MURPHY: I think I was looking at that from a different perspective. Regardless of whether or not 20 percent or 30 percent or 50 percent or 80 percent of customers take up those products, you still have the concern about an exercise of market power, if there's a small number of offerings in the market, don't you?

DR. MARC VAN AUDENRODE: But again it's a concern. There is nothing mechanical or thematic in -- in these considerations.

MS. MARLA MURPHY: Would you agree with me that in the context of the fixed price offering market that Centra offer -- operate -- offering a regulated fixed price offering would provide some regulatory constraint?

DR. MARC VAN AUDENRODE: A benchmark. I think I used the term "benchmark", yesterday.

MS. MARLA MURPHY: And I think you suggested to Mr. Peters that -- the other day, that the market is in fact segmented; that there is two (2) different segments to the market, one (1) which purchased fixed price products and one (1) which purchases a default supply?

DR. MARC VAN AUDENRODE: I think I said that. I think I even said that we could look at the market as Centra having 100 percent of the fixed price market and zero percent of the variable rate market.

MS. MARLA MURPHY: You actually mean the reverse, don't you?

DR. MARC VAN AUDENRODE: I'm sorry.

MS. MARLA MURPHY: Yeah.

DR. MARC VAN AUDENRODE: I'm sorry, yes.

MS. MARLA MURPHY: And if you look at it in that sense, it becomes even more desirable for Centra to offer a fixed price product that's regulated.

DR. MARC VAN AUDENRODE: I -- as I said, I tried to be as agnostic as possible with -- with respect to that, because I haven't done the exact study and -- and actually there are two (2) competitors on the long-term rates.

What I have said is because of all these considerations I think that allowing Centra to offer a long-term regulated product was a simple, easy, and -- and efficient solution to make sure that customers who want to participate in the fixed rate market would -- would get -- a price that get as close as possible to competitive price.

MS. MARLA MURPHY: Thank you. The final area that I wanted to address is with respect to the code of conduct. And I understood the evidence from both of the panel members yesterday to be that, certainly at first blush it made sense that Centra should be bound by the code of conduct. And I also understand that at least, Dr. Van Audenrode, you hadn't had an opportunity to read that code of conduct.

I'm wondering if you've had the opportunity, or if you enjoyed the hockey game last night?

DR. MARC VAN AUDENRODE: Do I really have answer that?

MS. MARLA MURPHY: Do you know the score in the hockey game?

DR. MARC VAN AUDENRODE: Well, anyway, that wouldn't definitely be my area of expertise.

MS. MARLA MURPHY: Okay. Are you aware that the -- either of you I suppose, are aware that the code of conduct was developed for use with licensed and unregulated marketers?

MR. MARK STAUFT: That's my understanding, yes.

MS. MARLA MURPHY: And, Mr. Stauft, you've reviewed the code of conduct?

MR. MARK STAUFT: I have but I'd have to say not recently and not last night, so I may not be able to help you very much. I did not go to the hockey game.

MS. MARLA MURPHY: Would you agree with me that there are certainly some sections which wouldn't apply to a regulated utility?

MR. MARK STAUFT: I think that argument could probably be made. I mean, I -- I think I have expressed a view in an IR response that, again with the qualification that I hadn't thought about it and I wasn't really asked by CAC to think about it, I said, you know, in general terms it would make sense for Centra to be subject to the code of conduct.

Now, in saying that, I'm assuming that the basic thrust of the code of conduct is that people who are selling natural gas supplies shouldn't be misleading, or cheating, or treating people unfairly. And if that's the major thrust of it, I don't see why Centra should be exempt from that requirement.

You know -- now I mean, it may be that there are particular technical requirements that are imposed in there that just are plainly not applicable to Centra; just don't make any sense in the -- in the case of Centra.

And I assume that in any sort of review of the code of conduct in a forum where the witnesses are better informed than I am about this, that kind of thing would be -- would be reviewed.

So I'll agree with you that there may well be arguments for Centra to be exempted from certain parts of it, but I -- I couldn't tell you what those are. And I wouldn't have an opinion on whether the arguments are persuasive or not to me. Again, my comments were just at a much more general level than that.

MS. MARLA MURPHY: I guess I sort of lied a little bit. I said that was my final area but I do have one (1) more question.

There's a suggestion that in -- in some of the evidence that if the Utility offers a fixed price, fixed term contract, that it would be in direct competition with the brokers. And I wanted to understand your view of whether or not in order to be in direct competition, it's necessary for the terms of the products that are offered by Centra and the brokers to be identical.

(BRIEF PAUSE)

DR. MARC VAN AUDENRODE: First, yeah, sometimes the mere threat of offering a product can serve very effectively as some type of way to get competition. So what I'm concerned about in this case is the situation where it is clear that Centra has no ability to get into this long term market. So that's the first thing.

So they -- they wouldn't need to offer the exact same products as the -- as the brokers but, you know, I think they should be allowed to -- to do it. And -- and I would expect that these product, not necessarily be exactly the same, but probably closer than, you know, the two (2) extremes that which we are -- one being the current complete -- almost completely -- completely variable ways or -- or this sort of extreme, which is a, you know, a five (5) year commitment that just people won't make anymore.

MS. MARLA MURPHY: And if Centra were to offer a one (1) or two (2) year term would you expect that the price of that would be comparable to a four (4) or five (5) year term?

DR. MARC VAN AUDENRODE: I mean there are so many variable involved in that that I really can't answer that. But I would say a priori, there is no reason to expect that the one (1) -- the price for a one (1) year contract could be same as the price for two (2) years and -- or a four (4) year, five (5) year.

MS. MARLA MURPHY: And do I understand it's your view that they would -- there would still be sufficient comparability, that that would be sufficient to address some of the concerns of the exercise of market power?

DR. MARC VAN AUDENRODE: I would think so. Obviously I haven't done the study but you know, at least that would be much closer than where we are today.

MS. MARLA MURPHY: Thank you, Panel. Mr. Chairman, those are our questions.

THE CHAIRPERSON: Thank you, Ms. Murphy. We'll move now to Mr. Hoaken.

Mr. Hoaken, are you ready to begin?

CROSS-EXAMINATION BY MR. ERIC HOAKEN:

MR. ERIC HOAKEN: I am. Thank you, Mr. Chair and good morning to the Panel. I think in view of how things have unfolded, unlike those who have gone before me, I'm going to direct my questions to one (1) of you.

But that's not to say that if the other of you has views or comments that are helpful, please add those or share those.

I'm going to start with you if I may? I'm going to start -- excuse me, with Mr. Stauft if I may.

You said in the course of your examination-in-chief at the beginning of the day yesterday, you talked about some of the expectations that you had at the time of the 1996 Hearing and coming out of that Hearing, right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And you said that your hope or expectation was that severing the link that the customer had with the Utility would lead to a proliferation of product offerings in this province, right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And I take you'll agree with me though that even though following the Board's Decision in 15/98 that consumers in Manitoba were able to contract directly with brokers, that link with the Utility was not completely severed, correct?

MR. MARK STAUFT: There is a link with the Utility in a sense that the Utility is -- is the delivery vehicle. That -- what I was talking about was the contractual link that existed through the buy/sell mechanism, but no -- certainly there's still a link, obviously.

MR. ERIC HOAKEN: Right. There's -- there's a continuing link in a couple of ways. Billing, for example.

MR. MARK STAUFT: Right, yes.

MR. ERIC HOAKEN: And also as you detailed, I think yesterday, to Mr. Peters, there certainly is a link as far as the WTS arrangements are concerned?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: In the sense that a Direct Purchase customer receives his or her gas through -- through exactly the same delivery mechanism as does the System Supply customer?

MR. MARK STAUFT: That's correct, yes.

MR. ERIC HOAKEN: And you -- you also said that your hope was that as a consequence of the opening up of the market in Manitoba that more participants would be attracted to come and offer products, is that right?

MR. MARK STAUFT: That's right, yes.

MR. ERIC HOAKEN: And I take it at the time that you had that hope or expectation, you knew about the size of the Manitoba market and how it compared to the markets in Ontario and British Columbia, for example?

MR. MARK STAUFT: Sure, yes.

MR. ERIC HOAKEN: Right. And you knew as well -- I think you talked earlier this morning about some of the structural features that may be different, but you certainly knew in 1996 or '98, when you had that hope or expectation, you knew about those differences in market structure.

MR. MARK STAUFT: Sure. I knew about the differences in market structure, but I wouldn't have known what effect, if any, they would have on the -- on the -- the actual development of the Manitoba market.

MR. ERIC HOAKEN: Sure. And my point is simply that even though you knew about the small size of the market, and even though you knew about some of those features, you still thought it was reasonable to expect that there would be more participants attracted to this market place.

MR. MARK STAUFT: Sure. Given the facts that I had at the time, sure, it was -- it was reasonable.

MR. ERIC HOAKEN: And -- and you said as well that your expectation, at that time, was that competition would lead to a squeezing out of the Utility sale service, is that right?

MR. MARK STAUFT: Potentially yes. Yes.

MR. ERIC HOAKEN: And that, to your knowledge, hasn't happened in any jurisdiction in Canada, has it?

MR. MARK STAUFT: No, it hasn't.

MR. ERIC HOAKEN: Right. And so in fairness, and not being critical, that perhaps may not have been a realistic expectation, is that fair?

MR. MARK STAUFT: I think that's fair. Certainly in retrospect, it was completely wrong, so --

MR. ERIC HOAKEN: Right. And my point simply, Mr. Stauft, is we can't conclude from the failure of that to happen, that this market is not functioning appropriately.

MR. MARK STAUFT: Fair enough. Sure.

MR. ERIC HOAKEN: Thank you. Now, one of the dangers of going last is I have to try not to tread on territory that has been well covered by my able colleagues, but let me just quickly review the landscape as I understand it.

And that is, I think we're all in agreement that there are a number of consumer benefits in circumstances where there is an efficiently functioning competitive market, right?

MR. MARK STAUFT: As a general principle, I think I -- we've all agreed on that, yes.

MR. ERIC HOAKEN: I just wanted to make sure I've been paying attention appropriately.

And one (1) of those consumer benefits that you've identified is that there'll be a lower price for consumers, right?

MR. MARK STAUFT: Well, yes, a competitive price. Yeah.

MR. ERIC HOAKEN: Right. But I take you to be saying something more than that. You're saying a lower price than would be the case in the absence of competitors, or the absence of competition?

MR. MARK STAUFT: Well, with competition, you will get a lower price than you would get in the absence of competition, and in the absence of regulation. You'll get, likely, a lower price than you would get if you have an unregulated monopoly.

MR. ERIC HOAKEN: But even where there is regulation, in the absence of competition you will have or may have a higher price than you'll have in the presence of competition, correct?

MR. MARK STAUFT: Well, the regulated -- the prices of the regulated service are, you know, in

principle regulated at a level that is intended to mimic or reflect the
-- what the regulator thinks the competitive outcome would be so --

MR. ERIC HOAKEN: But may actually not?

MR. MARK STAUFT: It may not. I mean, I agree that rate regulation is not a perfect science. I don't think anybody makes that claim but whether it's higher or lower maybe, maybe not.

MR. ERIC HOAKEN: But you were taking us through the bad old days yesterday, talking about the days of the buy/sells and what you said, as I understood it, Mr. Stauft, is that the presence in the marketplace of the buy/sell arrangements, or at least marketers who are able to use the buy/sell arrangements --

MR. MARK STAUFT: Right.

MR. ERIC HOAKEN: -- had a downward effect on the price that was being charged by the regulated utility, correct?

MR. MARK STAUFT: That's true, yes.

MR. ERIC HOAKEN: Right. So that I take it, you'll agree, is one (1) example that substantiates the point that even where you've got regulation, the presence of competitors in the market can have a downward effect on the price.

MR. MARK STAUFT: It can have in the particular fact situation that -- that you're faced with. I mean I -- I thought your earlier proposition was that it would always do that and I disagreed with that. In -- in the facts -- or in the situation that existed that -- that you were just mentioning when the buy/sell was first introduced, yeah, there was a particular set of facts around how Centra acquired its gas supply that made that a very effective discipline on Centra's sales rates.

So it can. I -- if that's your point, I agree of course. It's logically possible for that to happen. It may happen, depending on the facts, it may not.

MR. ERIC HOAKEN: Now, there's a further benefit of competition that you've told us all about, and that is the availability of choices of products that would not otherwise be available, right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And you and Ms. Murphy had some discussion a short while ago about the value to the marketplace of that choice, in the present context in Manitoba.

And as I understood you, you said that there's a product that permits a consumer to seek and obtain protection from rate volatility, that otherwise would not be available or of a type that would otherwise not be available in the marketplace.

MR. MARK STAUFT: In the form of fixed-price contracts you're talking about?

MR. ERIC HOAKEN: Yes.

MR. MARK STAUFT: Yes, that's the effect of -- of a fixed-price contract.

MR. ERIC HOAKEN: Right. And the effect further, is to insulate the consumer who elects to enter such a contract from unforeseen or unforeseeable events that may cause the commodity price to increase in the future?

(BRIEF PAUSE)

MR. MARK STAUFT: Yes, that -- that may cause a variation in its -- the price of its alternative and -- which is presumably the Centra sales rate.

MR. ERIC HOAKEN: Now, I don't want to take you outside of your area of expertise, and perhaps I'll ask you this and then turn to your colleague to ask his views as well, but let me start with you, Mr. Stauft.

A further benefit of competition, I take it you'll agree, is that the presence of competitive firms in any given marketplace helps to prevent the emergence of a dominant firm, right?

(BRIEF PAUSE)

MR. MARK STAUFT: I'm not sure I quite understand the question. If -- if there is a dominant firm -- well, I mean I guess at a very general level that sort of makes sense just as a matter of the meaning of the words you're using --

MR. ERIC HOAKEN: Okay. Well, let's go with what I thought you were going to say, is let's take it to the next step. Perhaps this is more helpful, is to say if there is indeed a dominant firm, the -- the presence of competitive firms in the marketplace helps to prevent that dominant firm from abusing its dominant position.

MR. MARK STAUFT: In an unregulated context that's true. If you have an unregulated market where there's a dominant firm, then the more competition -- competition, in principle acts as a constraint on the dominant firm. In -- in a case where the dominant firm is regulated, I mean, there -- there may be that effect, but the primary constraint on the behaviour of the dominant firm is -- is the -- the regulator.

That's why they're regulated, because they're -- they're dominant and they -- they need to be constrained by somebody and competition isn't -- isn't there to do it.

MR. ERIC HOAKEN: And so is it your view -- are you saying that the regulator is always going to be effective in constraining the -- the conduct of the dominant firm, if it's a regulated firm?

MR. MARK STAUFT: Well, that's their job; that's what they're supposed to do. You know, I mean, arguments can arise about how effective they are and whether they've done it right and -- and, you know, there may be a argument to be made at a theoretical level, but in principle, competitive forces might do it better, if they were there.

If they existed in -- in the context. But in general, I think the assumption has to be that regulators do what their legislation requires them to do.

MR. ERIC HOAKEN: All right, let me just ask you to pause and turn to Dr. Van Audenrode.

Do you have anything to add to that, Doctor?

DR. MARC VAN AUDENRODE: I think Mr. Stauft covered it pretty well, I think. If you are talking in -- in an unregulated market, it is clear that, you know, the presence of a smaller firm or competitors can act as a discipline device.

I -- I wouldn't disregard too much the -- the threat of entry. I mean, competition works equally because you actually have competitors, but it can work very well because you simply have the threat of having competitors and that works very well as a discipline device.

MR. ERIC HOAKEN: All right, thank you. Let me turn back to you, Dr. Stauft. Or -- sorry, I've just elevated you. Mr. Stauft.

Let's talk about market power. As I understand it, market power is normally defined as the ability of a firm to profitably increase the price of its product above the competitive level for a sustained period.

Is that a fair summary?

MR. MARK STAUFT: That's my understanding, yes.

MR. ERIC HOAKEN: And under competitive conditions, the market price of a product is going to be determined by the interplay of market forces at a level that reflects -- sorry, that reflects, more or less, the cost of producing the product, including the market return or a market return on capital employed in the production process? Is that fair?

MR. MARK STAUFT: Again, that is my understanding, yes.

MR. ERIC HOAKEN: And market power arises where a firm faces few or no effective competitors, and where customers therefore do not have an adequate competitive alternative to the firm's product, is that fair?

MR. MARK STAUFT: Again, I agree with that, yes.

MR. ERIC HOAKEN: All right. And the presence of market power is often associated with industries that are natural monopolies, right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And the utility industries are usually thought to exhibit natural monopoly characteristics, correct?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And so in that context, economic regulation that you referred to, as were answering my previous question, is commonly referred to as a substitute for competition, with the goal being to replicate, as closely as possible, the pricing and the output results that would be observed if the industry in question were competitive, right?

MR. MARK STAUFT: I agree with that, yes.

MR. ERIC HOAKEN: All right. And although the goal --

MR. MARK STAUFT: Sorry, go ahead.

MR. ERIC HOAKEN: And although the goal of utility regulation is to replicate the competitive outcomes, as we've just said, it's unlikely to be a perfect substitute for effective competition, fair?

MR. MARK STAUFT: I think I conceded that to you here just a while ago, yes.

MR. ERIC HOAKEN: All right. And there are also as I think we discussed and agreed thus far, there are incremental costs involved with adopting economic regulation as a response to market power, right?

MR. MARK STAUFT: Some, yes.

MR. ERIC HOAKEN: And although this may sound like heresy in this room, and it's not intended to be disrespectful, the truth is that regulators can sometimes make mistakes in relation to utility costs, and have costs that have some uncertainty associated with them, right?

MR. MARK STAUFT: I agree with that, yes. I have been involved in many utility regulatory proceedings where one (1) or both sides are basically making that suggestion, so that's the nature of the process, yes.

MR. ERIC HOAKEN: Okay. And you'll agree with me that the mechanics of maintaining prescribed prices and enforcing non-discrimination requirements, may prevent regulated utilities from responding as flexibly as competitive firms would to customer needs, in relation to service attributes in pricing structures, is that fair?

MR. ERIC HOAKEN: Again, I think that just is part of the nature of utility regulation and yes, I agree with that.

MR. MARK STAUFT: Okay. Let me give you a break and Dr. Van Audenrode if he disagrees with any of those propositions that I've just put to you, and to what you've just agreed.

DR. MARC VAN AUDENRODE: No. I just wanted to add one (1) thing -- one (1) thing, which from an economist might -- might sound as an heresy too, which is markets make mistakes sometimes too.

MR. ERIC HOAKEN: Right there's --

DR. MARC VAN AUDENRODE: I don't know if you've watched the new recently, but you know, markets make mistakes and big ones.

MR. ERIC HOAKEN: That's the only way I can explain the performance of my RRSP.

And so it sounds as though you would both agree that the -- the presence of competing firms in any given marketplace could also lead to innovations in products and services. Is that a fair statement?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And those are innovations that would not happen in a competitive marketplace? Or excuse me, in a non-competitive marketplace.

DR. MARC VAN AUDENRODE: By non-competitive, you mean --

MR. ERIC HOAKEN: Where there was a monopoly.

DR. MARC VAN AUDENRODE: I -- I don't think that's a fair statement. It would -- I don't know if Microsoft would -- would love my characterization of them as being monopoly but they're a very, very innovative firm.

MR. ERIC HOAKEN: I expect you'll be hearing from their counsel this afternoon.

DR. MARC VAN AUDENRODE: Yeah, I know.

MR. ERIC HOAKEN: Now going back to you, Mr. Stauft, your premise as you expressed in your pre-filed evidence and as you've expanded upon in the course of these proceedings, is that the theoretical benefits of competition and it sounds like we all agree on what those are; that the theoretical benefits of competition are not presently being realized in Manitoba, is that right?

And I'm sorry, just before I let you answer that question, I think to be completely fair to you, you -- you may have stated that -- that definitively in your pre-filed evidence, but I think you've quite fairly qualified that and said simply they might not be being realized.

MR. MARK STAUFT: I -- I was going to say, yeah, I think the numerous exchanges I had with Mr. Peters on that I -- I didn't want to be taken as -- as claiming sort of -- sort of factual conclusion on that.

I -- I think I told him there are reasons to be concerned about that.

MR. ERIC HOAKEN: That's quite right. Thank you. And so starting then with your assessment of the reasons why those theoretical benefits of competition may not be being realized in the Province.

Let's start with price. As I understood you in cross-examination with Mr. Peters, you agreed that Centra has certain advantages, or may have certain advantages in acquiring gas over brokers, right?

MR. MARK STAUFT: They -- they may have, just of a scale nature.

MR. ERIC HOAKEN: Right, exactly. That's what I was going to say, is that certainly the wholesale gas market is one where size matters, right?

MR. MARK STAUFT: To some extent. At the extremes it matters. I mean, there's a broad middle range, I think, where it doesn't, and I can't be any more specific than that. But it's possible, yes.

MR. ERIC HOAKEN: And so Centra has or may have an advantage when it comes to gas acquisition and the costs that it incurs in doing that. That's your assessment, as I understand it, is that accurate?

MR. MARK STAUFT: As I said, I think it's possible, but I would not make that assumption, actually. I mean, Direct Energy is a fairly substantial firm; its total gas purchases may be more than Centra's. In fact, I would guess they are, if you look at its operations all across Canada. So I would be very surprised if there's any substantial difference between the two (2) firms.

MR. ERIC HOAKEN: And in terms of the pricing, though, of the products, I understood you to say that Centra has a pricing advantage in the sense that its price, per primary gas product, doesn't need to embed a profit element, right?

MR. MARK STAUFT: That's correct.

MR. ERIC HOAKEN: But I think you both

said, quite fairly, that when looking at price and when assessing the appropriateness of the price being charged by the retailers for their products, it's not a meaningful comparison to look at the prevailing rate that Centra is charging for its product and compare it to the rate being offered for three (3) and five (5) year contracts, is that right?

MR. MARK STAUFT: That's correct, yes.

MR. ERIC HOAKEN: And I think, Dr. Van Audenrode, what you said is that it's simply not the same product and so why would you expect it to have the same price, right?

DR. MARC VAN AUDENRODE: That's what I said, yeah.

MR. ERIC HOAKEN: And you said this morning that the Utility price serves as a benchmark for the brokers' price but I don't take you to be suggesting that the price of the variable offering of the Utility is going to provide much meaningful information about the appropriateness of the price being charged by marketers for long-term products.

DR. MARC VAN AUDENRODE: I believe I said that a regulated long-time -- long-term price would serve as a benchmark.

MR. ERIC HOAKEN: I certainly understood

that but I thought even before you used the term "benchmark" with Ms. Murphy in the context of the long-term products, I thought you used it in connection with the variable rate product.

DR. MARC VAN AUDENRODE: I'm not sure I did that. I can't remember --

MR. ERIC HOAKEN: All right. And it doesn't matter, I think it sounds that we're at ad idem; that the price being charged by Centra for its variable right -- variable rate product really provides no meaningful information about the reasonableness of the price being charged for the brokers for their products.

DR. MARC VAN AUDENRODE: I -- I mean, we'd have to agree on what you mean by "reasonableness." I would prefer maybe objective fairness but yeah -- no, I agree, it's simply not the same product.

THE CHAIRPERSON: Gentlemen, by the way, I think we've got a problem with the mics and the reason is, is that, Doctor, I think if you switch yours off when you finish speaking it will probably clear it up. They're just not sophisticated enough to be able to handle two (2) on at the same time.

(BRIEF PAUSE)

CONTINUED BY MR. ERIC HOAKEN:

MR. ERIC HOAKEN: So if we're trying to get some understanding then of not the unit price but rather the overall gas costs, that a System Supply customer has in comparison to a Direct Purchase customer, the only way to do that is to perform a historical comparison, right?

DR. MARC VAN AUDENRODE: I -- no, I disagree with that.

MR. ERIC HOAKEN: Okay.

DR. MARC VAN AUDENRODE: I mean, the fairness of a long-term price is set exactly not exposed. Whatever happens in reality, once you have entered into that deal you might be very disappointed, you might be very happy, but that has nothing to do with the fairness of the price.

MR. ERIC HOAKEN: Okay. And that wasn't my question. Maybe I should have been more precise.

I'm talking about the cost. I'm talking about if you have a consumer who needs to heat her home for five (5) years, she is going to spend X-amount, right?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And you could look at -- you could easily do the historical comparison by looking at a consumer who from, for example, August 1, 2000 to August 1, 2005, purchased her supply from the Utility, in comparison to a consumer who purchased from Direct Purchase.

DR. MARC VAN AUDENRODE: You could certainly do that, yes.

MR. ERIC HOAKEN: And I'm not suggesting that that comparison is going to yield helpful information about the fairness of the price charged by the broker; that wasn't my question. But what it will do, is it will tell you whether or not the amount that that consumer paid was more or less than if she had stayed with System Supply?

DR. MARC VAN AUDENRODE: Obviously, yes.

MR. ERIC HOAKEN: Right. And if that consumer, or consumers, based on a comparison such as that, are spending less than they would have spent had they been on System Supply, those consumers are deriving a benefit?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: Right. And then the only question then becomes: Is the price that they paid to acquire that benefit an appropriate one?

DR. MARC VAN AUDENRODE: Well, again, I mean I -- I would want to insist on the fact that consumers might be very happy, as you said; consumers might be very disappointed in their decision to go with a fixed-price contract, and that has absolutely nothing to do with whether or not they paid a fair price for entering that deal.

MR. ERIC HOAKEN: The second category that I think we talked about as a benefit from competition, is customer choice. And I think you've now both agreed that the presence of gas retailers in this province have provided customers with choices they otherwise wouldn't have had, right?

DR. MARC VAN AUDENRODE: Yes, I did anyway. Yes.

MR. ERIC HOAKEN: And as I read your pre-filed evidence at page 21, Mr. Stauft, you appear to be suggesting that these contracts that customers have availed themselves of, are of limited value or use?

(BRIEF PAUSE)

MR. MARK STAUFT: Sorry, can you give me the line number you're looking at there or just let me get myself oriented?

(BRIEF PAUSE)

MR. ERIC HOAKEN: It's page 21, starting at line 12.

And at line 16 you say under -- sorry, even under ideally competitive conditions it's best -- sorry -- at best an even bet. And then you say from an objective perspective, the customer is more likely to lose than to win, right?

MR. MARK STAUFT: Just based on the analysis that goes before that, yes.

MR. ERIC HOAKEN: Okay. Well, explain that analysis to me, because what I would like to better understand is what data there are that substantiate the view that the consumer signing up for Direct Purchase is more likely to pay more for her gas.

MR. MARK STAUFT: The analysis is simply based -- one based on -- that we're talking about here -- is based on the cost of producing the service. The observation is that really the only component of the service on which the retailers compete is the gas acquisition function.

In principle or in general, I would expect that brokers not to be able to purchase gas anymore cheaply than Centra on a systematic basis. And on top of that they appear to have, or they do have, some costs at some level, that Centra doesn't have.

So if you imagine that their prices are set under competitive conditions at something like a cost based level -- which is similar to what Centra's prices should be set at, a cost based level, under regulation -- they should be more or less the same, or the -- the brokers would actually -- you'd expect them to be a little higher, just because of the -- the incremental costs that -- or the extra costs that they incur. That's all the analysis was.

MR. ERIC HOAKEN: But that to me sounds like an analysis supporting the proposition that you've expressed on a number of occasions, that Centra would be able to offer the same product as retailers on a cheaper basis.

How does that analysis substantiate the statement that customers signing up for a three (3) year or five (5) year contracts are more likely than not to pay more for their gas?

MR. MARK STAUFT: As I've said, on any particular -- we're talking about -- the analysis that I just gave you is expected outcome on average, in the long run. As we've said repeatedly, in any particular instance, including, you know, a customer that buys a -- a fixed price product from anybody, may turn out to be -- may turn out to be better off, may turn out to be worse off.

The only question -- this sort of discussion here is about the -- the average in the long run expectation. It's not about any particular customer, or -- or claiming that any particular customer, or set of customers, will or won't be better off.

MR. ERIC HOAKEN: But I think it's more than that, with respect, Mr. Stauft. What you say in the final line is, you say, as I read it anyway, you say that the customer over what you call the average of the long run, is more likely than not to quote/unquote "loose."

Where is the data supporting that?

MR. MARK STAUFT: If -- no. If it's the case -- if it's the case that there are issues in the way, or imperfections in the way the competitive market is working, so that competition in fact is not constraining retailer prices to the competitive level, then what that means is -- what that's saying is retailer prices in that case are higher than the competitive level. So they're -- they're worse off than, on average, than the Centra price that is, in principle, constrained to the competitive level.

MR. ERIC HOAKEN: I see. So this is a proposition then, that embeds the assumption that the competitive market is not constraining the broker prices as it should.

MR. MARK STAUFT: Well, that has an effect. I mean, there -- there's some of that effect just arguably from the observation that brokers probably have extra costs involved, but those may or may not be significant. You know, I -- again we -- it's hard to tell.

And again, if there is -- certainly the last sentence takes that possibility, or in my view, likelihood that there is some imperfection in the way the market is working into account as well, that just makes the effect worse.

MR. ERIC HOAKEN: Now you're aware that CAC asked -- I believe it was CAC -- asked as part of the Information Request process for data from Direct Energy, about the completed contracts that it had, in order to perform that historical analysis that we just talked about, right?

MR. MARK STAUFT: That's my understanding, yes.

MR. ERIC HOAKEN: And is it also your understanding that that historical analysis, although admittedly of a relatively small sample size, does not substantiate that conclusion you state in that paragraph?

MR. MARK STAUFT: Right. But as I said,

in any -- for any particular set of customers, some will win, some will loose, depends on when it is. It's conceivable, quite possible, that over a historical period that's the outcome.

MR. ERIC HOAKEN: But what you're saying, I think, is it is more likely than not that customers are going to loose, and at least based on the data that this Board has available to it, that hasn't yet been the experience in Manitoba, is that fair?

MR. MARK STAUFT: Assuming -- yeah. I have to say I have not studied carefully. I'll take your representation that the data produced by your clients says what you say it does.

MR. ERIC HOAKEN: Well -- please don't do that. Go and take a look at it if you need to. It says, eight (8) of twelve (12) -- eight (8) of twelve (12) contracts that were completed involved savings. So accept that to be the case, and if you don't, go ahead --

MR. MARK STAUFT: Okay.

MR. ERIC HOAKEN: -- and take a look at the brief. But assuming that to be the case, you would agree that that evidence that is before the Board in this proceeding does not substantiate the conclusion you've stated in your evidence.

MR. MARK STAUFT: Well, that's true. But

the conclusion stated in my evidence was not intended to make any kind of prediction about the historical experience has been for customers. Again, it's entirely a forward-looking analysis. So, yeah, as I said -- and I acknowledge that the historical experience could -- could be different. But I agree with you, yes.

MR. ERIC HOAKEN: Now, you use -- in this passage as well you use the expression win and lose. And I take it that what you mean by that is a customer who quote/unquote "wins" is one who based on this historical analysis that we've been talking about ends up paying less for her gas than would have been the case if she'd stayed with System Supply, correct?

MR. MARK STAUFT: Well, I mean, yeah. I mean, that's what I had in mind, sure.

MR. ERIC HOAKEN: And conversely, "lose" is a term you've used to describe someone who, based on this historical analysis, pays more for her gas than would have been the case had she stayed with System Supply, correct?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And, again, I suggest to you that "lose" is an inaccurate or misleading term in that context, because to the extent that a consumer pays more for her gas through Direct Purchase than System

Supply, that is simply the premium that that customer is paying to manage the risk and to contract out of volatility, if you will, correct?

MR. MARK STAUFT: Well, maybe. I mean, I don't -- you don't know what motivation the customer had in -- in the first place.

But you're right, I mean, there is a -- a benefit in a sense, if it's, in fact, a benefit to that customer from having the price fixed. If that was the -- the person's intention; to say, Oh, I want to fix the price and that's all I care about, then really it doesn't matter too much whether they pay more or less.

MR. ERIC HOAKEN: But --

MR. MARK STAUFT: If -- if the idea was -- if they went into the contract thinking, I'm going to save money, then they either did or didn't.

MR. ERIC HOAKEN: But leaving aside the consumer's intention, that consumer, by contracting, has actually received protection from volatility, right?

MR. MARK STAUFT: Right. The only -- and that's true. My only point is that the consumer may or may not value that. Some consumers do, some may not, that's all.

MR. ERIC HOAKEN: And -- and in a proceeding at this Board last fall, and expert called by

CAC/MSOS described fixed-price products as being analogous to an insurance policy.

Is that something you'd agree with?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And so, as with an insurance policy, the -- the consumer who purchases a fixed-price product should expect to pay a premium.

(BRIEF PAUSE)

MR. MARK STAUFT: Well, I don't think that follows from the -- it doesn't -- doesn't follow that because a fixed-price product is kind of like an insurance policy, that therefore they should be necessarily paying an insurance premium. I mean, it may be that the way a competitive market would develop the price for long-term products, that there would be such a -- you could attribute that kind of a premium to part of the price, that's possible.

In fact, I think it's sort of the general expectation, but it's hard to be -- to be real sure about that. And I don't think it follows from the insurance analogy; it's maybe just a -- probably just a fact about the way the gas market works.

MR. ERIC HOAKEN: Well, let's go back --

I think the insurance analogy -- as did Mr. Pringle, I think the insurance analogy works pretty well because the purchaser of a contract, a gas contract, like the purchaser of an insurance policy is seeking protection from certain events that he or she has decided that he does not to tolerate if they occur, right?

MR. MARK STAUFT: Fair enough, yes.

MR. ERIC HOAKEN: And it's a transfer of risk in effect, from the purchaser of the product to the insurance company or in the case the gas company?

MR. MARK STAUFT: That's how insurance works, yes.

MR. ERIC HOAKEN: And pre-fundamental principle of economics right, Dr. Van Audenrode, that somebody who assumes risk expects to get paid for doing that.

DR. MARC VAN AUDENRODE: If you assume risk, you get paid to do that, yes. But I wouldn't push the analogy with insurance too far. Your insurance, you carry insurance, you pay a premium to protect you against foreseeable risks.

MR. ERIC HOAKEN: Or unforeseeable risks.

DR. MARC VAN AUDENRODE: Or unforeseeable risks. In the -- in the future price of gas when you take a long term fixed price contract in terms of gas, all the foreseeable risks are already embedded in the price of gas.

MR. ERIC HOAKEN: See I -- I have trouble with that proposition. Let me explore that with you because you said that a few times.

But what you said as I understood it, is that if a gas company like my client goes into the market, the long term wholesale market, and is looking to purchase gas long for five (5) years, that all of the future expectations of the markets -- market, is embedded or are embedded in that price, right?

DR. MARC VAN AUDENRODE: Correct.

MR. ERIC HOAKEN: But that's all of the expectations that are known or knowable as of that day, right?

DR. MARC VAN AUDENRODE: That's correct.

MR. ERIC HOAKEN: And you would expect that the five (5) year long price of gas would have been pretty different on September 7, 2001 than it was from September 14, 2001, right?

DR. MARC VAN AUDENRODE: I don't know the exact dates. I don't know what the price of natural gas would --

MR. ERIC HOAKEN: Well I'm -- sorry I'm assuming you're familiar with the tragic terrorist events that occurred in New York and Washington of September 11, 2001.

DR. MARC VAN AUDENRODE: I -- you know, I would -- I would think that there was no price for natural gas on September 14, but that's a different story.

MR. ERIC HOAKEN: Okay.

DR. MARC VAN AUDENRODE: Because the market had been suspended.

MR. ERIC HOAKEN: All right. Change the date. But in -- in any case you're -- I think agreeing with my proposition, is that --

DR. MARC VAN AUDENRODE: I agree with your proposition but you take an extreme case there, you know, there can be a hurricane in the Gulf Coast and that's a foreseeable event and --

MR. ERIC HOAKEN: Or -- or actually more than one (1), right?

DR. MARC VAN AUDENRODE: Or more than one (1); that's embedded in the price. That -- that risk is embedded in the price.

MR. ERIC HOAKEN: But if risk is embedded in the price, there -- there was a substantial upswing in the commodity price for gas, following the fall 2005 hurricanes in the Gulf Coast, correct?

DR. MARC VAN AUDENRODE: Yes, there was some.

MR. ERIC HOAKEN: And -- and I'm going to suggest to you that the only explanation for that upswing in price was that the expectations of those hurricanes and the catastrophic effects that they would have on supply had not been adequately imbedded in the price.

DR. MARC VAN AUDENRODE: I would disagree with you.

MR. ERIC HOAKEN: Okay. So just help us understand then, what accounts -- sorry, let me finish my question.

Help us understand what accounts for the upswing of the price in that instance.

DR. MARC VAN AUDENRODE: To continue with your analogy with insurance coverer, with -- with insurance, you know, you pay for a hundred dollars ($100) or I don't know what's the rate, five hundred dollars ($500) a year to protect your car. And if you have an accident you could be a thirty thousand dollar ($30,000) cost to your insurance. Whatever happens exposed has nothing to do with the fair pricing and the way the prices are set ex ante, which is the way you should look at them.

MR. ERIC HOAKEN: Well, that maybe

exposed as the difficulty in the analogy because in -- in the example of the September 2001 events or the -- or the fall 2005 hurricanes, purchasers who are on system supply had not purchased any insurance, right?

DR. MARC VAN AUDENRODE: No. I would agree with that.

MR. ERIC HOAKEN: Right. And so they were then exposed to the upswings in the market that occurred, as a consequence of those events.

DR. MARC VAN AUDENRODE: To the extent that these were not covered by some hedging more -- by Centra, yes.

MR. ERIC HOAKEN: Well, you're aware that Centra's hedging program doesn't involve taking the market view in any way.

DR. MARC VAN AUDENRODE: I -- I don't know by what -- what you mean by that, but I...

MR. ERIC HOAKEN: Now let me come back to something you said in your pre-filed evidence, Mr. Stauft. You said at page 17 if you want to look at it, it's probably not necessary, but you said that volatility reduction is a matter of what you call common sense, is not a significant benefit to consumers.

Is that a fair summary of what you say in that portion of your evidence? I think it starts at line

17.

MR. MARK STAUFT: Right. I'm sorry, what was the page?

MR. ERIC HOAKEN: Page 24, line 17.

(BRIEF PAUSE)

MR. MARK STAUFT: That's right, yes.

MR. ERIC HOAKEN: And further, if you go over, if you will, just a number of pages forward in your pre-filed evidence, to page 50 at the top. You characterize it as absurd to say that customers care about rate volatility and you suggest that all they really care about would be bill volatility. Is that a fair summary?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: But I take it you'll agree, I think, this is also common sense, that bill volatility is contributed to by a number of things, including rate volatility?

MR. MARK STAUFT: Including rate volatility, yes.

MR. ERIC HOAKEN: Right. And that the bill of a customer who has contracted out of that rate volatility will have less volatility than a -- excuse me, a customer who has not?

MR. MARK STAUFT: Will have less bill volatility?

MR. ERIC HOAKEN: Less bill volatility.

MR. MARK STAUFT: Quite so.

MR. ERIC HOAKEN: All right. Dr. Van Audenrode, you're shaking your head.

DR. MARC VAN AUDENRODE: No, I would not agree with that. It depends on the correlation between the price and the volume.

I mean, the -- your bill volatility is the product of how much -- how much you consume and how much you pay for each unit you consume. If, in reality, when your price varies, it varies with a negative correlation with your volume you could have less bill volatility with a variable rate than with a -- than with a fixed rate.

MR. ERIC HOAKEN: But talking about the same consumer who has precisely the same volume factors, that consumer, on a fixed rate -- just -- I can't understand how a consumer on a fixed rate with a volume requirement of "X" is not going to have a less volatile bill, than a consumer who's not on a fixed rate.

DR. MARC VAN AUDENRODE: If it just happened that on a month where his consumption is way up. Now it's cold everywhere in North America so they are not spending a whole bunch of gas to cool down Texas and California, and the price of natural gas goes down, then in this case, there is less volatility. And I'm saying -- I'm not saying that this is what happens, but I'm saying that your proposition as it is, is not correct.

MR. ERIC HOAKEN: I understand now, thank you. And I think I agree with you.

MR. MARK STAUFT: Could I -- I think, in fact, Centra provided -- if I understood it properly -- a study or an IR response that looked at that. And I think their conclusion was that, in fact, on a -- looking backwards, historically, on a -- that under a fixed price arrangement, bill volatility would have been less.

I mean, I agree that it's kind of counterintuitive but if you want to be thorough about your investigation of that question, I -- you might want to look at that.

I think it's -- do you know? PUB-16 to Centra.

MR. ERIC HOAKEN: So you -- you had initially, I think, agreed with my proposition; you've now had an opportunity to be reminded of that answer?

MR. MARK STAUFT: Yeah, you're right. I mean, as Dr. Van Audenrode points out, there's no necessary correlation on that. I agree that sort of intuitively that's what you'd expect, but not necessarily.

And if I'm recollecting the Centra response properly; just for some reason on the facts it turned out not to be correct, so.

MR. ERIC HOAKEN: All right. But in -- in any case, going back to the portions of your evidence that I referred to, it -- if customers didn't care about volatility, and particularly didn't care about rate volatility, there'd be no point in Centra offering a fixed price product, right?

MR. MARK STAUFT: I mean, it's a question of how much they value it, right? I mean, people will probably -- at least some people will say, Yes I value a lack of volatility or an absence of volatility, and I'm willing to pay fifty (50) cents a month for that protection, right?

So in a sense you can say they value it, but if that's the facts, then not by much. It -- it -- maybe we get caught up in being too absolute in the terms we use, but the point is, the issue is how much do they care about it, which you know, in theoretical terms, you can think of is how much are they willing to pay to get rid of it, and that's a little harder to measure.

MR. ERIC HOAKEN: But -- but perhaps a

more appropriate question is: What products do they say they want, right?

MR. MARK STAUFT: Right, yeah, sure. And -- and the products -- yeah, people express opinions on that. They express opinions on that just by their purchasing behaviour and -- and so on.

MR. ERIC HOAKEN: And -- and you -- you've told us, I think, you've looked at the eNRG Research Study, and certainly it appears to support the proposition that customers want that product, right? Or those products, I should say.

MR. MARK STAUFT: A variety of longer term products, that's true, yes.

MR. ERIC HOAKEN: Now, on Page 26 of your pre-filed evidence, you say that:

"If competition in the natural gas market disappears as a result of the operation of market forces, that's an acceptable result."

Right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And I understood you, Dr. Van Audenrode, to have a similar view. Am I right about that?

DR. MARC VAN AUDENRODE: I'm sorry, yeah.

I'm sorry. What -- where was this?

MR. ERIC HOAKEN: It was on page 26, but it's a fairly simple proposition. Just that if competition disappears as a result of the operation of market forces, that that's an acceptable result.

DR. MARC VAN AUDENRODE: Again, depending on what replaces this; and, you know, the -- the next best thing to competition being regulation.

MR. ERIC HOAKEN: And there would be, though, or could potentially be some negative impacts of the elimination of competition in the market, right?

DR. MARC VAN AUDENRODE: Well, if this meant that there would be less choices for consumers, yes.

MR. ERIC HOAKEN: Okay, that's one (1), but there would also be other impacts that would be negative, or could be negative, correct?

DR. MARC VAN AUDENRODE: Which would be?

MR. ERIC HOAKEN: Firstly the potential for exercise of market power by the Utility.

DR. MARC VAN AUDENRODE: If the Utility is regulated, I don't see that.

MR. ERIC HOAKEN: Have you got available to you a copy of the Board's Decision in 15/98?

And in fact, I'm just gonna go through

that. It may take me a while. I'm in your hands, Mr. Chair, as to when you want to break.

THE CHAIRPERSON: Mr. Hoaken, not to control your presentation in any way, how much more time do you think you require of these witnesses?

MR. ERIC HOAKEN: Very difficult to say, Mr. Chair. I really can't give any informed estimate. I could give you an estimate, but it would have no value at all.

THE CHAIRPERSON: Well, to be sure then, what we'll do is we'll come back at 1:00.

MR. ERIC HOAKEN: Okay. Thank you.

--- Upon recessing at 12:00 p.m.
--- Upon resuming at 1:01 p.m.

THE CHAIRPERSON: Anytime you're ready, Mr. Hoaken.

MR. ERIC HOAKEN: I'm ready. Thank you, Mr. Chair.

CONTINUED BY MR. ERIC HOAKEN

MR. ERIC HOAKEN: Just before lunch, Mr. Stauft and Dr. Van Audenrode, I had suggested that there would be negative impacts if competition disappeared from the market in Manitoba. Do you remember that?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And I was just starting to take you through what one of -- what those were, and I'd suggested, firstly, that there was the potential for the exercise of market power, or market dominance by Centra, the regulated Utility, and I think, Dr. Van Audenrode, what you'd said to me in response was: In a regulated environment, that's not possible.

Is that more or less it?

DR. MARC VAN AUDENRODE: More or less, yes.

MR. ERIC HOAKEN: And then I had been just about to take you to the Board's Decision in 15/98, and I referenced it to your counsel so he could have you look at it over the break, and you'll see at the bottom of the page, on Page 32 of that decision, there is reference to CAC at that time having the concern about residential market dominance by the LDC, and that's a reference to Centra, right?

DR. MARC VAN AUDENRODE: I would guess, yes.

MR. ERIC HOAKEN: Yes, and so my question is: Wouldn't that same concern apply in circumstances where there was no longer any competition in the retail natural gas market in Manitoba?

DR. MARC VAN AUDENRODE: I think I already answered that question by saying, to a large extent, these concerns are alleviated and at rest by regulation.

MR. ERIC HOAKEN: All right, and do you have any understanding about why it was CAC had or expressed that concern in 1996 when Centra was none-the-less a regulated entity?

DR. MARC VAN AUDENRODE: I wouldn't know. I mean, I don't know. I'm -- I'm -- look, I'm not saying that, you know, everything is the best in the best of the world, and -- and the regulation. Like, I'm not saying that everything would be the best in the best of the world necessarily and their competition.

What I am saying is, you know, the biggest most important concern that you might have in this situation, being that having only one supplier could lead to price increases is taken care of by regulation in -- in large part. That's -- that's all I'm saying.

MR. ERIC HOAKEN: Right, and I think in our earlier discussion you quite fairly agreed that regulation is not ever going to be a perfect substitute for competition.

DR. MARC VAN AUDENRODE: I'm not sure I

agreed to that. I'd said regulation is not perfect, and I also said markets aren't perfect.

MR. ERIC HOAKEN: All right. Well, let me ask you now then, if you agree that regulation is not going to be always a perfect substitute for competition.

DR. MARC VAN AUDENRODE: I -- I'd qualify my answer to that. You know, people fifty (50) years ago who set up this mechanism weren't stupid, you know. They -- they started regulation because by definition competition couldn't work in this environment.

Now of course, there are industries where technology has changed that make sense to stop regulate and let the market in. The perfect sample being telecommunication. If the technology -- if the technology go in a market environment doesn't change in an industry, you know, people who decided to regulate this industry, regulated it because there was no competition possible.

MR. ERIC HOAKEN: I don't take any issue with that. I think maybe you and I are not on the same page here. All I'm suggesting -- I don't think it's a controversial thing to suggest, is that regulation, although it's intended, as you say, to simulate the affect that the presence of competitors will have in the market, it won't do so exactly as if there were actually competitors in the market.

DR. MARC VAN AUDENRODE: I would disagree with that. I don't see why it would be impossible.

MR. ERIC HOAKEN: But you do agree that there will be increased costs -- increased regulatory costs where regulation is a substitute for competition?

DR. MARC VAN AUDENRODE: There will be regulatory costs. I would think that most of the time these are minimal. Yeah.

MR. ERIC HOAKEN: Now, going back to your pre-filed evidence, Mr. Stauft. At page 13 -- no, I'm sorry, page 26, line 13. You say it would be wrong to take economically artificial steps to encourage or promote the entry of marketers or retailers in the Manitoba market.

And I'm going to suggest to you that it would not be economically artificial to eliminate any structural factors that may presently create a competitive disadvantage for brokers, correct?

MR. MARK STAUFT: Stated at that very general level, I think that's reasonable, depending, of course, on what you mean by "structural factors" and what structural factors we're talking about and all that other kind of thing. But as a general high level principle, that sounds sensible to me, yes.

MR. ERIC HOAKEN: Okay, that's very fair.

Let me now give you some examples to see if you still agree when I take it from the general --

MR. MARK STAUFT: Okay.

MR. ERIC HOAKEN: -- to the specific.

There would be nothing economically artificial about expanding the sales channels that brokers or marketers are able to pursue in order to sell their products, right?

MR. MARK STAUFT: Again, in principle, recognizing that there may be arguments about particular sales channels you may have in mind, but as a general principle, I think that makes sense, yes.

MR. ERIC HOAKEN: But if the sales channels - and I'm going to ask you to assume this for the purposes of this question - if the sales channels available to retailers in Manitoba are significantly more restricted than those available to retailers in other jurisdictions, there would be nothing economically artificial, to use your expression, about making the sales practises or channels in this province conform to those in other provinces, correct?

MR. MARK STAUFT: Well, again, I think that's the kind of question you have to evaluate on the facts of each case. I mean, I don't know what that logic assumes that the sales channels in use in other jurisdictions are appropriate and properly organized and all of the rest of it, and appropriate in their circumstances, and that the circumstances are the same and so on, but I wouldn't want to go too far in that direction.

Again, the logic seems sensible but in any given case, presumably, people are going to want to look at exactly what it is we're talking about, exactly what tariff changes we're talking about and that kind of thing.

MR. ERIC HOAKEN: But take my assumption again, for the purposes of this question, that the sales channels are more expanded in Ontario and British Columbia, for example, than they are here.

And I'd ask you to agree with me that it's at least a plausible theory that the greater market penetration that's been achieved in those provinces by marketers is related to or a function of those expanded sales channels, correct?

MR. MARK STAUFT: Again, I suppose that's possible although I would have -- my understanding, without having done an exhaustive or any kind of study of it, is that in most jurisdictions the door-to-door approach that is open to retailers in Manitoba is the primary sales channel that's used everywhere. I mean, I may be -- have my facts mixed up --

MR. ERIC HOAKEN: I was just going to ask you what's the basis of that understanding?

MR. MARK STAUFT: Historical experience. I mean, that's the way it was when I was more directly involved with these markets. As I say, it may have -- the market may have evolved since then in other jurisdictions.

MR. ERIC HOAKEN: Right. And you're talking about when you were at TCGS?

MR. MARK STAUFT: Right. This is --

MR. ERIC HOAKEN: Yeah.

MR. MARK STAUFT: -- Ontario and to some extent Alberta, but mostly Ontario.

MR. ERIC HOAKEN: Right. And so quite fairly, you're acknowledging that there may well have been some change in those markets since you left TCGS. Was it '99 you left?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: Yeah. And just sticking with your concept of economically artificial steps that you wouldn't want to see taken. You'll agree with me that there's nothing economically artificial about reducing the lag time that exists between when a direct purchaser signs the contract and actually has his or her flow started.

MR. MARK STAUFT: No, I think I'd agree with that, yeah. Whatever issues there are around that is -- is, I assume, operational as between you folks and -- and Centra and I agree that whatever can reasonably be done in that area should be done and wouldn't be in appropriate.

MR. ERIC HOAKEN: And if the evidence were in this proceeding to demonstrate that there had been occasions in the past where the lag time between a customer signing up and having his or her flow initiated could be as much as four (4) months, is that something you're aware of?

MR. MARK STAUFT: I wasn't aware of that, no.

MR. ERIC HOAKEN: And you'll agree with me that it's at least a possible theory that that makes -- that has made -- that lag time has made some contribution to the lack of success that marketers in Manitoba have had in achieving market penetration comparable to those in British Columbia and Ontario, correct?

(BRIEF PAUSE)

MR. MARK STAUFT: I'm not quite sure I understand quite how that follows. It's just in the sense that if the customers are signed up and they get enrolled some time, whether it's in two (2) weeks or a month of four (4) months, they still get enrolled.

So in that sense, it doesn't seem to me to make any difference. There may be other effects that you have in mind that I'm not -- that aren't coming to mind for me that -- that would have an effect but that's about as far as I've gone with that.

MR. ERIC HOAKEN: Fair enough. Let me take you now to page 37 of your pre-filed evidence, Mr. Stauft.

(BRIEF PAUSE)

MR. ERIC HOAKEN: And starting at line 20 where you say:

"It appears that the prices currently being charged by brokers in Manitoba are high relative to the prices charged by Centra and relative to the cost of providing those products."

Right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And I take it that you are attempting to use both price and cost as a means of illustrating that the brokers' products are too high or may be too high. Is that fair?

So price charged to consumers and cost incurred by the brokers in providing the service. Those are the two (2) bases that you're using to support that proposition, is that --

MR. MARK STAUFT: Right. And then what you're looking at is -- is the margin that's in the -- the difference between those two (2).

MR. ERIC HOAKEN: All right. But I see these, and tell me if I've got this wrong, but as I read this sentence, I see this as you saying there's two (2) independent bases for thinking that the price of the broker's product may be too high.

Because you starting in line 20 you say:

> "It appears that the prices currently being charged by brokers in Manitoba are high relative to the prices charged by Centra."

So stop there for a minute. And as I read that, it's a proposition that a comparison of the unit prices being charged by brokers is in some way meaningful if you compare it with the unit price being charged by Centra.

Am I reading that wrong?

(BRIEF PAUSE)

MR. MARK STAUFT: No, you're reading it correctly. But as we've already discussed, I think I've already agreed with you that a comparison with the current price of Centra's product is not terribly relevant to all of this.

And the real point of it is -- the real point of all of this analysis is to examine whatever we can find out about the difference between the Centra -- sorry, the marketers' prices and their costs.

So the crack here about the comparison with Centra's price I agree is really -- it probably shouldn't even be there. It doesn't -- doesn't -- nothing in the argument turns on it.

MR. ERIC HOAKEN: Okay, fair enough. So we can, for all intents and purposes, stroke that out of the sentence?

MR. MARK STAUFT: Mm-hm. I mean, it's factually true but not relevant or important to the argument.

MR. ERIC HOAKEN: Right. For all the reasons that you and Dr. Van Audenrode have --

MR. MARK STAUFT: Right.

MR. ERIC HOAKEN: -- discussed?

But even if, on a cost basis, you could look in some meaningful way and compare the prices of the Centra product and the prices of the marketer's product -- or, excuse me, the retailer's product, I think as you told My Friend, Mr Peters yesterday, you would expect even in an efficiently functioning market that the price of the marketer's product would be higher?

MR. MARK STAUFT: Just because of the extra cost burden that they have, to some extent, I -- without making any attempt to quantify what that difference would be.

MR. ERIC HOAKEN: Okay. So even if there was some way that you could accurately and meaningfully compare the price of the Utility offering to the price of the retailer's offering, there would be nothing in and of itself alarming about the fact that the price of the retailer's offering was higher?

MR. MARK STAUFT: No.

MR. ERIC HOAKEN: Now the second basis of the comparison you seem to be making here in this passage I've quoted, is on cost. And you've said the prices that are being charged by the brokers seem high in relation to the costs that they incur in providing those products.

Is that a fair summary of what you're saying?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And I think you've quite fairly acknowledged, both in your pre-filed evidence and in the things you said in cross-examination, that this is not a rigorous analysis, this is what I might characterize, and don't take this wrong way, is a back of the envelope calculation.

MR. MARK STAUFT: I think that's fair, yes. Because -- I think I've said, it's very difficult to do this on a fair basis, you know, given the data that's available and everything else, and it's -- so, yeah, as you say, I have adopted those qualifications. And I haven't tried to rely on this as -- on this analysis as conclusive proof of anything; it's just an indicator amongst -- an indicator that there may be reason for concern amongst other indicators and people can make judgments about how seriously they want to take that or what impact they think they have -- these analyses have.

MR. ERIC HOAKEN: All right. That's certainly very fair and I don't want -- I don't want to belabour this point, but the value of your analysis, even in the way that you've just framed it, would be further limited if it was demonstrated, for example, that there were categories of costs that brokers incur in providing their products that you have not accounted for here, correct?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And similarly it would be discounted if it was demonstrated that some of the costs that you have, in fact, accounted for have been understated?

MR. MARK STAUFT: That would be -- I think that would follow, just from the arithmetic and the logic, yes.

MR. ERIC HOAKEN: Right. And let's use as an example, broker costs in acquiring customers. You and your analysis have used the figure of fifty dollars ($50), right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And just help me understand where that number came from.

MR. MARK STAUFT: Ten (10) years ago when I was working very extensively in this area in Ontario, and, in fact, TCGS made a brief and not entirely successful foray into the retail market, my understanding at the time was that this sort of going rate for commissions to people signing up customers was in the range of $30, plus or minus. So the $50 basically is just that number plus a bunch -- plus some to account for the fact that that was ten (10) years ago. So, again, not a very precise estimate.

MR. ERIC HOAKEN: All right. So on the costs basis. I think what you've said then, to summarize, is that if we compare the broker price to the Centra price, it doesn't do anything for us in terms of reaching a conclusion about the appropriateness of the retailer price, right?

MR. MARK STAUFT: That's right, yes.

MR. ERIC HOAKEN: And, similarly, you've said if we're using a cost base analysis, we've got to make sure that we get all the costs in and we get all the right costs, and you've quite fairly conceded that you probably haven't done either of those things.

MR. MARK STAUFT: I think that's right. And I -- I think it would be very difficult for anyone to do frankly. I mean, it might be possible to come closer than I have but it's -- it's a difficult thing to do, particularly if you're talking about returns and stuff like that it's just difficult.

MR. ERIC HOAKEN: And just going back to

some of the difficulties inherent in a price based comparison. For all the reasons we've discussed it's not fair or appropriate to compare the price of the Centra offering to the price of the offering, or at least products, that the retailers have.

But there might be some value in trying to compare the prices that retailers charge in this jurisdiction for products, to the prices charged by retailers in other jurisdictions, correct?

MR. MARK STAUFT: There may be. Again, depending on all kinds of other factors. But it's possible.

MR. ERIC HOAKEN: And did you know in fact that CAC/MSOS asked an Information Request of the retailers, seeking that information?

MR. MARK STAUFT: I do recall that, yes.

MR. ERIC HOAKEN: Yeah. And did you have an opportunity to look at that? It was -- D's (phonetic) response to CAC-19 I believe.

MR. MARK STAUFT: I'm afraid I can't help you with that, I'm sorry. I -- I don't recall -- I -- I'm sure I looked at it but I have no present recollection of what it said. So -- and I don't believe that we have it here with me -- with us, so.

MR. ERIC HOAKEN: Okay. Well if it had

disclosed that prices of comparable products in other jurisdictions were systematically lower than those in Manitoba, that obviously would have been of considerable concern to you?

MR. MARK STAUFT: It -- it would have been an interesting point. There may be various explanations for that. I mean the -- the obvious conclusion to jump to is that in Manitoba the brokers are able to do that, you know, because of a lack of competition or some other imperfection on the market, and while that might be the initial guess at what's going on, there may be other explanations for it.

MR. ERIC HOAKEN: Yeah, but I guess what I'm saying, Mr. Stauft, is, you know, that's your hypothesis. You've certainly made it clear that the brokers or retailers can charge a higher price in this jurisdiction because there's only two (2) market participants.

But wouldn't it give you some comfort to know that in a jurisdiction, for example, like Ontario where there's eleven (11) market participants that the prices being charged are comparable?

MR. MARK STAUFT: Well again, that is an interesting piece of information and I guess it is comforting in some sense.

I don't know what state of play is in Ontario. I mean you may have a similar situation in Ontario, in terms of de-segmenting of the market, and all that kind of thing. It -- it would be a complicated analysis to -- to sort of draw definitive conclusions from that but --

DR. MARC VAN AUDENRODE: Can I give my opinion on this. I -- I would think that to compare the straight comparison of the rates is not the right comparison.

The right comparison is the comparison, the difference in spreads. So you look at the difference in Manitoba between this long term five (5) year rate and the -- and the short term rates, and you look at the same difference in Ontario and you look whether there are systematic difference over the long run.

That would be the right methodology.

MR. ERIC HOAKEN: All right, thank you.

(BRIEF PAUSE)

MR. ERIC HOAKEN: So just I guess to conclude the discussion on that point you made in your pre-filed evidence, Mr. Stauft, that price comparison doesn't really help us for the reasons that we discussed and the cost comparison also has its limitations, right?

MR. MARK STAUFT: The cost comparison has limitations, as I've acknowledged right from the outset. I don't think it's meaningless or irrelevant, but it has limitations.

MR. ERIC HOAKEN: Right. But if the evidence were to demonstrate actual costs and categories of costs that make the cost of providing the service substantially different, then you've hypothesized that would certainly have a significant impact on the value of the conclusions you've reached, is that fair?

MR. MARK STAUFT: Sure, if there's better data available, then that should be looked at.

MR. ERIC HOAKEN: Now, as I understood what you said yesterday to Mr. Peters, you said you would have a concern or a suspicion that the competitive market was not functioning appropriately if the retailers were earning more than what you characterize as a normal return, right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And in answer to followup questioning from Mr. Peters, I think what you also said was you couldn't define with any precision what a normal return was or would be, is that fair?

MR. MARK STAUFT: Yes, I think that's

fair.

MR. ERIC HOAKEN: And I think it follows from the discussion that we've already had, that you, although you've hypothesized certain ranges of margin, you can't say with any precision what the return is that's being earned by retailers in this province, is that also fair?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And so if retailers are in fact earning what could be characterized as a normal return, then that would be evidence that the competitive market in this province is functioning appropriately.

DR. MARC VAN AUDENRODE: Absolutely not.

MR. ERIC HOAKEN: Okay. Explain that to me.

DR. MARC VAN AUDENRODE: That might be totally inefficient in what they are doing in having low returns, just because they are totally inefficient. So while it works in one (1) direction, if you have very high returns that are above normal, that's probably a sign that there is no competition. The fact that you have normal quote/unquote "returns" is not proof that there is competition.

MR. ERIC HOAKEN: I see. So if the retailers were in fact losing money on their offerings, that could be evidence, as you say, of inefficiency in providing the product, not evidence of a brutally efficient competitive market; is that -- is that what you're saying?

DR. MARC VAN AUDENRODE: It could be either, yeah.

MR. ERIC HOAKEN: Now, let me just ask you a little bit more about that, maybe on a related point, Doctor. You've read I take it Mr. Stauft's evidence, where he has his hypothesis about the range of margins that may be earned by retailers, right?

DR. MARC VAN AUDENRODE: Yes, I have.

MR. ERIC HOAKEN: And his suggestion is that these margins are above the range of what the retailers should reasonably expect to earn, or in fact be earning; is that also fair?

DR. MARC VAN AUDENRODE: I'm not sure I understand your question.

MR. ERIC HOAKEN: Well, just tell me how you understand Mr. Stauft's proposition. Do you understand it to be that the margins that are being earned by retailers are in appropriately high?

DR. MARC VAN AUDENRODE: I would think that Mr. Stauft has been much more prudent in characterising his qualification of these margins.

MR. ERIC HOAKEN: He has been absolutely prudent in qualifying things that he's said, I agree with that. But if he is even floating a hypothesis that these margins being earned by the retailers are inappropriately high -- let's -- let's take that as an assumption for the purposes of my question.

If that were the case, as a matter of economic theory, wouldn't you expect to see a flood of new entrants to this market, to take advantage of that opportunity to earn those margins?

DR. MARC VAN AUDENRODE: Possibly.

MR. ERIC HOAKEN: And is there any inference in your opinion, Doctor, that we can draw from the fact that there has not been a flood of entrants to this marketplace?

DR. MARC VAN AUDENRODE: Without any further analysis, no. Because it could be simply because, as I said, I hypothesized -- one (1) possible hypothesis is -- that I made yesterday, that the market is simply not big enough. So there is no simple conclusion that you can draw from this.

MR. ERIC HOAKEN: Now, just on a related point, and I know I'm jumping around somewhat, but you'll appreciate that I'm trying not to duplicate that which has been done by others.

In answering questions from Mr. Peters yesterday, you were talking about the concept of returns and you made a comment that I noted, to the effect that retailers have no assets. And I understood you to be saying that that has some relevance to the determination of what return is appropriate.

Is that an accurate recollection of what you said, Doctor?

DR. MARC VAN AUDENRODE: No, I wouldn't -- I don't recollect saying that. I would think that Mr. Stauft had these comments. But I might just --

MR. ERIC HOAKEN: Oh --

DR. MARC VAN AUDENRODE: -- I'm just blank on this.

MR. ERIC HOAKEN: Okay, I'll tell you what I'll do, I'll look at the transcript at the break and then we can come back to that.

(BRIEF PAUSE)

MR. ERIC HOAKEN: Now let's turn to the area of broker practises. And, again, I think, Mr. Stauft, you've been very fair in saying that while you personally have some concerns, you don't know what's being said to the consumer on the doorstep, right?

MR. MARK STAUFT: That's correct.

MR. ERIC HOAKEN: You've conduct no systematic study of this, right?

MR. MARK STAUFT: Of what gets said at the doorstep, no, I have not.

MR. ERIC HOAKEN: Or of the level of satisfaction or concern that consumers have about the whole model of door-to-door?

MR. MARK STAUFT: That's correct.

MR. ERIC HOAKEN: And did the client -- or at least one of the clients for whom you're appearing today, the Consumers Association of Canada, you understand that part of its mandate includes doing research on customer patterns and preferences and those sorts of things?

MR. MARK STAUFT: I'm afraid I don't know that. I'm sorry.

MR. ERIC HOAKEN: Does that sound like a stretch or does that sound like a reasonable part of the mandate of a consumers' organization?

MR. MARK STAUFT: Well, it may be but -- I mean, it sounds reasonable as part of the mandate of a consumers' association but I don't have -- I have no idea whether they have undertaken that kind of activity in relation to gas-related issues. I haven't had -- I have not heard of that, in fact.

MR. ERIC HOAKEN: And they've not provided anything to you --

MR. MARK STAUFT: No.

MR. ERIC HOAKEN: -- of that nature? All right.

And then is it fair to say -- and I'm not trying to be negative, but is it fair to say then that the comments you've offered about the marketing practice are really anecdotal in nature?

MR. MARK STAUFT: Well, I mean, there's a certain amount of anecdotal material that you can -- that is out there and that's on the record. I mean, there are comments about it and observations about it in the customer survey and in the focus groups. Centra provided an Information Response to the CAC that was -- consisted of a log, I think, of a number of telephone conversations that Centra had gotten over a period of time, most of which had to do with broker activity and broker contracts. I mean, again, it's not a province-wide survey but it's material that's there.

So there is a certain amount of -- there is anecdotal-type material around. I mean, another basis for the observation, though, is just that -- just the structure or the nature of a door-to-door type of marketing arrangement for this kind of product, seems to me, sort of, you would expect that it creates a distortion, if I can call it that, in people's buying pattern just because of the informational asymmetries that exist.

I mean, I talked about this in my testimony that --

MR. ERIC HOAKEN: And I'm trying to understand I guess a little bit better the -- the basis for your conclusion or maybe that's too strong a word, your -- your concern --

MR. MARK STAUFT: Yeah.

MR. ERIC HOAKEN: -- that there may be this informational dissymetry (sic). What -- what your understanding about the information that is made available to or provided to a consumer in Manitoba at his or her doorstep by the representative of a retailer?

MR. MARK STAUFT: I don't have the material with me. I -- I'm sorry I don't -- I'm not sure I'm grasping what it is you're after. I --

MR. ERIC HOAKEN: Okay. Let me ask the question again because I don't want us to be at cross-purposes on this.

You stated your view that there is or may be an informational dissymetry and I take and I take that to mean that a consumer is inappropriately being asked to make a purchase decision where he or she doesn't have information that he or she should have.

Is that a fair summary of where you're coming from?

MR. MARK STAUFT: I think that's -- yes.

MR. ERIC HOAKEN: Okay. And so it would be helpful to me in understanding that. If -- if you could just let me know what your understanding is about the actual information that is provided.

MR. MARK STAUFT: Well my understanding is -- the information that people will have is information, if they attention to it, about their own Centra bill and I believe people have been provided with information or are provided with information just about the options that they have and so on.

When I was making those -- raising those concerns about information the -- the background to that or the context was that consumers really need a whole lot more information than could even, I think be, sort of, written down on three (3) pages in order to make -- have some idea of what they're doing when they're evaluating these products.

So my -- my comments in that area were, sort of, regardless of what information is provided at the door or in Centra's bill inserts, or any of that kind of thing.

MR. ERIC HOAKEN: I -- I see. So are you saying then that it doesn't matter what level of detail the information that's provided at the door goes into, that just by virtue of the nature the transaction, the consumer is always going to be at a disadvantage?

MR. MARK STAUFT: I think that is the concern, yeah. And I -- and I had that discussion yesterday I think with Mr. Peters that -- I mean obviously the more information that people have, the better off they are.

It's just that where the market structure and the market channel consists of essentially one (1) person showing up at your door giving you information and saying, Please make a decision here, that, as I've said, is pretty economically complex, if you're trying to compare the broker price with expected Centra prices, et cetera, et cetera.

Again, in a market where there is not -- I mean that economical evaluation is virtually impossible for people to do. And in the market, the way it exists now, there just aren't a lot of other sort of competitive options out there.

Like normally people don't have to make

that kind of evaluation, because there's all kinds of competitive alternatives in the market and they just pick. But here there aren't. There's really just one (1) point of contact between one (1) competitor and the householder, and information flowing from the salesman to the householder, and that's about it.

That's the kind of I think the base concern in all of this.

MR. ERIC HOAKEN: Okay. Let me explore that a little bit. Would your concern be alleviated if you knew that at least some of the information being provided to the householder was information that was not generated solely by the retailer itself, but had been jointly developed by a number of organizations or stakeholders and had the sanction of this Board?

MR. MARK STAUFT: Well directionally, yes, depending on what the information was and how helpful it was for purposes of making the decision.

MR. ERIC HOAKEN: Right. Because your concern, as I understand it, is that the retailer can share or disclose information that's only supportive of the proposition it's putting to the customer.

And, I'm going to suggest to you, that that's less possible where the retailers' practice in this province is to provide a neutral document that has been jointing developed by a number of parties, including CAC/MSOS.

Does that not seem reasonable to you?

MR. MARK STAUFT: Again, it seems reasonable depending on what the information that -- the sort of common information is and depending on what it is exactly that the guy says at the door when people open it and say hello. So, directionally, of course, that has to be true.

MR. ERIC HOAKEN: Now you said in your evidence, I believe it was in your evidence-in-chief yesterday, that very few products are still sold on a door-to-day -- door-to-door basis, right?

MR. MARK STAUFT: That has certainly been my experience, yes.

MR. ERIC HOAKEN: And that's because companies have generally migrated to other means that are less costly than door-to-door, right?

MR. MARK STAUFT: I assume so, yes. That wouldn't make sense.

(BRIEF PAUSE)

MR. ERIC HOAKEN: And those companies that previously may have been using door-to-door sales channels -- sales channel, have moved to other things like tele-sales and Internet sales; is that -- is that your experience?

MR. MARK STAUFT: I think that's true, yes. Or, you know, I mean, in the real old days you had vacuum cleaner salesmen and encyclopaedia salesmen and insurance salesmen, and those are all -- those goods and services are all sold through much more conventional retail channels nowadays. But more modern examples would be the ones you've mentioned.

MR. ERIC HOAKEN: And if there are restrictions in the code of conduct that prevent retailers from using some of those other sales channels that are available to other companies and businesses, I take it, then, you would support the removal of those restrictions; is that fair?

MR. MARK STAUFT: I think certainly from the standpoint of promoting competition, that has to make sense. I mean, if there are restrictions on those activities, there must be other bases for them. I'm sure nobody has put those restrictions in place in order to keep people from competing effectively. There must be other bases for it so, you know.

And I think I've indicated to other that while I would be sympathetic to the proposition that those restrictions should be removed or alleviated from a pro-competition or a pro-competitive perspective, I agree with you on that. I just don't know what the other -- what the arguments are on the other side. So that's kind of an argument you're going to have to have with Centra or, you know, other representatives of CAC if you get down to specifics about that.

MR. ERIC HOAKEN: But I understood you to say yesterday that one of the rationales for you advocating a Centra fixed price product was the retailer's reliance on door-to-door sales.

And I take it that if the sales channels are opened up and there are other avenues available to the retailers, that concern largely goes away, correct?

MR. MARK STAUFT: Well, I mean, I wouldn't say it necessarily goes away. As I said, I think it would be a positive development for competition and for consumers if sales channels could be opened up in a way that was not harmful to consumers and that didn't cause other problems.

You know, I mean, I imagine -- or my understanding anyways, although I can't remember exactly where I get this, is that in relation to telemarketing, for example, various concerns arise about the fairness of the process and, you know, how informed people are at making decisions and -- and that kind of thing; in other words, concerns that may be analogous to the kinds of nervousness I have about door-to-door stuff.

MR. ERIC HOAKEN: And those concerns certainly are not unique to the marketing of natural gas?

MR. MARK STAUFT: No. No. Exactly. So, you know, it's a -- it's a -- I don't think it's fair to say, oh, well, if -- if you just allowed people to use telemarketing or internet sales -- telemarketing in particular -- then the concerns about the fairness and efficiency of the marketing channels goes away. I don't think that follows at all. It creates more channels but maybe not better ones; I don't know.

MR. ERIC HOAKEN: Right, but telesales and Internet are being used in other businesses so, presumably, we, as a society, have been able to deal with whatever consumer protection issues arise there.

Why would it be different in the case of natural gas?

MR. MARK STAUFT: If there is -- well, if there is a difference -- well, I mean you would think that maybe -- it probably would be but, again, I don't know the facts.

And the other difficulty that we've talked about all through this is that marketing these kinds of products is complex in the sense that the products are quite different from their main competitor which is Centra's sales rate, for example, and it's just a conceptually difficult area thinking about the appropriateness of long-term prices. I think -- and Dr. Van Audenrode mentioned there's very few goods or services nowadays that are sold on a five (5) year basis and that in itself complicates it.

I mean, that's not attributing any fault to the brokers or anything like that, it's just a fact about the product that's being offered and a -- and a difficulty that's associated with it I think.

MR. ERIC HOAKEN: Right. But there's -- there's no reason to think that suitable consumer protection measures, to the extent that they're not already in place, can't be designed to permit the marketing of those products in a way that's appropriate; right?

MR. MARK STAUFT: No, I have no basis for saying right now that it would be impossible to do that. That's -- that's true.

MR. ERIC HOAKEN: Now, let me give you a rest, Mr. Stauft, and turn to Dr. Van Audenrode just on the issue of door-to-door sales.

You this morning in your evidence, Doctor, said that this is a complex financial transaction that consumers are being asked to enter into and did I understand you to analogize it to the purchase of securities or mutual funds or something like that?

DR. MARC VAN AUDENRODE: This morning, yes, that's -- that's what I said.

MR. ERIC HOAKEN: Right. And you made reference to the know-your-customer standard and that is a standard or practice that is applied throughout the financial services industry for the purposes of giving investment advice or selling investment products, right?

DR. MARC VAN AUDENRODE: Well, it has different names in different jurisdictions but the basic principle is the same, yeah.

MR. ERIC HOAKEN: Yeah, I think we're talking about the same thing. It envisions a fairly in-depth discussion between the seller of the product and the purchaser of the product so that the seller of the product can fully appreciate the financial circumstances that the purchaser is in.

DR. MARC VAN AUDENRODE: Well, I -- I would characterize it slightly differently and I'm not a lawyer here but -- so I don't -- wouldn't want to venture into your -- your sandbox but -- but I understand not as an obligation of means but an obligation of results that you -- you need to make sure that ultimately you -- it's not just that you've tried but, ultimately, your customer understands what he has bought and that what he is buying is suitable for his level of sophistication and -- and wealth and -- and et cetera, et cetera.

MR. ERIC HOAKEN: I'll certainly accept that characterization and, as you said this morning, that is a very stringer -- stringent standard, right?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And you're not aware of that standard being applied in other -- in any other Canadian jurisdiction for the sale of natural gas contracts, are you?

DR. MARC VAN AUDENRODE: I wouldn't know that.

MR. ERIC HOAKEN: You had an opportunity I take it, Dr. Van Audenrode, to look at the Centra customer research study?

DR. MARC VAN AUDENRODE: Yeah.

MR. ERIC HOAKEN: And you read, I take it, the portions that deal with the door-to-door sales channel?

DR. MARC VAN AUDENRODE: That was probably not part of the survey that I had most interest with.

MR. ERIC HOAKEN: Okay. Did you read the whole thing, or did you just read things that were of interest to you?

DR. MARC VAN AUDENRODE: I -- I went through everything, yeah.

MR. ERIC HOAKEN: Okay. Why don't we just take a look at it together, then. That may be the most efficient thing to do.

(BRIEF PAUSE)

MR. ERIC HOAKEN: Now if you look, Doctor, on page 47, the first question I'm going to ask you about is -- is, I'm sorry, dealing with table 28. So when you turn that up let me know.

DR. MARC VAN AUDENRODE: Yep. I'm -- I'm there.

MR. ERIC HOAKEN: And you'll see that 82 percent of respondents - these are customers or retailers - said that they were either satisfied or very satisfied with the current arrangement that they had with their gas provider. Correct?

DR. MARC VAN AUDENRODE: Yes.

And if you just stick your finger in that page for a minute and turn over to the next page and look at table 30, you'll see that 82 percent of the respondents to the study said that they, in fact, did enroll through door-to-door. Right?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And I'm going to suggest to you that there is nothing in those satisfaction numbers that supports the theory that consumers think, sometime after signing the contract, that they've been fleeced or hoodwinked or asked to make an important economic decision in inappropriate circumstances, is there?

DR. MARC VAN AUDENRODE: The way you put it is correct; there is nothing to suggest that, yes.

MR. ERIC HOAKEN: And as a matter of economic theory, you don't assume that people are dummies, do you?

DR. MARC VAN AUDENRODE: No, we don't.

MR. ERIC HOAKEN: You, in fact, assume that people will act in an economically rational fashion.

DR. MARC VAN AUDENRODE: That's what we do.

MR. ERIC HOAKEN: And some of these respondents to the survey would have had the benefit of some reflection after signing their contract and some experience with their marketer and they have nonetheless expressed high levels of satisfaction.

DR. MARC VAN AUDENRODE: That seems to be the fact.

MR. ERIC HOAKEN: And so although you and Mr. Stauft may have some hypothetical concern about the way that consumers are being disadvantaged, you'll agree that the results from the study don't support the view that con -- that they actually feel that way, consumers actually feel that way.

DR. MARC VAN AUDENRODE: I wouldn't agree with that -- with that reasoning, no.

MR. ERIC HOAKEN: Okay. Help me understand, then, how you would reconcile the customer satisfaction figure that we just looked at in table 28 with a widespread perception on the part of consumers that they've been treated inappropriately or asked to make an inappropriate decision by brokers.

DR. MARC VAN AUDENRODE: Well, let me -- let me give you an example. And -- and please don't -- don't interpret what I'm going to say as -- as -- as somehow saying that, you know, the retailers are doing inappropriate things. But -- but let me just give you an example.

You know, there are people who are very -- who could have been very, very, very happy with the way their RSP portfolios were -- were doing. And then one day they wake up and they understand that their broker had invested in Enron and not in T bills as they thought.

Now they could have been -- these people could have been very satisfied with their product for a very, very, very, very, very long time. That's all I'm saying, you know? People are satisfied; that's a good sign. The reason why, as I've said, I have a concern, it's not here -- which, I have to say is a good -- you know, it's a good number for retailers.

I've said, I have the -- difficulties matching, first, my belief that people are smart and understand what they are doing, although it's -- we went through this very long discussion about how making financial decisions can be difficult on the one hand.

On the other hand, my belief as an economist that there is no way that you can "save money" quote/unquote by -- by entering into these contract; and, third, this evidence that here somewhere people say that they went into this contract because they hoped to save -- to save money.

That's -- this array -- and the disconnect between these five (5) studies trouble me.

MR. ERIC HOAKEN: But isn't there also a disconnect between your stated conclusion as an economist that it's impossible to save money by purchasing one of these contracts?

And the Information Request response that's in the record showing that of the twelve (12) completed contracts in this Province, eight (8) people did, in fact, end up spending less for their primary gas during that period than otherwise would have been the case.

DR. MARC VAN AUDENRODE: I think we're going back to the discussion that -- that we had before which is I don't believe in ex-post -- a few ex-post realization of a very complex and random phenomena which is the one that we are talking about.

MR. ERIC HOAKEN: But -- but how else then can you evaluate the proposition that you're placing significant reliance on which is that consumers won't save money.

How else can you evaluate that except on an ex-post basis? On an ex-anti basis it may be that a consumer goes into the contract thinking that he or she may save money. But the evaluation of whether or not he or she did in fact save money can only be performed on an ex-post basis, correct?

DR. MARC VAN AUDENRODE: Oh yeah. That part I agree but that doesn't change anything to the fact that people -- rational people shouldn't go into these contracts thinking that they're going to save money.

MR. ERIC HOAKEN: Well what if they go into it thinking that they may save money but even if they don't they're going to get some protection from rate volatility?

That's -- there's nothing wrong with that, is there?

DR. MARC VAN AUDENRODE: There's nothing -- I mean there's nothing wrong but, essentially, I think I've detailed this problem that I have with the results here and squaring off all these results and the fact is that, you know, from what I've seen here, you know, these people say that they are getting into these contracts because they think that they're going to save money not because that they want to get protection.

MR. ERIC HOAKEN: Well I think in -- in fairness that was about 50 percent of the sample who said that, right?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And there -- there may be some nuances to that that we're obviously going to have to explore with the customer research people about what people actually said.

Did they say, I'm definitely going to save money or maybe I'll save money?

DR. MARC VAN AUDENRODE: I -- I totally agree with you and -- and this is why I just pointed to that as being one of the many elements that, you know, raise some red lights in my economist mind as to whether this -- this market is really being competitive right now.

MR. ERIC HOAKEN: But it -- it really depends I guess how bright those red lights are really depend on how you interpret that response of consumers about their expectation that they will or may save money, right?

DR. MARC VAN AUDENRODE: That's -- you know, how bright one of these red lights is, yes.

MR. ERIC HOAKEN: Right.

(BRIEF PAUSE)

MR. ERIC HOAKEN: I think you said this morning, Mr. Stauft, I believe it was in answer to a question from Mr. Peters but I may be mistaken that you are not now advocating the elimination of the door-to-door sales channel.

Is that a fair understanding of what you said?

I'd understood you to say that it's just that if there was evidence showing that there was an ongoing and incurable problem, that in those circumstances you might advocate it but you weren't presently doing so.

Am I on the right track there?

MR. MARK STAUFT: I think generally on the right track, yes. I mean I -- I didn't raise that in my direct evidence, right?

I mean, I -- I responded to an Information Request saying -- asking gee, you favour elimination of this and I said, sure, subject to questions about jurisdiction.

And I think what I said this morning was, through this whole process I haven't been promoting that or thinking of it even as a realistic option. I mean, I have proceeded right from the start on the basis that that mechanism is part of the -- part of the landscape and it's going to stay here so...

MR. ERIC HOAKEN: All right. Thank you. Let me now enter the well-travelled land of Centra fixed-price offering.

I think as I understand it your rationale, Mr. Stauft, for Centra being permitted to offer such a product is that, first, this would help address any issues about unfair pricing or inappropriate pricing by retailers, if such problems actually exist; right?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: And secondly, that this would be a way of alleviating or addressing the issues you've raised about the use of the door-to-door sales channel.

MR. MARK STAUFT: Well, I -- I guess so although I would think of those two (2) things as sort of different aspects of the same issue, but, if you want to describe it that way, that's fine.

MR. ERIC HOAKEN: All right. And you said yesterday in your evidence that it's really preferable for competitive products to come from nonregulated market participants and it is I think, as you characterized it, a second best alternative for Central to be the party who is offering those products; is that fair?

MR. MARK STAUFT: I think -- I certainly did -- did say that, yes, and that's fair. And I think as a matter of principle that's correct and to the extent that I have suggested, in this case, a departure from that that that's just based on an examination of -- of reality as opposed to the sort of idealized world we have when we think just in principle terms.

MR. ERIC HOAKEN: Right, but as a matter of practical reality, we would want to be satisfied that the first best alternative was not feasible or workable or foreseeable before we discarded it and went with the second best alternative; does that not follow?

MR. MARK STAUFT: Well, again, there's shades of grey all over the place here. I mean, if -- if the second best is only imperceptively -- imperceptively worse than the first best, then, you know, the trigger to -- to go to that option will come earlier and will be easier to hit; and secondly, it's a question I think of how strongly we feel about whether there is a problem in the competitive arena in the sort of first alternative that everyone has been working on for the last ten (10) years.

MR. ERIC HOAKEN: And -- and --

MR. MARK STAUFT: I mean, in principle your logic makes sense but I'm just pointing out that it's always going to be a matter of degree and -- and there's judgments to be made and factors to be weighed.

MR. ERIC HOAKEN: And I think you're absolutely right that it depends on how concerned we are or how convinced we are that there truly are competitive problems in the marketplace, right, or at least problems in the competitive marketplace.

MR. MARK STAUFT: That's one (1) factor, yes, as I just said I think.

MR. ERIC HOAKEN: And it appears to me that you are somewhat less definitive about that now than you were perhaps when you prepared your pre-filed evidence.

MR. MARK STAUFT: No, well, I -- I don't have that feeling myself. I mean it may -- may look that way. I think what I've been doing is trying to be completely candid about the qualifications and the -- the nuances of -- of the analysis.

MR. ERIC HOAKEN: And --

MR. MARK STAUFT: If those coming out makes it look that way, fine, but I think my overall view still is that there is a reason for the Board to be concerned about how the market is working in Manitoba so.

MR. ERIC HOAKEN: Let's try to drill down into the mechanics of a utility-offered fixed price product.

As you've quite fairly said, any offer of a fixed price product is going to have to deal with the risk inherent in offering that product, right?

MR. MARK STAUFT: That's correct.

MR. ERIC HOAKEN: And you had said -- oh, and sorry, just to back up. I think it, again, is well travelled ground that if someone is assuming risk they have to pay a premium -- or at least they should be paid a premium for assuming that risk, right?

MR. MARK STAUFT: Well, I guess, yeah, more generally compensated for it or kept whole for it. Yeah.

MR. ERIC HOAKEN: Okay, fair enough, I think we're saying the same thing.

And I understand you to say that one of the essential elements of any Centra-offered fixed price product is that Centra not bear any of the risk associated with that product; is that right?

MR. MARK STAUFT: From my perspective, that's not an essential property of such a product. I simply proceeded on that assumption -- on that basis on the assumption that it would be pretty darn important to Centra so.

MR. ERIC HOAKEN: And your part --

MR. MARK STAUFT: And if you don't do that, and probably the Board as well -- if you don't do that, I mean, it's possible to proceed on some other basis but then you have to start worrying about, you know, return issues and all kinds of other complicating factors. So you could do it that way, I just have not for these purposes.

MR. ERIC HOAKEN: All right. And I think what you did in your analysis was you said there's potentially three (3) parties who could bear or assume that risk: Centra, upstream suppliers and customers. And I think we've now agreed and you've explained why we'll stroke Centra off that list.

So that leaves upstream suppliers and Centra customers as the parties who are potentially going to have to bear the risk of the fixed price product, correct?

MR. MARK STAUFT: Yeah, the volume variances associated with that. Yeah.

MR. ERIC HOAKEN: Okay. And that's really what I wanted to start by exploring is that there's a volume-based risk that we've talked about and, that is, when a retailer, for example, signs up a contract with a customer, there's a contractual obligation to supply gas for the term of that contract at a fixed unit price, but the contract says nothing about the volume to be supplied.

MR. MARK STAUFT: Precisely.

MR. ERIC HOAKEN: Hence the volume risk?

MR. MARK STAUFT: Precisely.

MR. ERIC HOAKEN: And it's going to

operate precisely the same way with Centra?

MR. MARK STAUFT: Yes.

MR. ERIC HOAKEN: But there's also a risk on the financial side; I'm going to suggest to you. That there is, as we've already discussed, there's hedging that will necessarily have to be done in order to match or manage the mismatch - is a better way of putting it - between the price at which the gas is being sold on a forward basis and the actual gas acquisition costs, right?

MR. MARK STAUFT: Sorry, there must necessarily be --

MR. ERIC HOAKEN: There --

MR. MARK STAUFT: -- financial hedges put in place --

MR. ERIC HOAKEN: Yes.

MR. MARK STAUFT: -- you think?

MR. ERIC HOAKEN: That was a long question. There are going to be mismatches between the price at which Centra, in this example, offers a fixed price product and the cost it pays for acquiring the gas to fulfill those commitments, right?

MR. MARK STAUFT: Yeah. I think maybe what you're trying to say is there's going to be differences between their revenues under those arrangements and the costs that they incur to provide the service, which arises from a volume. I think we're saying the same thing.

MR. ERIC HOAKEN: I think we are.

MR. MARK STAUFT: So that's fair.

MR. ERIC HOAKEN: And then, let me take it to the next step, is that in order -- and so there's a risk inherent in that, right?

MR. MARK STAUFT: Right.

MR. ERIC HOAKEN: And so in order to manage that risk, what Centra will likely do or would most certainly do, is hedge its position to try to cover off those mismatches?

MR. MARK STAUFT: I would share your expectation that they would take some steps to do that, yes. And there's different ways they could do it, but yes.

MR. ERIC HOAKEN: Right. But there is certainly no way they can do it that they can ensure that they will eliminate those mismatches. Isn't that fair?

MR. MARK STAUFT: Well, I mean talking in an extreme case, they probably could but it would be very expensive. It would be so expensive that nobody would buy the product, I would expect. So at a practical level, I think I agree with you that there is always going to be some of that risk.

MR. ERIC HOAKEN: And like any sort of market activity, hedging of this nature by Centra would carry with it some risk?

MR. MARK STAUFT: Well, no -- sorry, we're -- I may be getting mixed up here. The -- the hedging in this case is -- is a matter of them reducing the risk. They're buying something to reduce the risk. They're making a commitment to reduce the risk.

Probably the simplest way to think of it, which I think is the way it's talked about in my testimony although there would be other ways to do it, is just to think of them buying fixed-price gas, right?

They have a certain amount of market and they -- for -- that they sell for two (2) years, so they just go out and buy sort of an expected amount at a fixed price in the market; that is, in a sense, a hedge. That may be what you're thinking of as a hedge.

MR. ERIC HOAKEN: All right. So let me just finish this point and I'll come to you, Doctor.

So I think, just so I understand the elements of this, firstly, you're agreeing that there are potential mismatches between the price that Centra takes on a fixed-price offering and its gas acquisition costs, right?

MR. MARK STAUFT: Yeah. And between its revenues and its expenses, yes.

MR. ERIC HOAKEN: Right. And that mismatch constitutes a financial risk to Centra?

MR. MARK STAUFT: To somebody, yes. Well in the first instance -- in the first instance to Centra, yeah, that's correct.

MR. ERIC HOAKEN: Right. And -- and then in order to manage or mitigate that risk, Centra may engage in hedging activity.

MR. MARK STAUFT: Broadly defined hedging activity, yes.

MR. ERIC HOAKEN: And that hedging activity may or may not be successful in managing or eliminating the risk being assumed. Isn't that fair?

MR. MARK STAUFT: Right. I think what I said was ideally Centra's objective would be to eliminate the risk. Just turn it into an expense from their perspective, add it to the price of the product and then the customers pay for it and there's no risk left over.

I think what you and I were discussing before is that, in the real world, it's likely that at some level that exact covering off of exactly all the risk is probably going to be very difficult to do at any reasonable cost.

MR. ERIC HOAKEN: All right. So doesn't that mean that in addition to the volumetric risk, there's also a risk on what I would characterize -- and you tell me if there's a better label -- there's a risk on the financial side.

MR. MARK STAUFT: I'm sorry -- no, I -- I --I'm thinking of this as -- they -- they have volumetric risk; financial risk that arises out of their volumetric risk. They try to reduce that as much as they can. If they can eliminate it all, good for them.

A more likely case, there is some left over but it's not a different kind of risk. It's just that they had a thousand (1000) units risk and they eliminated nine hundred and ninety (990) units of them so they've got ten (10) left over. It's the same risk.

MR. ERIC HOAKEN: Yeah, sorry, I invited you to jump in, Doctor.

DR. MARK VAN AUDENRODE: Yeah I -- I think we're getting a bit ahead here and talking to -- getting to a minutia but I would simply -- I mean I would -- I would try to qualify this -- this notion of risk.

I mean, every time Centra is going to buy -- is going to sell a long-term contract, they can go out and buy the equivalent long-term contract on -- on the -- on a purchase side, and they are just left with the volume risk then.

So the only risk there is the volume risk and -- and you know, you could expect that that risk would be, to some extent, one way we could do it would be to self insure it.

And again, I -- I haven't studied this in details but you could imagine that, you know, Centra is big enough that they could self-insure. Sometimes they'll be short and lose some money; sometimes they'll be ahead and lose -- and gain some money but you know, they could pretty much self-insure that part.

MR. ERIC HOAKEN: Okay, well let me perhaps come back to that idea of what you've characterized as self-insurance, because it would be interesting to look at who the "self" is there but let me just carry on with you, Mr. Stauft.

I'm in the Board's hands about what you want to do break-wise.

THE CHAIRPERSON: We'll go now and come back at 2:30.

MR. ERIC HOAKEN: Thank you.

THE CHAIRPERSON: Very good. Thank you.

--- Upon recessing at 2:16 p.m.

--- Upon resuming at 2:31 p.m.

THE CHAIRPERSON: Okay, Mr. Hoaken...?

MR. ERIC HOAKEN: Thank you, Mr. Chair.

CONTINUED BY MR. ERIC HOAKEN:

MR. ERIC HOAKEN: Dr. Van Audenrode, I do owe you an apology. I -- we checked the transcript and it was actually Mr. Stauft who made the comment I had in mind. I apologize for that.

Let me just deal with that while I'm thinking of it. There was a comment you made, Mr. Stauft, in your evidence about the fact that retailers don't have assets. Do you remember that comment? I can now give you the transcript reference --

MR. MARK STAUFT: No, I --

MR. ERIC HOAKEN: -- if you need it.

MR. MARK STAUFT: -- I do recall saying that and they don't have assets on the scale that a distribution utility does or a pipeline or something like that.

MR. ERIC HOAKEN: And --and -- and certainly that's true. But I -- I understood you to go further in your evidence, and maybe I heard it wrong. But I -- I understood you to say they don't really have any capital or physical assets at all; that they just have what you characterized as intellectual capital.

MR. MARK STAUFT: Sorry, no, I -- that -- that's a misunderstanding. I -- I may have said that but that's an exaggeration obviously. They have some assets it's just that you -- if I were them, I certainly wouldn't want to be trying to get a -- a return calculated just on the basis of a return on those assets.

MR. ERIC HOAKEN: Exactly right. Their return would be calculated based on the capital assets, based on the intellectual capital, but also based on the risk that they're assuming in the market.

MR. MARK STAUFT: Yeah. As I think I was saying yesterday, it's a -- it's a complex problem that's quite different from the problem of trying to determine what a fair return is for a Utility where the assets are all just sunk, stuff in the ground, kind of thing. It's just a way different problem.

MR. ERIC HOAKEN: Right. But those three (3) ingredients that I just detailed, you'd agree that those are appropriate considerations when determining the appropriate return?

MR. MARK STAUFT: I -- I would think that's correct, yeah.

MR. ERIC HOAKEN: Thank you.

Now let's continue the discussion we were having about hedging just before the break.

And I want to ask you, Dr. Van Audenrode, you've expressed some fairly strong views about the appropriateness of Centra's hedging its primary gas product, right?

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And I think in the course of that discussion, you've quite appropriately acknowledged that there are risks inherent in that process?

DR. MARC VAN AUDENRODE: Exactly.

MR. ERIC HOAKEN: And you now understand -- you may not at the time you first looked at this, but you now understand from the discussion that has occurred that the hedging program that Centra engages in, in relation to its primary gas product is a mechanistic program.

DR. MARC VAN AUDENRODE: Yeah, that's why -- what I understand, although I'm not sure I exactly understand what it implies and the details of that mechanic.

MR. ERIC HOAKEN: Well, what I think it implies is that it is a relatively conservative program that is not designed to incorporate any view as to what direction the market is going in.

Is that sort of consistent with your

understanding?

DR. MARC VAN AUDENRODE: No. I mean -- no, I mean, I -- I -- I wouldn't -- I wouldn't know that, yeah.

MR. ERIC HOAKEN: Okay. Would you expect, though, that a Utility, to the extent that it's going to have a hedging program, will have one that's a relatively conservative one?

DR. MARC VAN AUDENRODE: Well, yeah. Again, it depends on what they want to achieve with that program.

MR. ERIC HOAKEN: Right. If they're attempting to achieve the -- the maintenance of a relatively stable price, I mean, wouldn't that follow -- or at least wouldn't it follow that a utility, if that was its objective, would use a relatively conservative means to achieve that objective?

DR. MARC VAN AUDENRODE: But -- yeah. Yeah, I'm not sure I understand what you mean by -- by "conservative." But, if by that you mean -- let me put it differently. I mean, the -- the more price stability you want to achieve through this mechanism, the more expensive it's going to get.

MR. ERIC HOAKEN: Right. And there's hedging. I guess here's what I mean by "conservative."

You tell me if this makes any sense to you, but there's -- there's some hedging that is speculative in nature, right?

DR. MARC VAN AUDENRODE: I would say that, yeah, hedging is -- is not necessarily speculative in nature. Hedging is speculative whenever you take a position that is not covered.

MR. ERIC HOAKEN: You've said it much better, but I think that's what I was getting at is that hedging doesn't always have to be speculative, but there are types of hedging and exercises in hedging that can make it speculative.

DR. MARC VAN AUDENRODE: Yes.

MR. ERIC HOAKEN: And if that, more or less, is the continuum of hedging activity, you would expect that utilities would be towards the conservative end of that continuum in engaging in their hedging activities.

DR. MARC VAN AUDENRODE: Well, my -- my understanding is, you know, I don't -- I don't think there -- there is a continuum; either -- either your position is covered or it is not.

And my understanding is that the type of hedging that Centra is engaging is an uncovered position, meaning, that if the price falls below a certain threshold, you actually have to pay more than market price. That's an uncovered position.

MR. ERIC HOAKEN: All right. And is the type of hedging that Centra has engaged in, in relation to the primary gas product, the type of hedging you would expect it to engage in, in connection with offering a fixed price product?

DR. MARC VAN AUDENRODE: No, I -- I think I've been clear about that. I would expect them to cover the sales by purchase on the same time horizon as their sales which --

MR. ERIC HOAKEN: Right. Subject to the risk we've talked about on volume?

DR. MARC VAN AUDENRODE: Subject -- yeah, exactly.

MR. ERIC HOAKEN: Right. Okay. And so the -- the positions in that scenario would be covered --

DR. MARC VAN AUDENRODE: Exactly.

MR. ERIC HOAKEN: -- subject to uncovered positions arising from volume --

DR. MARC VAN AUDENRODE: From volume --

MR. ERIC HOAKEN: -- mismatches.

DR. MARC VAN AUDENRODE: Exactly.

MR. ERIC HOAKEN: Okay. Now, back to you, Mr. Stauft. Back to our discussion about the -- the potential candidates to assume the risk that arises from offering a fixed-price product. We've agreed to put Centra out of the mix so it leaves us really with two (2) candidates.

As you've outlined in your analysis, one (1) would be the upstream producers and the other would be customers themselves, right?

MR. MARK STAUFT: Correct.

MR. ERIC HOAKEN: And as I read your analysis or at least commentary on upstream producers, I took you to be somewhat less than optimistic about the prospect of finding producers who would be willing to take that risk at a price that would make sense. Am -- am I reading that right? I don't want to read too much into it, but that was the way I took it.

MR. MARK STAUFT: No, I think that's -- that's fair. I mean I -- I wouldn't say that Centra shouldn't bother exploring that but, at the same time, I wouldn't bet the farm on that type of approach producing a -- a workable result. It -- it could go either way. I wouldn't be confident about that.

MR. ERIC HOAKEN: And just to talk about what a workable result would be; I mean, first it would involve finding an upstream producer who is willing to enter into that kind of arrangement, right?

MR. MARK STAUFT: Right.

MR. ERIC HOAKEN: And then secondly, it would involve a price -- getting a price from that producer that would make Centra's offering competitive with that which is being offered by the marketers, right?

MR. MARK STAUFT: Right, yeah.

MR. ERIC HOAKEN: And if the premium that the --

MR. MARK STAUFT: Sorry. I mean there -- there may be cases where Centra has a different product is all I was thinking of, so it may not always be a one-on-one comparison with -- with the -- the broker's products. It may be that they just can't sell it, for example, you know, or they look at it and they just say well, never mind, you know. For whatever reasons we had for doing this in the first place, we just don't want to charge our customers that much or -- or whatever so -- but it could be unsatisfactory in various respects.

MR. ERIC HOAKEN: Okay. So although this is an option that is theoretically available, we don't really have any information to suggest that it would be workable in practice. Is that fair?

MR. MARK STAUFT: Well, I mean, I -- I would say that it may be workable, and -- and Centra may be able to come up with something. Just as I've said before, I mean, maybe it works and maybe it doesn't.

MR. ERIC HOAKEN: And we simply don't know one way or the other?

MR. MARK STAUFT: Not right now, no. And that would be -- if -- if this -- this type of approach is going to be going forward, Centra would have to look at that, I think.

MR. ERIC HOAKEN: I understood, then, in the course of your pre-filed evidence, the comment you made then, that you seemed, at least for now, resigned to the likelihood that customers ultimately would be the ones who would be bearing the risk. Am I right about that?

MR. MARK STAUFT: I'm not sure I would say resigned, but certainly I included that -- that leg of the analysis in the -- in the piece, because one thing you can say about that is that for sure you can make it work, right? Somehow. You may not like the -- how it looks when you're done, but at least you know it can be -- it can be made to work, whereas there's some question about that with the -- with the other approach where you're relying entirely on upstream suppliers.

MR. ERIC HOAKEN: All right. Thank you for that. And -- and so, of the three scenarios, do I take it that you think, at least for the purposes of the present discussion, that that is the one that is the most likely?

MR. MARK STAUFT: I -- I -- I think we can discuss it on that basis. I mean, I -- I think my position's clear on that. Yeah. Let -- let's just go ahead on that basis.

MR. ERIC HOAKEN: Now, when she asked you questions earlier today, Ms. Murphy said that she was a bit confused about something that she thought you'd said, and I must say that I shared her confusion and thought you'd said the same thing.

So I want to just be clear about this. When we come to what category of Centra customers bears that risk that we're talking about, I thought I heard you say that it's the customers who take up the fixed-price offering, who are the ones who have to bear the risk. Am I right about that? Or --

MR. MARK STAUFT: They -- they don't necessarily have to, no. I mean, I think that's one of the issues that is out there to be resolved when we -- when we sort of drill down on how this kind of program would be designed, if -- if and when we do. I mean, that is obviously the important conceptual issue.

I mean, if you are talking about customers as a group, I mean, in -- in a theoretical sense, what you'd like to do is say, well, all of the risk goes to the people that are getting that service, right? The problem with that is that in -- in one sense, that's inconsistent with the nature of the service that you're talking about.

And if it's a fixed-price service, they don't have that risk. So, I mean, you could certainly approach the matter as one of -- one approach Centra could take would be to sort of maintain its -- accumulate its -- its variances and shift those forward into -- into subsequent periods or subsequent service offerings, for example.

MR. ERIC HOAKEN: And -- and have those -- sort of like a rate rider, you mean?

MR. MARK STAUFT: Well, kind of. It would just be a cost factor that they would be -- that they would take into effect when they designed the price for the next batch that they went out and sold. Now, you know, the -- the disadvantage of that is that it may distort the price of that product, either up or down, in a way that's not quite what they had in mind or quite what the market will bear or -- or something.

I mean, on the other side, Centra could just try to recover those variances through its general PGVA for -- from the remaining base of -- of customers.

On the theory that -- again, it's a little bit inconsistent with the theory that we ideally would like risks to be borne by the people that -- on -- on whose behalf they were incurred.

But, you know, I mean, at a practical level it -- that may make sense under certain conditions and with provisos and -- and so on. There may be a way to make that work in a way that, in practical terms, holds those other customers harmless. It's difficult -- well, sorry -- I -- I outlined those as sort of two (2) -- conceptually two (2) possible approaches.

MR. ERIC HOAKEN: And I want to stick with the first of those for now, which is trying to conceive of and design and implement some mechanism that could be used to recover those costs from fixed price customers.

And it seems to me -- I can't think of any other way to do it than it has to be done retroactively or retrospectively.

So you're -- you're only going to know what your exposure is, if you have one, after you've committed to sell gas to a customer at a specified price, right?

MR. MARK STAUFT: Well, after the contract has run its course.

MR. ERIC HOAKEN: That -- that's more precise, you're -- you're right.

MR. MARK STAUFT: Right.

MR. ERIC HOAKEN: But in -- in any case, after the contract has run its course, you certainly don't have the opportunity to go back to the customer and say, gee, shucks, you know, we probably should have priced this differently and would you mind writing me a cheque? You can't do that.

MR. MARK STAUFT: I mean you could -- as I said you can -- you can try to do that and try to put that in your tariff, but it -- you know, conceptually, it's inconsistent with the nature of the product you thought you were designing in the first place, so.

MR. ERIC HOAKEN: Right. You -- you -- you'd be in that market segment for a pretty short time if that's what you did, right?

MR. MARK STAUFT: Certainly, if the bills were -- yeah, were amounts owing and they were significant, yeah.

MR. ERIC HOAKEN: Well, even if they were just amounts owing, that's the antithesis of a fixed price product as you said.

MR. MARK STAUFT: Right. I mean you're -- you're departing from the concept that you started out with.

MR. ERIC HOAKEN: Right. So if you're recovering then the costs from fixed price customers, you're not recovering them the customers in connection with -- well, let me ask it this way.

If you're covering costs from fixed price customers, you're not getting the cost from those customers whose experience caused the cost. You're passing it on to the next round of customers that you're contracting with, isn't that right?

MR. MARK STAUFT: In that scenario, yes. I mean that would be the -- I imagine what Centra would -- would want to do is try to recover it through, as you say, from the next tranche of -- of fixed priced customers.

MR. ERIC HOAKEN: Right. And is -- is that -- is that, Dr. Van Audenrode, an economically efficient distribution or allocation of the risk?

DR. MARC VAN AUDENRODE: Well you -- I mean you said it. The -- the essence of the product is to be fixed price and so that there is some risk associated with it.

What matters is that customers perfectly understand that. As long as customers are -- perfectly understand that and -- and they understand that, you know, sometime they could be winners, sometime they could be losers. Even with the respite, I don't see what's -- what -- what the economic problem this for -- for --

MR. ERIC HOAKEN: I think maybe -- well you -- you've definitely lost me. Let's go back. I think --

DR. MARC VAN AUDENRODE: Well, what -- what I'm just saying is that you know once you get into these contracts that you could win or lose. Even aside from the volume risk, you know that you could win or lose.

MR. ERIC HOAKEN: Okay, but winning or losing doesn't invol -- it's certainly not a feature of the present marketplace that a customer of Direct Energy or Energy Savings could, at the expiry of his or her term, have a representative of one (1) of those companies on her doorstep asking for more money.

DR. MARC VAN AUDENRODE: I totally agree with you.

MR. ERIC HOAKEN: Right. And you --

DR. MARK VAN AUDENRODE: So that -- that means that, you know, there is an aspect in that which you know at some point you'll get a good deal because the guys before you had a bad deal because -- because, you know, the previous contract wasn't -- wasn't the best it could have been.

What I'm saying is that in the long run, essentially, Centra will have to do exactly what your client is doing to make sure that this doesn't happen. Because if you push costs to the future customer, you're going to lose these future customers.

MR. ERIC HOAKEN: Okay. And I think that was exactly my point; is that if the costs get passed on to the next round of customers, it makes that product less attractive for a competitive.

DR. MARC VAN AUDENRODE: Definitely.

MR. ERIC HOAKEN: Okay. Now, let's go then to the second subset of customers who might conceivably be asked to bear this, and this is the variable rate customers.

And as I understand you in your pre-filed evidence, Mr. Stauft, do you see this as a possible option; that any costs that are incurred by Centra in providing the fixed price product would be put into the PGVA and flowed back to the variable rate customers.

Have I got that right?

MR. MARK STAUFT: Yes. I think I described that as a possibility.

MR. ERIC HOAKEN: And if -- if that is happening, is that not a pretty clear example of cross-subsidization where the customers who have decided not to get or obtain rate protection by getting a fixed price product are nonetheless being asked to pay the costs of it?

MR. MARK STAUFT: Yeah, I -- I think I -- I said in my testimony as well, that in principle you don't like to do that.

Keep in mind here, that we're talking about a shifting of variability and not expected costs. I mean, certainly, for sure, Centra would arrange it so that there's no, sort of, systematic flow of money from the PGVA people to the other people.

MR. ERIC HOAKEN: But --

MR. MARK STAUFT: What you do have is if -- if you've got these -- these variances can be positive of minus -- or positive or negative, that's the thing, right? So it -- it may be an addition or a subtraction to the PGVA.

Now I think I've acknowledged that even that is, in principle, sort of undesirable but, you know, there you go. Whether -- whether you want to do that versus any of the other alternatives will be a function of, I assume, lots of things; amongst them, the question of what kind of dollars we're talking about here. If it's -- if it's ten thousand dollars ($10,000) in a -- in a $40 million PGVA, I think most reasonable people would say big deal, you know, it doesn't matter.

MR. ERIC HOAKEN: Right. But at this point we can have no assurance that it would be so --

MR. MARK STAUFT: No.

MR. ERIC HOAKEN: -- limited?

MR. MARK STAUFT: No, no. And -- I mean, these are all the kinds of issues you're going to have to work out. And -- and there's probably a fair amount of analysis that Centra and the rest of us, you know, your clients and my clients, will have to do if this is a program that's -- that's carried forward.

Same with the other -- the other thing we -- the other approach we just talked about of try to recover these variances within the fixed price group. Or, for that matter, judgments we may make about the viability or otherwise of approaches that -- that try to shift the risk upstream.

I mean, those -- just -- you'd -- you'd have to look at all the amounts and you'd have to look as well at things like -- you know, there may be ways that Centra can reduce those risks, sort of directly, if I can put it that way. Rather than allowing the risks to materialize and then shifting them they could, in principle, buy enough storage, for example, to take that, you know, 99 percent of that volume variance out of play --

MR. ERIC HOAKEN: And --

MR. MARK STAUFT: -- so that you've reduced the whole problem to nickels and dimes for whoever it's getting shifted to. And then you'd have to look at, well, what is that amount of storage going to cost you and all that kind of thing.

I'm sorry, I'm not trying to suggest that there would be any particular way to go. It's just that it's going to be complicated and it -- none -- I -- I agree with you that probably none of the solutions sort of stands out as entirely -- entirely the correct way to go or as completely free of potential flaws or objections.

But I don't think any of them is equally -- I don't think our failure to be able to -- to establish that means that it's -- it's necessary to just toss the whole idea on it because there may be some imperfection turn up when we actually try to implement it.

MR. ERIC HOAKEN: But I take it you'd agree that the more successful Centra is with a fixed price product, if it's permitted to pursue one, the greater these imperfections are and the greater these costs are and the more acute these problems are?

MR. MARK STAUFT: Just -- yes, I -- I think I pointed that out. Again, just as a matter of the mathematics, if --

MR. ERIC HOAKEN: Right.

MR. MARK STAUFT: -- 60 percent of the customers are taking this product, you've got a lot more dollars at stake than if -- if 1 percent of the customers do.

DR. MARC VAN AUDENRODE: But also -- if I can just qualify -- the greater the opportunity it is for Centra to self-assure -- self-insure.

MR. ERIC HOAKEN: Yeah. And I was just about to come back to you on that point. You mentioned self-insuring. What do you -- I mean, how would you design self insurance?

DR. MARC VAN AUDENRODE: Again, to repeat it, I haven't talked through this minutia of how to -- to -- to do that. But essentially, you know, if you have -- you know, if the only thing you have to deal with is risk -- is volume risk, then you can cover that volume risk by buying on the short-term market.

And sometimes the coverage will cost you money. Sometimes you make money on -- on -- on buying on the short-term markets. And again, on average, if you are big enough, you might expect, you will expect that over a period of -- a reasonable period of time you -- you'll -- you'll come even on this.

MR. ERIC HOAKEN: It's -- well, let's assume, though, that you have a year where it costs you money. Where does that money come from?

DR. MARC VAN AUDENRODE: If in a year it costs you money, well, Centra will have to, you know, finance that money until it can pass it on in the future -- on its -- on its future rates.

MR. ERIC HOAKEN: It's the ratepayers who will have to finance --

DR. MARC VAN AUDENRODE: Sure.

MR. ERIC HOAKEN: Yeah.

DR. MARC VAN AUDENRODE: Well, but -- but that's consistent with my cradle as an economist that consumers should pay the real price for the -- the goods they are getting.

MR. ERIC HOAKEN: Okay, but in this scenario, what ratepayers are we talking about? If -- so -- if there's a year where a loss occurs, dollars have to be found somewhere.

Are you advocating that those dollars be found only from fixed-price customers or from all Centra customers?

DR. MARC VAN AUDENRODE: Well, I'm -- I'm saying ultimately, you know, if your program is well-designed you will recover that naturally because, you know, next year you'll get more money from -- from this volume risk. And then -- and so there is just only a financial risk associated that someone will need to pay for -- for the money for, you know, for borrowing that money.

And that cost of borrowing should be imbedded in the rate, exactly in the rate that Centra is going to offer their -- their consumer -- their customers, sorry.

MR. ERIC HOAKEN: All right. And as you fairly said, the details and nuances of a self-insurance program are probably beyond the scope of what we're talking about here, and you haven't looked into that.

But just going back to what Mr. Stauft said, he is saying, I think, that one of the possible ways of dealing with this risk is for the variable-rate customers to have it flowed through to them in their PGVA -- or through the PGVA account. Right?

DR. MARC VAN AUDENRODE: Well, I -- again, heard him being much more qualified than that, in saying, you now, that if -- if the amount -- the kind of amount we're talking about are inconsequential that would be okay.

I mean, as a general rule I would think that consumers should pay the right price for the goods they are purchasing so that it shouldn't happen.

MR. ERIC HOAKEN: Well, we could have a very long debate about what "inconsequential" is, but in any case, even assuming that those amounts were nominal, that still amounts to what you've said in your evidence shouldn't happen and, that is, cross-subsidization, right?

DR. MARC VAN AUDENRODE: As a general rule, consumers should pay the right price for the goods that they are purchasing.

MR. ERIC HOAKEN: And what you said in your pre-filed evidence is that the only way -- this is at page 4, lines 13 to 14, you say,

> "The only way that Centra could limit competition would be through cross-subsidization."

So I take it that in this scenario where there is this cross-subsidization occurring, this would have a limiting effect on competition, correct?

DR. MARC VAN AUDENRODE: It would but, again, your -- you have a very one-sided view of -- of the cross-subsidization here, you know.

I mean, clearly, you know, you wouldn't

want that to happen. If over a, you know, a reasonable period of time the amount of money flowing from one to the other first is never more than inconsequential and on average is -- is negative because it goes in both directions.

Sometimes the short-term customer will benefit from it; sometime -- sometimes they'd be hurt by it. That wouldn't be called to me strictly a subsidy, that would be, you know, inter-temporal sharing. But -- but I agree with you that, you know, the optimum would be for these things not to happen.

MR. ERIC HOAKEN: And just on that point in your evidence where you say the only way that competition can be limited is cross subsidization, I take it you'll agree there are, in fact, other ways? For example, if the cost allocation as between the variable product and the fixed rate product is not done accurately or appropriately, that would also limit competition?

DR. MARC VAN AUDENRODE: That would be called cross-subsidization.

MR. ERIC HOAKEN: You're quite right; that's another species perhaps of cross-subsidization.

Now, Doctor, you've talked about market segmentation and breakfast cereal and things like that. Do you have understanding -- sorry.

Do you have any understanding of how it came to be that the natural gas market in Manitoba is segmented in the way that it is?

DR. MARC VAN AUDENRODE: No.

MR. ERIC HOAKEN: Have you read the Board's decision that we made reference to, Board Order 98 -- or sorry, 15/98?

DR. MARC VAN AUDENRODE: I might have, I don't recall.

MR. ERIC HOAKEN: All right. And I'm going to suggest to you, and if I get this wrong, there's about a thousand (1000) people in this room who are in a position to correct me, but that Order effectively limited Centra or continued the limitation on Centra in terms of offering a fixed price product.

So, in other words, the effect of that was that only retailers, such as my clients, were in a position to do that.

DR. MARC VAN AUDENRODE: That's -- my understanding that yes, Centra could not offer anything but the regulated --

MR. ERIC HOAKEN: All right. So the fact that it's only retailers that offer a fixed price product, there's a pretty clear explanation for that.

In other words, that in and of itself is not evidence of market dysfunction by any means, is it?

DR. MARC VAN AUDENRODE: The fact that retailers have 100 percent of the fixed rate market, I would agree with you is not -- is not evidence of anything in and of itself.

MR. ERIC HOAKEN: All right. And conversely, the fact that the regulated Utility has 100 percent of the short-term variable market -- I mean, first of all, that is very consistent with what happens in other jurisdictions in Canada, correct?

DR. MARC VAN AUDENRODE: I wouldn't know that.

MR. ERIC HOAKEN: All right. But you've heard the evidence about the cost advantage or price advantage that Centra enjoys because of the fact that it does not need to earn a return.

So would that provide some explanation to you for the segmentation that has occurred?

DR. MARC VAN AUDENRODE: Not necessarily.

MR. ERIC HOAKEN: All right.

DR. MARC VAN AUDENRODE: I'm -- I'm -- I mean, I wasn't convinced by that discussion and I think that the way it was put was a very static view of competition. It's not like, you know, you're regulated, suddenly competition comes and prices go up because you need to high -- to earn a higher return; that doesn't make any sense to me.

MR. ERIC HOAKEN: I guess I'm not understanding what doesn't make sense to you. Mr. Peters took you through, I thought, in some detail, and very effectively, the way that the cost structure is different for Utilities than it is for brokers, right?

DR. MARC VAN AUDENRODE: Well, yeah. Actually, again, I -- I'm not sure I fully understand the way rates are set here but I would hope that they are set to include a certain level of returns -- a certain level of return for the Utility that is returned to the Manitoba taxpayers.

The fact that necessarily if competition comes here this rate should go up, I would question that and the fact that this -- because this rate should go up necessarily should translate into higher prices, I question that -- I do more than question that because it flies in why we want competition. We want competition because -- ultimately we want competition to bring lower prices.

MR. ERIC HOAKEN: But are you suggesting, Doctor, that the fact that only Centra, the regulated Utility, is offering the short-term variable product is evidence of some market dysfunction?

DR. MARC VAN AUDENRODE: I'm suggesting that -- as far as I understand, there's nothing that prevents the retailers from getting into that market or from offering -- even if they don't get in that -- exactly that market, from offering products that -- that is much closer to the kind of products that Centra is offering right now.

And that the fact that they don't do that is another of these red lights that I've highlighted as to their capacity to produ -- to -- to deliver products that are competitive.

MR. ERIC HOAKEN: Okay. Thank you.

(BRIEF PAUSE)

MR. ERIC HOAKEN: All right, thank you to the Panel. Those are all my questions.

DR. MARC VAN AUDENRODE: Thank you.

THE CHAIRPERSON: Thank you, Mr. Hoaken.

Mr. Saxberg, do you have any redirect?

MR. KRIS SAXBERG: No, I don't, thank you, sir.

THE CHAIRPERSON: Thank you, sir. So, Mr. Peters, I imagine we are done for the day.

MR. BOB PETERS: Yes, sir. We will begin

tomorrow morning with Centra putting forward a vice-president from eNRG Research Company and they will explain the reports to some extent that have been filed, I believe, through my colleagues opposite. Thank you.

THE CHAIRPERSON: Thank you. We stand adjourned.

--- Upon adjourning at 3:06 p.m.

Certified Correct,

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Wendy Warnock, Ms.