M A N I T O B A	**)**	**Order No. 156/08**
	)	
THE PUBLIC UTILITIES BOARD ACT	**)**	**December 2, 2008**

BEFORE: Graham Lane, CA, Chairman
Leonard Evans, LLD, Member
Monica Girouard, CGA, Member
Eric Jorgensen, Member

CENTRA GAS MANITOBA INC.
FIXED-RATE PRIMARY GAS SERVICES APPLICATION

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1. Executive Summary

By this Order, the Public Utilities Board (Board) approves Centra Gas Manitoba Inc.'s (Centra) July 11, 2008 Application to offer natural gas supply contracts for a fixed price and a fixed term for consumers' primary gas supply, hereafter referred to as fixed price offerings.

Centra's Application responded to a directive from the Board (Order 160/07). In that Order, the Board reviewed the natural gas competitive landscape, and one of the findings was that a competitive marketplace for natural gas had not developed in a meaningful way for small volume consumers. To meet the objectives originally set out in 1998 for a competitive marketplace, the Board directed Centra to file an Application to provide fixed price offerings for fixed terms.

In 1998, the Board articulated the following objectives for the establishment of a competitive market:

1) provide the consumer with meaningful choice;
2) provide additional service offerings; and
3) result in economic benefits.

Furthermore, the Board proposed a three-fold test to determine whether a competitive market had evolved:

1) whether supply has increased;
2) whether prices have decreased; and
3) whether the range of products and services has improved.

In the 2007 natural gas landscape review proceeding, the Board found that a competitive natural gas market had not formed for small volume consumers. At that same time, Centra requested approval to offer fixed price offerings, advising that customers were requesting that it do so.

Having Centra offer competitive natural gas products with the existing natural gas marketers has both advantages and disadvantages. One advantage is that the pricing of Centra's products will offer a yardstick or benchmark for consumers to compare with marketer products. A disadvantage is that if Centra's products are consistently less expensive than the marketers' products, then the marketers may exit the market reducing consumer choice.

The Board has stated in several past orders and proceedings that it is not interested in fashioning a market for either Centra or the marketers, and that its interest is the best interests of consumers. Fulfilling the objectives – increase choice while providing meaningful service offerings and economic benefits – are the Board's goals.

Primarily, the Board views Centra's entry into the market as providing a yardstick or benchmark for marketer prices. Although marketers have offered a number of different products with different terms, they have only competed directly with each other, consistently, on the five year fixed price offering. The Board would prefer different market participants competing directly with the same contract term. The Board has also considered the preferences expressed by Centra's customers in the customer research conducted in 2007.

After weighing the pros and cons, with this Order the Board approves Centra's Application to offer fixed price offerings to both small and large volume consumers for terms of one through five years.

As well, the Board supports Centra's proposed approach to gradually enter the market, beginning with offerings of 1, 3, and 5 years to small volume consumers. The Board is of the view that a gradual entry into the marketplace is in the best interests of Manitoba consumers.

Centra's offerings will be priced by a process involving determining the expected consumption in a normal weather year and using financial hedges, the latter to be obtained from competitive quotes. Hedging expected volumes will lock in the majority of the gas costs. As hedges will form an integral part in Centra's fixed price offerings, the Board requires Centra file its updated Derivatives Hedging Policy and its updated Hedging Operating Principles and Procedures, by December 12, 2008.

Centra will still be exposed to a number of economic risks, including the market price on any volumes greater or less than the hedged volumes. To mitigate these and other risks, Centra will add a Volumetric Risk Premium (VRP). Centra applied for approval to use a range of VRPs between 3 and 14%. The Board will approve a VRP of 5%, and require Centra to apply to the Board if and when the Utility seeks to amend the premium.

The Board recognizes that Centra will incur costs in the development and administration of its program of fixed price offerings. These costs include marketing, gas supply, gas accounting, customer billing, load forecasting, and contact centre costs, and Centra is expected to recover these costs through a Program Cost Rate (PCR).

Centra will use its cost allocation model to allocate direct and indirect costs to its fixed price offering program in order to determine an annual allocation amount; and that amount will be divided by the average volumes expected to be sold to determine the PCR. Centra's direct costs will also include regulatory costs incurred in the development and ongoing administration of the fixed price program. Accordingly, the Board requires Centra to amend the cost allocation study and file for a revised PCR, one reflecting the inclusion of regulatory costs.

Once Centra has obtained its hedged prices, it will add both the VRP and the approved PCR to determine the selling price to consumers. Centra will inform the Board of its selling prices, and, simultaneously begin offering them to consumers.

Centra plans to market its offerings using direct mail, print advertising, and its corporate website. Because of these “less aggressive” marketing techniques, in comparison with one portrayal of door-to-door marketing, Centra is not forecasting large numbers of customers migrating to its new offerings.

Centra plans to create new educational materials for consumers, to assist them in their understanding of their options. As a lack of information directed to consumers was identified as a major problem in the Competitive Landscape proceeding, one that perhaps has resulted in many uninformed or under-informed consumers, the Board commends Centra for its plan (though will require Centra to file the new materials with the Board).

Centra is to keep track of the results of its new offerings, so that the Board can verify that both system supply and marketer customers are not subsidizing Centra’s fixed price offering customers. Although Centra may take the net program profit or loss into retained earnings, Centra is to maintain a strict record of the results, both for reporting purposes and for consideration in developing future rates for future offerings. The Board expects to review the performance of the fixed price offering program on an annual basis.

Centra filed a standard form of contract with its Application, but this contract requires amendment to be congruent with the requirements of Order 109/08. The Board expects Centra to file an amended contract by December 12, 2008.

The Board finds Centra’s proposed Standard of Conduct not sufficient, and requires Centra to fortify its proposed Standard of Conduct by elaborating on the specific details of how sensitive marketer information will be protected. The Board expects Centra to file an amended Standard of Conduct by December 12, 2008.

2. Introduction

The Board made changes to the natural gas competitive landscape in Order 160/07. Many of those changes were to the rules for acquiring customers that are applicable to the existing marketers of fixed price contracts. These rules were more explicitly codified in Order 109/08.

Another change resulting from Order 160/07 is that Centra was permitted to apply to the Board to offer fixed price and fixed term Primary Gas contracts. Previously, Centra was restricted to offering only the default Primary Gas product, which price is set every three months and one that requires no contract.

While the current proceeding did not involve an oral hearing the Board has heard the concerns of the interveners through the submissions of information requests and final submissions. The interveners were: Direct Energy Marketing Limited (Direct Energy), Energy Savings Manitoba Limited Partnership (Energy Savings), Shell Energy North America (Canada) Inc. (Shell), the Consumers Association of Canada, Manitoba branch (CAC), and the Manitoba Society of Seniors (MSOS). For efficiency, CAC and MSOS combined their intervention.

In this Order, the Board considers Centra's Application to offer fixed price offerings to all customer classes, for terms from 1 to 5 years. Centra applied to begin by targeting its offerings to Small General Service and Large General Service class customers only, with terms of 1, 3 and 5 years.

3. Background

Centra is a natural gas distribution company, owned by Manitoba Hydro, that operates in franchised territories within Manitoba.

Centra charges all natural gas customers within its franchise areas for the transmission and distribution of gas. Some of those customers purchase the natural gas commodity from Centra, while others purchase the natural gas commodity from natural gas marketers and retailers (hereafter, marketers). This arrangement came into effect for larger industrial customers in 1987, and for residential customers in 1991.

The competitive marketing and selling of natural gas commodity is what is referred to as the natural gas competitive landscape.

In 1996, the Board held a generic hearing to investigate and review the natural gas landscape and assess how it was serving Manitoba customers. Order 15/98 from that proceeding introduced the current process for selling natural gas commodity to small volume and residential customers.

Marketers were able to sell gas to consumers for a defined price over a defined period of time, which was called Direct Purchase. Direct Purchase was facilitated under the terms of Centra's Western Transportation Service (WTS).

Practically, it meant marketers sold gas under a fixed price and fixed term contract while Centra was restricted to selling gas under what was called a "default supply" or "system supply".

System supply is a variable price supply that does not require the customer to sign a contract. The price is set every quarter based on the forecast future price of gas inclusive of hedges placed to mitigate price volatility.

Order 15/98 specifically prevented Centra from selling fixed price offerings unless it was done from an arm's length, unregulated affiliate. Centra chose not to establish an unregulated affiliate and, to this point, has only sold primary gas as a default supply.

In 2006, while hearing Centra's Application for approval of non-primary gas costs, the Board heard concerns from the natural gas marketers regarding the competitive marketplace. In Order 175/06, the Board ordered another generic hearing to address these concerns, which then took place in 2007 and resulted in Order 160/07.

The Board articulated three objectives for competition in Order 15/98. These objectives were reviewed in 2007 and found to still be valid. The objectives for competition are to:

1 provide the consumer with meaningful choice;
2 provide additional service offerings; and
3 result in economic benefits.

Having reviewed the current natural gas landscape and the objectives, the Board concluded that a truly competitive market offering a wide range of contract terms for small volume customers had not developed.

Accordingly, and by Order 160/07 the Board supported and directed changes to market rules and design that the marketers had maintained have restricted the range of pricing of their fixed price and term contract offerings. With the changes came a corresponding expectation that new and better-priced competitive offerings would soon be made available, particularly to small volume consumers.

These new changes were approved in Order 109/08, and came into force on September 1, 2008.

The changes made in 160/07 include:

1) elimination of the volumetric threshold for each marketer contract, meaning marketers can sign up as few as a single customer to a particular product, instead of aggregating over 100 customers;
2) permission to use telesales and internet sales, within defined conditions;
3) monthly instead of quarterly enrolment, so that gas may flow to customers much sooner; and
4) elimination of the requirement to forward an image of the signed contract to Centra.

In addition to reviewing the market rules that apply to marketers, the Board also examined "…the potential for Centra entering the fixed-price fixed-term market in competition with the retailers".

The Board concluded that, if Centra were to offer fixed price offerings, it would result in a benchmark with which customers could compare the offerings of the marketers:

> "As suggested by CAC/MSOS' witness Dr. Van Audenrode, the Board expects that if Centra is allowed to offer fixed term and priced alternative offerings, they will provide a benchmark price for consumers who will then be able to compare against retailer offerings." (Order 160/07, p.92)

3.1. Current Proceeding

Currently, there are two marketers operating in Manitoba that have been marketing and selling gas to residential customers. Energy Savings (Manitoba) L.P. (Energy Savings) and Direct Energy Marketing Limited (Direct Energy) have both marketed fixed price and fixed term contracts to residential and commercial customers.

There are other marketers in Manitoba that only market to commercial or industrial customers, one being Shell.

In Order 160/07, the Board directed Centra to file an Application for approval to enter the fixed price and term market segment. On July 11, 2008, Centra filed its Application seeking, among other things, Board approval for Centra to offer various fixed price primary gas offerings to all customer classes.

At the time of Centra's Application to offer fixed price offerings, Direct Energy offered fixed priced offerings for terms of one, three and five years. Energy Savings then-offered fixed price offerings for terms of four and five years.

3.1.1. Direct Energy's Request

Direct Energy filed a request on August 1 to have the Board decline to review Centra's Application.

The grounds for Direct Energy's request were twofold: that the Application did not meet the minimum requirements outlined in Order 160/07, and that the market conditions Order 160/07 sought to establish had not had time to materialize, and therefore not enough experience has been obtained with the new market conditions.

Direct Energy highlighted what it considered deficiencies in Centra's Application, those being: Centra does not intend on offering fixed price offerings to high volume customers initially, nor will it offer 2 or 4 year contracts. Direct Energy opined that Centra's limited plans do not meet the minimum filing requirements as specified in Order 160/07.

Further, Direct Energy noted that Order 160/07 states that:

> "Centra's Application is to include a business plan for the new offerings, indicating design, marketing, primary gas supply (physical supply, hedging, self insurance), risk management, administration, and pricing." (Order 160/07 p.91)

In Direct Energy's opinion, Centra's Application falls short in providing detailed information about these topics. In addition, Direct Energy stated that Centra's Application does not provide any detail about cost estimates and allocations for gas costs.

For these reasons, Direct Energy asked for the Board to refuse to hear Centra's Application.

3.1.2. CAC/MSOS' Motion

CAC/MSOS filed a motion demanding additional information on the details of Centra's Application. In its opinion, Centra's Application does not contain sufficient information on how the formula for the VRP is determined nor for the determination of the PCR.

As such, CAC/MSOS felt it's intervention would be impaired in its ability to formulate information requests and requested additional information in the following areas:

1. An historical analysis and description of the results of hypothetical offerings from Centra from 2000 to 2008;
2. Particulars of the methodology that was employed in the study and why that methodology was chosen;
3. The legal basis for Centra offering rates that are not approved by the Board; and
4. A detailed breakdown of the operational costs Centra expects to incur.

Energy Savings supported both Direct Energy's request and CAC/MSOS' motion.

3.1.3. Centra's Response

Centra opposed both the request (of Direct Energy) and the motion (of CAC/MSOS), stating that its Application met the requirements of Order 160/07 and should proceed according to the timeline established by the Board.

According to Centra, if interveners had questions about its Application, then there was the opportunity to submit information requests to Centra, and if more information were to be required a second round of information requests could be added.

In Centra's opinion, the market conditions envisioned in Order 160/07 are close to being realized and, therefore, the Application could be considered concurrently with the finalization of the market conditions.

3.1.4. Direct Energy's Response

In its response of August 11, 2008, Direct Energy maintained that Centra still had not addressed intervener concerns and opined that the Board should not consider Centra's Application at this time.

3.1.5. Order 125/08

The Board considered the interveners' request and motion and the response of Centra, and, by way of Order 125/08, ordered Centra to respond to the eight questions posed by the interveners.

The additional questions sought:

1. a further narrative description and supporting documentation of the analysis it performed (as referred to in Tab 4, Page 4 of its Application) that results in proposed Volumetric Risk Premiums ranging from 3% to 14% of hedged prices;
2. particulars of the methodologies considered and used in Centra's studies - with an explanation as to why alternative methodologies were not selected;
3. particulars of the statutory and legal framework supporting Centra's proposed methodology for rate setting;
4. particulars of the operating costs to support the new rate offerings that Centra forecasts will be incremental to the costs already imbedded in its distribution rate;
5. further explanation as to why Centra will not be offering fixed price contracts to large volume customers until sometime in the future – together with further explanation as to why two and four year fixed price products are not included in Centra's current Application;

6. further details of Centra’s business plan for the new offerings – including design, marketing, primary gas supply (physical supply, hedging, self insurance) risk management, administration and pricing;
7. further details on Centra’s assessment and management of other risks – including inter-month price and weather volatility, forecast methodology, consumer attrition risk, counter party default risk, settlement risk and bad debt risk; and
8. further details as to the particulars or methodology that is to ensure sensitive Retailer information is kept separate from Centra’s employees involved in fixed price offerings by Centra.

Centra responded to the Board’s request on September 5, 2008, when it filed Responses to Additional Questions.

4. Centra’s Application

4.1. Support for the Offering

Centra maintains that the reason that it plans to offer fixed price offerings is that its customers requested it do so.

Centra references the Customer Research Report and the Natural Gas Customer Review, Focus Group Report that were completed in 2007 as support. The studies were extensively reviewed in the 2007 Competitive Landscape hearing.

Centra asked for and received permission from the Board to submit an Application to offer regulated natural gas sales for fixed prices and fixed terms.

In Order 160/07, the Board directed Centra to offer fixed price gas contracts for terms of 1, 2, 3, 4 and 5 years, and for these contracts to be available to all customer classes. Centra applied for permission to offer contracts for these five durations, and to all customer classes, although their initial offering will only be 1, 3 and 5 year contracts to the SGS and LGS customer classes.

Centra cited caution as the reason for not initially offering contracts with all five terms and to all customer classes, as requested by the Board. Centra stated that a more limited selection of offerings will help it manage its risk at the outset of the program.

4.2. Product Design

Centra defined a process for pricing and offering fixed price contracts to its customers.

First, Centra would identify a target volume of customers that it felt would be interested in subscribing to each offering being contemplated. Second, Centra would estimate the expected volume that the group of customers would consume with normal weather on a monthly basis over the term of the offering. And, next, Centra would take into consideration customer attrition, weather, and conservation efforts.

Following those steps, and in order to fix the price of gas, Centra would execute financial derivative contracts (hedges) for the volumes of gas for the specified term. Then, once Centra has identified the price that has been locked in, it would add a VRP; Centra applied for permission to add a VRP of between 3 and 14%, to vary depending on the duration of the offering, market conditions, and management judgement.

Yet, for its planned initial offerings of 1, 3 and 5 years, Centra proposed a 5% VRP, with it being Centra's intention to be able to adjust the premium within the 3% to 14% window without applying to the Board.

Finally, the PCR would be added to the price to determine the final selling price of the offering; the PCR would reflect the administrative costs Centra expects to incur in offering fixed price offerings. In summary, Centra's offering price would be the hedged price plus the VRP and the PCR.

Under its proposal, Centra will market each fixed price offering to its customers and sign customers under contract until such time as the volume of the offering is fully subscribed. (An offering becomes fully subscribed when the volumes that Centra has hedged are matched by the expected volumes of the consumers that are enrolled.)

Centra would estimate the consumption of the enrolled consumers by reviewing their past consumption patterns. Thus, Centra does not assume that each customer that enrols is a "typical" customer. Rather, it plans to match the hedged volumes with the volumes that specific signed customers are likely to consume.

4.2.1. Timeline

Centra would begin each offering with a management decision to proceed with an offering or group of offerings. Within five days of that decision, Centra would place hedges and calculate the offering price or prices.

In the next day or two, Centra would notify the Board of its prices for its offerings and begin offering them to consumers.

The window for contracting with Centra would be determined by management, and typically would be 30 to 45 days. If the offering becomes fully subscribed, the contracting window will close.

Centra expects that it will take up to three days for the final contracts to be processed by its Contract Administrator, and that once the offering is closed, 45 days later, those customers' new Primary Gas arrangements would come into effect.

4.2.2. Volumes, Estimated Take-Up

Centra estimated that less than 5% of its customers will be interested in its fixed price offerings. Centra tempered its expectations of the number of customers that will sign up for several reasons.

One reason is that a large number of customers interested in fixing their primary gas rate have already contracted with a marketer and are not able to contract with Centra until their current arrangements expire. Another reason is that Centra will not be "aggressively" marketing their offerings, instead of marketing through door-to-door sales Centra would rely on print media, direct mail, its corporate website, and information available at Manitoba Hydro regional offices.

Centra estimates that it would sign up 199 customers in its initial offering in January 2009, and "ramp up" to 6,709 customers under contract in the fifth year of the program. Centra forecast it would sell 8,658,000 m^3 of gas in the second year, increasing to 34,800,000 m^3 in the fifth year. The average annual volume of gas that Centra expects to sell over the first five years of its fixed price and term offerings is 16,755,000 m^3.

4.2.3. Sample Contract

Customers who sign up for Centra's fixed price offerings will be required to sign a contract, which is also the case for customers who sign up with marketers. The contract would include such terms and conditions as: the length of the contract, the rate per cubic metre of primary gas, termination provisions including the 10 day cancellation policy, and other consumer rights.

Centra filed a sample contract with its Application. Subsequent to the filing of the Application, Order 109/08 was released by the Board and clarified some of the rules for how marketers may contract with customers. However, the sample contract Centra filed with its Application contravenes some of these rules.

Accordingly, Centra has stated that it will amend its contract so that it is aligned with the requirements placed on marketers.

4.3. Physical Supply, Risk Mitigation, and Hedging

4.3.1. Physical Supply

Centra does not intend to make any changes to its physical supply arrangements to accommodate its fixed price offerings. This means that Nexen Marketing (Nexen) will continue to supply the actual natural gas molecules that will be consumed by all Centra's customers, regardless whether they are system supply or fixed price supply customers.

The Nexen supply arrangement will continue until October 31, 2009 or such further extension as may be negotiated. Centra is evaluating other gas supply options beyond that date, but expects that any changes to the gas supply contract, or to its storage and transportation contracts, will accommodate the fixed price offering program.

The price paid to Nexen is set by Centra's gas supply contract. In this contract, Centra pays Nexen the AECO 'C' and Nova Inventory Transfer monthly average price for base volumes of gas, plus the Nova intra-Alberta toll in order to transport the gas to TransCanada Pipeline's receipt point at Empress on the Alberta-Saskatchewan border. Centra also purchases additional swing volumes at a slight premium to the base volume price. The swing volumes are priced at the AECO 'C' daily spot index price.

Therefore, the price Centra pays for its entire physical gas supply fluctuates daily.

4.3.2. Hedging

To fix the price of gas and eliminate daily and monthly fluctuations, Centra will enter into a financial transaction with a counterparty for each fixed term offering.

These transactions do not involve the physical movement of gas, but only provide for a transfer of money depending on whether the future index prices of gas are above or below the strike prices of the hedges placed by Centra.

At the end of each month, if the index price is higher than the strike price, the counterparty will pay Centra the difference multiplied by the volumes that were hedged for that month. If the index price is lower than the strike price, Centra will pay the counterparty the difference multiplied by the volumes that were hedged for that month. The funds will flow from or to each fixed price offering. The results for all fixed price offerings are summed and flow to the total fixed price offering program profit or loss.

These arrangements are purely financial. Centra continues to purchase the physical natural gas from its current gas supplier at the variable spot market prices. If the spot market price of gas goes up, Centra purchases the physical gas for a higher price, but then the counterparties to its hedges pay Centra the difference in the strike price to the spot price multiplied by the volumes hedged. Thus, for the volumes that are hedged, the price of the natural gas commodity is fixed.

In order that the hedges Centra places are not speculative, Centra’s customers must have an underlying requirement for the gas. That is, Centra may not place hedges for gas that it does not expect its customers to use. If Centra were to place hedges for gas that it does not expect to use, it would be speculating.

Centra expects that its fixed price offerings will attract sufficient customers to use the hedged volumes of gas in a normal weather year. If Centra does not attract sufficient customers, and thus hedges too much gas, then those customers that did not become fixed price offering customers will remain system supply customers, and they will consume gas that Centra hedged.

Thus, there is, with the exception of extreme circumstances such as especially warm weather, an underlying requirement by Centra's customers to use all the gas that was hedged.

4.3.3. Volumetric Risk Premium

Although fixing the price for a unit volume of gas is relatively straightforward, Centra has a greater challenge determining the total volume of gas for which it will fix the price.

There are a number of factors that affect the volumes of gas consumed by customers: these include the weather, conservation efforts, customer behaviour, customer additions or subtractions, and attrition. Because of these factors, Centra will be at risk of either hedging too high a volume of gas or not hedging enough. In either case, the over- or under-hedged volumes are then at risk to the changing market price of gas.

To mitigate the risk of over- or under-hedging the amount of gas that is actually used, Centra will add a VRP to the price of the offering. The VRP will also mitigate other risks, including the market price risk for unhedged volumes, the risk of customers exercising their 10-day cancellation period rights, the risk that a large volume user will go bankrupt or drastically change its consumption pattern, legislative or regulatory risks, and the risk of errors in forecast attrition rates.

The VRP will also cover the cost of gas items that are not included in the hedged price, such as the swing service premiums and the AECO 'C' to Empress tolls.

As previously indicated, Centra applied for approval to use a range of VRP (from 3% to 14%), with the initial offerings to employ a VRP of 5%. Centra advised that the sought 3% to 14% range was determined by its reviewing the outcomes of historical hypothetical offerings from May 2000 through March 2008.

Using the information that Centra would have known at the time of each offering, in terms of the market price and expected customer consumption, Centra estimated the hedge strike prices and thus the selling price of hypothetical offerings. Then, based on the actual historical consumption and market prices, Centra calculated the required Volumetric Risk Premiums in order to satisfy three distinct risk threshold criteria:

- Maximum Risk Mitigation Threshold: each and every individual contract collects all of the costs, or every single contract breaks even or makes a profit for Centra;
- Mid-range Risk Mitigation Threshold: 80% of the contracts collect all of the costs, or in other words 80% of the contracts break even or make a profit for Centra; and
- Minimum Risk Mitigation Threshold: the average profit and loss across all contracts is zero, or collectively the contracts break even – there is no profit or loss to Centra.

Collecting all of the costs means, in other words, the modeled contract settles at zero cost or a net profit to Centra.

Centra plans to use management's judgement when setting the VRP within the range approved by the Board. Initially to be set at 5%, Centra anticipates potentially adjusting the risk premium based on the profits or losses it experiences.

Further, on an ongoing basis Centra plans to consider possible adjustments to the program to ensure processes are adequately established and reflect market experience.

4.3.4. Customer Attrition

Centra anticipates a high rate of customer attrition; attrition means that a customer does not remain under contract for its entire duration. The most likely reason for a customer not remaining under contract is that the customer has relocated. As is the case for marketer Direct Purchase contracts, when a customer moves or relocates the contract is terminated.

Centra estimated its expected contract attrition rate by evaluating the frequency with which its customers move; Centra expects a monthly attrition rate of 1%. Thus, in one year Centra expects to lose 12% of its customers, and in the case of five-year contracts, a cumulative 60% by the end date.

Customers that relocate and thus terminate their contracts have the option, if they remain in Centra's franchised territories, of a) defaulting to system supply, b) contracting with Centra through a new fixed price offering, or, c) contracting with a marketer.

4.4. Marketing

As previously indicated, Centra does not plan door-to-door marketing, nor does it plan for a large marketing budget.

Centra plans to provide sufficient information to customers such as to able them to make informed decisions. Centra intends to employ its website, direct mail, and other print media to advertise new offerings, but does not plan to utilize bill inserts.

Centra also plans to issue educational materials and guides, to be available from Manitoba Hydro's website and offices.

4.5. Cost Allocation and Program Costs

Centra has estimated its fixed price offering costs to include gas supply and procurement, gas accounting, customer billing, program administration, marketing, contact centre, and load forecasting costs.

Included in Centra's projected costs is the Agency, Billing, and Collection fee (ABC fee) of $0.25 per bill that Centra now charges marketers utilizing Centra's billing function. Centra states that since their fixed price offerings will use the billing function in the same manner that the marketers use it, it is appropriate to include the ABC fee in Centra's program costs.

Centra estimates its start-up costs for developing and launching its fixed price offerings at $203,000, and plans to amortize these start-up costs over five years.

Centra will incur regulatory costs during the development of its fixed price offerings, and these costs have been estimated at $82,000. It will also incur regulatory costs on an ongoing basis as it files reports on the operation and financial results of the program at Cost of Gas Application and General Rate Application proceedings.

Centra states that these ongoing regulatory costs, like all other regulatory costs, are incurred for the benefit of all customers and, thus, should be recovered from all customers through distribution rates. Therefore, Centra did not include any amount for regulatory costs in its estimate of fixed price offering program costs.

Centra intends to add a Contract Administrator position, though the workload is not expected to be full-time. The Contract Administrator will receive all contracts, including ones entered into over the internet, and assign priorities according to the order submitted. Contracts will then be processed and submitted to the Direct Purchase department, this in a similar fashion to the submission of marketer contracts.

The Contract Administrator would also be available to assist customers requiring more detailed information about fixed price offerings.

4.5.1. Program Cost Rate

Centra will incur direct costs in the development and implementation of its Fixed Price Offering program, and these direct costs are expected to include marketing, customer service, load forecasting and start-up costs. Centra estimates that the five-year average of its direct annual costs to be in the order of $320,000.

Centra advised that it has amended its cost allocation model to determine what it considers a correct allocation of costs to its planned fixed price offering program. By using the cost allocation model, Centra also allocated indirect costs to the program. Indirect costs include the requirement for Centra to generate net income, meet a share of the corporate allocation from Manitoba Hydro, and, as well, a share of Centra's finance expense. The approach is expected to result in the program being treated in a similar manner as the ongoing quarterly Primary Gas service.

Centra uses its cost allocation model to functionalize, classify, and allocate costs to the different rate classes. Centra has created a new Fixed Price Offering service class, and, accordingly, removed 16,755,000 m^3 from the expected consumption of the quarterly Primary Gas service class. This volume was transferred to the Fixed Price Offering class, with the resulting model allocating $368,577 of costs to the new class.

The resulting average annual program costs are to be divided by the expected annual volumes, this to, according to Centra, initially result in a cost rate per unit gas volume of $0.022/$m^3$. This is the PCR Centra would add to the hedged price and VRP to arrive at the fixed price offering selling price.

Centra expects to revise the PCR at future General Rate Applications, as revisions are made to costs and forecast volumes.

4.6. Financial Monitoring

4.6.1. Monitoring and Reporting

In order to closely monitor the financial position of its new fixed term and price program, Centra proposes to mark its fixed price offering portfolio to market on a daily basis.

This will include the hedged portfolio, revenues from its fixed price offerings, and expected gas supply costs based on the future market prices. On a periodic basis, Centra will mark its entire portfolio to market, including expected customer consumption along with the hedges, revenues, and gas supply costs.

A report on program results and the marked-to-market position will be provided to the Board on a regular basis, and at least as often as Cost of Gas or General Rate Applications.

4.6.2. Program Results

The fixed price offering program will generate revenue from customers as the customers consume volumes of gas at the fixed contract rates. Against this amount will be deducted the costs of the physical gas supply, as determined by Centra's Nexen gas supply contract. Finally, the results of each settled fixed price offering hedge are to be applied against program profits and losses. Contract profit and losses will accumulate monthly as the hedges settle against the market prices and customers consume physical gas supplies.

When each month's hedge settles, it will be for a specific volume of gas, though Centra's customers will likely have consumed more or less gas than was hedged. In the case of customers consuming more gas than was hedged, if the market price, and thus the physical supply price, is lower than the fixed contract price, then the program will incur a profit (because gas volumes will have been sold to the customer at the contract rate, but gas purchases will have been less than the contract rate). If the market price turns out to be higher than the fixed contract price, then the opposite occurs and a loss will be incurred. The opposite will happen if too high a volume was hedged.

If Centra has over-hedged volumes and the market price is high, then the program will incur a profit. If Centra has over-hedged volumes and the market price is low, then the program will incur a loss.

In its response to PUB/Centra 15, Centra stated:

> "For a month where weather is warmer than normal resulting in consumption lower than forecast, the relationships described above are reversed. Lower than hedged consumption combined with a market price higher than the swap price would spread the benefits of the hedge settlement due to Centra from its counterparty over the smaller volume consumed by customers, a net positive. Conversely, a market price lower than the swap price would spread the hedge settlement payment due from Centra to its counterparty over a smaller consumed volume, which would be negative."

The sum of all of the contract results will represent the total program's profit or loss, and Centra will calculate this on a monthly basis and maintain a running cumulative total. Although the profits or losses will be recorded within Centra's annual net income and taken into retained earnings, Centra will track the profits and losses separately in order to a) gauge program success and b) to allow for any adjustments to program details that may be required.

In order to hold system supply and marketer Direct Purchase customers harmless from losses of the fixed price offering program, Centra intends to maintain the VRP at a sufficient level so that accumulated profits and losses, over the long term, will net to zero.

4.7. Standard of Conduct

If the Board grants approval to Centra's Application, then Centra will be competing with marketers in offering fixed price offerings.

Centra, being the local distribution company, currently includes in its overall customer base customers purchasing primary gas from Centra and the primary gas customers of the marketers.

Accordingly, Centra requires and receives information concerning marketer customers, and makes changes to the gas supply and billing arrangements for customers that contract with a marketer. This requires Centra to know the names, addresses, start and end dates of marketer contracts, and the contract price. Collectively, this information is known as sensitive marketer information.

If used inappropriately, this information would give Centra a significant competitive advantage, since Centra could selectively market to marketer customers whose contracts are nearing expiry, knowing what each customer is being charged.

To reduce its “knowledge advantage”, Centra has proposed a Standard of Conduct that it plans to follow to control the dissemination of sensitive marketer information. Sensitive marketer information will be withheld from staff that will be administering Direct Purchase transactions.

Centra has identified nine employees in its gas supply and treasury divisions that will require access to sensitive marketer information. Centra will communicate the Standard of Conduct to all staff in the provision of Direct Purchase services and, as well, to staff involved with fixed price offerings.

In addition to controlling sensitive marketer information, Centra’s Standard of Conduct prescribes that Centra market its products truthfully and without misrepresentation. The Standard of Conduct also requires that Centra (all of Centra’s employees are Manitoba Hydro employees) refrain from suggesting that customers of Centra’s fixed price offerings would be or are entitled to preferential or favourable treatment from Centra for other services.

Centra plans to submit an annual report to the Board detailing Centra's compliance with the Standard of Conduct.

4.8. Regulatory Process

Centra sought approval for the framework for setting rates for its fixed price offerings. The Board, in Order 160/07, preferred that a framework be established so that Centra can avoid undue regulatory costs and delays, and expediently react to customer demand and market conditions.

Centra plans to obtain quotes for financial hedges for each offering, add a VRP and PCR, the resulting sum to be the contract price for each offering. Centra will inform the Board of the price of the offering the day following the placement of hedges, and will begin offering the fixed price offering to consumers the same day that it informs the Board.

Centra elaborated on the legal authority that it would have to set rates within the framework approved by the Board, and opined that the Board has jurisdiction to allow Centra to set rates based upon a formula.

In support of its argument, Centra noted that Section 77 of *The Public Utilities Board Act* (Act) allows the Board to fix just and reasonable individual rates, joint rates, tolls, charges, schedules, as well as reasonable practices to be observed and followed. And, while section 127 of the Act requires the Board to set rates, tolls, or other charges, it does not define "rate". Section 65 of the Act contemplates contractual rates as well as rates, tolls, or charges established by contract and agreed upon as a fixed or variable rate, toll, or charge.

Centra proposed that it file its detailed program results as part of its Cost of Gas Applications or General Rate Applications. The program results to be reported would include customer numbers, volumes, risk premiums charged, hedge gains or losses, profits and losses on each contract, and incurred program costs. The procedures Centra followed in offering and pricing its products would be subject to review, to ensure that they complied with the Board-approved pricing formula and procedures.

5. Intervener Positions

5.1. CAC/MSOS' Position

CAC/MSOS was a proponent of Centra entering the fixed price fixed term market at the 2007 Competitive Landscape proceeding. In its submission to the Board for Centra's current Application, the intervener supported Centra's fixed price offering program, though with some "minor" changes.

With the primary purpose of Centra offering fixed price offerings being to provide a benchmark with which consumers can compare to marketer offerings, CAC/MSOS supported the program being revenue-neutral for Centra and entering into hedges to fix the cost of its gas.

5.1.1. Volumetric Risk Premium

CAC/MSOS are opposed to Centra having the freedom to set the VRP within the proposed range of 3 to 14%. To CAC/MSOS, Centra management exercising its judgement in setting the premium means the fixed price offering is no longer determined by a formulaic rate. As well, adjusting the VRP is, for CAC/MSOS, inconsistent with the long-term nature of fixed price offerings. If the VRP is adjusted frequently after a few contracts, CAC/MSOS suggests it will not equalize over the long term as originally intended.

CAC/MSOS recommend that Centra apply to the Board whenever it wishes to change the VRP, and that the Board should decide upon and approve a VRP for each offering based on the evidence from Centra and interveners.

Regarding the proposed VRP, CAC/MSOS feel that the range proposed by Centra is too high. In its responses to the Board's additional questions, Centra elaborated how the VRP would be determined, with Centra establishing different risk mitigation hurdles to serve to quantify the tolerance of the program to not losing money. At the minimum risk mitigation hurdle, the VRP is set so that, on average over the long term, all of Centra's fixed price offerings, in aggregate, would recover all of the incurred costs. Thus, the program is to "break even", and this objective would appear to satisfy CAC/MSOS' recommendation that the program be revenue neutral.

But, Centra also has more stringent risk mitigation hurdles. The maximum risk mitigation hurdle sets the VRP at such a level that each and every one of the hypothetical contracts that Centra tested against its historical data collected all their costs. Put another way, some of these contracts collected their costs and were revenue neutral while others ended with a positive balance. Thus, for the maximum risk mitigation hurdle, the program, if it had operated as modeled, would have generated a profit.

The mid-range risk mitigation hurdle was set by Centra so that 80% of the hypothetical contracts would have ended even or positive for Centra. The magnitude of the VRP required to generate this result is higher than for the minimum risk mitigation hurdle. Thus, the VRP for the mid-range risk mitigation hurdle will also generate a program profit, on average and over the long term.

For CAC/MSOS, if Centra desires to maintain revenue neutrality for its program, it should select a VRP equivalent or at least closer to the VRP established by the minimum risk mitigation hurdle.

5.1.2. Program Costs and Cost Allocation

CAC/MSOS did not dispute any of Centra's proposed direct or indirect cost allocations, and noted that Centra's cost allocation model is designed to receive as input the costs to be incurred each year and return the resulting allocation; the allocation to be divided by the annual sales volumes to determine the PCR.

However, the annual costs are a blend of costs including start-up costs and other costs that do not vary with the number of customers, along with costs that will increase with increases in the number of customers. The annual volumes are forecast to begin at a low level and ramp up as the program gains “popularity”. As it is challenging to forecast and include these varying costs and volumes in the cost allocation model, Centra chose to use a five-year average for both costs and volumes.

CAC/MSOS are not opposed to this methodology, and the intervener expects to review the direct costs, cost allocation model, and resulting PCR in future General Rate Applications.

Centra has stated that certain staff will be delegated to work on the fixed price offering program. The cost for the staff is to be included in program costs, although the costs are already included in Centra’s Operating and Administration costs (recovered from all ratepayers through distribution rates).

Centra states that these costs are not material, and, in any case, the duplication will be addressed in 2009 with its next General Rate Application. CAC/MSOS did not oppose Centra’s proposed treatment of this “double-counting”.

5.1.3. Board Approval of Rates

CAC/MSOS expressed concern with the Board approving a formula for establishing fixed price offering rates. Even if the Board were to approve the VRP, CAC/MSOS noted that the parameters that feed the formula are not publicly available, transparent, and verifiable. Yet, the main component of the offering prices is to be the hedged gas prices that Centra will obtain from a competitive bidding process.

CAC/MSOS would be satisfied if an expedited, least-cost method was used by the Board to test the offerings, ahead of the Board approving offering rates.

5.1.4. Large Volume Customers and Two and Four Year Offerings

CAC/MSOS neither objected to Centra delaying its fixed price and term offerings to large volume consumers, nor to the absence of two and four year offerings in the initial roll-out of the program.

CAC/MSOS agrees with Centra that a staged roll-out will minimize risk and represents a prudent course of action.

5.1.5. Marketing Plans

CAC/MSOS suggests that Centra should be required to reapply to the Board upon any proposed change to its marketing plans. In the current Application, and as previously indicated, Centra states it will not undertake an aggressive marketing plan.

For CAC/MSOS, if Centra were to change its approach that may change the competitive balance between Centra and the marketers, a situation that, for CAC/MSOS should be reviewed by the Board.

5.1.6. Standard of Conduct and Customer Contract

CAC/MSOS finds Centra's proposed Standard of Conduct and Form of Contract acceptable.

5.1.7. Ongoing Review

Because of the uncertainty associated with this new program, and questions about the program's ability to function under different market conditions, CAC/MSOS requested that interveners be given the opportunity to review the fixed price offering program on a regular basis.

While Centra plans to report to the Board at General Rate and Cost of Gas Applications, CAC/MSOS request that the Board require Centra to file additional information in support of the pricing mechanism approved by the Board.

5.2. Direct Energy's Position

Direct Energy filed evidence articulating their support for the marketplace that the Board created with Order 15/98. Direct Energy also indicates support for the changes to the marketplace that were made resulting from Order 160/07 respecting the acquisition of Direct Purchase customers.

That said, Direct Energy states that granting Centra the ability to enter the competitive market actually jeopardizes Direct Energy.

Direct Energy describes its view on the demarcation between regulation and deregulation by stating that transmission and distribution are natural monopolies and thus should remain regulated, but that generation and retailing are not, and thus, as is the case in many jurisdictions, these are and should be deregulated activities.

For Direct Energy, the advantage of deregulation and the resulting competition is that it allows markets to drive efficient and timely investment, innovation, and customer choice.

Yet, there are jurisdictions that allow the local regulated distributor to compete with unregulated retailers. Direct Energy advised that in those jurisdictions the regulator forces the distributor to compete from the base of a segregated affiliate.

According to Direct Energy, such a separation represents regulatory best practice, and not requiring the competitive entity to be segregated goes against best practice. Direct Energy suggests that if a separate entity is not to be prescribed by the Board, then a strict compliance regime is warranted to protect against abuses of sensitive marketer information.

5.2.1. Deficiencies

Direct Energy identified a number of deficiencies with Centra's Application and its responses to questions and information requests.

5.2.1.1. Product Offerings - Range and Scope

Order 160/07 called for Centra to offer, at a minimum, 1, 2, 3, 4 and 5 year offerings, and to also make them available to large volume consumers. As Centra's Application proposes Centra begins with only 1, 3 and 5 year offerings to small volume customers, for Direct Energy the Application is therefore deficient.

5.2.1.2. Detailed Business Plans and Pricing

On page 90 of Order 160/07, the Board stated that it would not lift the restrictions preventing Centra from offering fixed price offerings from within the regulated utility without Centra providing concrete details of its planned entry. Order 161/07 further elaborates on what those concrete details should include: a business plan with design, marketing, primary gas physical supply, hedging, self insurance, risk management, administration, and pricing.

Yet, according to Direct Energy:

- Centra's business plan is not sufficiently detailed, with inadequate information on marketing activities and no link between planned marketing activities and expected customer uptake. Direct Energy noted that in its Application Centra has not ruled out door-to-door sales in the future, although it has also not articulated in what circumstances Centra would reconsider the matter.
- There is a lack of detailed planning and a formulaic approach by using a subjective 5% VRP. Centra stated that no formula was used in the determination of the 5% premium. Direct Energy posits that Centra's approach is arbitrary and will lead to unstructured, periodic revisions to the VRP.
- Centra has advised that it expects to use management judgment for forecasting enrolment in the fixed price offering program. The only empirical research that Centra cites as relying on is the customer research conducted by NRG for the 2007 Competitive Landscape hearing. In that hearing, NRG confirmed that the Focus Group Report did not contain a large enough sample size, and, thus, the results are not statistically representative.
- For Direct Energy, Centra is not serious about continuing with the fixed price offering program, because Centra plans to evaluate the uptake from

its initial offering and then decide whether to continue. Direct Energy notes that Centra has not developed any plans for post-March 2009, including any plans for fixed price and term offerings for large volume consumers. As well, Centra has also not established any metrics to be used to gauge success.

- While Centra's training materials should be reviewed for accuracy and to ensure that they offer protection of sensitive marketer information, Centra has not provided any training materials and none have been prepared.

Direct Energy states that Centra's entry into the fixed price market will affect all consumers, the marketers and Manitoba taxpayers. For Direct Energy, and because of this, the Board needs to have a detailed and complete description and plan of Centra's entry, and in Direct Energy's opinion, this is lacking.

5.2.1.3. Market Conditions

Order 160/07 made several changes to the competitive market in Manitoba, including reduction of the volumetric threshold for offering fixed price products and permission to use telesales and internet sales, monthly instead of quarterly enrolment, and the elimination of the requirement to forward an image of the signed contract to Centra.

The purpose of making these changes was to remove or lower barriers for the marketers, which in turn will allow marketers to increase the number of choices offered to consumers, and to allow for a reduction in the costs for their products.

Direct Energy states that it will take time for the market conditions envisioned in Order 160/07 to materialize and take effect. At the same time, benefits will begin to flow to consumers as they are materialized. Centra's Application was filed before the market changes were finalized, and so the market has not had time to adjust. According to Direct Energy, the Board should wait until the market conditions develop before considering Centra's Application.

5.2.1.4. Cost Estimates and Allocation

In Order 160/07, the Board stated that costs are to be assigned based on cost causation. System supply and Direct Purchase customers are to be held harmless, which means they are not to cross-subsidize the fixed price offering. Centra attempted to demonstrate that there will be no cross-subsidization of its fixed price offerings by either system supply or Direct Purchase customers.

According to Direct Energy, Centra's proposed hypothetical 1-year rate of $\$0.337/m^3$ does not account for:

a. Counterparty default risk;
b. Credit risk – the risk that increasing credit requirements will result in increased costs to meet those requirements;
c. Settlement risk – that gas flows to customers do not equal settlement flows;
d. Billing risk – the risk that the amount billed will not compensate for the amount purchased; and
e. Transportation risk – the risk that the cost of moving gas from the AECO 'C' hub to Empress will increase.

In Direct Energy's view, Centra's strategy for mitigation of these risks has not been adequately documented.

According to Direct Energy, another indication that system supply and Direct Purchase customers will not be held harmless is Centra's re-prioritization of duties and tasks so that staff may attend to the new fixed price offering program.

Direct Energy accepts that re-prioritization of duties and tasks may occur, but in this instance, for Direct Energy, the benefits of this re-prioritization will be experienced by fixed price offering customers at the expense of system supply and Direct Purchase customers.

Finally, Direct Energy believes that Centra cannot hold system supply customers harmless from “out of the money” results on hedges.

5.2.1.5. Methodology to Protect Commercially Sensitive Information

Centra has neither developed a formal compliance framework nor plan, nor has Centra agreed that such are needed. Direct Energy has identified a number of deficiencies with Centra’s proposed methodology to protect sensitive information, such as Centra not planning to segregate work areas or databases, amongst others.

Direct Energy states that there are many details yet to be addressed to ensure that sensitive marketer information is sufficiently protected, and that to-date Centra has not addressed the details.

According to Direct Energy, Centra has inherent competitive advantages: brand recognition, no profit margin, and use of the Manitoba tax base to backstop risk. In addition, Centra has access to sensitive marketer data, including the start and stop dates for all marketer customers.

Direct Energy advises that Centra has an obligation to the marketers to ensure that access to and use of sensitive marketer information is severely restricted within Centra, and that Centra must also create a compliance framework equal to that required in other jurisdictions.

5.2.1.6. Provision of Meaningful Choices and Consumer Benefit

In its Order 160/07, the Board expressed concern that allowing Centra to offer fixed price offerings would risk the exit of the marketers, which in turn, if realized, would reduce consumer choice.

According to Direct Energy, Centra is not offering any more choice than what is already available in the marketplace. Further, Centra is not offering a four year or any green products, unlike the marketers.

For Direct Energy, Centra's entry into the fixed-price fixed-term market does not change the fact that some customers would save money with a Centra offering and some would pay more, which is, according to Direct Energy, the same as for marketer customers. Direct Energy advises that Centra has not demonstrated that its products would generate additional economic benefits compared to those provided by the offerings of the marketers.

Direct Energy notes that Centra will make a determination whether to continue offering fixed price offerings during March of 2009, and suggests that the Board and Manitoba consumers risk the loss of consumer choice if Centra then decides not to continue its program, and that a loss of choice would be compounded if the entry of Centra into the market drives the marketers away, which, as opined by Direct Energy, is a likely result.

Direct Energy advises that the marketers are creating jobs in Manitoba, while Centra does not propose any additional employment with its fixed price offering program, another example that Centra has not proven any additional choice or economic benefits in their Application.

5.2.2. Conclusions

Direct reiterated the Board's stated objectives in making changes to the competitive landscape in Manitoba:

1) Meaningful choices,
2) A broad range of product offerings, and
3) Economic benefits – the opportunity to secure pricing representing fairness and/or cost effective certainty.

Direct maintains that Centra's Application neither meets the objectives nor meets the minimum requirements as articulated in Order 160/07.

Direct requested that the Board deny Centra's Application and instead allow time for the changes to the competitive landscape made in 160/07 and 109/08 to take effect.

5.3. Energy Savings' Position

Like Direct Energy, Energy Savings is also opposed to Centra's entry into the fixed price fixed term market.

Energy Savings lists a number of reasons why the Board should deny Centra's Application:

1) Centra's business plan is missing important details;
2) Centra has not met the Board's directive with respect to offering 1, 2, 3, 4 and 5 year contracts;
3) Centra does not offer anything new or unique to Manitoba consumers;
4) The Application does not sufficiently address how Centra will protect commercially sensitive marketer data;
5) The Board contemplated six months to review the marketplace changes resulting from Order 160/07. The marketers should be given an opportunity to make the changes; and
6) Centra will have a competitive advantage by using existing assets and staff, having access to customer information, and through the use of the bill and bill envelope. Centra also has access to historical usage and contract details.

Energy Savings joins with Direct Energy in asserting that Centra's Application is deficient, and, because it is deficient and lacking the information that the Board needs to make a decision, it should be denied.

According to Energy Savings, Centra has not included all the risks associated with its fixed price offering program in its proposed pricing approach. For example, Energy Savings cites the fact that Nexen is the sole supplier as a risk that Centra has not priced into its offering.

For Energy Savings, the Standard of Conduct filed by Centra does not address how Centra will control and protect commercially sensitive marketer information. While Centra did not produce any training materials as a part of its Application, the training to be provided Customer Service Representatives is of significant interest to Energy Savings. Energy Savings wishes to ensure that Centra's Customer Service Representatives provide neutral, factually correct information to consumers.

Energy Savings highlighted areas that Centra should have, but did not, address in its Application, items that should be implemented, including physical separation of staff, database segregation, a dispute resolution process, recording of each customer's affirmation of the contract, scripts for staff communicating details of the fixed price offering program to consumers, and standards of reporting for breaches of the Standard of Conduct.

Energy Savings is of the view that Centra has not fulfilled the Board's request for concrete details of its planned entry into the fixed price market. According to Energy Savings, Centra has not included details such as media options, consumer education materials, internal training materials, compliance plans, pricing, and frequency of offerings.

According to Energy Savings, and as cited by Direct Energy as a reason to deny the Application, the market conditions resulting from Order 109/08 have not had time to develop, as they only came into force on September 1, 2008. Energy Savings suggests that the Board give these changes six months before allowing Centra to enter the market, so that consumer behavioural changes attributed to these market rule changes can be differentiated from those attributed to Centra's entry into the market.

In its final submission, Energy Savings states that:

> "Centra's Fixed-Rate Offerings must precisely allocate costs using fully allocated accounting practices based on a cost causation approach with no opportunity for cross-subsidization."

Energy Savings noted that other jurisdictions use physical separation of the regulated and competitive businesses in order to ensure that no cross-subsidization exists, to ensure a level playing field, and to protect sensitive marketer information. Centra has not defined in sufficient detail how it will accomplish this.

Energy Savings advances that prohibitions should exist to prevent Centra's Customer Service Representatives from promoting Centra's fixed price offerings.

Energy Savings comments on the Board's three objectives for the competitive landscape by stating that it is impossible to have fairly priced consumer choice options without a healthy competitive market.

Energy Savings asserts that Centra's offerings may be priced less than those of marketer offerings because Centra does not seek a profit, and that this may cause the marketers to leave the market and establish barriers to entry for new market participants, resulting in a reduction of consumer choice.

5.3.1. Conclusions

Energy Savings summarizes its submission by stating that Centra's Application is deficient in the information that it provides to the Board, and thus should be rejected.

Furthermore, Energy Savings opines that if the Board approves Centra's entry into the fixed price market, it may have the opposite of the intended effect and reduce the choice available to consumers.

5.4. Shell's Position

Shell reviewed the conclusions of Order 160/07, which affirmed that competition for small volume consumers is lacking but that adequate competition exists for large volume consumers. Shell noted that despite this finding, the Board ordered Centra to offer fixed price offerings to large volume consumers.

Shell expressed concern that the majority of the evidence and information requests posed and responded to through the proceeding were focused on the small volume user.

According to Shell, Centra should be held to all the elements of the marketer Code of Conduct, including being licenced as a marketer by the Board. In addition, Centra should be held to the elements of the Standard of Conduct that prescribe how the dual functions of competitive and regulated supply are to be kept separate in order to protect marketers.

Shell recommends that Centra not offer products to larger volume consumers, and to that end a volumetric threshold apply to Centra's offerings in the LGS class, as the requirements of smaller LGS customers can vary drastically from the very large LGS consumers.

Shell observes that pursuant to Centra's proposed approach to its initial offerings, one or more very large LGS consumers could subscribe to an offering and prevent many smaller LGS consumers from accessing the offer. Shell states that the Board's objectives will have a greater chance of success if Centra's offerings were limited to LGS consumers who consume less than 50,000 GJ annually.

Shell notes that Centra, in its September 12, 2008 filing, agreed that 50,000 GJ of annual consumption is an appropriate limit to distinguish between the small and large consumers in the LGS class.

6. Board Findings

Preamble

The Board notes the following excerpts from previous Orders that it has considered in reaching the findings and directions of this Order.

> "In deliberating and concluding on the current situation and Centra's proposals for a lifting of the current restriction on its marketing of fixed-price fixed-term contracts in the regulated environment, the Board's focus was not on the implications for either Centra or the retailers, but on the value of the present arrangement for consumers. Order 15/98's design of the natural gas landscape was not predicated on fashioning a market for retailers or assuring Centra's market and financial position, but on a desire for producing both choice and potential savings for consumers." (Order 160/07 p. 90)
>
> "The Board considered the evidence of Dr. Hall, a witness on behalf of Centra, who articulated a three-fold test to evaluate the benefits of competition, a test generally supported by the other parties to the hearing. The test consists of three questions:
> a) whether supply will be increased;
> b) whether prices will be decreased, and
> c) whether the range of products and services (choice) will be improved.
>
> If the answer was "yes" to each of the questions, then, according to Dr. Hall and the consensus of the time, the Board could assume that competition would be or was adequate. If an answer was no, then the Board could conclude there would be or was no consumer benefit arising through introducing competition.
>
> Order 15/98 also articulated three objectives for competition, those being consistent with Dr. Hall's test:
> a) provide the consumer with meaningful choice;
> b) provide additional service offerings; and
> c) result in economic benefits."
> (Order 160/07 p.10, 11)
>
> "Competition is not a goal in and of itself. The Board is interested in assuring that Manitoba consumers are provided meaningful choices and real economic benefits." (Order 160/07 p.20)
>
> "The objective is to enhance consumer choice from amongst a broad range of competitive priced options." (Order 160/07 p.1)

> "The Board has consistently maintained that the public interest will be served if choice is available, prices are fair, and consumers are well informed about their choices. The Board's focus was consistent with the design of the natural gas landscape from Order 15/98, wherein the natural gas landscape was not predicated on fashioning a market for Retailers or assuring Centra's market and financial position, but on a desire for producing both choice and potential savings for consumers." (Order 125/08)

> "The Board agrees with CAC/MSOS that any alternative offerings must be priced according to the full cost of providing them. In its filing of an Application to offer fixed price and term offerings, Centra is to strictly adhere to the principle of allocating cost based on cost causation with no cross subsidization . Therefore, any and all costs forecast to be incurred as a result of designing, administering, marketing, supplying, and financing alternative offerings to consumers are to be reflected in the modelled pricing." (Order 160/07 p.97)

6.1. Benefits to customers

In 2007, the Board heard from Centra and interveners in the Competitive Landscape proceeding, with the aim of evaluating the marketplace in Manitoba for the sale of natural gas. Amongst the issues canvassed, one of considerable importance was whether Centra should be allowed to offer fixed price, fixed term natural gas contracts in competition with the marketers.

In the proceeding, Centra maintained that it wished to add fixed price offerings at the behest of its customers. The marketers took the position that if Centra were allowed to offer fixed price offerings competition will be eroded and not enhanced. CAC/MSOS were in favour of Centra entering the fixed price offering market as long as its offerings were not cross-subsidized by system supply customers.

The Board wants customers to have a number of choices, fair prices, and sufficient information about their options. And, the Board decided in the Competitive Landscape proceeding that it did not have enough information to make a decision at that time on whether to allow Centra to offer fixed price natural gas contracts. Yet, the Board was sufficiently convinced that a competitive market for small volume consumers had not developed, and that Centra may apply to offer fixed price offerings in order to increase the choice available to consumers.

The concept of Centra offering fixed price products presents the Board with a dilemma. If the Board grants Centra's Application, then the marketers may find that their products are no longer competitive and may choose to exit the marketplace. If that occurs, will customers have enough supply choices?

In the customer research undertaken by Centra in 2007, some customers have indicated they do not like monopolies and would prefer a number of companies offering competing products. Yet, in that same survey a majority of customers indicated a desire that Centra enter the fixed price and term contract market, even if marketers exited as a result.

That the marketers may exit the Manitoba market is a genuine risk. During the course of this proceeding, Direct Energy announced that it was suspending sales of its residential offerings, although it was continuing to supply its existing customers. The Board also notes that natural gas prices had plummeted in the weeks preceding Direct Energy's announcement, a situation that likely makes it more difficult for the marketers to convince consumers that natural gas prices are increasing or at risk of increasing, and that they should lock in their primary gas rate.

On the other hand, if the Board denies Centra's Application, then Manitoba consumers will not be availed of a yardstick for comparing the prices of fixed price offerings. The creation of this yardstick, or benchmark, was one of the reasons for allowing Centra to apply to offer fixed price offerings.

In addition, in the absence of Centra's offerings, consumers would be forced to rely on the marketers to develop a variety of different products. Unlike with Centra, the Board cannot order the marketers to supply a full slate or variety of products.

In Order 160/07, the Board stated:

> "The Board is not satisfied with the options and pricing of options now available to consumers. Additional choice and better pricing is to be assisted by changes to the market framework."

The Board heard evidence of the pricing of the marketers' offerings in 2007 and in 2008, as well as hypothetical Centra offerings reflecting the same points in time.

These offerings are summarized in the following table:

Table 1: Comparison of Marketer and Hypothetical Centra SGS Class Offerings

	1 Year	3 Year	4 Year	5 Year
Direct, May 2007		$0.389/m^3		$0.359/m^3
Energy, May 2007			$0.3989/m^3	$0.3989/m^3
Centra, May 2007	$0.3588/m^3	$0.3478/m^3		$0.3371/m^3
Direct, Sep 2008	$0.479/m^3	$0.409/m^3		$0.399/m^3
Energy, Sep 2008			$0.447/m^3	$0.447/m^3
Centra, Aug 29, 2008	$0.3370/m^3	$0.3565/m^3		$0.3533/m^3

Note: All products are constant fixed price for the entire term of the contract Centra's prices are hypothetical, Direct and Energy Savings prices, actual.

From this comparison, consumers would clearly have been paying less for gas if they had contracted with Centra instead of with either of the marketers, assuming that Centra's offerings had been actualized. Also, the Board is mindful that the marketer pricing may have been determined at a point in time preceding the time Centra used to estimate its prices, and that if Centra had been in the market, its pricing may have affected the pricing of the marketers.

Nevertheless, the information in the table is the yardstick or benchmark that was contemplated in Order 160/07.

This yardstick is not the only information that the Board considered when deciding whether to allow Centra's Application. The Board also considered the number of supply options available to small volume consumers.

In addition to the offerings in Table 1, in September 2008 Direct Energy was offering a five-year, Carbon Neutral product. The Carbon Neutral component of the product refers to the corresponding carbon offsets that Direct Energy would purchase on behalf of consumers to offset the greenhouse gases produced by consumers as they consume natural gas.

The Board had expected more choices for Manitoba consumers, including additional choices from additional marketers. Currently, marketers only compete with each other directly on one offering – the 5-year flat rate product. As stated in Order 160/07:

> "For the Board to approve the entry of Centra into the competitive retail market, Centra's product offerings would have to provide an increase in meaningful customer choice." (Order 160/07 p.100)

As Direct Energy pointed out in its submission, the entry of Centra will not, at least at first, introduce different offerings than are currently available. However, Centra will increase customer choice by allowing customers to choose from more than one supplier for a given term of contract. In addition to increases in product choices, consumers would be exposed to increases in supplier choices.

Of course, if Direct Energy's exit from the marketplace is permanent, then the supplier choice has been reduced in the absence of a Centra entry. In this situation, and given Centra does enter the market, small volume consumers will still be left with two suppliers, as was the case before Direct Energy's exit and Centra's entry.

The Board is disquieted by Direct Energy's withdrawal from the retail market, reducing the private brokers in that market to one, Energy Savings. That one marketer, in the absence of Centra, would have a monopoly with respect to fixed price and term contracts, yet the majority of Centra and all natural gas retail users have indicated a preference for more certainty with future pricing, thus favouring fixed price and term contracts.

Another consideration is the expressed desires of consumers. Centra provided a customer research report at the Competitive Landscape proceeding. Although the methodology and findings of the report were disputed by interveners, it remains the only customer research document placed on the record in that proceeding. And, according to that report, consumers were interested in having Centra provide alternative product offerings, including fixed priced offerings.

Order 160/07 further states:

> "Competition is not a goal in and of itself. The Board is interested in assuring that Manitoba consumers are provided meaningful choices and real economic benefits." (Order 160/07 p.20)

Once again, the Board is faced with the dilemma of allowing Centra to offer fixed price products to provide consumers a yardstick for comparing prices while risking the loss of private marketers from the Manitoba market, versus the status quo.

In the Board's view of the dilemma, the yardstick and possible additional choice, wins out; Centra can and should supply a full slate of fixed price offerings, even if there is a risk that the marketers will choose to exit the Manitoba market.

When Centra offers a full slate of products, consumer choice will be better than has historically been available. Centra is to eventually offer a product for each term from one through five years. As stated in Order 160/07 and reiterated in Order 125/08, the Board in making this decision must consider the best interests of Manitoba consumers, and not the short term financial impacts on either Centra or marketers.

If Centra's prices are sufficiently and consistently lower than the marketers' prices, and this causes the marketers to leave the Manitoba market, the Board and consumers will have to accept that. The corresponding loss of consumer choice, while regrettable, should be, in such a case and based on the available evidence, compensated by the savings that Manitoba consumers should be expected to experience.

A statistically significant finding from the 2007 Customer Research Report is that while the majority of consumers felt that they benefited from competition they were unwilling to pay any additional cost for competition. The Board accepts this as an endorsement that the benefit of having additional choice should not come at the expense of increased prices; instead increased choice, if there is to be increased choice, should drive down prices.

Energy Savings strongly submitted that the Board should wait six months in order to properly assess the changes to the marketplace that took effect September 1, 2008 with Order 109/08. Yet, since Centra will not be offering its initial offering until January 2009, with its gas flow not expected until May 1, 2009, the regulatory amendments will have had an isolated four months to be evaluated.

Further, since Centra's initial offering will be on a small scale, the effect on consumer behaviour will be minimal. The Board feels that it will have ample time and opportunity to evaluate the regulatory changes that were implemented through Order 109/08.

Centra will be required to apply to the Board to expand their offerings beyond adding two and four year contracts, and must also apply to the Board should Centra choose to discontinue any of the offerings approved within this Order.

Centra's entrance into the fixed term and price gas supply market is a seminal event in the development of the Manitoba natural gas market, and may lead to marketer withdrawal and, as well, reduced interest in new market entry. Accordingly, once in, Centra should anticipate remaining in the market, regardless of the degree of success enjoyed in its initial offerings; that said, adjustments to future offerings to reflect experience are reasonable and to be expected, though will be subject to review.

In the sections that follow, the Board presents its findings on the specific details of Centra's Application.

6.2. Product Design

The Board, in its Order 160/07, requested that Centra develop a framework for setting the prices of its fixed price offerings. The Board was concerned that Centra would not be able to bring forth offerings rapidly enough if approval was sought for each offering. The Board is, therefore, satisfied with the formula that Centra is proposing, one that is based on the competitively sourced prices for fixed price and fixed volumes of gas, plus a VRP and a component for overhead costs.

Centra explained that it will use Over-The-Counter fixed-price swap derivatives, a minimum of three counterparties, and will select the best available price. The Board directs that Centra file the hedge quotes that it receives from its counterparties, redacted and in confidence as required, to demonstrate that Centra has selected the lowest hedge quote.

Centra is to file these quotes at the same time that it informs the Board of its fixed price offering prices. If the lowest quote is for some reason not selected, Centra must provide an explanation to the Board why it was rejected.

In addition, the Board requests that Centra file its updated Hedging Operating Principles and Procedures, and, also, its updated Derivatives Hedging Policy for Primary Gas.

Centra's approach to pricing its fixed price offerings accomplishes several objectives: it is simple, competitive, minimal administration overhead, and less risky that other possible approaches. It is simple in that the formula is based on a competitive bid, plus a fixed percentage risk premium and a fixed cost overhead component. It is competitive in that bids are obtained for the gas commodity from several counterparties.

Minimal administration overhead is anticipated and forecast because Centra is not creating a separate affiliate company. Lastly, the program is reasonably “safe” because it attempts to hold system supply and Direct Purchase ratepayers harmless from any profits or losses of the fixed price offering program.

The Board notes that Centra’s management expected to exert a level of judgment in the determination of the VRP. As recommended by CAC/MSOS, and since the premium is not explicitly determined by formula, the Board requires Centra to apply for any change to its VRP from the 5% recently articulated in PUB/Centra 30.

If and when Centra applies to change the VRP, the Board expects as the minimum filing requirements: a full update on the program profit or loss to date, the mark to market results of current contracts, the reason for requesting the change, calculations in support of the change, and the historical percentage of contracts that settled with no under-collection of costs.

The more fulsome Centra’s Application, the less likely the Board will request additional information and contribute to a delay in the implementation of new offerings.

The Board finds Centra’s initial expectations in terms of customer numbers and take-up to be reasonable. The Board recognizes that predicting the number of customers that will be interested in Centra’s fixed price offerings is a challenging task.

Centra has stated that it is using the customer research conducted in 2007 and submitted in the Competitive Landscape hearing as the basis for estimating the interest in its offerings. Further complicating Centra’s predictions are that natural gas pricing is unlikely to be a top-of-mind issue for the majority of consumers, and Centra’s planned “limited” marketing efforts are not likely to change this.

The Board directed Centra to apply for all classes, and with five offerings covering different terms. As has been pointed out by the marketers, Centra has not proposed to launch offerings to all customer classes, or for two and four year products. The Board expects Centra to very quickly proceed with two and four year products, and to propose such adjustments to its initial approach to the Board as it deems advisable due to the initial experience in a timely fashion.

The Board, on page 91 of its Order 160/07, singled out small volume customers as being especially important for whom Centra is to develop offerings. Other classes were included, as there did not appear to be any reason that the yardstick to be available to small volume customers should not be available to all customers. While the Board is still of this view, since the level of competition in the higher volume classes is greater, as was found in the Competitive Landscape proceeding, the urgency of offering these customers additional offerings is somewhat diminished. This should not be interpreted as suggesting that Centra does not proceed to develop offerings for other customer classes.

Energy Savings states that Centra has missed an opportunity to provide the marketplace with additional choice for consumers because 1, 3 and 5 year products are already available. The implication is that Centra's offerings are nothing new to the marketplace. The Board disagrees with this assertion.

Centra's offerings directly increase the choice offered to consumers, particularly as currently only one marketer offers one and three year products and one marketer, Direct Energy, has suspended or ceased offering fixed contracts to residential customers. And, the Board expects Centra's subsequent offerings to include a two and four year option, further increasing choice.

Centra's initial offering will be introduced in January 2009, with the new fixed price billing arrangements to take effect for May 1, 2009. Waiting 45 days until after the offering period closes negates any advantage Centra might have over the marketers, which must not only change the billing arrangements but must also change the physical gas supply arrangements.

Centra stated that it is planning to bring forth new offerings on a monthly basis, once the program is operational. The Board cautions Centra to be mindful about the volumes it makes available to consumers in the summer months when natural gas costs and other issues are not top-of-mind.

Centra included a copy of a standard contract in its Application. The Board finds this contract acceptable, with the exception of the cancellation procedures included. The contract was produced before the Board issued Order 109/08, which altered the cancellation procedure. Centra has promised to file a revised contract if the Board approves the Application. The Board therefore expects to see the revised contract by December 12, 2008.

Centra includes in point 1 of its proposed contract a reference to the General Terms and Conditions. This means that a customer is signing a document that does not have all the terms listed on it, obliging them to go to the website or a Manitoba Hydro office to see a copy.

The Board is not certain this point need be included in Centra's fixed price contracts. When a customer signs up to receive natural gas service, he/she/they agree to the General Terms and Conditions. If a customer subsequently signs up for fixed price supply, the Board is of the preliminary view that they should not need to re-agree to these General Terms and Conditions.

Marketers have done a good job at condensing the terms and conditions of their contracts so that there is no fine print or references to other documents. The Board suggests that Centra emulate this approach.

One of the concerns of both Energy Savings and Direct Energy is that Centra controls the daily nominations of gas flows. The concern of the marketers is that this gives Centra a competitive advantage, as Centra would have this information prior to communicating it to the marketers.

The Board does not see how this offers Centra a competitive advantage. Centra has confirmed that they will operate their gas supply and procurement the same way as they do presently. Centra will purchase the same volumes of gas for its primary gas customers, regardless whether they are system supply or fixed price supply, and there is no distinction made on the supply side.

As to Direct Energy's comment that some customers will save money and some will not with Centra's fixed price offerings is no different than is the case with existing marketer offerings. Although Centra stated in the previous proceeding that it would not be able to design a product that consistently saved money with respect to the system supply offering, the Board expects that Centra's offerings will generate greater economic benefits than the marketers' offerings, by virtue of Centra's offerings likely to being frequently priced lower given the lack of a "profit" motive and a common administrative base with its system supply operation.

Centra is not to speculate, and is expected to, at least initially, offer "generic" offerings to broad customer classes; this and the "less aggressive" marketing expected of Centra will leave opportunities for marketers, in all customer classes.

Shell expressed a concern that an offering to LGS customers may be completely subscribed by one or only a few customers, preventing a large number of smaller LGS customers from participating. For example, if Centra makes 1,722,240 m^3 available for a one year contract for LGS customers, as it predicts it will in the second year of the program, this volume of gas could be subscribed by just three customers, instead of the 23 that Centra predicts.

Although this is clearly a possibility, the Board does not find such a situation to be a major problem impossible to address. If in any particular offering Centra finds that interest exceeds availability, it can create a larger offering the following month. Pricing may well be different, but a subsequent and larger offering will provide consumers an opportunity to lock-in primary gas prices.

The Board continues to see no reason why Centra should refrain from offering contracts to the non-residential higher volume classes, including the High Volume Firm and Interruptible customer classes. There are 151 customers in the higher volume classes, of which 97 are system supplied (Centra provides the primary gas), 39 are marketer supplied, and 15 are T-service customers.

While the Board has considered Shell's proposal to delineate 50,000 GJ as the separation between large and small LGS consumers, and restricting Centra to below 50,000 GJ, on balance it does not intend to restrict Centra from serving higher volume customers.

In the Board's view, Centra's entry into such markets will provide increased competition and provide such users with the opportunity to contract with a party pledged to a cost-based speculation-free service.

6.3. Legal Authority

The question of whether the Board has the authority to allow Centra to establish rates based on a formula was canvassed in the proceeding. The Board is of the view that it has the authority to establish a framework that Centra may use to mechanistically set rates.

The Board recognizes that Centra is unable to accurately predict the prices it will receive from its counterparties prior to the actual placement of hedges. As the Board has witnessed this past summer, there can be wide fluctuations in intra-day natural gas market prices, such that Centra's hedging estimates may become stale before the Board is given a chance to review them.

Therefore, the Board will permit Centra to follow its Derivatives Hedging Policy and its Hedging Operating Principles and Procedures when setting its fixed price offering prices.

As stated above, Centra must file these with the Board prior to placing its fixed price offering hedges. Centra will enhance the transparency of the hedging process by filing with the Board the hedge quotes that it receives, redacted as necessary. Retrospectively, the Board will review Centra's actions and pricing to ensure that the policies and procedures were followed – not just for hedging, but also for its entire fixed price offering program.

As the Board has explained above, the Board will not allow Centra to determine its own VRP, to do so would amount to allowing Centra to set its own rates.

6.4. Risk Mitigation

When a customer signs a fixed price contract, risk is transferred to the supplier, be it Centra or one of the marketers. Centra articulated plans to mitigate risk. First and foremost, Centra will mitigate risk by hedging the normal weather volumes that it expects its fixed price offering customers to consume. The Board is satisfied with Centra's proposed hedging plan. The Board understands that Centra will likely frequently be in an over-hedged position, but the Board accepts this situation, since all profits and losses from the program will be confined to the fixed price offering program.

The Board is comforted by Centra's pledge not to engage in speculation as speculation has driven considerable volatility in commodity pricing and led to significant losses for some firms on occasion – losses sufficient to 'break' hedge funds and cause massive losses to counterparties, including banks. The Board has no such assurance as to the avoidance of speculation when it comes to private brokers, retail and commercial, as the Board plays no role in the pricing of their contract offers or the outcomes of those contracts for their firms or their customers. The Board acknowledges that speculation may lead to gains, indeed large gains, as well as losses. Speculation is best left to the private sector.

The Board finds Centra's customer attrition numbers surprisingly high and expects that if this level continues it will play a role in determining the success of the program. Not only will a variance between estimated and actual attrition lead to either being over-hedged or under-hedged, if attrition is higher than expected, Centra will not sufficiently recover its program costs. That said, the Board understands that there is little Centra can do about this; indeed the marketers identified this as a significant risk to their business in the Competitive Landscape hearing.

Centra's proposal to begin its offerings on a small, limited scale is probably the most effective way at reducing the risk to Centra and its system supply and Direct Purchase ratepayers. The Board is satisfied with Centra's initial plans for offering 1, 3 and 5 year contracts for residential customers, and is prepared to await the outcome of the initial foray into the market before Centra moves to offer 2 and 4 year options, and to other customer classes.

Caution is advisable as long as it is not paralysis, and should allow Centra to learn from experience.

Subscription risk is another risk borne by Centra. This is the risk that a Centra's offering is not fully subscribed. If an offering is not filled, then that offering will be over-hedged if normal weather is experienced. Again, Centra's proposed approach of offering only 1, 3, and 5 year terms for small volume consumers is an appropriate course of action to mitigate this risk.

The Board disagrees with Direct Energy that Centra has not priced into their offering all of the known risks. The billing risk does not exist for Centra or the marketers, at least as far as the primary gas offerings go. Billed but unpaid amounts are accounted for through the bad debt expense component of distribution rates. While it is true that Centra's modeling did not include an example of a counterparty default, Centra is cautious by not suggesting that the minimum risk mitigation hurdle, a 3% VRP, be used.

In the Board's view, the higher risk mitigation hurdle of 5% will sufficiently protect Centra and its distribution customers from these risks, subject to experience.

6.5. Volumetric Risk Premium

The VRP is yet another method that Centra will use to mitigate risks, such as weather risk, customer consumption risk due to conservation, inter-class migration, attrition, market price risk, risk of customers cancelling within 10 days, large consumer event risk such as a bankruptcy, and government or regulatory policy risk.

Centra considers the VRP calculation confidential, and thus did not provide the data or details, although they did describe the methodology.

The Board is satisfied with this methodology and the stress testing completed by Centra. The past 8 years has presented unprecedented and drastic price movements in natural gas markets, both up and down. These escalations, spikes, and precipitous falls in commodity pricing provide sufficiently rigorous scenarios for Centra to test its risk mitigation strategy.

Given this experience, the Board expects there may be future spikes or valleys that challenge the program, and coincident with extreme weather, the risk mitigation program must be exceedingly robust.

Centra articulated a number of risks to its program, and stated that it could not quantify the individual risks. One of the significant risks that Centra's stress testing did not model was a hedging counterparty default. Such a default could mean that Centra does not receive payment for "in the money" hedges. Centra will need to continue to be vigilant in its selection of counterparties.

The VRP range Centra proposes appears sufficient, although as mentioned in the previous section, the Board requires Centra to apply every time it wishes to adjust the VRP. That said the Board does not intend to hold an oral hearing over proposed changes, a paper-based process will allow for intervener participation. The Board recognizes that customer service requires timely actions, not only by utilities and marketers, but also by regulators.

Centra states that it is not its intention to incur profits or losses with the fixed price offering program. As identified by CAC/MSOS, if the eight years of experience serve as an expectation of future long run results, then using a VRP other than the one associated with the minimum risk mitigation hurdle will have the effect of generating program profits over the long run.

The fact that the mid-range risk mitigation hurdle premium is a higher value than the minimum risk hurdle premium means that it will collect more money from customers than the minimum risk hurdle premium. Since the minimum risk hurdle premium expects to break even, the Board concludes that collecting more money from customers will cause the mid-range risk hurdle premium to generate a profit.

The VRP for the maximum risk mitigation hurdle will likewise generate an even larger profit. The questions for the Board then are what risk premium should Centra use, and what to do with any profits if and when they materialize?

The Board must determine whether the proposed VRP strikes the appropriate balance between ensuring that the program collects its costs from consumers in order to hold system supply and Direct Purchase customers harmless, and charging fixed price offering customers too much of a premium. Centra could easily find itself in a position where it records hundreds of thousands of dollars in program profit. On the other hand, weather and market conditions could cause Centra's program to lose hundreds of thousands of dollars, even with a higher VRP.

CAC/MSOS opined that the VRP should be lower than the 5% proposed by Centra. They suggest a weighted average, or even an arbitrary selection of a 3% premium, which is approximately the minimum risk mitigation hurdle premium for most of the small volume customer classes and offering durations.

The Board agrees with Centra's proposed 5% VRP. Although Centra's historical stress testing determined that a lower VRP would result in the program breaking even, the Board desires a more conservative approach. The Board would be placed in a challenging position if, using the lower VRP, the fixed price offering program accrued significant losses in its first few years.

Could these losses expect to be balanced by future gains, such that the program eventually breaks even? Or, should changes be made to the program to recover these losses from future customers?

In the Board's opinion, it is better to be on the 'safe' side and therefore, Centra may proceed with the 5% VRP.

6.6. Cost Allocation

One of the only items of unanimous agreement in the Competitive Landscape proceeding was that if Centra was to offer fixed price offerings from within the regulated utility, then all costs incurred to develop, administer, and deliver the program must be allocated to the program and priced into the offerings. If some of these costs are not allocated to the fixed price offering program, then system supply and Direct Purchase ratepayers will be cross-subsidizing fixed price offering customers.

From page 97 of Order 160/07:

> "In its filing of an Application to offer fixed price and term offerings, Centra is to strictly adhere to the principle of allocating cost based on cost causation with no cross-subsidization. Therefore, any and all costs forecast to be incurred as a result of designing, administering, marketing, supplying, and financing alternative offerings to consumers are to be reflected in the modeled pricing."

Allocating all costs incurred in the development and delivery of fixed price offerings will serve to hold system supply and Direct Purchase ratepayers harmless from cross-subsidizing fixed price offering customers.

As directed by Order 160/07, Centra filed a cost allocation model that demonstrates the allocation of costs from its fixed price offering program. The Board agrees that including an allocation of indirect costs is appropriate, since the same indirect costs are also allocated to Centra's system supply Primary Gas Overhead Rate.

If Centra has successfully identified and allocated all the costs incurred in the provision of fixed price offerings, then system supply and Direct Purchase ratepayers will be held harmless. With the exception of regulatory costs, the Board is satisfied that Centra has identified and allocated these costs. The Board agrees with CAC/MSOS that Centra appears to have included the quantum of direct costs that it would incur, and thus Centra's other customers will not cross-subsidize the fixed price offering program.

6.6.1. Five Year Average

Centra has stated that a number of the costs are independent of the number of customers. Thus, to use year-by-year actual costs and volumes in the cost allocation model would result in a much larger PCR in the initial years with a decreasing rate in subsequent years. Because of the averaging that Centra has proposed, at any point in time the PCR may not exactly reflect the cost to provide the service. The Board agrees with CAC/MSOS that Centra's suggested approach of using the five-year average cost and the five year average volume is appropriate and will not penalize customers in the initial years that would otherwise bear a disproportionate amount of the program costs.

Over time and on average, the PCR will reflect the cost to provide the fixed price offering service. The Board hereby approves Centra's modification of its cost allocation model and the resulting allocation of costs to the fixed price offering program.

6.6.2. Regulatory Costs

On page 94 of Order 160/07, the Board commented:

> "Not needing to include a profit margin in the price of its offerings is a major advantage that Centra has over retailer offerings. The Board notes that this is partially offset by regulatory costs that would be priced into their offerings."

Centra, in response to PUB/Centra 21(a), states that regulatory costs are not included in the program costs because regulatory activities are undertaken for the benefit of all customers and are thus recovered from all customers in the distribution rate.

Centra has incurred regulatory costs in the preparation of this Application, responses to information requests, and Centra's final submission. These costs are, for the most part, labour costs and Centra states that they are non-incremental. As well, Centra will incur regulatory costs in the future when it undertakes its reporting activities.

The Board draws a distinction between regulatory costs incurred in offering fixed price offerings and the additional costs for facilitation of the WTS. In the 2007 Competitive Landscape proceeding, the Board reviewed the allocation of these additional costs for facilitation of the WTS, which included a premium for the additional flexibility in the Nexen gas supply contract, the additional bad debt expense related to the agency, billing, and collection (ABC) service, and costs to administer and process Direct Purchase enrolments.

Centra had argued that these costs were incurred for the benefit of the marketers, and thus they should be borne by the marketers. In Order 160/07 (p 66-67), the Board disagreed with Centra and ordered they continue cross-subsidization of these costs by all ratepayers, as the benefits of increased choice flow to all consumers.

Notwithstanding Centra's assertion that its regulatory costs are incurred for the benefit of all consumers, the regulatory activities of Centra for the provision of fixed price offerings provide a benefit to Centra's fixed price offering customers.

The marketers also incur regulatory costs which could be argued are for the benefit of giving all customers more choice, but the marketers have historically paid their own regulatory costs. Centra must compete with the marketers, and this means that each participant must bear their own regulatory costs.

Therefore, the Board requires Centra to include its regulatory costs – both the costs incurred to date and anticipated future regulatory costs – in its cost allocation model. This will yield a new PCR, which Centra must submit to the Board for approval.

6.6.3. Double Allocation of Costs

An issue arose during the current proceeding concerning Centra allocating staff and their associated costs to the fixed price offering program that had already been allocated to the distribution rates for all customers. Centra states that this "double counting" is not material, and it will be addressed in the next General Rate Application (GRA), that to occur in 2009.

Although the Board accepts Centra's proposed treatment of these costs, the Board does have a concern that there are "lower priority tasks" that Centra states are not required to provide safe and efficient gas service to Manitoba consumers.

If that is the case, the Board wonders why these tasks were being performed in the first place. If they were low priority or not required at all, then Centra was performing unneeded work and incurring unnecessary costs. The Board will address this further in the next GRA.

6.6.4. Summary

The Board expects that program costs will be reviewed in subsequent General Rate Applications. The upcoming GRA in 2009 will give Centra an opportunity to identify and report on the initial costs of the program, and whether they are in line with the projections included in this proceeding.

6.7. Marketing

6.7.1. Marketing Activities

Centra plans to use lower cost and possibly lower impact marketing channels. Centra plans to use print advertising, direct mail, and customer education materials to promote its fixed price offerings. Centra has not defined the specific details of where and when it will place advertisements or send out direct mail, although it has created a budget of $31,250 in the first year and $55,000 in each subsequent year.

It is difficult for the Board to predict whether Centra's marketing budget for the new program is insufficient, extravagant, or adequate. Success of the marketing efforts will only be known once consumers respond or not to the offers.

Centra abides by Order 160/07 by not including marketing materials as bill inserts. Bills are paid for by all customers, and the costs are met through distribution rates, so any marketing through bills or bill inserts must be open either to all market participants or to none.

The Board agrees with CAC/MSOS' position. If Centra wants to alter its marketing approach to include methods not specified in this proceeding that Centra must first apply to the Board, and the Board will ensure that interveners to this proceeding have an opportunity to provide comments and evidence.

The Board disagrees with Direct Energy that Centra should not direct market efforts towards Direct Purchase customers. Centra's marketing personnel will not know whether a customer is a Direct Purchase or a system supply customer; and to have access to this information would constitute a breach of the Standard of Conduct.

Therefore, if Centra is randomly selecting a portion of its distribution customer base, and some proportion happens to be enrolled in Direct Purchase, that is an acceptable eventuality.

6.7.2. Consumer Education

The lack of consumer education that was identified in the Competitive Landscape hearing, where half of the marketer customers surveyed did not know that they were being supplied by a marketer, alarmed the Board. As a result, the Board has taken steps to include information on its own website to assist consumers.

Centra has rightfully identified increasing consumer education as a priority, and has proposed to develop customer information and education materials. Such materials were not complete at the time of this proceeding.

As stated in Order 160/07, the Board does not require consensus amongst Centra and interveners for the production of these materials, but the Board will review all such materials before they are distributed to customers. The Board may also seek input from other parties prior to approving them.

The Board encourages Centra to ensure all of its residential customers are made aware of its new offerings, the basis underlying the offerings, and the intent to achieve break-even on the offerings. As well, Centra should advise of its commitment not to speculate on commodity prices in its new offerings.

The Board also encourages Centra to advise its customers of its initial retail entrance into the market, the reasons for it, and the potential for an extension to other classes in time.

6.8. Financial Results

Centra plans to take the program profits or losses into retained earnings, and the Board finds this acceptable.

The Board considered having Centra segregate these amounts, but the net effect on Centra will flow to its retained earnings, so segregation would be superfluous and is not required. Yet, Centra is to maintain an accounting of program profits and losses over time so that the position of the program is clear.

Maintaining a neutral or positive position, over time, for the program is essential to keeping system supply and Direct Purchase ratepayers from subsidizing the fixed price offering program. At the same time, the Board anticipates that offerings through the first few years of the program may well result in some losses for the program. This may not be cause for either redesigning or eliminating Centra's fixed price offerings; rather, Centra should continue to evaluate the program and propose and make changes if they are warranted.

The Board is interested in monitoring the results of the program. Centra is required to report to the Board on an annual basis the number of customers, offering details (including pricing components), the volumes hedged and the estimated volumes subscribed, marked to market positions of outstanding offerings, individual contract profit or loss, net program profit and loss, variances from projections, and identify any trends in the program.

6.9. Standard of Conduct

Centra proposes to 'police" its own employees concerning access to sensitive marketer data and concerning statements made by its employees regarding preferential treatment for fixed price offering customers. Centra's Standard of Conduct is the guiding document that Centra proposes to use.

The Board has extensively considered the positions of the marketers when evaluating Centra's Standard of Conduct, as breaches of the Standard by Centra may directly cause harm to the marketer business interests.

6.9.1. Additional Requirements for the Standard of Conduct

A dominating concern of the marketers is that Centra's Standard of Conduct falls well short of compliance plans that the marketers have experienced with in other jurisdictions, in both breadth of scope and depth of detail.

The Board is lifting the restrictions imposed on Centra by Order 15/98 and allowing Centra to offer fixed price offerings from within the regulated utility. That said, recognizing the competitive advantages that Centra would have if it had access to sensitive marketer data, the Board disagrees with Centra that a formal compliance plan is not required. The Board agrees with Direct Energy:

> "At a minimum, if an affiliate entity is not required, a strict compliance regime must be established to prevent any anti-competitive behaviour…" (ref: DEML/Centra 85, DEML final submission p.1)

Centra contributed a substantial quantity of information that assisted in explaining its Standard of Conduct through the information request process. Although Centra's Standard of Conduct contains the basic elements necessary to ensure a level playing field with the marketers, the Board requires more detail to be included in Centra's Standard of Conduct, as proposed in Direct Energy's and Energy Savings' submissions.

Although Direct Energy's extensive Code of Conduct manual was neither submitted nor accepted as evidence, the Board refers to it as an example to be referenced.

The Board requires Centra to codify this information in the Standard of Conduct. Specifically, the Board directs Centra to amend its Standard of Conduct to include the following:

i. that there be physical separation of the Direct Purchase department, which includes a DP supervisor and DP coordinator, from other Manitoba

Hydro and Centra departments, including providing controlled access to the Direct Purchase physical workspace; other staff that have access to sensitive marketer data include the Division Manager - Gas Supply, Department Manager – Gas Market Analysis, Corporate Treasurer, Department Manager – Credit, and Credit Risk and Banking Analyst. The latter perform work related to system supply, fixed price offering, and DP customers. To segregate them would require each of these staff to have two desks/offices, two computers, etc., an unnecessary burden of no benefit to consumers;

ii. more detail on the methods and procedures that will be used to control employee access to databases and other computer programs containing sensitive marketer information - absent segregated work areas, segregated and protected databases will be sufficient to protect sensitive data;

iii. details on the procedures for entering, monitoring progress, and following up of complaints that are entered into the database that is used for logging complaints from customers and marketers. Centra should have a database for filing and tracking any complaints that it receives; it seems reasonable Centra should detail this database in the Standard of Conduct;

iv. a procedure and methodology for the creation, control, use, and monitoring and auditing of the use of call centre scripts. Included in this procedure should be a listing of personnel who are responsible for creating, controlling, monitoring, and auditing of call centre scripts and their usage. The Standard of Conduct must also reference the creation of training programs for call centre staff, and define frequencies and procedures for the training of call centre staff. Centra's call centre staff are the most likely risk with respect to undermining the marketers, and they could do so unintentionally. The Board very decisively limited what the marketers could tell customers during telesales calls with a defined script, so it seems reasonable that Centra's staff should be limited in what they tell consumers. A frequently-asked-questions script should be prepared, with more complicated questions to be passed to the Contract Administrator (the Board shall vet the script); and

v. a procedure for conducting internal audits to demonstrate compliance with the Standard of Conduct. The procedure should include: identification of the personnel responsible for demonstrating compliance, specified frequencies for audits, the documents, databases, and communications to be audited including reviews of call centre calls and other customer communications, the reporting requirements both internally and to the Board, provisions for the development of corrective action plans where deficiencies are identified, and recourses to disciplinary procedures if there are intentional deficiencies or negligence. Centra should also codify in the Standard of Conduct its deadline for reporting breaches to the Board. Centra should audit themselves and identify any problems. For minor problems, Centra should develop a corrective action plan. If Centra determines someone is deliberately undermining the marketer's competitive position, the Utility should begin disciplinary procedures. It should be up to Centra to police themselves, and not wait for complaints from the Board, customers, or marketers.

6.9.2. Sensitive Marketer Information

The Board agrees with Centra's position on what constitutes sensitive marketer data, as outlined in its response to the Board's Question 8 in Order 125/08. The customer name and whether they are under contract are not considered sensitive marketer information.

Centra needs to know the customer name and whether they are under contract with a marketer in order to carry out its distribution utility functions, including billing. Direct Energy has not detailed how Centra knowing the customer name and whether they are under contract with a marketer would give Centra a competitive advantage.

Currently, marketers may direct marketing efforts at the customers of other marketers, which is innocuous since they cannot contract with a customer who is already under contract with another marketer. The Board does not distinguish between Centra or marketers as to marketing to existing Direct Purchase customers.

Further, the Board does not agree with Direct Energy that Centra must refrain from marketing to marketer customers. Centra plans to undertake its marketing activities from within its Direct Purchase department. Although this department may or may not know that certain customers are marketer customers, because of the controls that Centra will have in place, they will not know *when* these customers are available to contract with Centra.

Further, Centra stated it will not prioritize its marketing efforts towards marketer customers. The Board interprets Centra's statement to mean that any direct mail efforts will be broad, and not targeted either at or away from marketer customers.

6.9.3. Customer Consumption

The Board agrees with Direct Energy regarding customer volumes being sensitive marketer information.

Centra is to obtain the customers permission to obtain a customer's past consumption in order to estimate future consumption, and it may use this information to aid in its estimation of the number of customers it can supply under each offering.

This information might also be useful to the marketers in their estimates of volumes to supply to customers. Because of protection of privacy regulations, Centra is unable to provide this information to the marketers without the customer's expressed permission. The marketers may ask their customers for this information when they initially contract with the customer or at any time thereafter. The marketer must also obtain permission from the customer to acquire this information from Centra.

6.9.4. Licencing of Centra

Shell stated that Centra should be licensed as a marketer, with the potential for that licence to be revoked.

The Board does not find this necessary, since Centra and its products will at all times be regulated by the Board. If the Board finds Centra to be grossly in breach of its Standard of Conduct, or if Centra fails to adhere to the directives approved in this Order, the Board has the authority to terminate Centra's fixed price offering program.

And, Centra is the wholly-owned subsidiary of Manitoba Hydro, with Manitoba Hydro's sole shareholder being the Province. Centra and Manitoba Hydro are subject to considerable control and oversight beyond that provided by the Board – the Board of Directors of Manitoba Hydro and Centra Gas, the audit committee of both corporations, legislature, government, departments of government, Auditor General, Ombudsman, Crown Corporations Council, external auditor, media and the general public.

All of Centra's functions are carried out by Manitoba Hydro employees and agents, and Manitoba Hydro's annual report and financial statements are open to scrutiny, with quarterly reports published. The Public Utilities Board monitors Centra on no more than a quarterly basis, through quarterly Primary Gas rate changes, and, also through the public hearings related to Cost of Gas and General Rate Applications.

The Board is of the view that Centra's commitments can be sufficiently monitored to provide assurance that plans for the new program are carried out as approved.

6.9.5. Breaches

Direct Energy requested that there be an adequate remedy process for breaches of the Standard of Conduct. As Centra described in response to IR PUB/Centra

31(d), the Board has broad supervisory authority over Centra stemming from *The Public Utilities Board Act*.

As stated in Order 160/07, the Board is considering the imposition of fines or penalties on market participants for breaches of the Board's requirements, both from its Orders and from the Marketer Code of Conduct. Such fines or penalties could be extended to Centra for breaches of similar scope and magnitude.

As for the timing of resolution of disputes, the Board directs Centra to immediately provide an initial response to the customer and to the Board indicating that Centra has received and logged the complaint, that Centra is investigating, and the deadline that Centra undertakes to respond to the complaint. The Board is satisfied with the 60-day resolution deadline, and like Centra, expects most disputes to be resolved sooner.

6.9.6. Terminology

Item 5.5 of the Standard of Conduct states that the form of agreement used for fixed price service shall be labelled with "agreement" or "contract". Per the requirements of Order 109/08, only the term "contract" shall be used when describing the form of agreement. This will identify as clearly as possible to all consumers that they are entering a legally binding contract.

6.9.7. Copies of Contracts

As is the case for marketers, Centra must provide each fixed price offering customer with a copy of their contract. Centra must retain the contracts for the same duration of time as specified in the Marketer Code of Conduct, which at the time of this Order is three months after the completion of the contract. Centra must produce these contracts for review at the request of the Board. These requirements are to be enunciated in the revised Standard of Conduct.

6.9.8. Gas Volume Nominations

The Board disagrees with Energy Savings' position that Centra's control over daily and intra-day gas volume nominations gives Centra a competitive advantage.

The implication is that Centra, by virtue of it controlling the daily nominations of gas volumes, somehow obtains a competitive advantage because it has access to that data sooner than it is made available to the marketers. Because of the nature of Centra's fixed price offering program, specifically that it does not involve the physical supply of gas, there is no advantage to Centra. The volumes supplied to fixed price offering customers are the same as for system supply customers.

Centra shall monitor the state of competition and offerings by the marketers in order to assess the volumes of Centra's fixed price offering volumes.

Centra should continue to provide the marketers with notification of changes in the volume nominations in as timely a manner as possible.

6.9.9. Summary

Centra must file with the Board and receive approval of its Standard of Conduct prior to proceeding with its initial fixed price offerings.

7. Board Directives

BE IT ORDERED THAT:

1. Centra Gas Manitoba Inc.'s Application to offer fixed price primary gas products is hereby approved, subject to Centra filing and obtaining approval of the following:

   a. A revised Program Cost Rate which will include Centra's regulatory costs that must be included in the cost allocation model;

   b. The revised Derivatives Hedging Policy;

   c. The revised Derivatives Hedging Operating Principles and Procedures;

   d. The revised form of contract; and

   e. The revised Standard of Conduct.

   These documents and amended Program Cost Rate are to be filed by December 12, 2008.

2. Centra's proposed pricing formula of a hedged price with a Volumetric Risk Premium and a Program Cost Rate is hereby approved.

3. Centra shall inform the Board of the hedge quotes that it receives from its counterparties, and if the lowest quote is not accepted, Centra must explain the reasons why it was rejected.

4. Centra's Volumetric Risk Premium is approved at 5% and shall not be changed without approval of the Board.

5. Centra's marketing plan is hereby approved. The Board expects Centra to apply to the Board if it plans to make material changes to the media used for marketing.

6. Centra is to develop educational materials for consumers to improve their understanding of the natural gas marketplace and their available choices,

and file the drafts with the Public Utilities Board for approval prior to publishing or posting.

7. Centra shall report the financial results of the program, including marked-to-market results, on an annual basis.
8. Centra shall apply to the Board to expand their offerings for two and four year contracts and must also apply to the Board should Centra choose to discontinue any of the offerings approved within this Order.

THE PUBLIC UTILITIES BOARD

"GRAHAM LANE, CA"
Chairman

"GERRY GAUDREAU, CMA"
Secretary

Certified a true copy of Order No. 156/08 issued by The Public Utilities Board

Secretary