M A N I T O B A	**)**	**Order No. 93/10**
	)	
THE PUBLIC UTILITIES BOARD ACT	**)**	**September 14, 2010**

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

CENTRA GAS MANITOBA INC.: REQUEST TO REVIEW AND VARY ORDER 170/09 RELATED TO HEDGING OF PRIMARY GAS

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1.0 Summary

By this Order, the Public Utilities Board (Board) denies Centra Gas Manitoba Inc.'s (Centra) Application to review and vary Board Order 170/09. Centra's hedging of gas volumes for its quarterly set and priced Primary gas product is to cease, commencing with the gas month of August 2011 (in accordance with Board Order 170/09).

In part, due to significant past cost additions resulting from Centra's hedging program, and an expected, called-for, increase in the availability of Centra's Fixed Rate Primary Gas Service (FRPGS), to provide Centra's customers the opportunity to "lock-in" their Primary gas rate for periods of up to five years through Centra, the Board, by Order 170/09, ordered a phase-out of Centra's Primary gas hedging program for Centra's quarterly priced product.

Customers wanting to lock in their Primary Gas rate have the option to do so either through Centra's FRPGS or by contracting with a retail marketer. Customers preferring to pay the "market" price (tempered by the effect of storage gas and other elements of the quarterly set priced product) with rate changes expected over time can do so by remaining on Centra's quarterly-set Primary Gas rate service.

Centra submitted an Application to review and vary Order 170/09, citing three major reasons, the first being that Centra's FRPGS has not sufficiently "developed and matured", that evidenced in part by the fact that less than 1% of its customers had chosen, to-date, to participate in the FRPGS program. Centra suggested that many of its customers are comfortable with the quarterly primary gas rate setting methodology and the mitigation of rate volatility through the process of derivative hedging and prefer that program over contracting for a fixed gas price and term for up to five years. Centra stated that the level of participation in its FRPGS offerings to-date should be a factor when deciding if and when to phase-out its hedging program.

The second reason advanced by Centra for the Board to revise Order 170/09 and permit Centra to continue hedging its quarterly priced Primary gas product was that some larger volume customers (in the High Volume Firm, Mainline, and Interruptible customer classes) prefer to purchase quarterly priced Primary Gas from Centra that has been hedged, this to reduce rate

volatility. Currently, Centra does not offer a FRPGS product for larger volume customers, so, according to Centra, the only options available to such higher volume customers are either Centra's system supply Primary Gas rate (not to be hedged, per Order 170/09) or fixing their Primary Gas rate for a contracted period of time through a gas marketer. Centra contended that the views of these customers represent new information not available at the time the Board issued Board Order 170/09.

Centra's third reason for seeking to reintroduce hedging up to 50% of eligible volumes for its quarterly priced Primary gas product is that, in the Utility's opinion, that approach would represent balance (part way between no hedging and hedging normally expected volumes), one that would reduce the risk of increased costs arising from hedging while affording a significant and reasonable degree of price protection and volatility reduction for all those customers not on a fixed price fixed term contract and using system gas.

In addition to Centra's primary arguments in support of varying Order 170/09 and allowing for the continuation of hedging, albeit to a reduced degree, Centra suggested that it could experience difficulty attracting counterparties (to transact hedges related to its FRPGS offerings) once counterparties are no longer able to transact with Centra for its Primary gas supply. While Centra has observed that current FRPGS volumes (representing only 1% of its system gas volumes) may represent insufficient volumes to attract sufficient counterparties to transact hedges, the Utility has not confirmed with current counterparties that they will not enter into derivative contracts with Centra upon Centra ceasing hedging Primary gas.

In denying Centra's Application, the Board disagrees with Centra that the level of customer participation in Centra's FRPGS program should be a significant factor to consider in a reconsideration of the Board's decision to phase-out Primary gas hedging. The Board has directed and subsequently reiterated its direction that Centra is to continue to offer FRPGS on a continuous basis, to reassure customers of their ability to lock in their Primary Gas rate (if they so choose). It is relevant that the Board has not limited Centra from offering fixed price and term Primary gas products to large volume customers.

As for those larger volume customers, Order 156/08 provided Centra approval to develop a FRPGS for such customers, expecting that the development of such a product would address any demand that may be expressed by such customers, towards mitigating potential future rate volatility. As well, larger volume customers could work with any of a number of licensed private marketers to develop customized solutions to provide price volatility protection for their Primary Gas rates and costs. It is possible that customized solutions could provide larger volume customers with advantages over generic hedged Primary Gas service.

Furthermore, Centra may choose to seek approval to implement additional rate smoothing methodologies for any class of its customers, if it judges that the risk of rate volatility is unacceptable. The Board plans to review Order 170/09 on a regular basis, either as circumstances demand or, at minimum, on a three-year schedule. In future reviews, the Board will consider customer and Utility experience with a quarterly-priced Primary gas product that will no longer involve hedging. The Board will also then-consider the experience with Centra's FRPGS, and any other relevant information.

Accordingly, the Board expects Centra to monitor developments and develop hypothetical prices for Primary gas hedges, so that a retrospective comparison between the now to be un-hedged product with a simulated one involving hedging.

2.0 Introduction

Centra is a subsidiary of Manitoba Hydro (MH) and is Manitoba's largest natural gas distributor. Centra's Quarterly rates are subject to the approval of the Board pursuant to provisions of *The Public Utilities Board Act*.

In Order 170/09 the Board varied Centra's policy on hedging, directing Centra to phase out the placement of hedges for its quarterly-priced Primary Gas offering, also called its "system gas" offering. On July 23, 2010 Centra applied to the Board to Review and Vary Order 170/09, and to continue with its derivative hedging program. Centra's Review and Vary Application requests the Board to approve hedging up to 50% of its system gas.

3.0 Background

Centra hedges its Primary Gas purchases pursuant to a Board-approved policy implemented to reduce rate volatility. Hedging is one aspect of a Primary Gas Rate Setting Methodology (RSM) designed to provide system gas customers with a natural gas commodity price that is less volatile than following market prices. The other components of the RSM include the use of twelve months of forecasted gas prices, used to set quarterly rates, and a Purchased Gas Variance Account (PGVA). The PGVA reconciles the differences between the actual gas costs and the gas costs embedded in rates including the use of storage gas.

Centra's hedging involves entering into derivatives contracts with counterparties independent of the Utility's actual gas purchases - derivatives are strictly financial transactions. Centra purchases system gas at market prices (pursuant to its Primary Gas supply contract with ConocoPhillips Canada Marketing & Trading ULC) and has placed "costless collar" hedges with counterparties to constrain, between a floor and a ceiling price, the price of the volumes of gas hedged.

In reaction to the financial results experienced from hedging, Order 175/06 provided for a "wider" price band for Centra's costless collars; this wider band reduced the magnitude of both hedging gains and losses while providing customers with "protection" from severe price spikes. Natural gas commodity prices are quite volatile, with price swings over the last decade ranging from approximately $3 to $15 per GJ. At $15 per GJ, the average annual heating bill for a residential customer purchasing Primary gas from Centra, with rates set quarterly, would likely have proved unaffordable for a significant portion of the overall customer base.

From the time Centra began hedging approximately nine years ago, Centra hedged up to 90% of its eligible volumes of Primary gas (eligible volumes are volumes forecast for the warmest year on record). More recently, up to 100% of its eligible volumes were hedged.

A key component of Centra's approach to hedging was, at least initially, its "mechanistic" approach, one that included hedging eligible volumes in accordance with firm timelines, the use of costless collar hedges and the required involvement of at least three counterparties in the bidding. The advantage of the mechanistic approach, as cited by the Utility, was the avoidance of "taking a market position" – which is associated with "speculating" as to future market prices.

However, following the major escalation of prices that took place in the winter of 2000/01 and in the aftermath of hurricanes Katrina and Rita in 2005, Centra began taking more of a market view in its hedging actions, a stance accepted by the Board at those times due to the extreme price volatility then being experienced. More recently, in April of 2009, Centra chose to hedge only 50% of its eligible volumes; and, as a further example, in July of 2009, 75% of eligible volumes.

In September 2009, Centra's Board of Directors (represented by the full board of directors of Manitoba Hydro, its parent company) approved a change to Centra's Derivatives Hedging Policy, wherein hedges would be placed for only 75% of eligible volumes. Centra applied to the Board for approval of this revised hedging policy, and, after receiving input from the Consumers' Association of Canada (Manitoba) and the Manitoba Society of Seniors (CAC/MSOS), a registered intervener at Centra's General Rate Application hearings, the Board issued Order 170/09.

Order 170/09 directed Centra to phase-out hedging Primary Gas for system gas customers (from the then-current 75% of eligible volumes to 0%) by August of 2011. The Order directed that for the months of August 2010 through to January 2011, 75% of eligible volumes be hedged; for the months of February 2011 to April 2011, 50% of eligible volumes be hedged, and finally from May 2011 through to July 2011, 25% of eligible volumes are to be hedged.

From August 1, 2011, customers purchasing system gas from Centra may expect rates more reflective of the actual market prices of natural gas, adjusted to account for the cost of gas in storage and the quarterly pricing methodology of the RSM. Customers also have the option of enrolling in Centra's Equal Payment Plan, which reduces bill volatility over the course of the year.

The Board directed the phase-out of hedging, in part, because of the recent availability of Centra's FRPGS – a service the Board directed be introduced to enhance the competitiveness of fixed price and term offerings for consumers (with the continuing availability of fixed rate Primary Gas from retail marketers).

The Board's expectation was that the phase-out period would provide sufficient time to inform customers of the changes to the quarterly-priced system gas product, so as to allow those that prefer additional and more rate certainty to either enter into Centra's FRPGS program or contract with a private marketer of fixed price and term Primary Gas contracts. The Board also expected that Centra would not only provide frequent offerings of FRPGS, allowing residential consumers to enrol at any time, but would also, over time and in response to potential demand, extend the service to other customer classes.

4.0 Application to Review and Vary Order 170/09

Pursuant to Section 44(3) of the *Public Utilities Board Act*, Centra applied to the Board seeking that the Board vary the directions provided on pages 6, 7 and 8 of Order 170/09. Centra requested approval to hedge up to 50% of the eligible volumes of its Primary Gas supply for system gas customers.

Centra noted that its large volume customers - customers within the High Volume Firm, Interruptible, and Mainline customer classes - are not eligible for Centra's FRPGS, and thus the elimination of hedging may introduce greater rate volatility for those larger volume customers. Mr. William Carroll, a representative for several larger volume customers, made a presentation at the most recent Cost of Gas Application proceeding advocating that Centra not cease its hedging of system gas, at least so long as Centra is not offering FRPGS or an equivalent fixed rate and fixed-term Primary Gas option to larger volume customers.

Centra considered the views expressed by Mr. Carroll through his presentation as new information not available to the Board (although a presentation does not qualify as evidence in a Board proceeding) at the time the Board issued Order 170/09.

Centra advised that for a large volume gas user participating directly in the derivatives market is not an effective way to hedge Primary Gas costs, because there are no derivatives available to hedge a utility rate -- derivatives (hedges) are only available for market prices (such as AECO). In Mr. Carroll's view, attempting to hedge a utility rate by purchasing market price derivatives could result in unexpected cost implications, this since the derivative acquired could be "out of the money" (requiring a payment to a counterparty concurrent with an increase in Primary Gas rates).

Centra opined that a large volume customer wanting to "self-hedge" its Primary Gas supply would both need to utilize the Western Transportation Service and establish itself as a licenced marketer, or, alternatively, employ Centra's Transportation Service and procure its own Primary Gas supplies. Both options would require execution of legal agreements with Centra, a purchase contract with a natural gas supplier, and other agreements with hedging counterparties.

To the date of the recent Application, Centra completed FRPGS offerings on four occasions, these to its Large General Service (LGS) and Small General Service (SGS) class customers. The take-up of these offerings was described by Centra as "low", with only 43% of the forecast number of customers expected to take up the offers, representing less than 1% of its overall customer base, contracting for FRPGS. The participation rate in the currently offered FRPGS, Centra's fifth set of offerings, has not been determined, although preliminary indications are that the three year and five-year term offerings will be fully subscribed.

As indicated above, Centra also expressed concern that with the cessation of it system gas hedging program there may not be suitable interest from counterparties to hedge FRPGS offerings, given FRPGS volumes currently hedged are very low in comparison with the volumes hedged for the quarterly-priced system gas product.

As reported, Centra cited three reasons for requesting variance of Order 170/09:

1) Customer uptake of its FRPGS was not sufficient to justify the elimination of hedging, since the participation is less than 1% of Centra's SGS and LGS customer group;

2) New information from the larger volume customer group has been brought to the Board's attention since Order 170/09 was issued. The preference of some members of the large volume customer base is for Centra to continue to hedge its system gas offering, at least until such time as it offers FRPGS to this customer group; and

3) While natural gas prices have remained low, and relatively stable, for the past several months, Centra considers it prudent to continue to hedge 50% of eligible volumes in order to protect its customers from uncertainty and possible future price spikes.

Centra concluded customers have not embraced FRPGS with sufficient interest to warrant the cessation of hedging of system gas, and requests approval to hedge up to 50% of its eligible volumes for its system gas customers.

5.0 Interveners' Positions

5.1 CAC/MSOS' Position

CAC/MSOS supports the directions of Order 170/09, i.e. that Centra cease hedging its quarterly system gas offering. CAC/MSOS requested that the Board dismiss Centra's Application.

CAC/MSOS stated that Centra's Application is outside the time limit allowed by the Board's Rules of Practice. [Section 36(3) of the Rules requires an application to review and vary an order to be filed within 30 days.] Further, CAC/MSOS quoted Section 36(4), which requires the Board to first decide as to whether to hear the review. Being that the Utility's request was made outside of the time provided, CAC/MSOS requested that the Board dismiss Centra's Application on that ground alone. However, if the Board chose to hear Centra's Application, CAC/MSOS posited that there is no error of law, jurisdiction or fact that justifies a review of the order, and that there are also no new facts to justify a review. In the absence of sufficient justification for the review, CAC/MSOS requested that the Board dismiss Centra's Application.

In addition, CAC/MSOS addressed Centra's three reasons for applying to review and vary Order 170/09. First, Centra argued the demand for FRPGS is not robust enough to justify an elimination of hedging. In CAC/MSOS' view, the demand for Centra's FRPGS should not be a precondition to phasing out hedging. The availability of FRPGS, regardless of the participation by Centra's customers, provides other benefits, including a benchmark for the offerings of other retailers.

Second, Centra reasoned that information provided during the Cost of Gas hearings describing the views of the large volume customer marketplace was not available at the time of Board Order 170/09. This information supported continuation of the use of hedging. CAC/MSOS noted the presentation by William Carroll of Carroll and Associates, representing four large volume users, which stated Centra should continue to hedge its quarterly-priced system gas. However, for Mr. Carroll's clients, if hedging is to be phased out, it should be done concurrently with the introduction of FRPGS offerings for larger volume customers, since his clients want to procure their gas from Centra.

According to CAC/MSOS, Mr. Carroll did not clarify why his clients were averse to doing business with the private marketers, as these marketers are competitively vying for his clients' business. CAC/MSOS also stated that as a consequence of Mr. Carroll only appearing at the hearing as a presenter, his presentation was not tested as evidence or cross-examined.

Centra's final reason is that future natural gas pricing is uncertain. CAC/MSOS contended that natural gas pricing is always uncertain, and this does not represent new information justifying a review.

5.2 Just Energy's Position

Just Energy is a natural gas marketer in the Province offering fixed-term, fixed price natural gas contracts to residential and commercial customers. Just Energy, by way of letter dated August 9, 2010, responded to Centra's Application and indicated to the Board that it supports the direction provided by the Board in Order 170/09 and does not support Centra's request to Review and Vary Order 170/09.

6.0 Board Findings

6.1 Review

The Board notes that Centra's Application to review and vary Order 170/09 did exceed the time limit set by the Board's Rules of Practice [Section 36(3)]. That noted, the Board has heard Centra's Application, this for a number of reasons, these being:

1) Natural gas commodity prices are, historically, particularly volatile;

2) Although Primary gas rates have decreased considerably for all customer classes, the costs that result from the rate remain the largest portion of most bills. Thus, any significant issue, particularly one involving a change in approach that may well affect the pricing of Primary gas is worthy of a "second look";

3) Order 170/09 directed a material change be made to the pricing of Primary Gas for Centra's system gas customers, and thus may well have a material impact on Centra's system gas customers at some point; and

4) Centra has indicated that its Application is partially based on "new information" with respect to the preferences of larger volume customers. While the Board does not consider Centra's information concerning the interest of some larger volume customers in hedging to be "new information", it does acknowledge that larger volume customers have high annual natural gas costs and, accordingly, revisiting the decisions and implications of Order 170/09 from the perspective of a larger volume customer is reasonable.

As well, given the past and expected future volatility of natural gas prices, and the materiality of the implications of Order 170/09, reviews from time to time are justifiable and in the public interest.

6.2 FRPGS Offerings

The Board has carefully considered Centra's Application and the reasons for it that Centra advanced. The first reason Centra submits on page 4 of the Application to vary Order 170/09 is that the customer uptake and acceptance of its FRPGS has not matured, and that:

> *…the level of customer uptake in the FRPGS should be a factor to be considered in the timing of the phase-out of derivative hedging for quarterly Primary Gas service.*

The Board disagrees with Centra that the level of customer uptake in the FRPGS should be a major factor in its considering and directing the phase-out of hedging. The Board's main concern remains that there be sufficiently frequent FRPGS offerings, and, as well, that Centra's customers be adequately and continually informed of the nature (including pros and cons) and availability of these offerings.

The Board <u>requires</u> that Centra's customers have the option to fix their Primary Gas rate through Centra, irrespective of the number of customers that choose to do so.

In Order 170/09, the Board stated:

> *That said, Centra needs to do more to assure consumers of their ability to enter fixed price and term contracts for Primary Gas from either Centra or a private broker, such that hedging may be entirely discontinued from the quarterly set prices for system gas.*

And:

> *Therefore, to ensure existing quarterly supplied customers have the time and opportunity to be aware of an intended major change in hedging practices, and to be educated as to the options available to them to secure fixed price and term Primary Gas from Retail Brokers or from Centra, the Board will direct Centra to phase out its hedging of quarterly priced system supply.*

Centra was given notice in Orders 116/09 and 128/09 of the need to expand its FRPGS program with more frequent and continuous offerings:

> *Despite the fact that the Board is predisposed to agreeing with CAC/MSOS and ending hedging for the quarterly set Primary gas product, the Board is not prepared to have Centra cease hedging its default supply until Centra's fixed rate offering program is fully established and ongoing as to offerings.*
>
> *Consumers should have a viable and ongoing alternative to mitigate their rate volatility before the default system supply becomes an un-hedged and potentially more volatile product. [116/09 p.31]*
>
> *[The Board] affirms its view that any ceasing of the hedging of system supply gas should be only undertaken in concert with greater availability and promotion of ongoing Centra fixed rate offerings.[116/09 p.32]*
>
> *Until Centra regularly offers 1, 3 and 5 year fixed price Primary gas contracts to its customers, PUB will not direct an end to Centra's hedging for the Utility's "system gas" offering. [128/09 p.6]*

In light of this previous direction, Order 170/09 gave Centra eight months of notice to phase-out hedging, allowing more than enough time for Centra to ensure that its customers have the ability to participate in FRPGS. Since Order 170/09 was issued, Centra has only released a very limited number of FRPGS offerings, with terms of one, three, and five year durations, and has yet to expand its program to involve larger volume customers.

In Order 55/10, the Board reiterated that, even with the low participation in the most recent offering at that time, Centra was to continue to offer its FRPGS.

On page 51 of Order 55/10, the Board stated:

> *The Board predicated its decision to direct a phase-out of Centra's hedging for its default quarterly service on the availability of FRPGS, so that customers could choose the rate volatility mitigation that best suits their needs and risk appetite.*

The Board remains of this view, and notes that Centra has only recently offered its FRPGS again, this being the first time since March 2010. Thus, Centra has not been complying with Board Directive 8 of Order 55/10:

> *8. Centra is to continue to offer one, three, and five year Fixed Rate Primary Gas Service (FRPGS) offerings to residential and commercial consumers on a regular basis, and consider offering FRPGS to its larger customers (that consideration is to include consultation with larger customers).*

While the availability of FRPGS offerings is the Board's primary concern, the Board is encouraged by the preliminary indication on Centra's website that the three and five-year term of the current FRPGS offerings are fully subscribed. While Centra has not reported the details of the participation in the most current offering, the Board anticipates that full subscription could be due to either a small volume offering size or the participation of a few larger LGS customers.

With this in mind, the Board notes that the apparent experience of the most current offering may reflect the customer preferences expressed in the 2007 Natural Gas Customer Research Report, which included that the majority of Centra's gas customers prefer to lock in their rate for a period exceeding one year.

In summary, the Board reiterates its direction that Centra is to continue to offer FRPGS under the terms directed in Order 156/08, and with a regularity that will permit customers to subscribe to this service in a timely and ongoing basis.

The Board expected that FRPGS take-up rates would be low during times of declining natural gas commodity prices and rates; there should be no surprise to any party with knowledge of the natural gas market. The Board also anticipates that interest in Centra's FRPGS will increase when natural gas prices rise, and it is essential that Centra has offerings available to accommodate interest whenever it develops.

In short, regardless of the interest and uptake in Centra's FRPGS, the offerings are to be available to customers on a continuing basis as stipulated in Directive 8 from Order 55/10.

The Board will therefore direct Centra to provide alternative business models with options which would allow for the continuous availability of FRPGS options to gas customers. Board staff and Advisors are, as always, available to meet with Centra representatives to further explore and discuss options for the FRPGS business model.

6.3 Larger Volume Consumers

Centra's second reason for requesting a variance of Order 170/09 is that the large volume consumers – those in the High Volume Firm, Interruptible, and Mainline customer classes – have explicitly expressed their view that they want Centra to continue to hedge its quarterly priced Primary Gas service, at least until Centra offers a FRPGS to large users.

While Centra claimed that the views of some larger volume consumers represent "new information", the Board did consider the issue of the larger volume user group when issuing Order 170/09. In fact, the Board foresaw the need for FRPGS for large volume consumers when it released Order 156/08:

> *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.*
>
> …
>
> *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.[p.53-54]*

The Board concluded, in Order 160/07, that a competitive market for sale of Primary gas exists for larger volume customers. There are several private brokers offering fixed price and term gas supply to larger users. As such, and even ahead of Centra entering the market, larger volume customers should not have difficulty in obtaining competitively priced fixed rate and fixed term Primary Gas supplies that meet their particular needs for volatility protection.

In the Board's view, and ahead of Centra making fixed price and term offerings to them, large volume consumers have the wherewithal and resources to hedge their own Primary Gas purchases using the services of a licenced retail marketer.

Because of the large volumes of Primary Gas consumed by these customers, a retail marketer has the ability to tailor-fit a Primary Gas supply contract for these users that reflects the term and volatility protection desired by these customers. Centra's past hedging program and its current fixed price and term offerings for SGS and LGS customers were and are generic programs that provide the same level of rate volatility reduction to residential customers as to its largest industrial customers.

The Board is of the view that there are large volume customers that do not share the views of those large volume customers represented at the 2010 Cost of Gas Application. The Board fully expects that there are large volume customers that do not want to lock in their Primary gas supply prices, may not want to pay the additional cost of hedging, or may not want to deal with private brokers or other counterparties.

Instead of continuing to hedge its quarterly-priced Primary Gas rate to placate some, mostly unnamed, larger volume customers, with an approach that may not suit many other large volume customers, Centra has other options.

The Board has already made it clear that Centra may develop a FRPGS for its larger volume customers. Given that there are fewer than 150 larger volume customers eligible for such a service, it should not be onerous to determine the level of demand and the scale of volatility reduction desired by such customers. Working with each customer individually, Centra can and should develop an offering of the term and volume that meets larger volume customer requirements.

As confirmed in previous Orders, Centra can apply to the Board for approval of a larger volume FRPGS at any time. In Order 156/08, the Board stated:

> *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. [p.51]*

6.4 Board Decision

It is noteworthy that the Board has not received a single complaint directly from any customer concerning Order 170/09 and the direction to Centra to eliminate hedging for the quarterly set price product. That said, the Board acknowledges the presentation of a representative of some large customers at the recent Cost of Gas proceeding, which followed the issuance of Order 170/09. It is apparent that consumers have had ample opportunity to contact the Board in the seven months since Order 170/09 was issued. Board Orders are placed on the Board's website, referred to in the Utility's newsletters to gas customers, and made known to the media through media releases.

Elimination of hedging will, according to CAC/MSOS, provide a more accurate price signal to consumers as to the true price of the commodity they are purchasing. RCM/TREE, when they intervened in Centra's 2007/08 and 2008/09 rate Application proceeding, advocated that an accurate price signal is essential for consumers to make informed consumption decisions, that is, whether to conserve or not. While RCM/TREE's position was in reference to an inverted rate-setting scheme, the principle of an accurate price signal is relevant to the issue of hedging.

CAC/MSOS has consistently, over many years, sought for an end to Centra's hedging of system gas. CAC/MSOS, which represent the interests of smaller volume residential customers, stated that there is no new information that would form the basis for the Board to review its Order 170/09, and that participation in Centra's FRPGS is not a gauge that should be used to determine when to cease hedging, since the participation rate in FRPGS is not an indicator of the maturity of those offerings.

Centra took market views in the past with its hedging decisions. In 2001 Centra chose not to hedge, or, more accurately, delayed hedging, despite the Board's approval of the hedging program, and Centra's delays in hedging contributed to additional gas costs in the tens of millions of dollars. In 2006, Centra again took a market view, this time with the Board's support, choosing to delay hedging 50% of its eligible volumes at a time of considerable price volatility. While delaying hedges on 50% of the eligible volumes resulted in cost reductions for consumers, this represented a further deviation from Centra's mechanistic hedging practice.

The proposal now placed before the Board by Centra would provide a hedging policy that would permit Centra to hedge *up to* 50% of eligible gas volumes, with the option to hedge less than 50% (if approved by Centra's Executive Committee). Like the previous hedging policies, the proposed policy would, if accepted, provide for discretion on the part of Centra, and the exercise of such discretion will either increase or decrease gas costs for consumers. Rather than trying to determine when it is an appropriate time to exercise this discretion, or in other words to "beat the market", the elimination of the hedging of system gas removes this burden entirely and leaves to consumers the decision as to whether to lock-in rates or not. The key to making this new approach beneficial for consumers is the ongoing availability of FRPGS offerings.

Centra was given sufficient time to develop its FRPGS offerings and educate its customers about their ability to lock in their Primary Gas rates if they so choose. Some of Centra's customers may wish to pay Primary Gas rates that better and more quickly reflect the market price of natural gas, which Centra has in the past stated reflects the lowest cost for gas over the long term (i.e. not locking in prices for extended periods of time and "going with the market" is alleged to develop lower bills for consumers in the long term than entering into fixed price and term contracts of up to five years, which, understandably, reflect market price risks).

Some larger volume customers may likewise wish to pay only the lowest cost for gas over the long term. For larger volume customers, retail marketers can provide a customized rate that incorporates the volatility reduction desired by these customers. Alternatively, the Board has previously recommended, and reiterates that recommendation at this time, that Centra develop a FRPGS for these larger volume customers. Ahead of introducing a FRPGS program for larger volume customers, Centra should consult with these customers.

It is for the above reasons that the Board denies Centra's Application to review and vary Order 170/09, and, once again, directs Centra to provide opportunities for customers to lock-in rates through FRPGS offerings.

6.5 Loss of Hedging Counterparties

One of Centra's concerns about the cessation of its hedging program for its system gas customers is the loss of interest from hedging counterparties in conducting further business with Centra. Centra currently uses these same counterparties to hedge its FRPGS offerings. FRPGS hedges are considerably smaller than the hedges placed for Centra's system supply. A counterparty may not feel it is worth the time and effort to hedge such small volumes of gas. As a result, when Centra ceases system supply hedging, it may be left with no counterparties to hedge its FRPGS.

The Board is concerned about the possible loss of counterparties, and would like more information as to the other options Centra has to hedge its FRPGS. It is the Board's understanding that companies in the business of hedging gas supplies will be interested in continuing that business with Centra, albeit, perhaps, at a higher price.

The Board is of the view that Centra has not sufficiently explored options for continuing to hedge its FRPGS, to address the potential event that its current counterparties will no longer express interest in doing so. Further, the Board is interested in understanding the magnitude of the margin costs for Centra's FRPGS hedges.

The Board requests correspondence from Centra on these matters.

6.6 Changes to the RSM

Centra has expressed concern that the cessation of hedging of its system supply will lead to excessive and unnecessary volatility of its Primary Gas rate. During oral testimony in Centra's most recent Cost of Gas proceeding, Centra witnesses suggested that Centra was considering introducing additional rate smoothing methodologies in light of the Board's decision to cease hedging of Centra's system supply. It appears to the Board that Centra has chosen not to pursue this option. Once again, the Board suggests additional consideration is very much warranted.

The Board notes that there are other options available to Centra to mitigate rate volatility.

The first iteration of the current RSM was introduced by Centra in early 2000, and approved by the Board in Order 55/00. At that time, the derivatives hedging program was not mechanistically implemented, as it has been in more recent years. Additional rate smoothing was achieved by incorporating only 50% of the difference between the updated 12 month future price of gas, weighted for gas in storage and the current sales rate from the previous quarter.

Under this RSM, the run up of natural gas prices in the spring of 2001 caused the Primary Gas PGVA to increase to over $100 million. In order to limit the potential growth of the PGVA in the future, the Board approved a change to the RSM such that 100% of the updated twelve-month future price of gas, weighted for gas in storage, was used to establish the Primary Gas sales rate for the upcoming quarter.

The current RSM was developed and refined over a period of several years, and it has served Centra's ratepayers well. The Board is open to hearing from Centra about any proposed alterations to the RSM to achieve additional rate smoothing.

If Centra is of the view that such rate smoothing is required, a balance will need to be maintained between rate smoothing and the potential for sizeable accumulations in the PGVA (which can well lead to material intergenerational inequity). In the event that the Primary Gas PGVA experiences an unusually large accumulation, Centra has the option of bringing forward an Application to amend the Primary Gas rate, even between its scheduled quarterly applications.

Such an application should be of the same form as the regular quarterly applications, with the expectation that the PGVA would be refunded to, or collected from, customers over the customary twelve-month period. By changing the Primary Gas rate more frequently, Centra can prevent a large run-up in the PGVA.

To address the potential for Centra proposing changes to the RSM in the future, the Board reiterates its priorities for the RSM (as were articulated in Order 55/00):

> *…the Board considers market responsiveness should be ranked first followed by frequency and oscillation of changes, magnitude of rate changes, and finally, simplicity of implementation.*

6.7 Future Review

Barring the unexpected, the Board plans to revisit the question of hedging of Primary Gas for system supply customers in three years' time. That said, in the eventuality that Centra is unable to secure hedges for its FRPGS, it is to advise the Board immediately.

Centra should prepare for a regular retrospective testing of hedging versus not-hedging experience, by recording representative hedge prices during the three-year time frames established above.

Based on Centra's report "Retrospective Review of the Derivatives Hedging Program For Primary Gas", dated July 2005, the Board understands that Centra will be unable to "exactly" determine hedge quotes without actually placing hedges. To address this acknowledged problem, Centra should identify a proxy and consistently use the proxy selected in tracking the theoretical and simulated results of maintaining its now denied proposed system gas hedging program.

7.0 IT IS THEREFORE ORDERED THAT:

1. Centra's Application to Review and Vary Order 170/09, and to allow Centra to continue to hedge 50% its Primary Gas system supply volumes, BE AND IS HEREBY DENIED;

2. Centra report to the Board within 90 days of the date of this Order, with new proposals for alternative business models / options to allow for the continuous availability of FRPGS options for gas customers;

3. Centra report to the Board as to options for hedging its FRPGS offerings, in the event that current counterparties discontinue to provide hedges and new counterparties cannot be involved (Board staff and Advisors remain available for discussion with Centra representatives to explore options); and

4. Centra immediately inform the Board if it is unable to hedge its FRPGS offerings.

THE PUBLIC UTILITIES BOARD

"GRAHAM LANE, CA"
Chairman

"H. M. SINGH"
Acting Secretary

Certified a true copy of Order No. 93/10
issued by The Public Utilities Board

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Acting Secretary