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MANITOBA PUBLIC UTILITIES BOARD

Re: CENTRA GAS MANITOBA INC.
 2007 COMPETITIVE LANDSCAPE PROCEEDING

Before Board Panel:

- Graham Lane - Board Chairman
- Len Evans - Board Member
- Eric Jorgensen - Board Member

HELD AT:

Public Utilities Board
400, 330 Portage Avenue
Winnipeg, Manitoba
September 4th, 2007

Vol I

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APPEARANCES

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18) & Energy Savings
19) (Manitoba) Limited
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APPEARANCES (CONT)

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

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9	PUB/DEML/ESMLP-7-26	The Public Utilities Board's	
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14	CENTRA-2-1	Affidavit of publication and	
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18	CENTRA-3-1	Witness Qualification of Vince Warden	
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20	CENTRA-3-3	Witness Qualification of Greg Barnlund	
21	CENTRA-3-4	Witness Qualification of Robins Wiens	
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10	CENTRA/CAC/MSOS-4-2	Centra Gas Manitoba Inc.'s
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13		Canada (Manitoba) Inc. and
14		Manitoba Society of Seniors'
15		Response. Comparison of mortgages
16		with fixed price gas contracts
17	CENTRA/CAC/MSOS-4-3	Centra Gas Manitoba Inc.'s
18		Information Requests and
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20		Canada (Manitoba) Inc. and
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10	CENTRA/CAC/MSOS-4-5	Centra Gas Manitoba Inc.'s
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14		Manitoba Society of Seniors'
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17	CENTRA/CAC/MSOS-4-6	Centra Gas Manitoba Inc.'s
18		Information Requests and
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21		Manitoba Society of Seniors'
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10	CENTRA/CAC/MSOS-4-8	Centra Gas Manitoba Inc.'s
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21		dated August 20, 2007 on behalf of	
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23	DEML/ESMLP-1	Evidence of Direct Energy Marketing	
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16	DEML/ESMLP/CENTRA-2-71 Direct Energy Marketing Limited/ 17 Energy Savings Manitoba LP's 18 Information Requests and Centra Gas 19 Manitoba Inc.'s Response. Focus Group 20 Report
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15	DEML/ESMLP/CAC/MSOS-3-2	Direct Energy Marketing 16 Limited/Energy Savings Manitoba LP's 17 Information Requests and Consumers' 18 Association of Canada (Manitoba) Inc. 19 /Manitoba Society of Seniors Responses	
20	DEML/ESMLP-4	Rebuttal Evidence of Professor Philippe 21 Cyrenne dated June 11, 2007	
22	DEML/ESMLP-5	Motion filed by D Direct Energy Marketing 23 Limited/Energy Savings Manitoba L.P. 24 on July 24, 2007	
25			

1 --- Upon commencing at 9:05 a.m.

2

3 THE CHAIRPERSON: All right. Good
4 morning everyone. Welcome to the Public Hearing in
5 respect to the Manitoba Natural Gas Landscape Proceeding.

6 In this Hearing the Board expects to hear
7 evidence and consider issues related to the means to best
8 serve Manitobans' natural gas needs.

9 I think introductions are probably
10 unnecessary but in any case I'm Graham Lane, Chairman of
11 the Public Utilities Board, and I am joined on this
12 Hearing Panel by Len Evans and Eric Jorgensen. Also
13 assisting are Gerry Gaudreau, Board Secretary and
14 Executive Director and Gerry Barron, Associate Secretary.

15 By way of public notices, the Public
16 Utilities Board of Manitoba has given notice of its
17 intention to hold a review of the competitive natural gas
18 landscape in Manitoba and request that stakeholders
19 submit their views.

20 The general purpose of the Competitive
21 Natural Gas Landscape Proceeding is to evaluate the
22 current market structure and determine the optimal way to
23 serve customer needs.

24 In addition to the matters raised by the
25 stakeholders, the Board provided a list of related issues

1 for consideration. These related issues include the
2 potential abandonment of Centra of hedging for its
3 current system gas offering, with possible amendments to
4 the rate setting mechanism to mitigate the effect of
5 leaving hedging.

6 b) The establishment of the equal
7 payment plan as a default condition, with respect to
8 system gas customers.

9 c) Centra entering the fixed price,
10 fixed term market in competition with natural gas
11 marketers.

12 d) Amendment to Centra's supply
13 arrangements to facilitate improved broker service.

14 e) The allocation of Centra's costs
15 associated with the operations of natural gas brokers, to
16 brokers.

17 f) Forecast implications of changes to
18 the competitive natural gas landscape in Manitoba.

19 g) The nature and extent of competition
20 in the natural gas market.

21 h) The terms and conditions of fixed
22 price contracts.

23 I) The marketing model and practices of
24 gas brokers.

25 j) The rules and practices for

1 enrollments, terminations, termination and switching of
2 suppliers, and;

3 k) The code of conduct for gas brokers.

4 The Board has received evidence filed on
5 behalf of CAC/MSOS, Centra Gas/Manitoba Inc. and Direct
6 Energy Marketing Limited in cooperation with Energy
7 Savings Manitoba Limited partnership.

8 In addition to the pre-filed evidence and
9 rebuttal evidence, there has been Information Requests
10 posed by all parties to those who have filed evidence.

11 Additionally, the Board has received two
12 (2) reports from NRG Research Group which addressed
13 natural gas customer research as well as a natural gas
14 customer review focus group report. Related to theses
15 reports there has also been additional Information
16 Requests posed.

17 The Board looks forward to an orderly
18 hearing in which the parties will have the opportunity to
19 provide their views and reasoning to the Board for the
20 various positions that are taken.

21 Following the parties' opportunity to
22 highlight and expand on their positions and to draw the
23 Board's attention -- the Board panel's attention to
24 specific aspects of the evidence, the Board will hear
25 closing submissions from the parties.

1 To assist the Board, in terms of the
2 procedures proposed to this Hearing, I now turn to Board
3 Counsel, Mr. Peters, for his introduction, opening
4 remarks, as well as the proposed procedures for the
5 Hearing. Bob...?

6 MR. BOB PETERS: Thank you, and good
7 morning, Mr. Chairman, Board Member Dr. Evans, Board
8 Member Mr. Jorgensen, ladies and gentlemen.

9 For the record, my name is Bob Peters and
10 I appear as Counsel to the Board in this proceeding. I
11 am assisted by the Board's accounting advisor, Roger
12 Cathcart of Cathcart Advisors, Inc. on my left, and the
13 Board's engineering advisor, Brady Ryall of engineer --
14 sorry, of Energy Consultants International.

15 As mentioned by the Chairman, the purpose
16 of this proceeding is to evaluate the current market
17 structure in Manitoba for natural gas, and determine the
18 optimal way to serve customer needs.

19 To assist the parties in focusing on the
20 various topics, the Board provided a list of the issues
21 that was contained in the public notices, as well as
22 reviewed by the Chairman in his opening comments. And in
23 addition to those issues, the parties may have further
24 matters they want to advance before the Board, and
25 they'll be given that opportunity through these

1 proceedings.

2 In response to your specific request, Mr.
3 Chairman, to discuss the procedures, I have circulated to
4 the parties and the Board an outline of procedures
5 document, that I propose be followed in this Hearing.
6 You'll find it on yellow paper, amidst the mass of paper
7 that I'm sure you already have. And let me briefly walk
8 through it. I will make my suggestions and, of course,
9 invite my colleagues, if they have any revisions or
10 suggested revisions to certainly speak to that when their
11 opening comments are being provided.

12 Mr. Chairman, Board Members, as you will
13 see from September the 4th, summer is truly over now,
14 that we're back in session, and I'm looking at the
15 opening comments. I have taken the liberty of dividing
16 the Intervenors that registered for both the General Rate
17 Application and this Competitive Landscape Hearing into
18 active parties and those that are monitoring.

19 And in terms of active parties, I see Mr.
20 Saxberg here on behalf of his client, CAC/MSOS, and the
21 client Ms. Desorcy, behind him, and he his witnesses with
22 him this morning that he will later introduce.

23 Centra appears with Ms. Murphy and Mr.
24 Czarnecki.

25 And Direct Energy/Energy Savings Manitoba

1 Limited Partnership is represented by Erik Hoaken, also
2 present today.

3 In terms of parties monitoring, I don't
4 see - as I look around the Hearing room - them present,
5 but that's not to say we shouldn't canvass and to make
6 sure. But those were the parties that did register for
7 the General Rate Application and/or this Hearing. And
8 their level of interest, some has been communicated by e-
9 mails that they will simply be monitoring.

10 Following the opening comments, Mr.
11 Chairman, on the second page, number 2, of the items to
12 follow, CAC/MSOS will put forward a witness panel
13 scheduled for today and tomorrow, and perhaps also
14 Thursday. Following that will be a senior Vice-President
15 from NRG Research Group to speak to the -- two (2)
16 reports that you mentioned, Mr. Chairman, in your opening
17 comments. And we hope to complete that evidence this
18 week.

19 Then following, essentially a week away,
20 we would resume on September 17, 18 and 19 for Centra's
21 witness panel. That would be followed the following week
22 by the Direct Energy/Energy Savings witness panel on
23 September 24, 25 and 26. And Direct Energy and Energy
24 Savings have a rebuttal witness that they will put
25 forward, on approximately either September 26 or

1 of procedures are the dates for closing submissions and
2 that is a matter, Mr. Chairman and Board Members, that I
3 will work with the Board Secretary on and confirm shortly
4 to the parties. It's my present understanding that there
5 may be an opportunity to reserve a couple of consecutive
6 days before this panel, in or around the middle of
7 October, for parties to provide their oral closing
8 submissions. Now once I have that matter attended, I
9 will certainly advise the Board and seek their
10 concurrence as to the dates that have been selected.

11 At this time, Mr. Chairman, I would also
12 like to speak to the draft exhibit list that Mr. Singh,
13 the Board's Associate Secretary, has prepared and
14 circulated. It's my understanding that this draft twenty
15 (20) page exhibit list was circulated to all parties and
16 that any comments they have can be provided either to me
17 at the break or during their opening comments this
18 morning.

19 In an effort to facilitate the
20 proceedings, I propose to enter the exhibits as contained
21 on the draft exhibit list, again, subject to any
22 revisions or corrections that the parties may advise me
23 or the Board about in their comments.

24 These exhibits include the public notices
25 of the Hearing, together with the Pre-hearing conference

1 procedural order and its transcript, as well as
2 Information Requests posed by all parties, including
3 Board Counsel, through the parties filing the evidence.

4 Mr. Chairman, the Board will have recently
5 received responses, or revised responses, to questions
6 posed by Direct Energy/Energy Savings of Centra,
7 particularly numbers 47 and 68, and those will be in a
8 separate binder or provided separately.

9 I can indicate as well that there has been
10 a transcript of the focus group sessions prepared and
11 filed, I believe yesterday, and to the best of our
12 collective memory those transcripts are in response again
13 to an amended Information Request posed by Direct Energy
14 and Energy Savings so they will simply form part of that
15 -- that Information Request.

16 What is not included as an exhibit, to my
17 knowledge at this time, would include the data tables
18 that the Board has -- that have been provided by Centra,
19 as well as something known as SPSS data which were
20 produced. And those may or may not be marked as
21 exhibits, and if counsel determines that they want them
22 marked, certainly we'll provide them with an exhibit
23 number.

24 I can indicate lastly, in terms of late-
25 breaking exhibits, there's been an update to Direct

1 Energy/Energy Savings Manitoba Centra question number 60,
2 and that came over on August 31st in about three (3)
3 batches on the e-mail, the better part of five hundred
4 (500) pages again, and that will be part of Centra
5 Exhibit 60 in the filing.

6 I hope that's not confusing, but as a
7 suggestion, Mr. Chairman, when and if further exhibits
8 are filed, I'll also ask the parties to the proceeding to
9 draw the Board's attention to what exhibit number they
10 suggest that their documents be provided. I can indicate
11 that the PUB exhibits are from 1 to 8, CAC/MSOS's
12 exhibits are from 1 to 4, Centra has -- exhibits given 1
13 to 7, and Direct Energy has exhibits from 1 to 6 -- I'm
14 sorry 1 to 5, and their next one would be document number
15 6.

16 Mr. Chairman, subject to any questions
17 that you may have of me at -- of me at this time, I'll
18 conclude my opening comments by suggesting you turn to
19 the active parties on the list of proceedings for their
20 opening comments. And as I indicated, although I don't
21 see any of the parties who I understand to be monitoring
22 these proceedings present, you may want to go down the
23 list of those parties to see if they are in attendance,
24 and if so what their level of participation will be.

25 So thank you, Mr. Chairman, Board Members,

1 ladies and gentlemen. I suggest, Mr. Chairman, you turn
2 it over to Mr. Saxberg for his opening comments before
3 canvassing the other parties to the proceedings and then
4 calling for CAC/MSOS to introduce and have their witness
5 panel sworn.

6 THE CHAIRPERSON: Thank you, Mr. Peters.
7 Mr. Saxberg...?

8 MR. KRIS SAXBERG: Thank you, sir. The
9 last time that natural sales market -- the natural gas
10 sales market in Manitoba was reviewed, was 1996.

11 Mark Stauff, who's our witness and you'll
12 hear from later today, was there. Mr. Peters was there.
13 The rest of us weren't -- well, maybe -- I guess Howard
14 was there and maybe some others. But for the most part
15 this is a new group of people that are interested in this
16 issue, but I would put to everyone that the object of the
17 exercise back in 1996 was to ensure that there was
18 choice, a good variety of choice for consumers at a fair
19 price.

20 And here we are eleven (11) years later
21 and the objective remains the same: How do we structure
22 the market so that consumers have the most choices
23 available to them at fair prices?

24 The Board Order that came out of that
25 first Competitive Landscape Hearing had a vision which

1 was to grow the unregulated competitive environment. And
2 some of the mechanisms to do that were providing some
3 incentives, and we might argue, subsidies to companies to
4 set up shop here and to sell unregulated products.

5 So with that, good morning, Mr. Chairman
6 and Board Members, ladies and gentlemen. You're going to
7 hear from CAC/MSOS throughout this proceeding, and in
8 particular as we deliver our evidence in these first two
9 (2) days, our position that the vision of how the
10 competitive marketplace was going to unfold didn't come
11 to fruition, and that something needs to be done about
12 it. And you'll hear from us that our view is that having
13 Manitoba Hydro enter that market is, from our
14 perspective, the solution to the -- to the -- the fact
15 that the competitive market hasn't developed as everyone
16 hoped it would.

17 In terms of the issue list, I'm just going
18 to quickly set out the issues that we are addressing, and
19 really what we've done is taken the Board's list of
20 issues that was read out earlier and simplified it. And
21 our issues then would be:

22 Number 1. The first question is the issue
23 of whether competitive offerings, the competitive market
24 itself, generates a benefit for consumers.

25 The next big question is whether or not

1 Manitoba Hydro, on a regulated basis, should be allowed
2 to compete against unregulated retailers in this
3 competitive market.

4 The next big question is whether there
5 should continue to be any form of incentive or subsidies
6 to retailers to sustain or promote the competitive
7 market.

8 Fourth issue is relating to the marketing
9 practises of brokers, and specifically the mechanism of
10 door-to-door sales.

11 Fifth. If Centra or Manitoba Hydro is
12 allowed to compete in the competitive market, what should
13 the default gas rate look like and should it contain a
14 hedging component.

15 And finally, the issue of whether the
16 equal payment plan should be set as a default.

17 With me is Gloria Desorcy, at the back row
18 here. She is the head honcho, or Executive Director, at
19 the Consumer Association of Canada, Manitoba Branch. And
20 beside her making a timely entrance is Lori Hunter who is
21 Executive Director and of the Manitoba Society of
22 Seniors. And they will be in attendance throughout the
23 proceedings, as far as their schedule allows, and -- and
24 needless to say that as representatives of their
25 organizations they take a keen interest in this

1 proceeding.

2 And I'll introduce, just briefly right
3 now, the witnesses. To my left at the -- at the -- to my
4 far left is Dr. Marc Van Audenrode, and beside him Mark
5 2, Mark Stauff. And the -- the only other face that
6 isn't here is Ivan Holloway from D'Arcy & Deacon, who may
7 be assisting me or replacing me at various points during
8 this Hearing. Those are my introductory comments, thank
9 you.

10 THE CHAIRPERSON: Thank you, sir. Ms.
11 Murphy, or Mr. Czarnecki...?

12 MS. MARLA MURPHY: Good Morning. Good
13 morning, Mr. Chairman, Members of the Public Utilities
14 Board, Board advisors, Intervenors and ladies and
15 gentlemen.

16 For the record, my name is Marla Murphy
17 and I, together with my colleague, Mr. Czarnecki, will be
18 representing Centra Gas Manitoba Inc. throughout the
19 course of this Competitive Landscape Proceeding.

20 Centra's very pleased to take part in this
21 proceeding to address the philosophical questions and
22 issues which the Board has outlined in its notice to this
23 proceeding. These are very important issues and the
24 direction which the Board will provide in its order
25 flowing out of the proceeding, will guide and shape the

1 natural gas market in Manitoba for many years to come.

2 This proceeding is somewhat unusual for
3 Centra, in that we do not appear today as an applicant
4 seeking approvals, but rather as an interested party
5 prepared to discuss, and in some cases debate, the broad
6 issues of the competitive natural gas market and Centra's
7 role in that market in Manitoba including offering a
8 viable and desirable cost base service offering to its
9 customers.

10 Centra is also pleased to be able to share
11 with the Board its views, with respect to the current
12 system gas offering and the role of hedging in that
13 service offering, the equal payment plan, broker service
14 and costs and the rules and practices associated with
15 meeting customer mobility requirements.

16 Throughout the course of this proceeding
17 Centra will, of course, participate in the testing of the
18 evidence put forward by other parties, and will call on
19 its own behalf at least two (2) panels of witnesses.

20 By virtue of some of the scheduling
21 matters we'll present first the evidence of Mr. Andrew
22 Enns of the NRG Research firm, later this week.

23 Thereafter, Centra will present the
24 evidence of the company witnesses, specifically Mr. Vince
25 Warden, Mr. Howard Stephens, Mr. Greg Barnland, Mr. Lloyd

1 Kuczek and Mr. Robert Wiens.

2 The parties have also contemplated that
3 Centra may call a rebuttal economist, to respond to any
4 new or expanded evidence that may be presented during the
5 oral portion of Professor Cyrenne or Dr. Van Audenrode's
6 testimony.

7 Thank you and good morning. Those are my
8 comments.

9 THE CHAIRPERSON: Thank you, Ms. Murphy.
10 Mr. Hoaken...?

11 MR. ERIC HOAKEN. I'm out of practice on
12 that one, Mr. Chair. Good morning and good morning to
13 the Board Members, Evans and Jorgensen.

14 My name, for the record, is Eric Hoaken.
15 I have been counsel to Direct Energy in past proceedings
16 at this Board, and in order to achieve greater efficiency
17 in their interventions here, both Direct Energy and
18 Energy Savings decided to have one (1) counsel speak for
19 both of them and that is going to be me; that's a long
20 winded way of saying, therefore, that I appear this
21 morning on behalf of those two (2) companies, which I
22 will refer to collectively as the Retailers.

23 To my immediate right is Ms. Ruzycki,
24 who's known to many, if not all of you, as the Director
25 of Regulatory Affairs at Energy Savings. Ms. Karen

1 Melnychuk of Direct Energy was to be here today; she's
2 had an unfortunate and unforeseen personal event happen.
3 While it has prevented her from being here I'm hopeful
4 that she will come somewhat later this week.

5 I appreciate, as do my clients, the
6 opportunity to make some opening comments, so let me do
7 that briefly.

8 I should start by saying that my clients
9 view this Hearing as the next step in -- in evolution
10 that was expressly contemplated and commented upon by the
11 Board in the Order that Mr. Saxberg made reference to and
12 I'm talking, of course, about Board Order 15/98.

13 In that decision it is, I think, clear
14 that the Board and the parties expected that the
15 continued transition to a fully competitive market would
16 take both some time and some work, and that there would
17 be a revisiting at some stage by the Board of the
18 appropriate regulatory approach to take.

19 And to this -- excuse me, to the extent
20 that this Hearing represents that revisiting, we welcome
21 it and we commend the Board for recognizing that the time
22 was ripe to take stock, as it were, of the current state
23 of the competitive market in this province.

24 One (1) of the central recognitions in the
25 Board's Order that I made reference to, was that

1 competition, in and of itself, is not a goal, and that in
2 order to be desirable, competition has to produce
3 benefits.

4 In its Order in 1998 the Board concluded
5 that there were such benefits. And for example, without
6 being exhaustive, I would note that at page 65 of that
7 Order the Board stated that while Manitobans -- or excuse
8 me -- while not all Manitobans have chosen to purchase
9 their gas requirements through brokers or marketers, all
10 customers have benefited from the evolution of the
11 natural gas marketplace.

12 And I suggest that the evidence in this
13 Hearing will demonstrate that Manitoba consumers have
14 most certainly continued to benefit since the time that
15 those words were written, from the presence of
16 competition in this market.

17 Now, in its Order in 1998, the Board also
18 concluded that there were "imperfections;" I think is the
19 word that is used. What it meant, I took from that, was
20 room for improvement or development in the market.

21 And in making that recognition, the Board,
22 I think if you read that decision and I'm sure all of us
23 have gone back and looked at it in the past few weeks or
24 months, in the course of making that recognition, the
25 Board then turned its mind to what it could do to remedy

1 those imperfections. And I predict that the evidence in
2 this Hearing will also establish that there are
3 imperfections or room for improvement in the competitive
4 marketplace in Manitoba in 2007.

5 And I say that the approach that the Board
6 takes to these imperfections in 2007 should be the same
7 approach it took in 1998, one of remediation.

8 So in other words, I say to you at this
9 early stage, I think all of the sub-optimal aspects of
10 the current competitive market are going to be shown on
11 the evidence to be amenable to remediation, or attempted
12 remediation, by the Board in a manner that is consistent
13 with the central observations that the Board made in its
14 1998 Order.

15 Now, let me just quickly say a word about
16 the nature of the imperfections in the market. In its
17 1998 decision, the Board said that the impediments to a
18 competitive retail market at that time included Centra's
19 long-term storage, transportation, and supply contracts.

20 And I submit that the evidence is going to
21 demonstrate that these factors continue to be impediments
22 to the development of a fully competitive market, and
23 that more broadly, Centra's role in the retail market as
24 well as -- and I think this is an important distinction --
25 - its perception of the role that it should play and

1 wants to play are substantial contributors to the present
2 market imperfections.

3 And this is a proposition that is going to
4 be at the heart of the evidence that my clients present
5 and elicit in the course of this Hearing.

6 Now, at the risk of sounding or perhaps
7 actually being presumptuous, let me just say a word about
8 the importance of the Board's role or task in this
9 Hearing. It is obviously a crucially important one.

10 The Board is effectively the guardian of
11 the public interest. It is responsible for ensuring that
12 the benefits being produced from competition, in the
13 retail natural gas market, are not only continued but
14 enhanced.

15 The retailers will be contending, in the
16 course of this proceeding, that the approaches and
17 conclusions of regulators in other jurisdictions are
18 directly applicable and relevant to the issues that are
19 being canvassed in this proceeding.

20 And that being the case, I very
21 respectfully would suggest that the Board should, as it
22 hears the evidence about how regulators in other
23 jurisdictions have approached these issues, it should
24 consider whether there is anything in the Manitoba
25 marketplace that warrants diverging from the approaches

1 taken in those jurisdictions.

2 The position of my clients at the
3 conclusion of this Hearing, I anticipate, will be that
4 based on all the evidence it hears, the Board will have
5 to fashion orders and directives that will further
6 enhance the development of a competitive market in this
7 province, to ensure that benefits continue to be passed
8 on to consumers.

9 Now, finally, let me switch gears and say
10 on a personal note, I'm delighted to be back in this
11 province, certainly at this time of year, Mr. Chair, and
12 delighted to have the opportunity to take part in this
13 Hearing and to work with the counsel that I have worked
14 with previously.

15 I should also say that my clients very
16 much appreciate the opportunity to participate in this
17 proceeding and have the opportunity to present their
18 perspective, which is precisely what they will be doing
19 over the next few weeks.

20 Thank you.

21 THE CHAIRPERSON: Thank you, Mr. Hoaken.

22 As Mr. Peters indicated earlier, unless my
23 eyesight has completely gone, I don't see any of the
24 monitoring parties either; them being, Sandy Boyd for CEP
25 Local 681, Mr. Kerr for Coral Energy, Mr. Hill for Koch,

1 Mr. Gretner for Simplot, or Mr. Gange for RCM/TREE. But
2 perhaps they will attend at some point during the
3 proceedings.

4 So now we'll go back then to Mr. Saxberg,
5 if you want to complete your introduction of your
6 consultants and then we'll swear them in and get
7 underway.

8 MR. KRIS SAXBERG: Thank you, Mr.
9 Chairman. I have already introduced the Panel Members,
10 they are ready to be sworn in.

11 THE CHAIRPERSON: Mr. Singh...?

12

13 CAC/MSOS PANEL:

14

MARC STAUF, SWORN

15

MARC VAN AUDENRODE, SWORN

16

17

(VOIR DIRE)

18

19 EXAMINATION-IN-CHIEF BY MR. KRIS SAXBERG

20

21

22

MR. KRIS SAXBERG: Good morning, Mr.
Stauf. You're responsible for preparing written
evidence in this proceeding?

23

MR. MARK STAUF: Yes.

24

25

MR. KRIS SAXBERG: And for everyone's
information, Mr. Stauf's evidence is marked as CMC/MSOS

1 Exhibit number 1.

2 In addition to your evidence, Mr. Staft,
3 you have given answers to Information Requests posed to
4 you by the Board, Centra and the retailers?

5 MR. MARK STAFT: That's correct.

6 MR. KRIS SAXBERG: Do you have any
7 corrections to make to your evidence or with respect to
8 your Information Request responses?

9 MR. MARK STAFT: No, I do not.

10 MR. KRIS SAXBERG: And I take it, then,
11 that you adopt that information in evidence here today?

12 MR. MARK STAFT: I do.

13 MR. KRIS SAXBERG: Could you please
14 describe your qualifications and experience, relative to
15 the issues outlined in the notice to this Hearing?

16 MR. MARK STAFT: Yes. Included as
17 Appendix 1 to my testimony, is a CV or resume that sort
18 of sets out, quite broadly, my experience and
19 qualifications in regulatory matters. From about 1986
20 until 1999 I was employed by TransCanada Gas Services, as
21 it ultimately was known, which was the gas marketing
22 affiliate of TransCanada Pipelines. And throughout most
23 of that period I was basically the person in charge of
24 TCGS' efforts in regulatory forums across North America.

25 Before deregulation, TransCanada was the

1 supplier of Canadian gas to basically everyone east of
2 the -- east of Saskatchewan, both in the domestic market
3 and the export market. And deregulation in the mid '80s,
4 1986, ultimately left TCGS with a lot of gas to sell, in
5 an environment that was basically just being made up by
6 everyone as we went along in those early days. And so
7 doing that and meeting that challenge, required the
8 company to deal with and find solutions for a great many
9 issues involving access to regulated systems and rates
10 and competitive issues of various kinds.

11 TransCanada's -- TCGS' biggest market, at
12 least in those days, was domestic distributors. And
13 probably one of its biggest challenges was dealing with -
14 - well, was competition for the load that was served by
15 the domestic distributors. The company was therefore
16 vitally interested in the nature and extent and
17 underlying economics of competition in the domestic
18 markets, both at the wholesale and the retail levels.

19 A big part of my job, therefore, was to
20 understand all of that and understand how it affected my
21 employer's interests and to direct our activities in
22 dealing with -- well, our activities in regulatory --
23 regulatory proceedings in Canada.

24 Now, in the mid 1990s, sort of after the
25 initial adjustment was made to deregulation, sort of in

1 the -- in the industrial markets and in the export
2 markets, questions came to the fore about competition at
3 the retail level for small volume customers. And this
4 happened more or less simultaneously in Manitoba and in
5 Ontario, both of which have really been sort of, I think,
6 on the forefront of this kind of inquiry, just over the
7 entire period since -- since 1986.

8 In Manitoba that took the form of the
9 proceeding that has been referred to already by Mr.
10 Saxberg and Mr. Hoaken, that resulted in this Board's
11 Order 15/98. And in Ontario it took the form of what was
12 called the Ten Year Market Review, which was a -- not so
13 much a hearing process so much as a very extended
14 consultative process with a number of stages in it.

15 In any event, I was involved in both of
16 those processes very, very heavily. And essentially my
17 entire job from probably 1996 through to 1998 was dealing
18 with, in one way or another, issues related to
19 competition at the distributor level, particularly for
20 small volume customers.

21 So in terms of my experience that's
22 relevant to -- to this proceeding, I would say that is
23 most -- that was basically what it -- what it amounted
24 to.

25 MR. KRIS SAXBERG: And could you comment

1 briefly on your experience with respect to gas markets?

2 MR. MARK STAUFF: Well, as I was saying
3 earlier, TCGS had a significant problem on its hands,
4 starting in 1986, of trying to maintain and expand
5 markets for the gas supply that it was -- that it had
6 under contract, and so I, as I said, was responsible for
7 dealing with the regulatory aspects of those marketing
8 efforts.

9 And what that involved was being able to
10 understand and synthesize concepts around how gas markets
11 work, how gas transportation markets work, how
12 competition is effective or not; this is not just at the
13 retail level, but also at the pipeline or wholesale
14 level.

15 And so in the course of that I necessarily
16 familiarize myself with, and have followed over the
17 years, the evolution of gas markets, both here and in --
18 in the United States, in supply areas, and as well as
19 down -- in downstream market areas.

20 MR KRIS SAXBERG: Thank you, Mr. Stuaft.

21 And with that, Mr. Chairman, Board
22 members, I ask that you formally recognize Mr. Stauff as
23 an expert, with regard to the historical development of
24 the competitive market in Manitoba and elsewhere, and as
25 an expert in gas markets and gas supply.

1 THE CHAIRPERSON: Ms. Murphy, do you have
2 any thoughts?

3 MS. MARLA MURPHY: No, we have no
4 objections.

5 THE CHAIRPERSON: Mr. Hoaken...?

6 MR. ERIC HOAKEN: Just have a few
7 questions that would help me understand the scope of the
8 expertise. If I could start with you, Mr. Saxberg, could
9 you just tell me again how you're at least framing that?

10 MR. KRIS SAXBERG: Sure. As an expert
11 with regard to the historical development of the
12 competitive market in Manitoba and elsewhere -- being
13 Ontario -- and as an expert in gas markets and gas
14 supply.

15 MR. ERIC HOAKEN: And I take it when you
16 say gas markets, you mean retail gas markets?

17 MR. KRIS SAXBERG: Well, that would go
18 hand in glove with the earlier -- with the expert in
19 historical development, but also in the wholesale gas
20 market.

21

22 CROSS-EXAMINATION BY MR. ERIC HOAKEN: (Qual)

23 MR. ERIC HOAKEN: All right. Thank you.
24 Let me just ask a few questions to Mr. Stauff, and I
25 anticipate I won't have any objections. You are, as I

1 understand it, Mr. Stauff, a lawyer by training?

2 MR. MARK STAUFF: Yes, sir.

3 MR. ERIC HOAKEN: Not an economist?

4 MR. MARK STAUFF: That's correct.

5 MR. ERIC HOAKEN: And to the extent this
6 panel -- this Board is going to hear from PhD economists
7 on matters of economic theory and principles, you would
8 defer to those experts?

9 MR. MARK STAUFF: Yes.

10 MR. ERIC HOAKEN: And I've looked at your
11 curriculum vitae and see that you have, in fact,
12 testified in a variety of energy-related hearings. Am I
13 correct, though, that for all of those -- in the year
14 2000 and earlier --all of those have been in your
15 capacity as an employee, either of TCGS or TCPL?

16 MR. MARK STAUFF: That's correct.

17 MR. ERIC HOAKEN: And so in those
18 proceedings you were not appearing as an objective,
19 disinterested expert but rather as a witness on behalf of
20 your employer who had a stake in the outcome of the
21 proceedings?

22 MR. MARK STAUFF: Yes, I think that's
23 fair.

24 MR. ERIC HOAKEN: And if we look, then at
25 the experience you've had testifying post-2000, it

1 appears to me -- and you tell me if I've got this wrong,
2 but it appears to me as I look at your curriculum vitae,
3 that the vast majority of the hearings that you've
4 testified in, pertain to pipeline and other
5 transportation issues.

6 Am I right about that?

7 MR. MARK STAUFST: Many of them had to do
8 with, it's true, with TransCanada Pipelines. There have
9 been some -- I mean, I don't know that I need to go back
10 and think hard about every single one of them, but
11 certainly there was some proceedings in Ontario, that I
12 think it is fair to say that were related primarily to
13 upstream transportation, although they were sort of
14 utility prudence matters and things of that nature.

15 MR. ERIK HOAKEN: Right. Which case was
16 that, Mr. Stauff?

17 MR. MARK STAUFST: The consumer's -- I'll
18 have to find it if you want a citation.

19

20 (BRIEF PAUSE)

21

22 MR. MARK STAUFST: Top of page 5, on the
23 list of written and oral testimony, Ontario Energy Board,
24 Enbridge Consumers Gas RP2000-0040.

25 MR. ERIK HOAKEN: Yes. And in that case

1 you gave evidence on upstream pipeline transportation
2 issues?

3 MR. MARK STAUF: Quite so, yes.

4 MR. ERIC HOAKEN: Right.

5 MR. MARK STAUF: Similarly, with a
6 similar type of issue in 2002 Ontario Energy Board,
7 another Enbridge Consumers Gas case.

8 MR. ERIC HOAKEN: And -- and those cases,
9 as I understand it, didn't involve the retail market per
10 se, but rather --

11 MR. MARK STAUF: No, that's correct.

12 MR. ERIC HOAKEN: All right.

13 MR. MARK STAUF: That's correct.

14 MR. ERIC HOAKEN: And just finally just
15 so I understand it, Mr. Stauff, have you ever been
16 qualified as an expert to testify on issues that relate
17 to consumer behaviour?

18 MR. MARK STAUF: No.

19 MR. ERIC HOAKEN: And you -- you don't, I
20 take it from looking at your curriculum vitae, have any
21 expertise in that field?

22 MR. MARK STAUF: Consumer behaviour,
23 being -- maybe I'm not quite understanding --

24 MR. ERIC HOAKEN: Yes. Have --

25 MR. MARK STAUF: I don't think so, no.

1 I've -- I've never held myself out as such a thing.

2 MR. ERIC HOAKEN: All right. Thank you.
3 All right on the basis, Mr. Chair, I'm content. Thank
4 you.

5 THE CHAIRPERSON: The Board accepts Mr.
6 Stauff.

7

8 CONTINUED EXAMINATION-IN-CHIEF BY MR. KRIS SAXBERG:

9 (Qual)

10 MR. KRIS SAXBERG: Thank you, sir.
11 Turning now to Dr. Marc Van Audenrode. You're
12 responsible for preparation of certain written evidence
13 in this proceeding?

14 DR. MARC VAN AUDENRODE: Yes, I am.

15 MR. KRIS SAXBERG: And for everyone's
16 information, Dr. Van Audenrode's evidence is marked as
17 CAC/MSOS Exhibit 4.

18 Do you have any corrections to make to
19 your evidence?

20 DR. MARC VAN AUDENRODE: No, I -- I
21 don't.

22 MR. KRIS SAXBERG: And I take it then
23 that you adopt that evidence in its entirety?

24 DR. MARC VAN AUDENRODE: Yes.

25 MR. KRIS SAXBERG: Could you please

1 describe your qualifications and experience relative to
2 the issues that you were asked to address by CAC/MSOS?

3 DR. MARC VAN AUDENRODE: Well, I've been
4 asked to review a certain number of opinions that were
5 included in Dr. Cyrenne's documents, and also a certain
6 number of facts that came out of Mr. Stauff's opinions
7 that dealt with economic theory and the basics of -- and
8 basic economic principles.

9 And I'm an economist. I actually hold a
10 PhD in Economics from the University of California,
11 Berkely, and a Masters from UCLA. Before that I had
12 Masters, again in Economics, from the University of
13 Louvain, Belgium.

14 After graduating from Berkely I took
15 several teaching positions. First at the University of
16 Quebec at Montreal, then at Laval University in Quebec
17 City, where I became a full professor and the head of the
18 department for four (4) years.

19 In 2003 I quit full time academics,
20 although I kept an adjunct position at the University of
21 Sherbrooke. But I kept -- I quite full time academics to
22 join the Analysis Group -- to join Analysis group where I
23 am now a managing principle, meaning that I'm the partner
24 in charge of the Canadian office of Analysis Group.

25 Analysis Group is an economic consulting

1 firm which has in excess of three hundred and fifty (350)
2 professionals in ten (10) offices in North America -- the
3 Canadian office being located in Montreal -- and we
4 provide councils on topics that range from competition
5 economics to health economics and going through finance
6 and other -- other areas.

7 MR. KRIS SAXBERG: Do you have any
8 experience in applying economic theory to natural gas
9 markets?

10 DR. MARC VAN AUDENRODE: I have limited
11 experience. I have no knowledge on the natural gas
12 market in Manitoba, but yeah, as any good economist I
13 know the energy market which is crucial to here, and I
14 don't -- I don't believe that the opinions that I'm
15 rendering require that kind of, you know, institutional
16 knowledge that someone like Mr. Stauff does have.

17 MR. KRIS SAXBERG: Mr. Chairman and Board
18 Members, I'd ask that you qualify Dr. Van Audenrode as an
19 expert in economics and economic theory.

20 THE CHAIRPERSON: Mr. Hoaken, do you have
21 any views or comments?

22 MR. ERIC HOAKEN: None.

23 THE CHAIRPERSON: Ms. Murphy...?

24 MS. MARLA MURPHY: I have no comments.

25 THE CHAIRPERSON: Very good. The Board

1 accepts Dr. Van Audenrode.

2

3

(VOIR DIRE CONCLUDED)

4

5 EXAMINATION-IN-CHIEF BY MR. KRIS SAXBERG:

6 MR. KRIS SAXBERG: Turning to -- again
7 with you, Mr. Stauf, as I mentioned earlier in this
8 proceeding, you participated in the first Competitive
9 Landscape Review Proceeding; could you describe your
10 involvement in that proceeding and the nature of that
11 Hearing?

12 MR. MARK STAUF: As I said earlier, I
13 was the -- sort of Director of TCGS's effort in that
14 case, and one of its two (2) witnesses to appear.

15 In broad terms, the proceeding, as I
16 understood it, was -- well, let me back up a little bit
17 here. The situation that -- the structure that existed
18 at the time, was that Centra was sort of a conventional
19 gas utility that was subject to competition from
20 unregulated marketers, but at that time only through the
21 buy/sell mechanism, as it was then called. And I'll --
22 we can come back to that and talk about it a little bit
23 more, but just in those days the delivery mechanism for
24 competitive supply was -- was the buy/sell.

25 The Board, as I said earlier, around that

1 period, both in Manitoba and Ontario, there was a number
2 of issues, sort of bubbled to the surface, around the
3 nature and extent of competition at the retail level.
4 And this was a topic that also was hot in the United
5 States in some jurisdictions.

6 Enron was spending a fortune sending
7 people around North America lobbying for various forms of
8 deregulation at the retail level, and so when the
9 Manitoba Board decided that it would like to look at
10 these issues, of course, everybody that was interested in
11 -- many people that were interested in those issues
12 appeared. Centra, of course, was there; my employer at
13 the time, TCGS, was there. Municipal Gas, I believe was
14 the main, if not, only supplier of competitive,
15 unregulated supply in Manitoba, so it was there.

16 But, also, there were a number of sort of
17 potential entrants. There was a large contingent of us
18 from out of town at that hearing; certainly
19 representatives of Enron and Direct -- and this was
20 before Direct had acquired Municipal -- I think Dynegy
21 and maybe some others, so it was a fairly well attended
22 and thought to be an important proceeding.

23 I would say that the biggest issue -- to
24 some extent my -- my sort of recollection and impressions
25 maybe filtered by what was interesting to myself and my

1 client -- but from my perspective, the biggest issue at
2 the time was basically the question of whether the
3 Utility should be ejected from the regulated merchant
4 function altogether. That was a fashionable theory in
5 those days in some quarters, and it was debated in that
6 case. Ultimately, the Board didn't go for that; didn't
7 agree that that would be a good idea.

8 There was also a considerable amount of
9 discussion about the limitations of the buy/sell
10 mechanism and possible substitutes for it, and with the
11 suggestion being made that a bundled T-Service be
12 introduced instead and, ultimately, the Board agreed with
13 that. And that is where we got the existing WTS Service;
14 that was the -- as I understand it, the genesis of that
15 service, and also the occasion for the elimination of the
16 buy/sell, ultimately.

17 There was also some discussion, I think
18 some of which -- a large part of which, probably came
19 from me about unbundling of upstream transportation and
20 storage assets, and the potential for there to be
21 consumer benefits arising from that. Ultimately, the
22 Board did not agree with us on that and so that pretty
23 much the status quo was maintained.

24 And I believe that there was also a
25 certain amount of discussion about the issue of whether

1 the Utility, on a regulated basis, should be offering
2 alternative products. And again the Board declined to
3 adopt that suggestion at the time and in the
4 circumstances that -- that existed then.

5 I think those were the -- obviously there
6 -- it was a lot more to it than that. This went on for --
7 -- for weeks and weeks but to my recollection that was --
8 that's an outline of what happened in that case.

9 The upshot of it, as I say, was more or
10 less the maintenance of the status quo as it then
11 existed, except a bundled TWTS service was substituted
12 for the buy/sell, as the primary mechanism for delivering
13 competitively or unregulated supply to -- to small volume
14 customers.

15 MR. KRIS SAXBERG: What did you and
16 others who participated in that hearing, expect would
17 happen after WTS came online?

18 MR. MARK STAUFF: The -- the tremendous
19 limitation of the buy/sell mechanism was that it tied the
20 delivery and pricing of retailer supply, to adopt Mr.
21 Hoaken's terminology for -- for unregulated retail
22 suppliers, it -- it tied their activities inextricably to
23 the Utility's own sales service. I can come back and
24 explain if anybody is interested in how exactly that
25 worked.

1 But that was the -- the kind of the -- the
2 problem with it and it -- it depended on the Utility gas
3 prices behaving in such and such a way for it to -- or in
4 a particular way, in order for it to work, and that the
5 same thing was happening in Ontario.

6 So the hope was that by introducing the
7 bundled T-service -- well, the -- the effect of the
8 bundled T-service is to sever that link. It enables
9 brokers and marketers -- or retailers, sorry, to
10 establish a direct contractual link with customers --
11 individual retail level customers, without involving the
12 Utility at all.

13 So the hope was in my -- I -- I maybe
14 shouldn't speak about -- speak to what everybody's hopes
15 and expectations were, but certainly my expectation was
16 that severing that link with the Utility's service would
17 result in a -- in a flowering of competition, in the
18 sense that there would be a proliferation of -- or a
19 proliferation of different services; in terms of the
20 terms that services are for and the pricing mechanisms,
21 so that you would have, ideally, a variety of products
22 available to customers; variable priced or, you know,
23 various forms of hedging, or one (1) or two (2) or three
24 (3) year fixed prices or just whatever people could dream
25 up. And also that, of course, that you would attract

1 more market participants, in addition to the -- the one
2 (1) or two (2) that existed in Manitoba at the time.

3 I think the expectation was that this sort
4 of blossoming of competition would lead ultimately to a
5 squeezing out of the Utility's sales service, that the --
6 eventually competitive forces would make it unnecessary
7 for there to be a sort of one (1) size fits all utility
8 sales service, because in the competitive market
9 customers could buy whatever they wanted, whatever suited
10 their particular needs, and the prices for all of this
11 would reflect, you know, a competitive outcome that
12 basically reflects cost in more or less the same way that
13 the Utility service does. So that was sort of the vision
14 that -- that people had.

15 I mentioned earlier that -- that the issue
16 of upstream unbundling was raised in that case, sort of
17 an issues of whether it would make sense to, sort of,
18 parcel out or distribute out to market participants the
19 existing Utility upstream storage and transportation
20 infrastructure. As I said, the Board was not keen on
21 that idea.

22 But I think still at that time, my picture
23 was -- the picture in my head was that in the long run
24 probably the market would force that and that eventually
25 you would see efficiencies in the wholesale market, in

1 terms of -- related to the operation of upstream storage
2 and transportation infrastructure. As I say, that didn't
3 come out of that particular hearing, but at the time I
4 certainly saw that as a long run evolution of the market.

5 MR. KRIS SAXBERG: And here we are now,
6 eleven (11) years later, why, from your perspective, is
7 there a need to revisit these matters?

8 MR. MARK STAUF: Well, I -- the fact is,
9 I think, that the real world has just not unfolded in
10 quite the way that our idealistic vision called for ten
11 (10) years ago.

12 What has happened, in fact, is that Centra
13 is still by far the main supplier to small volume retail
14 customers. There's still only two (2) marketers in the
15 market in Manitoba. There's no sign of Enron, and, you
16 know, we have Direct here but only because they bought
17 Municipal. There's no sign of TCGS. There's no sign of
18 Dynegy, or any of those people that were at the Hearing
19 and thought they were going to swoop in and create this
20 competitive market.

21 Still, you know, the only -- this didn't
22 exist at the time but, I mean, the only competitively
23 priced products that are available now are long-term
24 fixed price offerings, in contrast with, what I thought
25 anyways, would be a much wider variety of things.

1 I would say in the current environment
2 there's probably a little bit more customer choice than
3 there was at the time but just in the sense that at that
4 time you couldn't buy anything other than, sort of,
5 variable price supply via buy/sell. So now people can
6 sign up long-term contracts if they want but that's about
7 it. So there's more customer choice but not a whole lot
8 more, and certainly not, I would say, customer choice on
9 the scale that was hoped for at the time.

10 So in that circumstance, looking back at
11 it that way, I think it makes good sense for the Board to
12 now examine that history and consider whether the
13 premises that underlay its 1998 decision are still valid,
14 and whether adjustments are either necessary or
15 desirable.

16 My view, in fact, is that some aspects of
17 the plan probably should be re-thought and that some
18 adjustments should be made, as set out in my evidence.

19 MR. KRIS SAXBERG: Thank you, Mr. Staft.
20 Now turning to the meat of your evidence. You start your
21 evidence and spend a considerable time with a very
22 provocative assertion. You challenge the very notion
23 that retailers, such as Direct Energy and Energy Savings,
24 will necessarily generate benefits for consumers.

25 MR. MARK STAFT: Yes. Just by way of

1 background to that. I mean, there is a Q&A in my
2 testimony, sort of after that initial discussion, that
3 says well, if this isn't -- if this activity isn't
4 creating big consumer benefits why does it exist at all.

5 And in that section, in response to that,
6 I go through a discussion of the history of direct sales
7 or retailer sales, in both Manitoba and Ontario because
8 the experience is essentially the same. And I describe
9 there how the buy/sell mechanism works and what its -- I
10 mentioned already, some of its limitations.

11 But at the end of the day, the buy/sell
12 depended on the Utility weighted average cost of gas
13 being higher than market prices in Alberta. If that
14 condition wasn't met, the whole thing didn't work;
15 customers got no benefits; marketers lost money; it was a
16 -- it was a mess.

17 What happened though is that eventually
18 over time, that competitive pressure that was created by
19 the buy/sell had the effect of incenting the utilities
20 and their suppliers, indirectly, to buy and sell gas
21 respectively at prices that were much more closely
22 reflective of prevailing prices in Alberta.

23 So there was an economic incentive for
24 retailer direct purchase in the early days, because the
25 utility prices were just higher than market and the

1 buy/sell created the mechanism for people to bypass the
2 Utility and -- and access lower priced supplies. So
3 there really was a, you know, fairly obvious.

4 But as you'd expect, I think, the effect
5 of that competitive pressure was to force the Utility
6 weigh cogs down, basically to -- to where they were at
7 market -- where the utilities were buying gas at
8 essentially the same price as the brokers were. So the
9 net result of that is that the economic advantage of
10 direct purchase by the retail customers basically
11 disappeared.

12 Now, the discussion in my testimony talks
13 about this -- this whole issue of the extent and nature
14 of consumer benefits from this competitive activity from
15 -- from two (2) perspectives. One (1) of those is that
16 of cost or efficiency.

17 And in -- in that connection -- I don't
18 want to go over this in too much detail -- but in that
19 connection I identify a number of functions that are
20 involved in providing gas sales service to a small volume
21 customer; those include gas supply. You have to buy the
22 gas in Alberta. You have to transport it to the Winnipeg
23 area. You have to distribute it on the distribution
24 system. There are a variety -- you have to bill for it
25 and collect the -- collect the money. And there are

1 various other customer care-type functions involved.

2 Under the bundled T-Service that exists
3 now that -- with WTS the -- there is essentially -- well,
4 most of those functions are provided exactly,
5 identically, for both retailers and for the -- for the
6 Utility. So the transportation function, the
7 distribution function, the billing and collection
8 function, are all provided by Centra on exactly the same
9 terms to brokers as they're provided to itself for its
10 own sale service.

11 So the only room, the only arena in which
12 brokers can compete with the Utility is really the
13 acquisition function itself; the purchasing of gas at the
14 wholesale level in the Alberta market. And as I say in
15 my testimony, that is a -- the way that market is
16 structured, there's no reason in the world to believe
17 that the Utility is going to be a less efficient or worse
18 acquirer of gas, in terms of cost, than anybody else.

19 It's very difficult, in my view, for
20 marketers to obtain any competitive advantage over the
21 Utility in purchasing gas. And that's to say that --
22 that observation applies whether you're talking about
23 monthly or daily or annual or five (5) year gas.
24 Ultimately it all -- the -- the same logic works, no
25 matter what term you're talking about.

1 In addition to that of course, brokers
2 have costs that the Utility does not have. They pay
3 money to acquire customers. They like to make a profit
4 on their purchases and sales. They have to pay staff.
5 It's not clear -- I mean, I don't have good data on what
6 those costs are but there's some.

7 So, you know, on an expected basis, it
8 looks to me as if it's very difficult to avoid the
9 conclusion that just the costs of providing broker sales
10 service is going to be at least as great, and probably on
11 average greater than the cost of providing utility sale
12 service, at a regulated rate.

13 The other aspect of it that I discuss in
14 my testimony is the question of whether, in fact, sort of
15 given the actual facts as they exist in Manitoba,
16 competition is effective to -- or would be effective to
17 ensure that any efficiency benefits that might exist
18 would get flowed back to customers, as opposed to just
19 winding up in the pockets of the brokers.

20 Even if you assume that there is some
21 efficiency benefit to be gained, which I -- as I said, I
22 don't think is true, but even if you assume that, that
23 doesn't do consumers any good if competition isn't
24 effective to keep the brokers' prices at a level that
25 flows those benefits back to consumers.

1 And in this connection, I discuss in my
2 testimony some concerns that I have about that. It's a
3 difficult area to -- to sort of measure quantitatively,
4 but I think there are reasons for the Board to be
5 concerned about whether competition at that level, is
6 effective.

7 One of the things I talk about is the
8 dynamics and operation of the door-to-door sales
9 mechanism. Another aspect of that is an analysis that I
10 go through, at a pretty high level, admittedly, just of
11 the costs that appear to be involved in supply -- making
12 retailers' supply available versus the prices that appear
13 to be charged for it in the marketplace. And again, it
14 seems to me that there may be some -- may be -- there may
15 be some reason to be concerned about the level of those
16 margins.

17 So those are the -- those are the major
18 points that are hit on in my written testimony.

19 MR. KRIS SAXBERG: My next question is to
20 you, Dr. Van Audenrode.

21 Mr. Stauff's opinion, as he's just
22 expressed, is that brokers -- "retailers" as we're
23 calling them here -- may not be selling a product that is
24 beneficial to customers, but yet they have 20 percent of
25 the gas sales market in Manitoba.

1 Is there any economic theory that explains
2 that result?

3 DR. MARC VAN AUDENRODE: I've been
4 puzzled by that reality, and essentially because I think
5 Mr. Stauff's evidence that the areas for the retailers to
6 actually provide a product at a better cost than Centra,
7 are clearly very limited.

8 Now in looking at the kind of products
9 that are being sold on the market, the way to understand
10 these, you know, non-trivial number of customers actually
11 signing up with these retailers is -- is to look at this
12 like, you know, the retailers having a hundred (100)
13 percent of the market of the fixed rate long-term
14 contracts, and zero percent of the market of the short-
15 term, fluctuating rate contracts and customers.

16 And that's in -- in economic theory is
17 called market segmentation. And market segmentation, you
18 know, it's well known, it appears in many markets, and
19 it's just a way to somehow use customers' differences to
20 sell differently the same product or products, that are
21 very clear.

22 The best example of market segmentation is
23 the airline industry, where because leisure travellers
24 are probably more cost-sensitive but are more flexible,
25 and on the other hand business travellers are less cost-

1 sensitive but are less flexibility in their plans,
2 airlines can manage to price their seats in ways that may
3 -- that you can in an airplane be sitting next to a
4 person that has paid a price that is completely different
5 from yours.

6 And that's, you know, what -- that's
7 what's called market segmentation. There's nothing wrong
8 with that; customers make their choice -- at least in the
9 airline industry -- make their choice fully -- fully
10 informed.

11 But what it ends up doing is that, you
12 know, it manages to -- going from having practically one
13 (1) product to having two (2) products. The products,
14 even if these are seats that are in the same air plane,
15 next -- right to each other, in fact they are different
16 products because these are bought by different people.

17 And -- and this is the way that I
18 understand what is going on here, that on one hand you
19 have these retailers saying long -- selling long-term
20 contracts -- fixed-rate contract -- which are in a sense
21 very different from what other customers are getting from
22 Centra where they get, you know, fluctuating rates. And
23 there are clearly enough people who are willing to buy
24 into these long-term contracts either because they are
25 riskevers (phonetic) and want some protection.

1 Or because they, you know, to some extent
2 want to beat -- they want to beat the market. They --
3 they hope that by doing that they will do better, in
4 terms of cost, than by just staying in -- with -- with
5 fluctuating rates.

6 MR. KRIS SAXBERG: Thank you, Dr. Van
7 Audenrode. Have you -- I think you note in your evidence
8 that you have read the market survey and -- and focus
9 group reports of ENRG (phonetic)?

10 DR. MARC VAN AUDENRODE: Yes, I have.

11 MR. KRIS SAXBERG: And those reports
12 indicate that broker customers have entered into
13 contracts, for the most part, to save money. From an
14 economic theory perspective, is it reasonable for those
15 people to expect that they would save money by entering
16 into these long-term contracts?

17 DR. MARC VAN AUDENRODE: Well it's true
18 that a large number of respondents indicate that they
19 wanted to save money. And the -- and the -- the response
20 to your question is no, there's no way you can hope by
21 entering in such a long-term contracts that you are going
22 to systematically -- let me qualify what I'm saying --
23 that to systematically save money.

24 I was a but puzzled by that -- by that
25 evidence because I tend to think that consumers are smart

1 and well informed and make informed decisions, and -- and
2 to have these responses that are, you know, so wrong,
3 with respect to simple economic theory, puzzled me.

4 And -- and I think that -- I mean I only
5 have one (1) explanation for that and let me get to that.

6 Now, let me first explain to -- to the
7 Board why I believe that there is no way you can hope
8 that you are going to save systematically money by
9 entering into -- into these -- these contracts -- these
10 long-term contracts.

11 When you enter into long-term contracts
12 for -- in a market like natural gas, which is hugely
13 liquid and well traded across North America, it's not the
14 same as, you know, going to your Costco and buying three
15 (3) month's supplies of your favourite breakfast cereals,
16 because you think that the price is going to go up; and
17 by buying it today you basically make sure that you get
18 the price that you have today for the next three (3)
19 months or six (6) months or whatever you buy in these
20 huge boxes at Costco.

21 The -- the price that you get on the long-
22 term contracts on natural gas, already reflects and
23 embeds what the market expectation is about what the
24 market -- the price for natural gas is going to be in the
25 next five (5) years.

1 So it's not you buy your gas for the next
2 five (5) years at today's prices, you buy your gas at the
3 market price for the next five (5) years, which embeds
4 the expectation of the market for the next five (5)
5 years.

6 And of course sometimes, you know, this
7 prediction quote/unquote "on market" gets it -- gets it
8 wrong and some people win, and sometimes it gets wrong
9 and some people lose. But on average, you get it right
10 and the market gets it right. And consumer will, you
11 know, get on average a price that is similar to the price
12 that would have gotten by, you know, sticking with a
13 short-term -- short-term rate.

14 The difference is that, on one hand they
15 get stability in their rent -- in their rate. On the
16 hand, well, they have to pay some premium implicit in --
17 in these rates to cover themselves, to provide themselves
18 that insurance that their rate is going to be stable.

19 And in -- the only way that I can -- we
20 can reconcile this reality with the fact that consumers
21 seem to be saying in a large number, that they wanted to
22 save money; is that they probably did not fully
23 understand the distinction between, you know, the Costco
24 example that I gave you and -- and the reality of the --
25 of, you know, buying this -- into these long-term

1 contracts.

2 MR. KRIS SAXBERG: Thank you, Doctor.

3 It's twenty-five (25) after 10:00 and I'm
4 moving on to a new area of questioning, so we could take
5 a break now if the Board so wishes.

6 MR. CHAIRPERSON: That's fine, Mr.
7 Saxberg. So we'll come back in fifteen (15) minutes.
8 Thank you.

9

10 --- Upon recessing at 10:22 a.m.

11 --- Upon resuming at 10:44 a.m.

12

13 THE CHAIRPERSON: Okay, Mr. Saxberg...?

14

15 CONTINUED BY MR. KRIS SAXBERG:

16 MR. KRIS SAXBERG: Thank you, Mr.
17 Chairman. One (1) of the biggest questions from my
18 client in this proceeding is the question as to whether
19 Manitoba Hydro should be able to compete with retailers
20 in the competitive market.

21 Mr. Stauff, in your evidence, you make a
22 recommendation favouring Manitoba Hydro competing as
23 such. Could you explain your reasons?

24 MR. MARK STAUFF: Basically, my support
25 for that proposition is based on the fact that it is a

1 response -- a reasonable response -- to the failure of
2 the competitive vision, that I talked about earlier, to
3 materialize.

4 In fact, in the current environment, there
5 are very few competitors, there are very few alternative
6 products, there is an absence of alternative products
7 that people apparently want. I'm thinking there of
8 shorter-term one (1) or two (2) year fixed-price
9 arrangements. As I'd said, I think there are reasons to
10 be concerned about whether the pricing of the long-term
11 products that are available, reflects genuinely
12 competitive outcomes.

13 Allowing the Utility to provide
14 alternative products at regulated cost-based rates would
15 address those issues.

16 The original objective was, as I
17 understand it and as I think Mr. Saxberg discussed, was
18 to create choices for customers at reasonable or
19 competitive prices. The original theory was that the
20 fully developed competitive market would do that, and
21 that there would, in that case, be no need or value in
22 involving the Utility in -- in that whole enterprise, in
23 achieving -- in achieving that objective. As it's turned
24 out though, in my view, that original theory turned out
25 not to be true. And in that circumstance, a reasonable

1 response to that is to meet the original objective by
2 having the regulated Utility do it.

3 Now, it might be theoretically preferable
4 to have the objective met by unregulated market
5 participants as originally contemplated. But if in the
6 real world that just isn't going to happen, then I think
7 the second best alternative of having the Utility fill
8 that role and meet that market need is better than not
9 achieving the objective at all.

10 So in my -- that is, in general terms, the
11 basis for my support for that proposition.

12 MR. KRIS SAXBERG: My next question is to
13 Dr. Van Audenrode.

14 Dr. Van Audenrode, in your evidence you
15 also favour Manitoba Hydro competing with brokers. Can
16 you explain that?

17 DR. MARC VAN AUDENRODE: Well, in short,
18 I would say, I don't see how that would hurt customers
19 and consumers. We know that the products that are being
20 sold are sufficiently different -- that, you know, it
21 raises questions as to -- do we have completely
22 competitive price in this market for the long-run fixed-
23 rate market?

24 What I -- you know, what I want to say
25 that -- and Mr. Hoaken said it -- you know, competition

1 is not a goal, per se. It's not a philosophy or quest.
2 Economists love competition because generally that's the
3 simplest and easiest way to get the lowest price to
4 consumers. If that doesn't work then, you know, there
5 are other ways to reach the same goal.

6 And the goal, ultimately, is to make sure
7 that consumers get the lowest possible rate. In this
8 case, I would think that allowing Centra to offer a
9 regulated rate in the long-term contract area, would
10 provide consumers with a very nice benchmark that would,
11 you know, probably help them make their choices.

12 MR. KRIS SAXBERG: Would you support
13 Manitoba Hydro offering or competing in the competitive
14 market even if the result was that the -- it may lead to
15 some participants in that market exiting the market?

16 DR. MARC VAN AUDENRODE: Well, again, I
17 go back to my previous statement, which is that
18 competition is not a goal in -- per se. Unless you
19 assume that somehow Centra would be unfairly competing
20 with these retailers in that market, I don't see why they
21 would be pushed out of the market, if they are any good
22 at what they do.

23 Again, I have trouble with this reasoning
24 of saying that, you know, consumers should pay high
25 prices because if they pay low prices then they are going

1 to have to pay high prices later on. That reasoning I
2 don't understand.

3 You know, if there is a way to make sure
4 that consumers pay lower prices today, let's apply it and
5 make sure that consumers pay lower prices today. And if
6 down the road, it comes out that the circumstances and
7 the environment changes and that there is a risk of
8 prices going back up, then, you know, the Board can
9 always intervene at that time.

10 But, you know, somehow -- if it is the
11 case that consumers are paying too much today, imposing
12 that to them in the name of competition, I think, is a
13 bad idea, and the simplest way to know that is to let
14 Centra compete with these retailers.

15 MR. KRIS SAXBERG: Thank you, sir.
16 Turning back to you, Mr. Stauff.

17 In your evidence you -- you speak of costs
18 to sustain the competitive market, and in the light of --
19 of that evidence I ask: Should there be any form of
20 incentives to retailers to assist in sustaining the
21 competitive market or -- or growing it?

22 MR. MARK STAUFF: No, in my view there
23 should not be. Nor, I would say, should there be
24 subsidies going the other way. Nor should there be
25 subsidies flowing between alternative products that

1 Centra might offer.

2 I mean, my -- my view is that the way this
3 works best and the way you get the optimal outcome
4 ultimately, is to have everybody paying pretty much the
5 costs that they cause the system for the purpose of -- of
6 serving them.

7 I went through a discussion earlier about
8 consumer benefits of competition, with the conclusion
9 that on an expected basis there probably aren't a whole -
10 - a whole bunch of them. The -- the point of that --
11 part of the point of that discussion though, was to
12 suggest that there's really no point, in my view, in
13 artificially propping up or subsidizing competitive
14 activity just for the sake of competition, as Dr. Van
15 Audenrode just discussed, as well.

16 This is not I think a situation where we
17 can sort of see off in the distance the promised land of
18 -- of pretty much complete, unregulated competition. And
19 the only problem is one of, sort of, the mechanics of how
20 to get that competitive regime working and how to get it
21 up this tiny little hill and then there'll be a sort of a
22 long, downhill slide to -- to where we want to be.

23 If that were the situation, then I -- I
24 can at least the argument, that as a sort of transitioned
25 approach or as a kick-starting mechanism, then maybe some

1 accommodations might be appropriate for competitive
2 players, in terms of their costs and their access and --
3 and their operational parameters and things like that.
4 As I said, I -- I don't think that's the case here at
5 all.

6 I mean, I don't think that the -- I don't
7 think that there is a long, downhill glide to the market
8 state that we all were thinking about back in 1996. So
9 in -- in that environment, there's no rationale for --
10 for trying to prop up competitors to Centra.

11 My evidence discusses these issues in
12 several contexts. I won't go through my analysis of each
13 of those, but they include the issue of how to allocate
14 the recently introduced premium in the Nexen contract to
15 accommodate monthly changes in base gas amounts.

16 I think there are issues about agency
17 billing and collection fees. My understanding is that
18 that is priced right now on basically a marginal cost
19 basis, and I think there are various other ways that you
20 could consider pricing that product, for example:
21 embedded cost or -- or, you know, in an extreme case,
22 some kind of an avoided cost analysis. And I believe
23 that Centra as well, has an issue in that area around bad
24 debt expenses.

25 Centra has also issued, and I -- or

1 raised, and I also raised in my testimony, the issue of
2 an administration fee for the WTS service. And in my
3 testimony as well, I talked briefly about issues around
4 the operating parameters of the WTS service and the
5 potential for the provision of hidden subsidies, in
6 effect, by -- by relieving the marketers from some of the
7 operational constraints that are associated with that --
8 with that service.

9 My understanding now -- and when I wrote
10 this testimony I wasn't quite sure exactly what the
11 procedure was going to be. My understanding now is that
12 these issues will be dealt with at a detailed level in a
13 subsequent rate case, assuming that the Board -- well,
14 depending on what the Board decides about them.

15 But -- so for these purposes I'm, I
16 think, just sort of indicating directionally my views on
17 the allocation issues that will need to be addressed and,
18 in general terms, how they should be addressed, without
19 making any specific recommendations about rates, or cost
20 categories or any of that kind of thing.

21 MR. KRIS SAXBERG: Another issue raised
22 by the Board in the Notice of Proceeding, relates to the
23 marketing practises of retailers and specifically the
24 door-to-door sales approach.

25 Can you summarize your evidence on this

1 issue?

2 MR. MARK STAUFF: In my testimony, I do
3 express some concerns about that mechanism. Basically, I
4 think the problem is that it's difficult to know whether
5 -- or it's difficult to be persuaded, I guess, that
6 customers are getting adequate or correct information
7 through that marketing channel and with that sort of
8 market structure.

9 I mean, there are very few products
10 nowadays that are -- are sold in that manner, and I think
11 there's a reason for that. That's just not how it's done
12 with just about any other good or service that you might
13 -- you might choose to buy.

14 Just as an example, I did look at the
15 focus group report that Centra has filed and most of the
16 people, or most of the focus group, seem to be saying
17 that people bought long-term supply from brokers,
18 basically because they thought they were going to save
19 money. Dr. Van Audenrode talked about -- and I talked
20 about in my evidence as well -- the rationality of that
21 belief.

22 But the question is where did these people
23 get that idea? They didn't get it from Centra and they
24 didn't get it from CAC. They had to have gotten it from
25 the guys that were at their door selling them these

1 products.

2 And as I said, I think that is just a
3 misconception in the marketplace and that the mechanism
4 that has been adopted for marketing these products
5 contributes to that, or certainly doesn't help it any
6 way. So I -- I have concerns about that.

7 And that, in fact, is one of the reasons
8 that I -- one of the bases that I have for supporting the
9 idea that Centra could offer these alternative products.

10 If there is a problem, as I suspect there
11 is, with that marketing channel, in terms of the
12 information that people get, Centra offering alternative
13 products is a -- would be a competitive check on that.
14 It would be a constraint on that -- on that kind of
15 behaviour, so.

16 MR. KRIS SAXBERG: Another issue raised
17 in the Notice of Proceedings is, essentially, what should
18 the default gas rate look like if Centra is allowed to
19 compete in the competitive market?

20 MR. MARK STAUF: Yes. My -- my
21 understanding is that, in the past at least, the CAC has
22 supported essentially a month-to-month redetermination of
23 gas cost rates, or primary gas rates, so I -- without any
24 hedging. In my testimony, I did not address my mind to
25 the details of the PGA mechanism, in terms of the timing;

1 whether you're looking at quarterly or monthly or how
2 that math would get done.

3 I did, however, comment on the -- on the
4 hedging issue and -- and I -- I think I agree with the
5 CAC's position that for a default supply, the elimination
6 of the hedging problem would -- or hedging program
7 rather, would be -- would be appropriate.

8 Particularly in -- in an -- that's
9 particularly true in an environment where Centra was able
10 to offer alternative products of a fixed-term nature. So
11 that if customers could buy one (1) or two (2) year gas
12 because they have some peculiar -- or some particular
13 view about price stability, again they would have the
14 option to do that, and there doesn't seem to be any need
15 for Centra to achieve part of that effect through a
16 hedging program.

17 At the end of the day, the hedging program
18 costs a little bit of money, and in my view doesn't add
19 anything in terms of overall costs and has a number of
20 other drawbacks. So my view is that the better option is
21 probably just to eliminate it.

22 MR. KRIS SAXBERG: Dr. Van Audenrode, you
23 also comment on hedging in your evidence. Can you
24 summarize what you said?

25 DR. MARC VAN AUDENRODE: Yeah, I do, and

1 -- and I think Dr. Cyrenne, to some extent, is in
2 agreement with that and us. Yeah, hedging is a financial
3 activity which is risky and it's best left to the private
4 sector where, if you make the wrong decision, you get
5 punished and you go bankrupt. That's simple as it is.

6 As it is now, if Centra makes a mistake in
7 terms of, you know, its computation for rate change, you
8 just pass it onto the consumer. So I would think that
9 these activity, which are risky, and -- and keep in mind
10 that if you are a private corporation and you take such
11 kind of position, you have to declare it to your -- to
12 your stockholders because it's dangerous, it has impact
13 on -- on the corporation.

14 And so, yeah, I -- I would think that it's
15 better left to the private sector.

16 MR. KRIS SAXBERG: Mr. Stauff, you
17 comment on the equal payment plan in your evidence. Can
18 you summarize your observations?

19 MR. MARK STAUFF: Yes. As I understood
20 it the proposal has -- had been made that the equal
21 payment plan be established as the default condition for
22 sales customers.

23 By that I mean they -- people can freely
24 choose whether to take it or not. It's just that the
25 question -- that the question of the default is what do

1 you get if you don't do anything? And right now, if you
2 don't do anything you get the regular PGA driven rates
3 then you have to elect into the EPP.

4 Now, my reasoning on that, in large part,
5 was based on the idea that people seem to be concerned a
6 lot about volatility and seem to think that volatility is
7 a big concern for consumers. And certainly, if you
8 believe that, then one of the easiest ways to deal with
9 that would be to make the EPP the default option. Now I
10 have to say that at the same time this is not something
11 that I feel terribly strong about -- terribly strongly
12 about.

13 It really is just a default, and people
14 are perfectly entitled to go either way on it and, you
15 know, I think that ultimately it doesn't make a whole lot
16 of difference which way the default switch is set.

17 I don't see it, frankly, as a negative
18 option. I don't -- as Centra seems to have suggested.
19 There's not a negative option in quite the same way that
20 some other things are. And I -- I'm not really persuaded
21 that it would be huge inconvenience for people to opt out
22 of it if it was the default.

23 On the other hand, I acknowledge that in
24 the focus groups and some of the survey results, that the
25 notion of making the EPP the default, seemed to elicit,

1 according to the reports anyways, a pretty negative
2 reaction from people. And obviously that's something
3 that Centra and the Board will have to consider as well.

4 MR. KRIS SAXBERG: Thank you, sir. Is
5 there -- is there any other areas in your evidence that
6 you want to highlight for the Board and stakeholders?

7 MR. MARK STAUF: The only other area
8 that -- that we -- major area that we haven't discussed,
9 occurs right at -- near the end of my testimony. In
10 probably the last ten (10) pages or so there's quite an
11 extended discussion of potential approaches to designing
12 utility-regulated cost-based fixed-price services.

13 At the time I wrote this, I again was not
14 entirely sure about what the scope of the proceeding was
15 or how much detail people wanted to get into on topics
16 like that, which are sort of a layer down from the -- the
17 more conceptual ones that we've been talking about so
18 far.

19 My understanding now, given the way Centra
20 has presented its evidence, is that probably issues like
21 that will be much more thoroughly canvassed in a
22 subsequent proceeding, depending on what the Board
23 decides in this case. Certainly I'm happy to talk about
24 and discuss the observations and analysis that I set out
25 in that section of my evidence, but I don't want to

1 highlight it here because I don't think it's, sort of, a
2 core part of the -- of the presentation.

3 MR. KRIS SAXBERG: Thank you, Mr. Stauff.
4 Dr. Van Audenrode, you were retained by CAC/MSOS, in
5 part, to respond to Dr. Cyrenne's evidence.

6 Dr. Cyrenne states that, quote:

7
8 "If Manitoba Hydro was a private firm
9 at the time of purchase, the
10 acquisition of Centra Gas would not
11 have been approved by competition or
12 anti-trust authorities in any modern
13 country." End quote.

14

15 How do you respond to that?

16 DR. MARC VAN AUDENRODE: Well, as I said
17 in my direct evidence, I don't know. For that matter, I
18 don't even know if we would agree on what the list of
19 modern countries would be with Dr. Cyrenne, but that's --
20 that's a different issue.

21 Essentially, you know, I don't know what
22 the Commissioner of Competition in Canada would have
23 decided, and -- and to some extent, you know, I don't
24 care, because the point is moot, you know? It's not two
25 (2) private firms merging in -- in a free market. We're

1 talking about regulated public monopoly, to some extent,
2 and -- and they fall into the category of -- of
3 regulatory economics.

4 Just to -- to make things simple, you
5 know, we worry -- economists worry about the fact that
6 concentration, you know, horizontal concentration or
7 vertical concentration can hurt customers, because it
8 gives firms that are merging some market power and allows
9 them to -- to raise their -- their prices. And there are
10 essentially two (2) ways that we deal with that.

11 One (1) is competition economics where,
12 you know, if you're a private firm you want to work -- to
13 merge you have to show the Competition Bureau that you're
14 not going to raise prices to consumers, or you're not
15 going to improve your market position in a way that will
16 allow you to raise prices, or that you're going to create
17 efficiency gains that would justify the -- the merger.

18 But if you are under the -- the realm of
19 regulatory economics, that's because we believe that, you
20 know, you are outside this traditional market economy for
21 reasons that have been historically very clear.

22 You know, there are natural technological
23 constraints that make it that this industry works
24 naturally as monopolies. There are huge economies of
25 scale here. They're huge gains from being big. And so

1 the only way to regulate and to make sure that these big
2 firms give the lowest possible price to their consumers
3 is by regulating them.

4 That's where we are and -- and of course,
5 there were concerns at the time of the merger, from what
6 I've read in -- in previous Board Orders, but you know,
7 the Board has -- has looked at this issue of potential
8 cross-subsidisation between electricity and -- and gas,
9 and I don't see why that would be a problem.

10 DR. LEN EVANS: I wonder if I could ask a
11 supplementary question, to Dr. Van Audenrode? I
12 appreciate your last comments, distinguishing between
13 various types of industry categories; monopolies on one
14 hand versus, say, the free market on the other hand, and
15 many different industry groups in between. So I
16 appreciate your remarks.

17 But would you not think back to what you
18 said about a private company that in hedging would go out
19 of business. And that's true if you were, say, in the
20 manufacturing business or retail sector, but if this was
21 a private utility -- and private utilities are monopolies
22 generally -- they are monopolies -- and they are
23 regulated -- even as a private utility, they're regulated
24 -- so how -- if a company went -- made bad decisions in
25 hedging and went bankrupt, maybe that ownership might

1 have to change, but the operation -- the entity -- would
2 have to carry on, because presumably, it's providing an
3 essential service and being regulated by a government
4 body.

5 DR. MARC VAN AUDENRODE: I'm -- look, I'm
6 -- I'm -- I'm -- I believe that, you know, that this is
7 something that -- that might be needed in some
8 corporation, and if this corporation go -- this
9 corporation go into hedging or -- or, you know, taking
10 position on the financial markets, if they bet wrong,
11 they're punished for that.

12 All I'm saying is here, in this case, I
13 don't see the -- the mechanism by which Centra making a
14 wrong decision, in terms of hedging, could be punished.
15 And, I mean, the only way I could imagine that happening
16 is -- is by making it in a very -- in a way that would
17 not make sense from a financial point of view, which
18 would be to somehow give guidelines to Centra on how to
19 hedge that would be so stringent that somehow there
20 wouldn't be any area of, you know, initiative for the
21 people in charge of the -- of the -- of the -- the -- the
22 program. And that, I think, wouldn't be a good way to --
23 to deal with -- with -- with the problem.

24 But all -- all I'm saying is, I don't see
25 here the immediate and -- and -- and clear sanction

1 coming from making the wrong decision on -- on, you know,
2 things that are very risky. I'm not saying anything more
3 than that.

4 DR. LEN EVANS: Yeah. Well, I appreciate
5 your comment. It just seemed to me it was a bit
6 confusing, but -- on that your distinction between a
7 privately-owned company and a publicly-owned company who
8 made decisions in hedging that could cause them to go
9 bankrupt. And you said, well, if it was private, you
10 know, definitely they would suffer --

11 DR. MARC VAN AUDENRODE: Yes.

12 DR. LEN EVANS: -- the consequences but
13 not public, necessarily.

14 But my point is that even if it was true
15 that the private owners would suffer, nevertheless, as a
16 utility providing an essential service regulated by
17 government agency, it wouldn't disappear. I mean, the
18 service would continue; perhaps under different
19 ownership, but it would still be there.

20 DR. MARC VAN AUDENRODE: If you -- if you
21 were the only utility, yes.

22

23 CONTINUED BY MR. KRIS SAXBERG:

24 MR. KRIS SAXBERG: And finally, Dr. Van
25 Audenrode, Dr. Cyrenne discusses the concept of cross-

1 subsidies when gas and electric services are provided by
2 the same firm. Do you recall that discussion in his
3 evidence?

4 DR. MARC VAN AUDENRODE: Yes. And -- and
5 he raises that issue, I -- I think, at two (2) levels.
6 One (1) is the potential for cross-subsidization between
7 electricity and natural gas that comes from the merger.
8 And then a little later on in his evidence, he -- he
9 raised it as the potential -- if Centra were allowed to
10 go into the long-term contracting, that Centra could
11 cross-subsidize its long-term clients by somehow
12 overcharging the -- the short-term default clients.

13 And I can -- I mean, fundamentally, I
14 think he -- he's right. I mean, these are things that
15 you should -- the Board should worry about, and these are
16 things that are possible. I wouldn't over-estimate the -
17 - the risk of cross-subsidization between electricity and
18 -- and natural gas because, as Dr. Cyrenne, himself,
19 says, you know, there are very economies of -- very
20 little economies of scope. These two very different
21 operations.

22 And so the -- the potential to -- for that
23 utility to somehow fool the Board by -- by switching
24 costs between these two (2) completely different
25 operation is -- is -- it's very limited.

1 But on -- on the issue of cross-
2 subsidization between the -- the short term regular
3 customers and the long term clients, I -- I think that's
4 a valid issue and the Board would have to make sure that
5 this doesn't happen.

6 MR. KRIS SAXBERG: Thank you very much.
7 With that, that closes our direct examination, and hand
8 it over to Board counsel.

9 THE CHAIRPERSON: Thank you, Mr. Saxberg.
10 Mr. Peters...?

11

12 CROSS-EXAMINATION BY MR. BOB PETERS:

13 MR. BOB PETERS: Thank you, Mr. Chairman.
14 Good morning to the panel of witnesses. and welcome
15 here, Dr. Van Audenrode. I have said that correct, have
16 I? Have I pronounced your name correct?

17 DR. MARC VAN AUDENRODE: Yes, you have.

18 MR. BOB PETERS: Thank you. Mr. Stauff,
19 I -- I don't make a mess of your name anymore so we'll --
20 I would indicate to Dr. Van Audenrode that when I have
21 questions for the witnesses, I may initially address it
22 to Mr. Stauff but if you feel you have a comment that the
23 Board would benefit from, you're welcome from my
24 perspective, to provide it.

25 And if I have questions as a result of

1 your answer, I'll pursue it with you. And likewise, if
2 Mr. Stauff has anything to add or supplement to any
3 answers you give, I will receive those and follow it up.
4 Is that acceptable? All right. thank you.

5 Mr. Stauff, in -- in preparing your
6 evidence that's been filed before the Board, to the
7 extent that there were principles included that had
8 economic theory embedded in them, was that theory from
9 you or was that theory from someone else in the
10 preparation of your testimony?

11 MR. MARK STAUFF: We may have to talk
12 about specifics but I -- and I was trying to avoid doing
13 that. I will say that having spent, you know, close to
14 twenty (20) years in the regulatory arena, I am generally
15 familiar with the, sort of, basic principles of
16 regulatory economics.

17 So I guess I would have to say that it
18 came from my general experience and understanding of the
19 industry, and I did not -- I have -- I did not consult
20 specifically, prior to writing a testimony, with anybody
21 else.

22 MR. BOB PETERS: And would it be fair,
23 Mr. Stauff, to summarize your evidence as your
24 suggestions that this Board should consider to change the
25 services offered by Centra, in an effort to optimize gas

1 supply options for Manitobans?

2 MR. MARK STAUFY: I think that's fair.

3 MR. BOB PETERS: And is it also fair that
4 in coming at your suggestions to the Board you're taking
5 into account where you see the competitive environment
6 today in Manitoba?

7 MR. MARK STAUFY: Yes.

8 MR. BOB PETERS: And also I believe you
9 qualify in your evidence that you want to talk about the
10 competitive environment for the small volume retail
11 customers which would include the small general service
12 class or SGS class of customers in Manitoba, is that your
13 understanding?

14 MR. MARK STAUFY: Yes, yes.

15 MR. BOB PETERS: And -- and the SGS class
16 in Manitoba's -- Manitoba, just so we're clear, it
17 contains both residential customers and some small
18 commercial customers?

19 MR. MARK STAUFY: That is my
20 understanding, yes.

21 MR. BOB PETERS: And you don't
22 differentiate between those two (2) in -- in your
23 evidence at all?

24 MR. MARK STAUFY: No. For these purposes
25 they're -- I treat them the same. My understanding is

1 that numerically there's a lot more residential than
2 small commercial but I -- there's -- nothing turns on
3 that distinction.

4 MR. BOB PETERS: Mr. Stauff, in your
5 evidence I understand it to be telling the Board that if
6 there was effective competition in Manitoba, prices of
7 natural gas and primary natural gas would be driven down
8 to their cost plus a normal return. Is that your view?

9 MR. MARK STAUFF: Well, at a -- at a high
10 level, I think that is a pretty generally understood
11 principle. I mean, certainly the primary gas that is
12 provided by Centra is regulated at a cost-based level,
13 and I -- I don't think it's going too far out on a limb
14 to say that in principle the -- the outcome of
15 competition or the trend of prices under competition
16 should be towards a cost-based level. That's what
17 competition does.

18 There's all kinds of nuances about
19 marginal cost versus average cost versus long-run, versus
20 short run and all that kind of thing, that I don't want
21 to get into here, but I mean in general terms that is my
22 understanding; is that's the expected effect of
23 competition and that is what regulation is intended to
24 mimic when regulators prescribe cost-based rates for
25 various services.

1 MR. BOB PETERS: Dr. Van Audenrode, you'd
2 agree with that answer from Mr. Stauff?

3 DR. MARC VAN AUDENRODE: Yes, I do.

4 MR. BOB PETERS: And that is that if the
5 market is well functioning, then consumers will pay a --
6 for their products, the cost of the product plus a normal
7 market return?

8 DR. MARC VAN AUDENRODE: If the market is
9 well functioning, gets to a competitive equilibrium, then
10 the price that is set on that market is cost plus normal
11 return, and normal return depending on, you know, the
12 nature, the risk, et cetera, et cetera.

13 MR. BOB PETERS: All right. And Mr.
14 Stauff, I took one of the other principles from your
15 evidence to be that if the market is competitive and
16 effective in Manitoba, that would ensure that the good or
17 service at issue is being produced in the most cost-
18 effective way, and that would be a by-product of this
19 effective-competitive market?

20 MR. MARK STAUFF: I as a general
21 principle I have assumed that, yes.

22 MR. BOB PETERS: You assume that, too,
23 Dr. Van Audenrode?

24 DR. VAN AUDENRODE: Yes, it's a basic
25 principle that if you are in a competitive market and

1 your costs are higher than your competitors and you're
2 being driven, you will be driven out of the market. And
3 ultimately only the lowest-cost competitors would stay.

4 MR. BOB PETERS: Well, in the terms of
5 Centra providing primary gas, in an effective competitive
6 market, what price would Centra charge its customers?

7 MR. MARK STAUF: For the service that it
8 provides now? Roughly, you mean?

9 MR. BOB PETERS: For the primary gas that
10 it provides, yes.

11 MR. MARK STAUF: Yes, on the kind of
12 pattern that it provides it now.

13 Well, I mean that -- Centra flows its
14 costs through -- in a particular pattern that may or may
15 not correspond to what it would actually charge if it was
16 a competitive firm, and if it, in fact, faced
17 competition.

18 But I think on -- on average, then, they
19 would -- what they would do is recover their actual gas
20 costs as they do under their current mechanism. And they
21 may have, if they were a competitive firm, they might
22 have -- probably would have -- some element of markup or
23 return built into their price. It might be higher; in
24 other words, on average.

25 MR. BOB PETERS: If I'm understanding

1 your answer, Mr. Stauff, if the Manitoba market was by
2 your definition an effective competitive market, Centra's
3 price for their primary gas product would be different
4 than what it is now?

5 MR. MARK STAUFF: It could be.

6 MR. BOB PETERS: And --

7 MR. MARK STAUFF: Not a lot different, but
8 it might be marginally different.

9 MR. BOB PETERS: Okay, thank you. If it
10 could -- if it might be a little bit different, in -- in
11 an effective competitive market place, I'm understanding
12 your evidence to suggest that it would be higher than it
13 is today?

14 MR. MARK STAUFF: Again, all else equal I
15 think it -- that's probably fair, yes.

16 MR. BOB PETERS: And that's fair because
17 if Centra's price was in a fully functioning, a well-
18 functioning effective competitive market it would have to
19 include a higher return in addition to the costs it
20 presently recovers.

21 MR. MARK STAUFF: It may well, sure. I
22 mean it's -- it's sort of a weird world that we're
23 talking about here, I have to say, because you know, the
24 notion that you would have an utility on the scale that
25 Centra is -- in an environment where it was actually

1 facing competition in gas sales on a scale that would --
2 that would be sufficient to constrain its prices to
3 something like a competitive level -- I'm just having
4 trouble generating that picture in my head. But in
5 general terms I think you're -- you're correct. Probably
6 a competitive firm would -- would earn its return in a
7 different way on gas sales, than what Centra does.

8 What -- part of my confusion -- part of my
9 reluctance to be definite about this is, it's not clear
10 that Centra doesn't already in some sense own a -- earn a
11 return on making gas sales. It doesn't show up as a
12 margin added to gas costs but they -- and again this is
13 even more confusing with it being a publicly-owned
14 company -- but if you take a typical privately-owned
15 utility like Union Gas or something, they don't charge a
16 markup on the gas that they sell, but what they do do is
17 earn a return on their overall business.

18 Now, we all sort of notionally attribute
19 most of that to a return on their capital investment in
20 facilities. But I think if you wanted to get picky about
21 it, you could argue that they are earning, as part of
22 that return, some compensation for whatever risk they
23 take in providing their gas sales service, if their
24 return is in fact a fair one for the overall business
25 that they conduct.

1 And again, it's difficult to measure
2 because most of these utilities take very little risk on
3 their gas sales services. They don't take zero risk.
4 There certainly have been instances in North America of
5 utilities getting disallowances over gas supply issues
6 but it's -- it's pretty rare and it's a pretty small
7 risk.

8 So it is a confusing area. I mean I agree
9 generally you may see -- you might see slightly higher
10 prices overall if Centra was operating in a competitive
11 environment, but on the other hand, its -- its risk
12 profile might be different as well, which could account
13 for some of those differences. It's hard to make an
14 apples-to-apples comparison, I think.

15 MR. BOB PETERS: All right. Just to
16 capture that one (1) thought, that if Centra was in this
17 -- the effective competitive market that you envision and
18 their cost was higher, that cost might be higher to
19 compensate them for the return -- sorry, the -- the cost
20 might be higher by way of a return to compensate them for
21 the risks that they're taking in procuring the gas?

22 MR. MARK STAUF: Right. The risks that
23 they take in matching up their -- their procurement
24 activities with their sales activities, which right now
25 they don't have any.

1 MR. BOB PETERS: Well, that was my next
2 question and I -- can you tell the Board in this -- if
3 the envisioned environment where there's a fully-
4 effective and competitive marketplace, what additional
5 risks, over and above those that Centra has as of the
6 last time you were in our province, at the GRA, would
7 exist for the gas utility?

8 MR. MARK STAUF: I'm sorry, could you --
9 could you give me that one again? I'm --

10 MR. BOB PETERS: Yes, certainly. You
11 were at our General Rate Application --

12 MR. MARK STAUF: Yes, I was.

13 MR. BOB PETERS: -- and you provided
14 evidence at that Hearing?

15 MR. MARK STAUF: Yes. Yes.

16 MR. BOB PETERS: And in that Hearing
17 there was some discussion, including evidence by one (1)
18 of the CAC-led witnesses dealing with risks and rate of
19 return and compensation to the company for their efforts?

20 MR. MARK STAUF: Right.

21 MR. BOB PETERS: And I'm understanding
22 you to be telling the Board that as you see the future,
23 if it evolves to an effective, competitive marketplace,
24 Centra's default offering may have to increase in price
25 because it would be wanting a larger return for the risks

1 that it would then be taking?

2 MR. MARK STAUF: If in fact it was
3 taking on more risk, yes, it would --

4 MR. BOB PETERS: You don't see then that
5 there would be any occasion where it would have to take
6 on more risks in a future environment?

7 MR. MARK STAUF: Well, it might. It
8 could, it depend -- it would depend on what the nature of
9 the competition was. Like right now, they don't have --
10 they have very little risk on that because they have
11 deferral accounts, first of all, and they -- in the sale
12 of retail gas, they probably have enough market power,
13 that no matter what happens they're always going to
14 recover their -- they have enough customers that they
15 will always be able to recover whatever deferral amounts
16 they happen to run into. Again, it's sort of a -- we're
17 talking two different styles of universe here.

18 Under competitive conditions where they
19 really did stand -- did face competitive -- effective
20 competitive pressure from some other comparable-sized
21 entity, they probably would have more risk and they would
22 probably build that into their pricing somehow. I don't
23 know how they would do it but they would probably do it.

24 MR. BOB PETERS: Well, I'm going to jump
25 a little bit ahead with that answer, then, Mr. Stauff.

1 If, as you've indicated in your evidence, Centra was
2 permitted to offer a competing fixed-price offering with
3 the retailers or brokers, you suggest that there might be
4 some added risk that they carry by doing so?

5 MR. MARK STAUF: Well, my assumption in
6 all of this -- the analysis of that in my testimony is
7 that Centra, itself, would not assume any of that risk.
8 And so one of the problems with designing those services
9 -- this is all discussed in the last little section of my
10 testimony that I alluded to, or that I talked about right
11 at the end of my presentation.

12 One of the issues with designing those
13 services will be how exactly you deal with that, if the
14 Utility isn't going to take it. I mean, you could make
15 the Utility take it but that raises all kinds of other
16 thorny issues. But my assumption was if the Utility
17 wouldn't be taking that risk -- which means it has to go
18 to somebody else, either upstream to a supplier or
19 downstream to customers. And there will be an issue
20 about how that gets done.

21 Now the -- sorry. Providing those fixed
22 term products does create risk, sort of at an abstract
23 level, right? Because you do have inevitably mismatches
24 between revenues and costs, and so then the question
25 becomes: Who that risk goes to.

1 MR. BOB PETERS: All right. You have
2 identified three (3) parties to whom that risk could go
3 to: one (1) being the Utility; one (1) being the
4 customers; one (1) being the upstream suppliers.

5 MR. MARK STAUF: Right.

6 MR. BOB PETERS: And you've jumped to the
7 conclusion that the Utility shouldn't carry any
8 additional risk if it was even allowed to offer
9 additional products?

10 MR. MARK STAUF: Well, I made that
11 assumption, yes. I mean, obviously, you could make
12 another assumption or you could make -- you could adopt a
13 different model for the offering of those kinds of
14 products, under which the Utility did assume some of that
15 risk. In that case, I assume -- I expect that the
16 Utility would be looking for compensation for that. I
17 mean, in order for it to have a fair return, it would
18 need to be compensated for those risks.

19 MR. BOB PETERS: All right. And if the -
20 - if the risks were to be borne by the upstream supplier,
21 you would expect the upstream supplier would charge more
22 for their product or their natural gas to Centra?

23 MR. MARK STAUF: Yes, that would get
24 imbedded in that price, yes.

25 MR. BOB PETERS: All right. And then the

1 third person, or the third option on this risk tree,
2 would be to leave the risk for the consumers?

3 MR. MARK STAUF: Right. Yes.

4 MR. BOB PETERS: And would that manifest
5 itself in higher costs as well?

6 MR. MARK STAUF: Not necessarily, I
7 don't think. When I'm talking about risk here -- what
8 you're talking about, really, is variability in cash
9 flows, essentially. Because if Centra was offering
10 fixed-price products, if it was priced properly, sort of
11 on an expected basis, it would be either over- or under-
12 recovering its costs of associated with providing that
13 service, during most of the periods.

14 And so that over- or under-recovery would
15 have to go somewhere. And in the scenario we're talking
16 about it would probably go to the, sort of, base or
17 variable rate customers. But it's not necessarily a
18 systematic addition to gas costs or a systematic
19 subtraction from gas costs. There would be a little bit
20 more volatility probably, but it wouldn't necessarily be
21 a systematic positive or negative for -- for customers.

22 And in fact, if you thought there was you
23 -- you would probably want to design the sales that --
24 the fixed priced rate in a way to compensate that, to
25 make sure that there wasn't any systematic effect on the

1 remaining customers.

2 MR. BOB PETERS: So -- so just a couple
3 of points on that, Mr. Stauff. If the risks were going
4 to be passed to the customers, that could include
5 increasing the sales rate to those customers for any
6 fixed price offerings, and that's where the risk would be
7 captured?

8 MR. MARK STAUFF: Sorry, for the -- well
9 it -- sorry, the point I was making is -- was that if you
10 thought that there was going to be a systematic shift of
11 expected costs to the variable rate customers, I assume
12 that what Centra would want to do and Intervenors would
13 want to do is adjust the sales rates to -- to compensate
14 for that.

15 So that yes, sales rates would go --
16 basically you'd have to charge the -- the fixed rate
17 customers some increment to make up for that, just to
18 keep the -- the variable rate customers whole.

19 MR. BOB PETERS: Well -- and -- and
20 that's my second point, Mr. Stauff, is that if there were
21 additional costs as a result of any additional risks, for
22 offering a fixed price offering by the Utility, the
23 Utility or the customers who -- who take up that offering
24 should be responsible for those additional costs, should
25 they not --

1 MR. MARK STAUF: Yes.

2 MR. BOB PETERS: -- rather than be cross-
3 subsidized by the default customers?

4 MR. MARK STAUF: I -- I agree with that
5 completely, yes.

6 MR. BOB PETERS: And likewise, Dr. Van
7 Audenrode, you -- you would agree that if you ran into
8 additional risks by offering a fixed price offering and
9 there were additional costs that were attracted to that,
10 the default customers, the ones who don't elect Centra's
11 fixed price offering, should not be exposed to those
12 additional costs?

13 DR. MARC VAN AUDENRODE: Yes I -- I agree
14 with that.

15 MR. BOB PETERS: All right. Just --

16 DR. MARC VAN AUDENRODE: If -- if I may--

17 MR. BOB PETERS: Yes, yes, Mr. --

18 DR. MARC VAN AUDENRODE: -- add. I mean
19 ultimately what you want are for consumers to pay the
20 real -- the right -- the fair and correct price for their
21 -- for their gas. I mean, you don't want them to pay too
22 much, you don't them to pay too little, because then they
23 will waste it.

24 And if there are risks associated with
25 offering long term contracts, these risks should be borne

1 by the consumers who elect to buy these long-term
2 contracts.

3 MR. BOB PETERS: Thank you. Mr. Stauff,
4 I don't want to lose sight of what might be a small
5 point, but I think you've agreed with me in general
6 terms, that in this effective competitive market that you
7 envision, not only will prices be down to their cost plus
8 a normal return, but also the goods or the natural gas
9 would be produced in a most cost effective way.

10 You've agreed with me on those points,
11 correct?

12 MR. MARK STAUFF: Yes. The good in this
13 case being -- are being natural gas delivered to people's
14 houses in Manitoba.

15 MR. BOB PETERS: And that would be the
16 primary gas, just to be more specific?

17 MR. MARK STAUFF: Primary gas, yes,
18 sorry.

19 MR. BOB PETERS: Now in case of -- in the
20 case of Centra, can you tell the Board whether or not
21 Centra is ensuring that the natural gas they sell is
22 produced in a most cost effective way? Or do you make
23 that as an assumption?

24 MR. MARK STAUFF: Under the existing
25 regime basically -- for the existing sales service?

1 MR. BOB PETERS: As it exists today, yes.

2 MR. MARK STAUF: Well, I think that is
3 the purpose of the Board's review of Centra's rates in
4 the general rate applications.

5 MR. BOB PETERS: And so with respect to
6 natural gas, the molecules themselves, you're not
7 suggesting that Centra can acquire them any cheaper than
8 they are presently?

9 MR. MARK STAUF: No, I'm not suggesting
10 that. I'm not suggesting that at all. But particularly
11 in this case. But even in our discussion in the --
12 during the GRA, I -- I didn't express any concerns about
13 the upstream supply arrangements that Centra has.

14 MR. BOB PETERS: Mr. Stauf, do you know
15 whether or not brokers who are supplying the SGS market
16 in Manitoba are obtaining their primary gas in the most
17 cost effective way?

18 MR. MARK STAUF: Well, I assume that
19 they are for their own purposes, or they think they are.
20 They're trying to.

21 MR. BOB PETERS: And I'll -- I'll just
22 expand the vocabulary here. I haven't gotten to -- or
23 Mr. Hoaken hasn't trained me well enough yet, but when I
24 say "brokers" I also mean retailers or marketers or
25 aggregaters or --

1 MR. MARK STAUFY: Sorry. Yeah, that's
2 how I understood you.

3 MR. BOB PETERS: All right. And that's
4 how I mean it, and I will -- I won't always catch myself,
5 although I'll try.

6 So as you're sitting here, Mr. Stauff,
7 you're not suggesting to the Board that the brokers could
8 do something different to acquire primary gas cheaper
9 than they presently are?

10 MR. MARK STAUFY: Well, I don't know how
11 they do it now, so it's -- it's difficult for me to say
12 that. It would surprise me a lot if Direct or Energy
13 Savings or any other retailer was operating its upstream
14 business in a way that I would be in a good position to
15 criticize them. I mean, they -- they operate their
16 business, they're -- they know what they're doing. They
17 presumably are being as efficient as they can already, in
18 order to maximize their -- their profits.

19 MR. BOB PETERS: And then turning to
20 profits. It's your view that competition in Manitoba has
21 not yet driven down the retailers' primary gas prices to
22 the cost plus normal return?

23 MR. MARK STAUFY: I don't want to
24 overstate that. I think the way I expressed it in my
25 evidence, or at least was hoping to express it in my

1 evidence, was that I think there is some reason to be
2 concerned about that. It's -- it's a very difficult
3 question to answer empirically, and there is no bright-
4 line test for these kinds of things.

5 So what I go -- the analysis that I go
6 through in my testimony, is just pointing out some
7 factors that I think should make the Board nervous about
8 whether competition is being effective in that sense.

9 MR. BOB PETERS: Well, if you make the
10 Board nervous, you also acknowledge that there's really
11 no way they can know otherwise. They can't have an
12 empirical answer to the question of whether or not
13 brokers have -- and retailers have competed to the point
14 where their prices are driven down to a cost plus normal
15 return.

16 MR. MARK STAUF: No, that's -- that's a
17 fair observation, that's true. And it's -- part of the
18 reasoning behind allowing Centra to participate in the
19 market on a regulated basis is that, regardless of what
20 any of us might think about the empirical question, if
21 Centra's fixed-price sales rates are designed properly,
22 they will -- they will help to ensure the competitive
23 result that we're hoping for.

24 We don't really know what's happening with
25 the -- with the returns and -- and cost bases for the

1 brokers' products, but it certainly won't hurt that, and
2 it will help it from a public interest perspective, I
3 think, if they have more competitors and more competitive
4 pressure on them.

5 MR. BOB PETERS: Not that we assign
6 blame, Mr. Stauff, but it's not Direct Energy's or Energy
7 Savings' fault that there's no more competitors in
8 Manitoba, is it?

9 MR. MARK STAUFF: No. No, it's not.

10 MR. BOB PETERS: It's -- you had
11 mentioned in your direct evidence to Mr. Saxberg that
12 back in '96 when Enron visited upon Manitoba, as well as
13 Dynegy and a few other retailers, there was an
14 expectation by you that those parties would come to
15 Manitoba and compete for some of the residential market
16 share?

17 MR. MARK STAUFF: Either directly or
18 indirectly, yes. I think that was the hope and the
19 expectation, that's fair.

20 MR. BOB PETERS: When you say indirectly
21 compete in Manitoba --

22 MR. MARK STAUFF: Well --

23 MR. BOB PETERS: -- what do you mean by
24 that?

25 MR. MARK STAUFF: -- I was -- sorry, I

1 was drawing a distinction between -- again, in that
2 proceeding, I had in my head; a sort of unbundled picture
3 of the world.

4 So, some companies might or might not be
5 engaged in the business of actually selling gas to
6 individual customers at their houses, versus supplying
7 those types of retails with -- retailers with gas at the
8 Centra city gate, for example.

9 People can -- different parties can occupy
10 different, sort of, layers in the -- in the supply chain
11 along there but, again, in my picture of the world at
12 that time, I was hoping that there -- you would see much
13 more of a market develop at the Utility city gates than
14 existed at the time or than has happened so far.

15 MR. BOB PETERS: And that hasn't happened
16 so far, primarily because of the long-term fixed assets
17 that the Corporation has, including their storage and
18 transportation arrangements?

19 MR. MARK STAUF: Right. It's -- it's
20 because of the way that WTS service works, right?

21 You -- you -- really, your only option, if
22 you're a retailer, is to use the WTS service. And it is
23 -- that is the case, and it is designed the way it is for
24 a reason. And as you say, the reason for that,
25 basically, is that somebody has to pay for all of the

1 upstream transportation and storage infrastructure that
2 Centra has contracted for on a long-term basis.

3 MR. BOB PETERS: And you -- and you're
4 not filing evidence, and you haven't filed evidence in
5 these proceedings to suggest to the Board that -- that
6 there should be this unbundling vision at this time?

7 MR. MARK STAUF: No. No, I haven't.
8 And I -- in fact I -- I responded to an IR about that.
9 In my testimony, I -- I noted the fact that in the -- the
10 earlier proceeding that you and I participated in; that
11 was a big part of our pitch, frankly.

12 MR. BOB PETERS: Apparently three (3) of
13 us participated.

14 MR. MARK STAUF: Yeah, I think it was.
15 I -- it was a long time ago, but that was -- from TCGS's
16 perspective, that was -- that was a big deal. The theory
17 being -- even back then, you know, that if what you're
18 talking about is competition in -- to acquire supply in
19 the Alberta market, there's really very little room for
20 anybody to be better at that than Centra, or any of the
21 other utilities are.

22 So the unbundling theory was, well, where
23 there may be room for efficiency gains to be obtained is
24 in the operation and -- and contracting for upstream
25 infrastructure.

1 So, if -- the pitch was, basically, to the
2 Board, if you want meaningful improvements or meaningful
3 reduced costs, the only way to get that is going to be to
4 let companies like TCGS or Enron or whoever's interested,
5 perform the upstream transportation and storage function
6 on an unregulated basis as well. That -- as I say, that
7 was the -- the pitch.

8 Now I mean, I was asked about that in an
9 Information Request about -- well, is that still what you
10 think, or why didn't that happen, or do you still think
11 that would be a good idea?

12 Again, as I say, I don't want to turn it
13 up but, basically, what's happened is that the world just
14 hasn't unfolded in the way that we sort of hoped and
15 expected back at that time.

16 The -- well, there's -- it's a -- it's a
17 complicated business trying to unbundle all of those
18 services, given that Centra has to retain them
19 ultimately, because they are, I'm sure Centra will claim,
20 needed for the purposes of serving the Manitoba market in
21 aggregate; not just its customers, but everybody else.

22 So it's very complicated trying to figure
23 out how to allocate these out and how to get them back,
24 and how to transfer these little tranches of capacity and
25 storage around. So that's one difficulty.

1 And the second difficulty is, I'm not sure
2 that there are enough people in the market that are
3 interested in doing that kind of thing to make it
4 worthwhile. When I worked with TCGS, that was sort of
5 our picture in our own heads of how we would grow and
6 prosper over the coming decades. But it didn't happen
7 with TCGS; it didn't grow and prosper. And there aren't
8 that many firms -- there are a few -- but there's not
9 that many firms that are engaged in that kind of thing.

10 And the firms that do do that sort of
11 activity aren't typically interested in retail sales.
12 And vice versa, companies that are interested in door-to-
13 door retail sales don't typically operate on that kind of
14 wholesale level.

15 And just to -- to finish this off, the
16 other piece of evidence that I was basically just wrong
17 in my prediction about this was going to work, is that in
18 Ontario, they actually did the experiment of creating
19 unbundled services for Union Gas.

20 Union Gas went to the trouble, basically,
21 on the same premises that we've been talking about, of
22 creating all these unbundled services and creating
23 mechanisms to allocate all this storage and
24 transportation out, and all the technical stuff that's
25 required to make that make sense. And the net result was

1 that zero people have signed up for that service.

2 As of a year ago, anyway, the last time I
3 checked, they had no customers. It was all, you know, in
4 the tariff. The rate schedules were all there, but no
5 customers.

6 And what that tells me is that however
7 attractive my -- you know, the - the unbundling theory
8 is, in the real world, real world market participants,
9 when they look at that and look at what's involved in
10 actually mounting that kind of an effort, decide the cost
11 isn't worth the benefit, basically.

12 That's the market result. That's -- the
13 market has spoken and it's just not there.

14 MR. BOB PETERS: In your evidence, Mr.
15 Stauff, you indicate that if competition was to
16 effectively exist in Manitoba, then the retailers should
17 only expect to recover their costs, plus a normal return.

18 MR. MARK STAUFF: Again, as --

19 MR. BOB PETERS: Correct?

20 MR. MARK STAUFF: -- as it -- yes.

21 MR. BOB PETERS: As it relates to primary
22 gas?

23 MR. MARK STAUFF: Yes.

24 MR. BOB PETERS: Can you tell the Board
25 and define what a "normal return" is?

1 MR. MARK STAUF: In this instance, I
2 can't, no. I mean, I was saying before that it's a very
3 difficult thing to measure, sort of, empirically or to
4 even conceptualize empirically.

5 And -- and let me put it this way. The
6 idea of what a normal or fair return is, even in the
7 relatively simple case of a utility where the return is
8 conceived of, basically, it's just a return on invested
9 capital. I mean, I'm sure you've seen and been a party
10 to hugely controversial proceedings about that. It's
11 very difficult to do.

12 And in the case of a retail business like
13 what Direct and Energy Savings operate, it becomes even
14 worse. I mean, they don't have significant physical
15 assets. A lot of their assets that you would think they
16 are earning an normal return on are really intellectual
17 capital; didn't cost them anything. It's -- it's a very
18 difficult problem.

19 They've run into this problem in -- in
20 Alberta, actually, in trying to figure out what a normal
21 return is for electricity; default electricity regulator
22 -- or retailers, where the government just said, yes,
23 they should be -- that they should be entitled to earn a
24 return, and the UB had -- was faced with the problem of
25 trying to figure out what that was going to be.

1 I mean, they ended up coming up with a
2 number, but it's a difficult process and I certainly
3 don't have any idea what it would be.

4 MR. BOB PETERS: Would it be fair, then,
5 to conclude that if you don't know what it would be, you
6 don't know for sure that it's not presently being earned
7 by the retailers in Manitoba?

8 MR. MARK STAUF: As I acknowledged
9 before, yes. I mean, I -- I'm not trying to be definite
10 about that. I'm just -- as I just -- as I said, there's
11 cause for concern, but it could be that they are --
12 everything is just absolutely as it should be with --
13 with the way their businesses are working now.

14 MR. BOB PETERS: And maybe the market is
15 effectively competitive as it exists today?

16 MR. MARK STAUF: It's possible, yes.

17 MR. BOB PETERS: You answered to me just
18 a few minutes ago that -- that the retailers were not
19 using their own assets but they were using -- I wrote it
20 -- I wrote down "intellectual capital."

21 What did you mean by that? If I've
22 remembered you correctly.

23 MR. MARK STAUF: Okay. Again, I don't
24 want to wander too far into theoretical economic areas
25 that I'm not really qualified to talk about. But I mean,

1 my understanding is -- as I said, it's -- it's hard to
2 see what a -- what an appropriate return is for a company
3 that doesn't really have any cash assets, right?

4 Part of energy savings assets is the skill
5 set of Ms. Ruzycki, for example, and all of their --
6 their staff. These people are valuable and, as I say --
7 my point was just that it's very hard to -- to evaluate
8 the appropriateness of returns on these things, just
9 because they are, as I say, skilled people; institutional
10 knowledge inside the company; just business organization
11 systems that they've developed. Stuff like that.

12 MR. BOB PETERS: Thank you for that. I
13 take it from your answer then what you're trying to tell
14 the Board is that unlike the local distribution company,
15 there's not an intensive capital investment in the
16 physical assets, and that's why you went to the
17 intellectual assets?

18 MR. MARK STAUFFT: Yes, as far as I know.
19 I mean I can't imagine what physical assets they have.

20 MR. BOB PETERS: Fair enough. Mr.
21 Chairman, with that answer and the hour being
22 approximately noon, this might be an appropriate place to
23 take the lunch recess and I'll resume after the break.

24 THE CHAIRPERSON: Sounds good, Mr.
25 Peters. We'll come back at 1:30, thank you.

1 --- Upon recessing at 11:58 a.m.

2 --- Upon resuming at 1:31 p.m.

3

4 THE CHAIRPERSON: Okay, Mr. Peters...?

5

6 CONTINUED BY MR. BOB PETERS:

7 MR. BOB PETERS: Thank you, Mr. Chairman.

8 Good afternoon, Mr. Stauff and Dr. Van Audenrode.

9 Mr. Stauff, you don't know if competition
10 has driven brokers prices down to cost plus a normal
11 markup, do you?

12 MR. MARK STAUFF: No. I think I said
13 that. What I said was there are reasons to be concerned
14 about whether that is the case or not.

15 MR. BOB PETERS: All right. Can I take
16 that answer to say you have suspicions that it's not a
17 cost plus a normal return for what they're charging?

18 MR. MARK STAUFF: Right. Given -- given
19 the analysis that I've done of -- of their cost versus
20 their prices and the -- my understanding of the dynamics
21 of how door-to-door marketing works, I think -- yes, as
22 you say, I have suspicions about that.

23 MR. BOB PETERS: And if we define the
24 cost of the primary gas molecules as the market price,
25 then that's the market price that Centra's presently

1 paying for their primary gas; is that correct?

2 MR. MARK STAUF: Well I -- I was
3 thinking about it in terms of the cost of the delivered
4 service that Centra or the -- or the brokers provide.

5 MR. BOB PETERS: Well if we -- if we
6 understand from what you told us before lunch, Mr.
7 Stauff, the delivered service isn't what's provided by
8 the retailers, because the delivered service is really
9 provided the Utility with the exception of the primary
10 gas. Everything is exactly the same whether it's Centra
11 or a retailer, except the primary gas molecule source.

12 MR. MARK STAUF: Okay, fair enough. But
13 I -- you know, as a -- just as a brute fact, what happens
14 is the -- the retailers sell people gas at their houses,
15 right? It's delivered to their house.

16 And, as you say, the delivery
17 infrastructure that moves that gas from imprest to those
18 houses is basically under the control of Centra. But,
19 you know, there -- there may be other costs apart from
20 gas -- just the cost of gas that the brokers incur.

21 They have to pay their staff, they have to
22 pay their door-to-door guys commissions; all that kind of
23 thing.

24 MR. BOB PETERS: Okay, and we'll come to
25 that. But I want to explore with you, Mr. Stauff,

1 whether or not brokers can buy natural gas cheaper than
2 Centra can.

3 MR. MARK STAUF: Right.

4 MR. BOB PETERS: And is it your
5 conclusion that they cannot?

6 MR. MARK STAUF: On an expected basis,
7 on average, in the long run, I would say no. I mean, in
8 any given -- on any given day, they may be able to but,
9 on average, no.

10 MR. BOB PETERS: Dr. Van Audenrode, is
11 that -- does that theory sound -- is that supported by
12 economic theory; that the retailers cannot purchase the
13 molecules of primary gas cheaper than the utility
14 currently is?

15 DR. MARC VAN AUDENRODE: Can I -- can I
16 just qualify first your question? They -- they are not
17 buying the same molecule. Well, it's gas, but it's a
18 different financial instrument.

19 Centra buys gas for the, you know, spot
20 market. The retailers sell gas with long-term fixed-
21 price contracts. I would suppose that they are operating
22 on, you know, future markets and -- and so that they are
23 operating on a -- on a different -- on a -- on a -- on a
24 market that is not the same in terms of buying their gas
25 than Centra is.

1 Now transfer directly your question.
2 Being able to beat the market every time for sure is the
3 Holy Grail of every single operator on any financial
4 market. And if it is the Holy Grail, it's for a good
5 reasons; nobody has ever reached it.

6 So I think that, on average, you know, the
7 retailers might be very good at what they do, but, on
8 average, I don't see them in the long run significantly
9 beating the market.

10 MR. BOB PETERS: Dr. Van Audenrode, what
11 if the -- what if the retailers owned the producing
12 assets of the natural gas? Would that be possible, then,
13 that they could acquire the gas cheaper than could
14 Centra?

15 DR. MARC VAN AUDENRODE: I don't think
16 so.

17 MR. BOB PETERS: Why not, if they own the
18 supply?

19 DR. MARC VAN AUDENRODE: Well, the market
20 is very liquid and so, you know, if you own the producing
21 asset there is a market price and -- and -- and, you
22 know, the -- the -- the real value of this molecule is --
23 is the one that is set by the market.

24 Now you could -- you know, you -- you
25 could fool your -- your shareholders by selling yourself

1 the -- the -- this -- these molecules at a price that is
2 below market rate. But that won't be proper business, I
3 would think.

4 MR. BOB PETERS: Mr. Stauff, you told the
5 Board a couple of months ago that Centra could procure
6 gas on different hubs and that might make it cheaper than
7 a western Canadian source. Do you recall evidence to
8 that effect?

9 MR. MARK STAUFF: Yes, that's physically
10 possibly for -- for Centra.

11 MR. BOB PETERS: And is it not physically
12 possible for the retailers to do that too?

13 MR. MARK STAUFF: It could be, yeah. And
14 that goes to the unbundling issue that we talked about.
15 I mean, I -- I'm not sure that right now you would say
16 that that's likely to be a -- a successful strategy, but
17 in principle that's certainly possible to do from where
18 Manitoba is situated.

19 MR. BOB PETERS: Mr. Stauff, to follow up
20 with you on a -- on a -- an answer given by Dr. Van
21 Audenrode.

22 Do you expect the retailers are buying gas
23 on the physical market and then hedging their product, or
24 are they buying it on the physical market and leaving it
25 unaffected by financial instrument?

1 MR. MARK STAUF: I really have no idea
2 how they operate their business. They -- they could do
3 it in any number of different ways. They could be buying
4 gas -- they could be supplying their long-term customers
5 with gas that they buy on a daily basis for all I know.
6 Or monthly, or yearly, or, you know, fixed price physical
7 for various terms with financial instruments applied as
8 well.

9 More likely, I would guess that they
10 actually use a variety of different approaches, depending
11 on their view of the market and their view of their
12 overall requirements and what assets they have, and it's
13 probably not a stable -- a stable thing. Although,
14 obviously, you -- you'd have to ask the -- you really
15 should ask them if you --

16 MR. BOB PETERS: I'll try to remember to
17 do that, but I just wondered if you had a view on whether
18 that could happen. But --

19 MR. MARK STAUF: They could do it in any
20 number of different ways.

21 MR. BOB PETERS: Well, and whereas Dr.
22 Van Audenrode talked about Centra being on the spot
23 market, it's possible for the retailer to be in the one
24 (1) year, three (3) year, five (5) year physical market?

25 MR. MARK STAUF: And they may well be.

1 I mean, I -- I would guess, without knowing their
2 business, that for at least some part of their supply,
3 they would think that it's prudent to purchase it under
4 long-term arrangements of same kind; either physically or
5 with a -- a long-term hedge applied.

6 I mean, that reduces their risk; it's part
7 of their risk management strategy. So they -- I think
8 it's reasonable to assume that they do that for at least
9 some of the time, but I don't know that for sure, and I
10 don't know that they would do it for everything.

11 MR. BOB PETERS: Is it possible that
12 those purchases on the longer-term market would yield
13 them a lower cost than Centra's?

14 MR. MARK STAUF: Just by chance, it
15 might, sure. I mean, it's -- it's the same -- again, the
16 -- the prices at which they will be able to acquire gas
17 under a five (5) year deal in the market, that market
18 price -- whatever it is -- should, in principle, reflect
19 the market's collective expectation about what the
20 average of the shorter-term prices are going to be over
21 that five (5) year term.

22 So, on average, in the long run, on an
23 expected basis, it should turn out to be same. Now, in
24 real life it'll -- it will almost certainly be either
25 higher or lower by some amount.

1 But you -- you can't predict which way it
2 will go. So they -- they may do better but they may be
3 worse too.

4 MR. BOB PETERS: To take Dr. Van
5 Audenrode's analogy, is it possible that the retailers
6 will -- not go to Costco, but to purchase a large
7 quantity of primary gas, larger quantity than the Utility
8 is buying in Manitoba and by -- by virtue of the larger
9 quantity, receive a lower price?

10 MR. MARK STAUF: I don't believe that
11 just factually, at the kinds of volumes we're talking
12 about, you're -- you're going to see significant
13 differences in price based on volumes.

14 If anything, the -- the -- if -- if
15 anything it would probably go the other way against the
16 brokers if they're buying gas in -- in smaller lots just
17 because their market is smaller.

18 But again, that is a function of how they
19 operate their business. Whether they integrate their
20 purchases here with their activities in other markets or
21 -- or what. And again I -- you'd have to ask them about
22 that.

23 MR. BOB PETERS: Is it possible, Mr.
24 Stauff, that the retailers would speculate on the price
25 of gas and, in the words in somebody's evidence, try to

1 beat the market and, because of that, they're able to
2 offer a lower price than -- than Centra might be able to?

3 MR. MARK STAUF: They may be able to do
4 that, sure. It wouldn't surprise me if they speculate to
5 some extent with this and they may -- they may be able to
6 offer a lower price for some period.

7 But again, you know, I'm -- I'm thinking
8 about this in the long run as a sustainable business,
9 right? And, you know, as Dr. Van Audenrode said, sure,
10 you're got all kinds of traders and speculators in
11 Calgary who get paid to try to out-guess the market, just
12 as there are all kinds of mutual fund managers that get
13 paid for that, but the reality is, on average and in the
14 long run, they don't. So, sure.

15 MR. BOB PETERS: Well then, let's take
16 those last series of answers, Mr. Stauff, and come to a
17 conclusion that you believe that retailers and Centra are
18 on average paying the same price for the molecules of
19 gas?

20 MR. MARK STAUF: Yes. That that's what
21 should be expected; again in the long run, subject to all
22 the caveats I've already given you about how on any given
23 day or month, then sure, you can beat the market, but on
24 average, no.

25 MR. BOB PETERS: All right. Then let's

1 take some stock here and go forward. You had told us
2 this morning, I believe, that in a well functioning
3 competitive market two (2) things would happen.

4 One (1) was the goods or services, and in
5 our case, primary natural gas would be produced in a cost
6 effective way, and you take the assumption that that is
7 in fact happening already, correct?

8 MR. MARK STAUF: Sorry, the goods are --
9 goods or service we're talking about here being?

10 MR. BOB PETERS: The primary natural gas
11 molecules.

12 MR. MARK STAUF: Certainly for the --
13 yes, I -- I -- I think that's true for Centra. Having
14 looked at their supply acquisition model that they have,
15 their Nexen contract and -- and all of that.

16 MR. BOB PETERS: And then you are also of
17 the view that on average the cost of the molecules of
18 primary gas is the same whether it's sourced by Centra or
19 the retailer?

20 MR. MARK STAUF: Right. They're all
21 buying it from the same market.

22 MR. BOB PETERS: And, therefore, it's
23 your conclusion that any difference in price charged by
24 Centra compared to the retailers would be due to the
25 return or margin that's built into the price?

1 MR. MARK STAUF: Right. I -- I think
2 so, yes. The -- the marketers probably don't -- I don't
3 know how they set their prices but it's probably -- it's
4 not a cost of service exercise for them, I'm sure. It's
5 -- it's a market-driven exercise. They figure out what
6 they think their profit maximizing profit or price level
7 will be.

8 But, in principle, competition should
9 drive the price down to that -- to a level that enables
10 them to recover whatever their costs are, including a --
11 a normal return; whatever that is.

12 MR. BOB PETERS: Well, where that leaves
13 us then, Mr. Stauff, is to conclude that the brokers are
14 earning more than a market return in Manitoba because of
15 the competitive market that presently exists.

16 MR. MARK STAUF: And how do you get to
17 that conclusion, I'm sorry, from what I've said?

18 MR. BOB PETERS: Well, you're telling the
19 Board that the cost of acquisition for the two (2) is on
20 average the same. You're saying that the market price
21 where they secure their product will be, again, on
22 average the same.

23 MR. MARK STAUF: Yeah.

24 MR. BOB PETERS: And so the only
25 difference between the two prices to consumers would be

1 in the amount of markup or return that they're taking.

2 MR. MARK STAUFF: Right. Well, in fact,
3 just looking at the prices; maybe, maybe not. I mean, I
4 don't know how they set their prices.

5 MR. BOB PETERS: All right. Let's just -
6 - so maybe, maybe not what? Maybe -- maybe they're
7 earning an excessive return or maybe they're not earning
8 an excessive return?

9 MR. MARK STAUFF: Well -- okay. The --
10 we talked this morning about the sort of conceptual
11 difficulties with figuring out what is or isn't an
12 excessive return, first of all.

13 But, certainly, just to take the example
14 of the door-to-door marketing model that is in place in
15 Manitoba, I think it's arguable that what that does is
16 allow the marketers to sell more volumes at any given
17 price level than would be the case if consumers had
18 better information about what the product is that they're
19 buying, and about what the relative prices and values are
20 of the alternatives that they have. And I talked about
21 this is in my evidence.

22 If that's the case, then, you know, you
23 would -- you would say you would expect that what the
24 brokers are able to do is earn, in whatever sense is
25 relevant, an above-normal return just because of that

1 imperfection in the market.

2 MR. BOB PETERS: You can't tell the Board
3 what is being said at the door-to-door level that leads
4 you to believe that competition is imperfect?

5 MR. MARK STAUF: No, again, I'm not --
6 as you say, I'm not at the door listening to these
7 people. I don't know exactly what they say. And
8 probably different things get said to different customers
9 and -- on different days.

10 But the observation I gave you during my
11 direct examination I still think applies here, right?
12 The -- the -- the impression of customers seems to be
13 that they should expect to save money by signing up for
14 these long-term deals. And, as we've just talked about,
15 I don't think that's true. They had to get that
16 impression from somewhere.

17 I think it's reasonable to infer that they
18 get it from the -- the people at the door. Maybe not;
19 maybe they just make it up or they read it in newspapers
20 or something. I have no idea. But, again, we're talking
21 about drawing reasonable inferences here about how this
22 is working.

23 MR. BOB PETERS: Okay, so when you draw
24 your inferences -- you also in your evidence -- is that
25 an inference that the markup, based on your calculation,

1 is that the retailers are earning a gross margin of
2 between 9 and 13 percent on their three (3) and five (5)
3 year products?

4 MR. MARK STAUF: Yeah. Can you just
5 give me a page reference just so I can look at that?

6 MR. BOB PETERS: Page 40 of 77.

7

8 (BRIEF PAUSE)

9

10 MR. MARK STAUF: Right. And that --
11 that -- those are the gross margins that come out of the
12 calculation and analysis that is gone through on the two
13 (2) or three (3) pages leading up to that point.

14 MR. BOB PETERS: This morning you didn't
15 tell the Board what you thought the gross margin or
16 return was that Centra has included on its delivered
17 product, did you?

18 MR. MARK STAUF: Over and above gas
19 acquisition costs, I don't believe Centra includes
20 anything other than the -- the very small basically
21 allocation of O&M costs to the primary gas rate.

22 MR. BOB PETERS: Let me -- let me deal
23 with that. I wasn't planning on it, Mr. Stauf, but in
24 that coil book of documents that was provided to you, in
25 the third document is a copy of a -- an Information

1 Request from the Utility at the General Rate Application
2 you were at.

3 I borrowed it from the last proceeding and
4 I'll -- I'll put it to the Centra witnesses to verify its
5 accuracy.

6 Let me start off by saying that PUB/CENTRA
7 105 is -- is what they asked for, and I think Ms. Derksen
8 will be the first to say they didn't get what they asked
9 for because there were some adjustments by the Board.

10 But, in essence, this was how Centra
11 calculates their primary gas overhead rate. And that's
12 the rate you were referring to in your last answer to me
13 where some of Centra's costs get captured in the primary
14 gas rate --

15 MR. MARK STAUF: Yes.

16 MR. BOB PETERS: -- that aren't related
17 to molecules?

18 MR. MARK STAUF: That's correct, yes.

19 MR. BOB PETERS: All right. And to some
20 extent this is -- there's a breakdown on -- on PUB/CENTRA
21 105 from the GRA which sources the -- the different
22 overhead components.

23 But you understand these are the
24 components that the Utility doesn't charge to direct
25 purchase customers in the distribution rate. They charge

1 them only to systems supply customers in the primary gas
2 rate.

3 MR. MARK STAUF: That's right, yes.

4 MR. BOB PETERS: And what's your
5 understanding as to why the Utility does not charge these
6 costs through to all distribution customers?

7 MR. MARK STAUF: My understanding is
8 that these would be reflective of costs that are incurred
9 by Centra for the purpose of buying its system -- buying
10 and managing it's system sales gas.

11 MR. BOB PETERS: And you would expect
12 that the retail -- sorry, I didn't mean to cut you off.

13 MR. MARK STAUF: No, just go ahead.

14 MR. BOB PETERS: The -- and you would
15 expect that the retailers would likewise have, if not the
16 same headings, other costs that they have to incur for
17 their direct purchase customers that likewise are
18 analogous to these?

19 MR. MARK STAUF: Yes, I -- I'm -- I'm
20 sure they would.

21 MR. BOB PETERS: And we'll come to some
22 of those later. But the -- the point that -- that we
23 diverged on in getting to this document was I wanted to
24 know if you could tell the Board what you calculate to be
25 Centra's return on its primary gas, including its

1 delivered service and all of the steps that it takes to
2 get it to the customer. Did -- did you do any such
3 calculation?

4 MR. MARK STAUF: No, no. Because as I
5 said, my understanding is they just take their gas
6 acquisition cost add this point one six four (.164) cents
7 per cubic metre and that's basically the -- the -- the
8 primary gas rate.

9 MR. BOB PETERS: But you also said before
10 lunch that you do acknowledge that the Utility does earn
11 a profit or a return on its operations, even though it's
12 not distinctly enclosed in the primary gas rate.

13 MR. MARK STAUF: Maybe I didn't express
14 myself clearly enough on that. I thought the discussion
15 we were having is about -- was about the -- the way
16 Utilities or the extent to which Utilities may or may not
17 be compensated for any risks they have associated with
18 providing the gas supply function.

19 And I was just pointing out that the
20 return that they earn, I think, can be attributed to
21 their conduct of their overall business, which would
22 include that supply function.

23 Certainly, it's not expressed that way.
24 It's not calculated that way, certainly, for Centra which
25 is not even really regulated on a -- as I understand it,

1 on a conventional rate of return type of model.

2 But even for a conventionally privately
3 held Utility, there's no -- nothing in the rate making or
4 cost of service analysis process that would -- would
5 point to such a number.

6 The process -- it's a lot simpler than
7 that. They just take their -- their rate base and apply
8 a rate of return and that's it. So there's --

9 MR. BOB PETERS: You're aware --

10 MR. MARK STAUF: -- there's nothing
11 embedded in the rates that has to do with that return for
12 -- for the sales to service.

13 MR. BOB PETERS: You're aware, Mr.
14 Stauff, that Centra, in its applications before the
15 Board, whether it's on a cost-to-service or rate base
16 rate of return, seeks to recover some amount over and
17 above its costs from its ratepayers?

18 MR. MARK STAUF: That's my
19 understanding, yes.

20 MR. BOB PETERS: And your understanding
21 would be that that is approximately \$12 million, what is
22 called -- is a corporate allocation that they allocate
23 back to the parent company?

24 MR. MARK STAUF: I have heard that term
25 before, yes, and that's --

1 MR. BOB PETERS: And you also are aware
2 that net income is approximately \$3 million allowed to
3 the -- to the Utility as well?

4 MR. MARK STAUF: Again, I have -- I have
5 heard that figure just --

6 MR. BOB PETERS: And those --

7 MR. MARK STAUF: -- overhearing
8 conversations.

9 MR. BOB PETERS: And that \$15 million;
10 that is, the 12 million and the 3 million, that's over
11 and above the actual costs of the Utility that are
12 allowed to be charged through in the rates to consumers
13 and is in --

14 MR. MARK STAUF: I gather that, yes.

15 MR. BOB PETERS: You would consider that
16 a return to Centra?

17 MR. MARK STAUF: Well, it -- again, I --
18 I'm a little bit out of my depth on these matters, in
19 terms of Centra's return policies and how they're
20 regulated on that. It looks to me like something that's
21 analogous to a return, yes, to a conventional utility
22 return.

23 MR. BOB PETERS: Why do you suggest that
24 the gross margin of the retailers for the three (3) year
25 contract is greater than the gross margin for the five

1 (5) year contract? Can you explain that to the Board?

2 MR. MARK STAUF: You're asking me why I
3 think that might be or...?

4 MR. BOB PETERS: Explain why a -- a three
5 (3) year fixed contract would have a -- a higher gross
6 margin than a -- a five (5) year fixed contract offering.

7 MR. MARK STAUF: Again, I really have no
8 information to go on with that. I agree with you that
9 it's a little bit counterintuitive but, you know.

10 Again, I think it's a mistake to think of
11 the brokers setting their prices on some kind of cost of
12 service analogy. They probably don't do that.

13 Again, I'm not familiar with their
14 business so I'm not sure, but they probably don't do
15 that. They -- they probably develop their prices in
16 response to more general factors about just what they
17 think they can -- what the price level is that will
18 maximize their revenues.

19 So, I think you probably shouldn't be
20 expecting the kind of cost-of-service analysis that we
21 apply in utility rate-making contexts to be applicable or
22 to yield us useful information in the context of
23 analysing the util -- or sorry, the marketer type prices.

24 Now I acknowledge that I sort of did that
25 in -- in this -- in this passage in my testimony, but I

1 was quite careful, I think; or I was trying to be careful
2 to -- to say that this is an illustrative example and,
3 you know, there's a lot of unknowns and a lot of factors
4 that can affect these results, plus or minus, if you
5 wanted to be real picky about it.

6 But I really have no idea why that result
7 would -- would pop out.

8 MR. BOB PETERS: Okay. Your -- your last
9 point to the Board is that there are many uncertainties
10 in your calculations, but you're -- you're trying to
11 provide an illustration as to what raises your suspicion
12 as to whether the retailers products are priced --

13 MR. MARK STAUF: Right.

14 MR. BOB PETERS: -- above a normal
15 return.

16 MR. MARK STAUF: Yeah. I mean, even the
17 market prices that are quoted here -- this was done in
18 whenever it was, May or April -- I'm -- I'm quite sure
19 that these market prices have all changed, right? So,
20 you know, this analysis would -- would not be applicable
21 right now anyways.

22 Yeah, I mean, the -- just -- as I say,
23 these -- the margins look pretty high. You and I, I'm
24 sure, both remember the time when one fifty (1.50) a
25 gigajoule was the whole price for natural gas in Alberta,

1 you know, never mind a -- a sales margin, so.

2 MR. BOB PETERS: You might have me
3 mistaken for Mr. Stephens, but --

4 MR. MARK STAUFFT: Mr. Stephens remembers
5 that, I'm sure. Yeah.

6 MR. BOB PETERS: But, Mr. Staufft -- or
7 Dr. Van Audenrode, Mr. Staufft, I asked him the question
8 as to, on his calculations, why would the three (3) year
9 fixed price offering come in at a possible 13 percent
10 gross margin and the five (5) year offering is only at 9
11 percent? Is there some economic theory that might help
12 explain that?

13 DR. MARC VAN AUDENRODE: Not that I know
14 of. You know, just -- I'm not saying it's impossible,
15 it's just that, you know, whatever return you are getting
16 on your products depends on the whole of -- a whole lot
17 of things and a lot of uncertainty and, you know --

18 MR. BOB PETERS: Is it possible there's
19 greater risk in the three (3) year product than the five
20 (5) year product?

21 DR. MARC VAN AUDENRODE: I would think
22 that the intuition would go the other way.

23 MR. BOB PETERS: Mr. Staufft, if you think
24 back to when I suggested to you that Centra earns, in my
25 words, a return of approximately \$15 million a year, if

1 you took that \$15 million return and put it over their
2 primary gas costs which, say, rounded out to 3 -- \$300
3 million, that would be an approximate 5 percent return.
4 Would you accept that as a -- a reasonable calculation if
5 one was to -- to try to seek out what would be the return
6 earned by the Utility over the primary gas it sells?

7 MR. MARK STAUF: No, I don't think I
8 would. Assuming, for these purposes, that I'm correct to
9 be thinking about that as a return -- or let's just say
10 we were talking about a conventional utility -- the
11 return that utilities like Centra earn is a return on the
12 capital that they have invested in their business. It's
13 -- it's a return on their rate base; the opportunity
14 costs of the capital that they have invested in their
15 rate base.

16 As I said before in the conventional rate-
17 making scenario, nothing is attributed to a return on the
18 --on the business of the -- the business of buying and
19 selling gas.

20 So I -- no, I would not say that -- I
21 mean, even if I was conceding that there may have been
22 some element of the return that you could in some
23 theoretical sense attribute to the retail buying and
24 selling business, that's going to be a tiny, tiny, tiny
25 fraction of the overall return that the Utility would

1 need as a fair return just to compensate it for the
2 opportunity cost of the capital it has invested. That's
3 by far and away the -- all of it.

4 Certainly, in cases where utilities are
5 proposed to exit the merchant function, nobody had ever
6 said to them and they sure didn't say, Oh and by the way,
7 we'll take a reduced return when we exit the merchant
8 function. They don't think of it that way at all. They
9 -- their return is return on rate base.

10 MR. BOB PETERS: All right. If you
11 wouldn't characterize Centra's overall return and take it
12 as a percentage of their primary gas rates, you would
13 acknowledge that in whatever return Centra does earn, no
14 portion of that return is needed to pay the out-of-pocket
15 costs for customer acquisition, like a retailer would
16 incur? They don't have the same marketing expenses?

17 MR. MARK STAUF: That's -- I think yes,
18 I made that point. That's a --

19 MR. BOB PETERS: And they don't have -- I
20 suppose the brokers would also have some O&A expenses
21 perhaps analogous to the primary gas overhead rate that
22 we reviewed briefly?

23 MR. MARK STAUF: I assume that they do,
24 yes. That's --

25 MR. BOB PETERS: And do you also assume

1 that they have to have in their return some amount for
2 the risk premium for the activities that they're engaged
3 in?

4 MR. MARK STAUFST: Yes, some -- some
5 profit.

6 MR. BOB PETERS: Well, and -- and --

7 MR. MARK STAUFST: If you want to put it
8 that way.

9 MR. BOB PETERS: -- and over and atop of
10 the risk premium would be a profit margin?

11 MR. MARK STAUFST: Yeah. I mean, I -- I
12 guess I think of the -- of the risk premium being sort of
13 imbedded in the profit margin, but if you want to talk
14 about it that way, we could.

15 MR. BOB PETERS: It could be considered a
16 distribute -- separate item?

17 MR. MARK STAUFST: I'm not sure how you'd
18 quantify that, though. I mean, I certainly have made no
19 attempt to quantify that; I'm not sure how you would do
20 it.

21 MR. BOB PETERS: It's your belief,
22 though, Mr. Stauff, that Centra's competitors face higher
23 costs than Centra does?

24 MR. MARK STAUFST: Yes. In summary, I
25 think that was the conclusion that I came to.

1 MR. BOB PETERS: You can't tell the Board
2 how much higher those costs are with any certainty,
3 though, can you?

4 MR. MARK STAUF: No, as we've discussed.

5 MR. BOB PETERS: And so even if
6 competition in Manitoba was entirely and completely
7 effective, whatever that will be defined as, so that it
8 would force brokers to sell their product at its cost
9 with no return, the cost to the broker would be higher
10 than it would be to Centra?

11 MR. MARK STAUF: That seems to follow,
12 yes. As I said most of the cost categories, they're
13 pretty much on the same footing, but in some respects the
14 brokers have more costs.

15 MR. BOB PETERS: So even -- and you don't
16 know how much more, but intuitively more --

17 MR. MARK STAUF: Sure.

18 MR. BOB PETERS: -- is what you're
19 telling the Board?

20 MR. MARK STAUF: Yeah. Yeah.

21 MR. BOB PETERS: And so even if the
22 market was totally efficient and effective in driving
23 down the consumer's price of the primary gas from a
24 retailer, intuitively, you believe it would be more
25 expensive than the default offering currently by the

1 Utility?

2 MR. MARK STAUF: Yes, I think that, in
3 principle, is true.

4 MR. BOB PETERS: Dr. Van Audenrode, I'll
5 prompt you, do you have any different view on that?

6 DR. MARC VAN AUDENRODE: Well, I'm having
7 some problems following, and there are lots of concepts
8 that are getting mixed up here.

9 You know, again, let me repeat that, you
10 know, we aren't talking about the same product here. So
11 we are -- so if these are not the same product there is
12 no reason for these products to be sold at the same
13 price.

14 MR. BOB PETERS: All right. And just let
15 me go back. The product -- you're distinguishing the
16 three (3) month variable rate offering from the Utility
17 as a different product from the what the retailers are
18 able to sell on either a three (3) or a five (5) year
19 term?

20 DR. MARC VAN AUDENRODE: Exactly.

21 MR. BOB PETERS: All right. So if I get
22 my mind around that, they're different products, do you
23 agree that the long term fixed price product will always
24 be more expensive than the variable three (3) month rate?

25 DR. MARC VAN AUDENRODE: Not always. On

1 -- on -- in expected value there will be some risk
2 premium imbedded in it but, you know, sometimes if -- you
3 know, if today everybody were expecting that five (5)
4 years from now there will be hundreds of boats bringing
5 liquid gas into North America at four dollars fifty
6 (\$4.50), of course the long -- the five (5) year price of
7 gas will be lower than today's price.

8 So it doesn't follow mechanically that it
9 has to be, you know, higher always, all the time. What
10 I'm -- what I think Mr. Stauff was getting at and which
11 is correct, which is, on average, everything else being
12 equal, if you want to guarantee a price for the next five
13 (5) year for your deliveries of gas you are going to have
14 to pay some form of a premium.

15 MR. BOB PETERS: Dr. Van Audenrode,
16 presently, the five (5) market price takes into account
17 whether the market feels there will be liquid natural gas
18 in the marketplace in five (5) years?

19 DR. MARC VAN AUDENRODE: Exactly.

20 MR. BOB PETERS: So the five (5) year
21 market price has already spoken to that issue, correct?

22 DR. MARC VAN AUDENRODE: It has.

23 MR. BOB PETERS: And so if we check the
24 newspapers or the reporting services, if five (5) year
25 gas is more expensive than the current gas --

1 DR. MARC VAN AUDENRODE: Yeah.

2 MR. BOB PETERS: -- the market has
3 spoken?

4 DR. MARC VAN AUDENRODE: The market has
5 spoken but, you know, what exactly do you mean by more
6 expensive than current gas?

7 I mean, if you are paying your delivery of
8 gas for the next five (5) year at a rate that is higher
9 than what you are paying your delivery of gas for the
10 next three (3) months, that doesn't tell you whether one
11 of the products is higher than the other because, you
12 know, after another -- after three (3) months you have to
13 go into another three (3) months contract, and then
14 another three (3) months contract.

15 It's only five (5) years down the road
16 that you will figure out whether it was a good deal to
17 get into the five (5) year contract, so to stay open and
18 get a variable rate.

19 MR. BOB PETERS: And what -- what you're
20 telling the Board is that you'd need to look in the
21 rearview mirror and see if the premium you paid was
22 offset by the market price that affected the three (3)
23 month variable price of gas?

24 DR. MARC VAN AUDENRODE: What I am saying
25 is, everything else being equal, the five (5) year rate

1 on gas today embeds everything that -- especially is the
2 markets, the brokers know about what is going to --
3 happening to the market over the next five (5) years.

4 But to get to that there is some risk
5 premium which can be high -- which can be low depending
6 on the uncertainty around this information of what is
7 going to happen in the next -- in the price of gas in --
8 over the next five (5) years. And that's true for any
9 commodity, that's true for any future purchase that you
10 might want to do.

11 MR. BOB PETERS: Do you know, Dr. Van
12 Audenrode, if Centra was to enter the fixed price
13 offerings of comparable terms to the retailers, whether
14 Centra could offer a cheaper product? A cheaper three
15 (3) year product or a cheaper five (5) year product?

16 DR. MARC VAN AUDENRODE: I don't know. I
17 -- I mean we are here -- as I said, we are here getting -
18 - I mean you, once you are getting with this -- we're
19 getting with products that look much more like financial
20 products than anything that looks like natural gas.

21 And, you know, some people might be very
22 good at buying these three (3) year -- three (3) or five
23 (5) years out deliveries of natural gas. What I know by
24 experience that no broker on any financial market can
25 guarantee you that he's going to beat the market for sure

1 for the next five (5) years, or forever.

2 MR. BOB PETERS: That's the only thing
3 you're prepared to commit to? It's absolute is it, that
4 the brokers don't know what -- what's going to happen
5 over the long term, but they do know what costs they will
6 incur, at this point in time.

7 DR. MARC VAN AUDENRODE: Well depending
8 on how they run their business. If they, you know, if
9 they perfectly cover their sales by, you know, purchasing
10 always five (5) years out gas when they sell a contract
11 for five (5) years out gas. And even they -- there's
12 some volume issue.

13 But, you know -- but there is always a lot
14 -- some uncertainty in -- in what is going to happen to
15 their cost over the next five (5) years. And that level
16 of uncertainty depends on the way they run their
17 business.

18 MR. BOB PETERS: Dr. Van Audenrode, in --
19 in one of your answers to me, I just want to make sure I
20 had it clear for the Board, that over a long term fixed
21 price arrangement, there would be a risk premium added to
22 the cost. is that right?

23 DR. MARC VAN AUDENRODE: Well long term
24 prices and future prices embed in their -- in the price
25 is embedded the risk aspect that is -- that exists in --

1 in every future price, yes.

2 MR. BOB PETERS: Is the risk premium
3 always higher the further you go out?

4 DR. MARC VAN AUDENRODE: As far as I
5 know, yes, because the -- the further you go out, the
6 more uncertainty you have about what is going to happen
7 to your prices.

8 MR. BOB PETERS: Are you able to quantify
9 that risk premium; that is what additional risk premium
10 is needed to go from a one (1) year to a two (2) to a
11 three (3) to a five (5) year?

12 DR. MARC VAN AUDENRODE: My kids do that
13 all the time. Mind you, just go on Bloomberg and see how
14 much you have to buy to pay for -- to get delivery of
15 natural gas in three (3) years and see how you have to
16 pay to get there every -- in five (5) years.

17 MR. BOB PETERS: So the market will set
18 the premium is what you're telling the Board?

19 DR. MARC VAN AUDENRODE: The market set
20 the premium according to what it perceives as being, you
21 know, the future trend and the future risk in these...

22

23 (BRIEF PAUSE)

24

25 MR. BOB PETERS: And unless the retailer

1 is prepared to absorb that risk premium, that risk
2 premium is embedded in their price?

3 DR. MARC VAN AUDENRODE: Oh, it is. And
4 it is because consumers are willing to pay for that, to
5 some extent.

6 MR. BOB PETERS: And you would expect
7 that to be the case even if the Utility was permitted to
8 offer a fixed price offering, that it would have a risk
9 premium built in that would be charged through to
10 consumers?

11 DR. MARC VAN AUDENRODE: Yes.

12 MR. BOB PETERS: Mr. Stauff, I want to
13 change gears with you and talk a little bit about the --
14 the high volume customers in Manitoba.

15 As you told me at the outset, your
16 evidence was focussed on the SGS class in Manitoba which
17 by definition is the small general service class, and
18 includes residential and small commercial, correct?

19 MR. MARK STAUFF: Yes.

20 MR. BOB PETERS: And in addition to small
21 commercial customers, there are other customer classes in
22 Manitoba for the large general service customers which
23 are the larger commercial customers, as well as classes
24 like the high volume firm and the mainline; that -- you
25 refer to those as the high volume customers, is that

1 correct?

2 MR. MARK STAUF: I think so. Do you
3 have a reference in my testimony?

4 MR. BOB PETERS: I don't, but just agree
5 with
6 me on that one.

7 MR. MARK STAUF: We'll -- we'll go with
8 that, sure.

9 MR. BOB PETERS: So the high-volume
10 customers aren't the ones who are the focus of your
11 evidence?

12 MR. MARK STAUF: No, that's correct.

13 MR. BOB PETERS: All right. Recognizing
14 that - and Mr. Saxberg may be reaching for his microphone
15 - you do say that there is a competitive market in
16 Manitoba for the higher-volume customers though?

17 MR. MARK STAUF: I believe that's the
18 case, yes.

19 MR. BOB PETERS: And why do you say
20 that's the case?

21 MR. MARK STAUF: Well, you -- in simple
22 terms, you don't hear them complaining about their access
23 to gas or the prices at which they're able to acquire
24 gas; large-volume customers, certainly the large
25 industrials that I know to be or understand to be

1 operating in Manitoba.

2 Again, I'm not -- I have to say I'm not
3 familiar with the sort of detailed market dynamics for
4 these customers over the last few years. I haven't been
5 close to that market, but certainly the model that I'm
6 aware of is that they basically negotiate directly with
7 the same people that Centra does or could in Alberta for
8 their supplies. They go right to the NIT market or to
9 the Empress market and acquire their supply from
10 marketers or producers in Alberta.

11 So there's no sort of intermediary
12 problem. They operate on a sufficient scale that it
13 makes sense for them to purchase their supply in that
14 market from those types of players.

15 MR. BOB PETERS: All right. If the
16 large-volume or high-volume customers were paying the
17 same rate from a retailer per cubic metre that the
18 residential customer was, would that lead you to believe
19 that there still is competition -- effective competition
20 in the high-volume customers?

21 MR. MARK STAUF: Sorry, we're just
22 talking about the primary gas, I take it, here, right?

23 MR. BOB PETERS: Yeah, let's take --

24 MR. MARK STAUF: We're not talking about
25 the distribution charges or --

1 MR. BOB PETERS: No. Let's just talk the
2 primary gas.

3 MR. MARK STAUF: Sorry. If the case
4 were that an industrial were paying the same rate per
5 cubic metre as a residential customer for a five-year
6 supply, then --

7 MR. BOB PETERS: Does that tell you that
8 there is or is not effective competition in that market?

9 MR. MARK STAUF: Not necessarily one way
10 or the other. No, I don't think so.

11 MR. BOB PETERS: But you've concluded
12 that there is effective competition in the high-volume
13 markets in Manitoba.

14 MR. MARK STAUF: Well, I didn't
15 independently study that, right. I have just, as I say,
16 made that assumption because my understanding of the
17 scope of this proceeding was that it -- we're concerned
18 about residential customers, which presents sort of
19 unique problems.

20 For the industrials -- I mean, if they
21 have a complaint, obviously they can bring it to the
22 Board, but life is a lot simpler for them. They just, as
23 I say, they go to NIT or they go to Alberta and buy the
24 gas under competitive conditions there and arrange for
25 the transport and that's it.

1 MR. BOB PETERS: But those are the
2 transportation customers, not the WTS customers?

3 MR. MARK STAUF: Yes, yeah. There may
4 be large-volume customers that buy from Centra, for all I
5 know, I mean, that's possible. But they have a lot of
6 different strategies available to them as well.

7 MR. BOB PETERS: Maybe, Mr. Stauff, on
8 that note, we should keep the Board with us and look at
9 the book of documents. I believe at Tab -- Tab 2.
10 Again, and I think this is the last one that I reached
11 back -- and My Friend, Ms. Murphy will correct me if I'm
12 wrong -- but back to the GRA proceedings at which you
13 were at and have a copy of PUB Centra-13.

14 And if you turn to the attachment, page 1
15 of 6 in that document, the customers that you have
16 focussed on for the purposes of your report to the Public
17 Utilities Board. And I'm sorry the font is so small.
18 But are contained on lines 18 and 19 of that attachment
19 to PUB/CENTRA-13 from the GRA.

20 Would you agree with me there?

21 MR. MARK STAUF: Yes.

22 MR. BOB PETERS: And in terms of other
23 customers who are on Western Transportation service,
24 higher volume customers, those would be the customers
25 found on lines 20 to 23, correct?

1 MR. MARK STAUF: Okay.

2 MR. BOB PETERS: You're okay with that?

3 MR. MARK STAUF: Yes, sorry.

4 MR. BOB PETERS: And then in terms of the
5 Transportation Service customers, those are customers
6 that not only line up their molecules but they line up
7 their own transportation to Centra city gate, correct?

8 MR. MARK STAUF: Right, yes.

9 MR. BOB PETERS: And so they're --
10 they're contained differently on the schedule, going down
11 from lines 25 to 31, correct?

12 MR. MARK STAUF: Yes.

13 MR. BOB PETERS: All right. So let's --
14 let's talk about -- let's not talk about the
15 Transportation Service customers, let's talk about the
16 larger volume customers who also use Centra's WTS or
17 Western Transportation offering. And we can see on lines
18 20, 21, 22 and 23, if we go over to the -- even if we go
19 to the forecast year of 2006/'07, that there's a few
20 thousand of them.

21 Actually, I better correct that. If I
22 exclude the SGS commercial, there may be closer to a
23 thousand (1000) of those customers that are the higher
24 volume customers that also --

25 MR. MARK STAUF: Right.

1 MR. BOB PETERS: -- use WTS service.

2 MR. MARK STAUF: Seven (700) or eight
3 hundred (800) it looks like, if you sort of add it up.

4 MR. BOB PETERS: All right. Less than a
5 thousand (1000).

6 MR. MARK STAUF: Less than -- okay

7 MR. BOB PETERS: All right. I'll take
8 your math, Mr. Stauff. Being lawyers we -- we don't do
9 math in public remember. And --

10 MR. MARK STAUF: Sound advice. Good
11 advice.

12 MR. BOB PETERS: Yes. Having said that,
13 my suggestion to you is that if -- if the Board was to
14 learn that the retailers were charging those higher
15 volume customers the same price for a cubic metre of
16 primary gas as the residential customers, does that then
17 mean that the larger volumes aren't in a competitive
18 market?

19 MR. MARK STAUF: Yeah. I'm not sure you
20 can draw a firm conclusion just -- if -- if that
21 observation was to -- was to surface. I mean you -- you
22 could take -- you could draw that inference.

23 I mean you -- you might draw the inference
24 that if -- that if marketer price is to -- say for these
25 purposes -- large general service customers were

1 essentially the same as prices to residential customers,
2 that might give you some comfort that in fact competition
3 is being effected in the way the -- the marketers provide
4 service to these various classes, then there's nothing to
5 worry about.

6 I'm not sure either whether the -- the
7 kinds of arrangements would be similar between the
8 different classes, right? I mean, for residential
9 customers it's basically very long term fixed prices.

10 And I'm not familiar enough with these
11 rate classes to know what kind of companies are in here
12 but they may not all be -- they may not all be dealing
13 with five (5) year supplies. They may not even all be
14 dealing with brokers. They may be operating that service
15 on their, for all I know.

16 MR. BOB PETERS: Can I take from your
17 answers, Mr. Stauff, that the price that is charges to
18 the customer in the high volume classes, is not an
19 indicator as to whether or not the market is competitive?

20 MR. MARK STAUFF: Well, I hate to say
21 it's not an indicator. It may or may not be depending on
22 a whole bunch of other facts and circumstances
23 surrounding it. It's just that I'm having a great deal
24 of difficulty being -- having drawing any firm
25 conclusions just on the basis of, sort of, one (1)

1 hypothetical market observation --

2 MR. BOB PETERS: Does that -- does that
3 same answer apply to the number of broker servicing the
4 high volume customers? That is, you can't conclude
5 whether it's competitive or not competitive, just because
6 of the number of brokers in that market?

7 MR. MARK STAUF: I think the fact that
8 there are more participants, more sellers in that market
9 suggests that competition is working better for that
10 segment.

11 MR. BOB PETERS: How many sellers do you
12 understand to be in that market?

13 MR. MARK STAUF: I'm not sure offhand.
14 I thought it was seven (7) or nine (9), or somewhere in
15 that range. Not a huge number, but more than two (2).

16 MR. BOB PETERS: Yes. And if it was
17 seven (7), do you know how many of those sellers are
18 customers themselves that are self-sourcing and how many
19 of those are actual retailers --

20 MR. MARK STAUF: No --

21 MR. BOB PETERS: -- or brokers?

22 MR. MARK STAUF: No, I don't. You're
23 right, some of them could be just self-sourcing, as you
24 say.

25 MR. BOB PETERS: Well, I think that's

1 what you told me, is that --

2 MR. MARK STAUF: They may be, sure.

3 MR. BOB PETERS: Yeah.

4 MR. MARK STAUF: Yeah, I don't know.

5 MR. BOB PETERS: And -- but when I go
6 down the list and I'm asking you why you think that
7 there's competition in the classes that are characterized
8 by higher volumes, the answer you give me is that you
9 haven't heard about any complaints.

10 And I know that's a little trite but if --
11 you know, maybe the Board has heard of complaints, or
12 maybe you just haven't been in the know or maybe there
13 are none, but surely that's not an indication as to
14 whether the market itself is competitive?

15 MR. MARK STAUF: No. No, you're right.
16 I mean, what's going on here is that I -- this was not,
17 as far as I understood, the point, or the object of the
18 inquiry in this case, so I didn't look into it; is about
19 as far as I went.

20 MR. BOB PETERS: Okay. Thank you for
21 that.

22 Turning back to the SGS class, or for
23 purposes of our discussions we're talking the residential
24 customers as an example, your evidence leads to the
25 conclusion that there is not effective competition in

1 that class because the brokers are not constrained by
2 competition.

3 MR. MARK STAUF: Again, I hate to be
4 repetitive, but I think there are reasons to be concerned
5 about that. Yes, I think there -- I am suspicious that
6 that is the case. The Board should be concerned about
7 that.

8 MR. BOB PETERS: Do you agree, Mr.
9 Stauff, that with the entrance of natural gas retailers
10 into the Manitoba marketplace, the consumers have an
11 increased choice of provider of the primary gas?

12 MR. MARK STAUF: Yes, that's almost by
13 definition true. If you didn't have any retailers you'd
14 have only one (1) choice, which was Centra; and Centra
15 only offers one (1) product right now. Right now you
16 have three (3) choices and Centra's product, and a few
17 very long-term products as well. So, yes, there's more
18 choice, but --

19 MR. BOB PETERS: And --

20 MR. MARK STAUF: -- but not a lot.

21 MR. BOB PETERS: There's more choice in
22 who the provider is, and there's also more choice in the
23 service offerings that are available?

24 MR. MARK STAUF: Yes.

25 MR. BOB PETERS: Now in your evidence, I

1 think, to Mr. Saxberg, I heard you say that you thought
2 there would be more product offerings as a result of the
3 Board Order 15 of '98. That was your expectation?

4 MR. MARK STAUFF: Yes.

5 MR. BOB PETERS: And when you say, "more
6 product offerings", which product offerings are not being
7 made today that you thought would be made by today when
8 you and I and Mr. Stephens were together in 1996?

9 MR. MARK STAUFF: Well, I would have
10 thought if the theory is that the competitive market
11 participants are going to serve the full range of
12 products that can be -- will be demanded by consumers,
13 then you would expect that there would be variably priced
14 products, something like what Centra does; I mean,
15 without getting into the details of the three (3) months
16 versus the one (1) month and all that other stuff.

17 But you would expect variable prices. You
18 would probably expect one (1) year fixed prices. That
19 was a -- that was sort of an industry standard for a long
20 time with the utilities and with industrial customers in
21 Canada.

22 In fact, I mean, before -- before WTS,
23 when we were in the era of either industrial direct sales
24 for basically one (1) year or buy/sells, you didn't have
25 long-term contracts at all. Nobody did five (5) year

1 deals. The five (5) and four (4) year deals are really
2 just a creation of the WTC bundle "T" environment. So in
3 '96 they didn't exist.

4 Now I think we probably thought that they
5 probably would, people would offer those things, but I
6 expected a full range.

7

8 (BRIEF PAUSE)

9

10 MR. BOB PETERS: When you say you would
11 have expected a full range, can you tell the Board what
12 full range exists in other jurisdictions? Let's pick
13 Ontario.

14 MR. MARK STAUF: I don't have it with me,
15 but I -- or easily accessible to me, at any rate. I
16 believe that some Information Requests were asked of
17 Direct and Energy Savings and that they provided some
18 data on that.

19 My recollection is that they did say in
20 those responses that in Ontario, their understanding was
21 that there were some one year and two year products
22 available, and perhaps some variable price products
23 available in Ontario, but I don't recall much beyond
24 that. Like how much, or if any information was provided
25 about what kind of volumes, how many suppliers, that kind

1 of thing.

2 MR. BOB PETERS: How about in Alberta?

3 Can

4 you tell the Board what's the range of product offerings
5 in Alberta?

6 MR. MARK STAUF: Again, I think...the
7 information is available to Direct and Energy Savings was
8 provided to the Board in an IR Response and, really,
9 we're in a position where I'm trying to remember and
10 guessing about what I read in their IR response, so
11 probably the more efficient way to do it is to just ask
12 them, or -- or go to the IR response.

13 MR. BOB PETERS: All right, and whenever
14 you read it, you didn't think it was incorrect as it was
15 filed? You -- you would think --

16 MR. MARK STAUF: I had no reason to think
17 it was incorrect, no.

18 MR. BOB PETERS: Yeah. All right. Thank
19 you. And would you agree with me, Mr. Stauff, that with
20 the entrance of natural gas retailers into the Manitoba
21 marketplace, there has been an increase in economic
22 benefits to some direct purchase customers?

23 MR. MARK STAUF: I don't have any basis
24 for agreeing with that, no. I mean, there may be cases
25 like that, but --

1 MR. BOB PETERS: All right. Do you --
2 would you agree with me that since the entrance of
3 natural gas retailers into the Manitoba marketplace, some
4 customers have received an increase in non-monetary
5 benefits from the offerings by the retailers?

6 MR. MARK STAUF: Sorry. Can we just back
7 up to the -- the question you just asked just to make
8 sure I understand.

9 Was the question whether I know whether
10 people have actually paid less under long-term contracts
11 than they would of if they'd bought Centra supply?
12 Whether there were any cases of that?

13 MR. BOB PETERS: Well let's -- let's go
14 back and I was going to visit that, but let's do that now
15 that we're onto it, and if your counsel can maybe show
16 you a book of documents. Start with Tab 9 if you could.

17 Tab 9 is an Information Request in these
18 proceedings that was asked of Centra. It's PUB-Centra-
19 35, and it was a comparison of three (3) offerings over
20 three (3) different time periods, and Centra responded --

21 MR. MARK STAUF: Yep.

22 MR. BOB PETERS: -- and they've -- they
23 have graphs attached to it which I'm not going to turn
24 to, but they also have a chart, or a table, and Table 1
25 which is attached to PUB/CENTRA-35(b) is one table which

1 compares Centra's billed rate to the broker-fixed
2 offering.

3 Do you -- do you see that? On Table 1?

4 MR. MARK STAUF: I'm just looking at
5 Table 1 here. Just give me --

6 MR. BOB PETERS: All right.

7 MR. MARK STAUF: -- five (5) seconds to
8 orient myself. Okay.

9 MR. BOB PETERS: And do you accept that
10 the -- what Table 1 is showing the Board is that from
11 August 2000 to July 2005, assuming there was a five-year
12 contract in place at that time, with the -- with the
13 retailer price of 18.6 cents a cubic metre compared to
14 the varying rate charged by Centra, in this example, the
15 consumer would have paid four hundred and six dollars and
16 eighteen cents (\$406.18) less than they would have if
17 they had been on Centra's System Supply?

18 MR. MARK STAUF: Yes.

19 MR. BOB PETERS: All right. And that's
20 an example of a consumer receiving an economic benefit,
21 as a result of entering into a long term arrangement,
22 would that be correct?

23 MR. MARK STAUF: Yes.

24 MR. BOB PETERS: And likewise in Table 2
25 and Table 3, there is a netting out of the various months

1 under a contract, in a pricing scenario.

2 And in Table 2 there's an example of where
3 the consumer would have ended up paying up more under a
4 fixed price arrangement with a retailer, than they would
5 have had they stayed with System Supply of the Utility?

6 MR. MARK STAUF: That's right. And
7 Table 3 is similarly.

8 MR. BOB PETERS: Similarly. And the only
9 difference in Table 3 is that the -- the additional cost
10 of primary gas in Table 3, it's not as much as it was in
11 table 2?

12 MR. MARK STAUF: Right.

13 MR. BOB PETERS: And -- and just so that
14 you have that complete, Mr. Stauff, and the Board also,
15 there were two (2) more tabs in this book, and if you can
16 look to Tab number 10; and I'll give you a few minutes to
17 look at that if you need.

18 Centra provided a response to PUB in IR
19 number 21 in these proceedings, and they attached some --
20 some tables and Attachment 3, of particular note.
21 Attachment 3 shows that there have been approximately
22 twenty-six (26) fixed price offerings that have been
23 offered by retailers that have come to fruition before
24 this proceedings was suppose to start.

25 And -- and as a result of those different

1 offerings, consumers have, in some cases, paid less for
2 their primary gas than System Supply customers and in
3 other ones consumers have paid more than what the System
4 Supply customer would -- would have paid.

5 MR. MARK STAUF: Yes, that's how I
6 understand the table that we're talking about.

7 MR. BOB PETERS: And just before I -- I
8 also I think in fairness, I have Tab 14 in the book of
9 documents. It's a question that Centra asked of Direct
10 Energy and Energy Savings number 5, and it was to deal
11 with the offerings that had been put forward at that
12 time.

13 And the evidence there indicates that of
14 twelve (12) fixed price, fixed termed contracts that have
15 completed their life cycle, eight (8) of them have
16 produced savings and the other four (4) would have ended
17 up costing consumers more than the System Supply
18 customer.

19 MR. MARK STAUF: I -- I'll accept your
20 characterization of the --

21 MR. BOB PETERS: All right.

22 MR. MARK STAUF: -- of the information.
23 I have made no attempt to reconcile any of that.

24 MR. BOB PETERS: Okay. Well and -- and
25 then getting back to the -- to the previous question that

1 I think got us back here: You would acknowledge that
2 there have been economic benefits to some customers on
3 direct purchase, correct?

4 MR. MARK STAUFFT: Sure. Yes. I -- I've
5 not ever denied that. I -- I'm sorry if that's not
6 clear. I mean, when we're talking about expected
7 benefits, I'm talking about on average, in the long run
8 what people expect.

9 In the real world, yes, with any kind of
10 deal like that there could well be cases like -- and
11 obviously apparently have been cases, where customers do
12 better with a fixed price. But there's lots of other
13 cases where they do worse.

14 And the point being made is, there's no
15 reason to expect that on average, in the long run, they
16 will -- they will do better or that all of them will do
17 better.

18 I've -- I've never denied -- I've never
19 said anything more than that, and I'm sorry if I've given
20 you a different impression. So sure there -- obviously
21 there are people who have won, momentarily speaking, with
22 these long term deals.

23 MR. BOB PETERS: And, Dr. Van Audenrode,
24 I'm not going to go past this without asking for your
25 comment, but much as -- that Mr. Staufft is saying, even

1 though that exists, there's -- there's -- I'll use his
2 words, "winners and losers," I think, if I interpret his
3 answer.

4 That's unpredictable because you don't
5 know what the market price is going to be in absolute
6 terms, as the three (3) months changes?

7 MR. MARK STAUF: It's unpredictable and
8 I would -- and I would submit to you it's not the right
9 question. The right question is: Could the loser have
10 been losing less and the winner having winning big --
11 winning big if -- you know, if more competition,
12 assuming, you know, more competition could have been in
13 place in these -- in these long-term contracts.

14 MR. BOB PETERS: Well, if that's the
15 question you've asked, you can't give a definitive answer
16 on it, though, can you?

17 DR. MARC VAN AUDENRODE: Can't give a
18 definite answer, but I can find a solution to figure it
19 out.

20 MR. BOB PETERS: And just so we're clear,
21 your solution is let the Utility enter --

22 DR. MARC VAN AUDENRODE: Exactly.

23 MR. BOB PETERS: -- the same market and
24 if -- they will establish the benchmark?

25 DR. MARC VAN AUDENRODE: Exactly.

1 MR. BOB PETERS: All right. And in
2 addition to the financial benefits that are seen in some
3 of the Information Requests, Mr. Stauff and Dr. Van
4 Audenrode, I was asking whether or not there have also
5 been non-monetary benefits that customers get from this?

6 DR. MARC VAN AUDENRODE: Well, if I --
7 you know, if I can answer that one, clearly there are. I
8 mean, some consumers are being offered two (2) choices
9 and they choose the long-term contract. So if they
10 understand correctly what they are getting into, they
11 must be better off getting into these long-term contracts
12 otherwise -- otherwise they would go for the other
13 contract.

14 That's, you know, elementary economics
15 called revealed preference. You know, once you -- once
16 you are given choices, by taking a choice and refusing
17 another choice it means that you prefer the choice that
18 you are picking.

19 But, again, I get back to the point I was
20 making. The issue is -- is not were they happy with that
21 choice, but could they have been even happier with that
22 choice, getting a better deal?

23

24

(BRIEF PAUSE)

25

1 MR. BOB PETERS: In the book of
2 documents, Mr. Stauff, there is -- we reviewed briefly at
3 Tab 2, some data that came out of the General Rate
4 Application Hearing; and I did see Mr. Kuczek in the room
5 previously, so I'd better correct the record as best I
6 can until he gets on the witness stand.

7 But in the column under the 2006/07
8 forecast year, going down to line item number 18, there's
9 a number that's published in the GRA of fifty-four
10 thousand one hundred and sixty-four (54,164) SGS
11 residential customers on WTS Service; do you see that?

12 MR. MARK STAUFF: Yes.

13 MR. BOB PETERS: Just for the sake of --

14 MR. MARK STAUFF: Yes.

15 MR. BOB PETERS: -- trying, Mr. Chairman
16 and Board Members, to keep the record, I think, accurate,
17 according to Mr. Kuczek at the GRA in June, that number
18 was -- was revised to forty-three thousand six hundred
19 (43,600). And I'll ask him that again when he's on the
20 stand, but I want to make sure the numbers are as current
21 as I can keep them.

22 Now, Mr. Stauff and Dr. Van Audenrode, the
23 fact that forty-three thousand six hundred (43,600)
24 residential customers have -- have voted with their
25 chequebooks, you seem to suggest is evidence of -- of --

1 not of competition in Manitoba, but just as segments of
2 the market who have moved over?

3 DR. MARC VAN AUDENRODE: That's what I
4 said. Yeah, it looks to me like these two (2) products
5 are sufficiently different; that, you know, these
6 customers decided to buy another product.

7 MR. BOB PETERS: Every market will have
8 segments, though, will it not, Dr. Van Audenrode?

9 DR. MARC VAN AUDENRODE: I wouldn't say
10 every market. I would say in many markets it's possible
11 to segment the market to some extent.

12 MR. BOB PETERS: Is segmenting the market
13 bad?

14 DR. MARC VAN AUDENRODE: Segmenting the
15 market is a strategy that is used by corporation to go
16 get as much of the consumer surplus that they can get off
17 them, and get as much of the consumer value that they can
18 get from them. It's, in many cases, not illegal but it's
19 certainly a direct transfer of wealth from consumers to
20 the firms and to the producers.

21 MR. BOB PETERS: In every market there
22 are segments along a continuum, are there not?

23 DR. MARC VAN AUDENRODE: I'm not sure I
24 exactly understand what you mean by that.

25 MR. BOB PETERS: Well, let's pick the

1 natural gas primary gas market. You would expect some
2 customers would be interested in a variable contract that
3 may be changed daily and you think at the other end of
4 the spectrum there might be customers who would want a
5 fixed-price contract that stayed the same for five (5)
6 years.

7 DR. MARC VAN AUDENRODE: Yes.

8 MR. BOB PETERS: And somewhere along the
9 line between the one (1) day rate and the five (5) year
10 rate --

11 DR. MARC VAN AUDENRODE: Yeah.

12 MR. BOB PETERS: -- everybody else will
13 be fitting into the market?

14 DR. MARC VAN AUDENRODE: Or somebody will
15 provide another product in between; that's basically how
16 many markets work, you know.

17 I like the example of breakfast cereal
18 that, you know, essentially, what launching a new
19 breakfast cereal about is finding that combination of
20 attributes that doesn't exist already in the market and
21 you can, you know, mark your product right at that
22 position and, you know, get a new segment of the market.

23 In itself, segmenting the market is not
24 bad as long as everybody can play in that -- play the
25 same game.

1 When the segmentation becomes a way to --
2 to be the only player at one end of the field then --
3 then segmentation becomes detrimental to consumers.

4 MR. BOB PETERS: I know I'm getting ahead
5 of myself, Dr. Van Audenrode, but why haven't other
6 breakfast cereals come into the Manitoba market to offer
7 a product different than what's presently offered by the
8 retailers or by Centra?

9 DR. MARC VAN AUDENRODE: That's a good
10 question and I don't know the institutional aspects well
11 enough to answer that question.

12 If you -- if you asked me to make a wild
13 guess or an educated guess, I'd say size of the market
14 would probably be the explanation or the most likely
15 explanation, or the one that I would investigate first.

16 MR. BOB PETERS: Can you help explain
17 that to the Board what you mean when you say that a
18 possible reason there aren't more retailers in Manitoba
19 is because of the size of the market?

20 DR. MARC VAN AUDENRODE: Well, there are
21 costs associated with setting up such an operation and
22 these costs are largely fixed costs. And, you know, if
23 the size of your market do not support enough players to
24 justify these fixed costs, then players just don't come
25 in.

1 But, as I said, this is just a guess, an
2 educated guess on my part.

3

4 (BRIEF PAUSE)

5

6 MR. BOB PETERS: Mr. Chairman, this might
7 be an appropriate time for a short afternoon break and
8 I'll catch up on my notes and proceed after the break.

9 THE CHAIRPERSON: Very good, Mr. Peters.
10 We'll be back at three o'clock.

11

12 --- Upon recessing at 2:48 p.m.

13 --- Upon resuming at 3:05 p.m.

14

15 THE CHAIRPERSON: Okay, Mr. Peters.

16

17 CONTINUED BY MR. BOB PETERS:

18 MR. BOB PETERS: Thank you, sir. Dr. Van
19 Audenrode, before the recess, you speculated that the
20 size of the marketplace in Manitoba may contribute to
21 there not being additional retailers here. Is that
22 correct?

23 DR. MARC VAN AUDENRODE: Yes.

24 MR. BOB PETERS: And can you tell the
25 Board -- and I -- that -- that was in response to a

1 question of mine about segmentation of the marketplace.
2 Does segmentation of the marketplace, Dr. Van Audenrode,
3 lead to barriers to entry?

4

5 (BRIEF PAUSE)

6

7 DR. MARC VAN AUDENRODE: Well these are
8 two (2) very different problems. I could imagine how
9 segmenting could potentially create barrier to but that
10 would certainly not be my first concern.

11 If -- if access to the market is -- is
12 free, then, by definition, there are no barriers to
13 entry.

14 MR. BOB PETERS: I'm not sure I
15 understood your answer, sir. Are you telling the Board
16 then that segmentation in of itself is not a barrier to
17 entry into the market?

18 DR. MARC VAN AUDENRODE: In itself, no.
19 You could potentially use it, but in itself, no.

20 MR. BOB PETERS: Would Utility offering a
21 fixed price contract lead to further segmentation of the
22 market?

23 DR. MARC VAN AUDENRODE: No, not
24 necessarily. I mean the brokers might and the retailers
25 might choose to offer yet another product in response to

1 Centra being allowed to offer one (1) month on contract.
2 But that necessarily wouldn't follow.

3 MR. BOB PETERS: But wouldn't it follow
4 if the Utility offered a one (1) year or a two (2) year
5 fixed price contract that's presently not being offered?

6 That's another market segment that they're
7 going after?

8 DR. MARC VAN AUDENRODE: Oh yeah. But it
9 would be very different in the sense that the retailers
10 could go after that market. Nothing would prevent them
11 from going into that market.

12 They are already present, they've paid a
13 fixed cost to enter into the market.

14 MR. BOB PETERS: Mr. Stauff, turning to
15 the issue of volatility management, as I understand your
16 evidence, there's two (2) aspects related to this; one is
17 hedging and the other is the equal payment plan. Do you
18 agree with me?

19 MR. MARK STAUFF: Yes.

20 MR. BOB PETERS: Would you agree that
21 hedging as conducted presently by the Utility is designed
22 to smooth the rates and reduce the rate volatility?

23 MR. MARK STAUFF: My understanding is
24 that that is the theory that the Utilities advance, yes.

25 MR. BOB PETERS: And, in terms of the

1 equal payment plan, that deals more with bill volatility
2 than rate volatility?

3 MR. MARK STAUF: Yes. It -- it
4 addresses the bills independently of what the rates are.

5

6 (BRIEF PAUSE)

7

8 MR. BOB PETERS: In terms, Mr. Stauff, of
9 Centra's default product offering. You haven't gone out
10 and specifically said a one (1) month offering, but
11 that's a possibility, is it?

12 MR. MARK STAUF: Sure, as a matter of
13 rate making practice, I'm sure they could do that one way
14 or another.

15 MR. BOB PETERS: And that would make it
16 similar, perhaps, to the Alberta example that you're more
17 familiar with?

18 MR. MARK STAUF: Yes. My understanding
19 is that in Alberta they do essentially that. They
20 redetermine regulated prices on a -- every month.

21 MR. BOB PETERS: And there's no hedging
22 in the setting of the regulated prices? No hedging
23 impacts?

24 MR. MARK STAUF: That's correct, as far
25 as I understand. Yes.

1 MR. BOB PETERS: But they do have a PGVA
2 and they -- they keep flowing that through in the
3 succeeding months?

4 MR. MARK STAUF: Yes.

5 MR. BOB PETERS: In your evidence, Mr.
6 Stauff, you encourage the Board or suggest to the Board
7 that there should be no hedging in Centra's default
8 product, and you also want the Board to allow Centra to
9 offer fixed-price offerings, correct?

10 MR. MARK STAUF: Yes.

11 MR. BOB PETERS: Are those two linked?
12 Is one conditional on the other?

13 MR. MARK STAUF: I'm not sure they would
14 be absolutely linked, or that there -- there is a sort of
15 necessary logical connection between them. I would say,
16 though, that to the extent that part of the rationale
17 that people may have for allowing Centra to continue with
18 the hedging program, is that it reduces rate and bill
19 volatility, rate volatility to some extent.

20 And -- and that that's a good thing. That
21 concern or that rationale should be weakened if the
22 environment were such that Centra could offer, for
23 example, one (1) or two (2) year fixed-price products.
24 In other words, if people can -- can deal with their own
25 volatility concerns individually through their

1 contracting practices, through deciding what kind of gas
2 product to buy, then it would seem there would be less
3 justification for the Utility going out and doing that
4 rate-smoothing on a -- on a generic basis for everyone.
5 So, in that sense, I think they're linked.

6 MR. BOB PETERS: Is your primary reason
7 for recommending the discontinuation of the hedging
8 program by the Utility, the fact that it may cost more in
9 the long run?

10

11 (BRIEF PAUSE)

12

13 MR. MARK STAUFF: Yeah, I mean there are
14 a number of points that I think that have been raised and
15 that I raised in my testimony. One (1) is I think
16 everybody accepts that on an accepted basis hedging does
17 cost ratepayers something. There are costs involved

18 I also pointed out in my testimony that,
19 in -- in a sense, hedging does introduce risk for people,
20 in the sense that you can get significant and unexpected
21 increases in gas costs. Now, I understand all the
22 arguments how, in the long run, those probably more or
23 less equal out, but, I mean, it's still a -- a risk for
24 the Utility and it's a risk for -- for customers that
25 they can have significant bumps in their gas costs

1 relative to -- to what they would otherwise have been as
2 a result of the hedging program.

3 And I think even if you sort of concede
4 that the costs aren't that significant; if you call them
5 \$1 million or even if they're \$2 million, if they're not
6 -- if it's not doing any good, or if it's performing a
7 role in the market that can be handled in some other way,
8 then why spend the \$2 million.

9 Even if it was a hundred thousand dollars
10 (\$100,000), why spend the hundred thousand dollars
11 (\$100,000) for an activity that -- that doesn't do you
12 any good? So a lot of the rationale was, look, there are
13 other ways of handling these volatility issues, the EPP
14 being a major one. Potentially, alternative products
15 like one (1) and two (2) year fixed price products are
16 another option.

17 I think, I said as well, there's probably
18 a fair -- fairly significant segment of the population
19 that just doesn't care at all about volatility, or for
20 whom it's just not a significant concern. So, again for
21 that segment, all this activity is useless and -- and the
22 costs incurred are essentially wasted. Storage already
23 reduces volatility to some extent.

24 I think I discussed, as well, that there
25 rate-making approaches that can be taken to smooth out

1 peaks and valleys in -- in gas costs, that I understand
2 the Board has actually employed in the past. So there's
3 a whole range of tools that utilities and regulators can
4 use to deal with this that don't really cost anything.

5 And on that, I -- my view is that on
6 balance the reasonable thing to do is avoid those costs
7 whatever they are and deal with it some other way.

8 MR. BOB PETERS: One of the things you
9 didn't mention was perhaps changing the quarterly rate
10 setting methodology, where we could revert back to a
11 system where only 50 percent of the quarterly rate change
12 was passed on to consumers and the balance was put into a
13 PGVA. Is that a viable option?

14 MR. MARK STAUFF: Yes. Yes. When I --
15 when I mentioned rate-making approaches that we'll deal
16 with, that that was sort of a generic description of that
17 kind of mechanism, but certainly that's something that
18 can be done.

19 And you can do that, again, as you suggest
20 in your example, either automatically or you could do it
21 on an ad hoc basis, when weird and bad things happen in
22 the gas market. There's -- there's all kinds of
23 different approaches that are possible.

24 I mean, there's a bit of a tension between
25 the desire to have the default rate reflect market

1 conditions as closely as possible, which is where you're
2 headed with a -- with a month-to-month type of
3 redetermination, versus the kind of thing we've been
4 talking about where you go longer term, or you kind of
5 defer extraordinary costs over a period. There's a -- I
6 acknowledge -- a tension there but, again, that's all --
7 those are all approaches that can be dealt with and
8 judgments can -- can be made about what the appropriate
9 approach is from time to time.

10 MR. BOB PETERS: Dr. Van Audenrode, in
11 your evidence to Mr. Saxberg, I think you found some
12 common ground with Dr. Cyrenne on hedging being a risky
13 proposition; is that what you told the Board?

14 DR. MARC VAN AUDENRODE: Yes.

15 MR. BOB PETERS: Can you explain to the
16 Board how, under the current system, if you know, does
17 Centra have a risk in their hedging program?

18 DR. MARC VAN AUDENRODE: Well, I'm -- the
19 only thing I know about the current program is -- is what
20 -- the discussions I've had with Mr. Stauff and -- and
21 Mr. Saxberg.

22 I -- I understand that their program falls
23 into what is known in -- in financial market as being a
24 costless collar where, to some extent, you agree to pay
25 more for your natural gas when the natural gas is

1 exceptionally cheap, and in exchange for paying less for
2 any natural gas when natural gas is exceptionally
3 expensive.

4 Now the definition of what exceptionally
5 expensive is and what exceptionally cheap is depends on,
6 you know, what the market is going to require from -- to
7 pay on one side to get the benefit of paying less when
8 it's exceptionally expensive, and -- and more in the
9 other case. And that needs not be symmetric, depending
10 on the expectation of the market about these things.

11 So if you end up in a situation where you
12 set up your collar but, because of exceptional
13 circumstances, you hit the floor all the time, you end up
14 paying your natural gas at a much higher rate than you
15 would otherwise, without that -- without that collar
16 being in place, and that cost has to be passed on to a
17 customer.

18 MR. BOB PETERS: And I -- I -- I thank
19 you for your answer, sir. Your -- your evidence to the
20 Board, was to the effect that because hedging is risky,
21 you should leave it to the private sector.

22 DR. MARC VAN AUDENRODE: Well because --
23 the way I characterize it is, yeah, I don't see the
24 immediate sanction that is normally embedded in these
25 kind of -- of taking these kind of position that you

1 would expect to be -- to be present for -- for a private
2 corporation.

3 In there, the cost is just being passed on
4 to -- to consumers. Which, by the way, if I might add
5 one thing, I wouldn't probably mind if, you know, one of
6 the product that Centra were to offer to its customers as
7 an option, would be a three (3) months hedged price.

8 But a consumer choosing that rate, being
9 the ones assuming the risk and the cost of, you know, the
10 hedge if -- if you end up being paying much more than --
11 than -- than you would have with a -- with a market
12 price, and the cost being, you know, specifically put on
13 -- on these consumers.

14 By -- by that I would mean, you know, that
15 Centra would just be hedging on behalf of their consumers
16 and that I would not have any problem with that.

17 MR. BOB PETERS: So, I take from your
18 answer, Dr. Van Audenrode, that you think the default
19 product from the Utility should be a -- a one (1) month
20 floating price? Would that be correct?

21 DR. MARC VAN AUDENRODE: I think so,
22 yeah.

23 MR. BOB PETERS: And if the Utility
24 decided to offer a three (3) month variable hedged price,
25 that's just one of the service offerings on the continuum

1 that they could -- they could offer?

2 DR. MARC VAN AUDENRODE: Could offer, and
3 -- and the cost of that hedge should be borne by the
4 people who would like to take that -- that contract.

5 MR. BOB PETERS: All right. Well that's
6 where I was headed and -- and -- but presently, right
7 now, do you see Centra accepting any risks from price
8 management or hedging that they don't pass onto
9 consumers?

10 DR. MARC VAN AUDENRODE: My understanding
11 is they passed on their costs.

12 MR. BOB PETERS: In terms of the equal
13 payment plan as a default option, Mr. Stauff, let me just
14 make sure I have your position clear.

15 You're not -- I think I wrote down the
16 words, you're not terribly strong about whether it's
17 offered as a default product or not. But if it is a
18 default product, you want consumers to have the option to
19 opt out of EPP and onto regular readings?

20 MR. MARK STAUFF: Sure, yeah. Yeah, I
21 understood that's what we meant by default, right? That
22 -- that --

23 MR. BOB PETERS: All --

24 MR. MARK STAUFF: -- you could -- in
25 either case, consumers can choose which -- which option

1 they want. The only question is which one do you fall
2 into if you don't ever bother to say anything to the
3 Utility about it.

4 MR. BOB PETERS: All right. And does
5 your answer then apply to existing customers who
6 heretofore have never elected EPP; they would default to
7 EPP unless they elected out? Or would it only be for new
8 customers coming onto the system?

9 MR. MARK STAUF: You could do it either
10 way. I mean my -- my original concept was that you would
11 -- you'd have a mechanism or you'd kind of make that the
12 default for everyone.

13 But I think your suggestion might be a
14 good one that if -- as a sort of less intrusive approach
15 would be to say that for new customers, they will take
16 that -- take the EPP as a default, subject always to
17 their ability to opt out of it, and then just leave
18 everybody else where they are now. That would be another
19 option that would -- would make sense.

20 MR. BOB PETERS: I think I have your --
21 your point on that.

22 Dr. Van Audenrode, is the using of the
23 equal payment plan as a default option counter intuitive
24 to economic principles where you're selecting for them?

25 DR. MARC VAN AUDENRODE: Well, to the

1 extent that you have to have a default option, which I
2 believe is the case because you can't force people to
3 tell you absolutely how they want to be -- how they want
4 to pay. You -- you have to have a default option. And I
5 have no priority reason to believe that one would be
6 better than -- than the other.

7 MR. BOB PETERS: All right. Mr. Stauff,
8 presently the Utility claims that it incurs costs to
9 serve direct purchase customers. You're aware of that?

10 MR. MARK STAUFF: Yes.

11 MR. BOB PETERS: And one area of those
12 costs is a WTS administration fee?

13 MR. MARK STAUFF: Yes.

14 MR. BOB PETERS: I think it's quantified
15 in the materials, and I may have it wrong, but
16 approximately three quarters of a million dollars a year.

17 MR. MARK STAUFF: I'll accept that for --
18 sorry, you're saying that Centra -- Centra's evidence is
19 that they incur those kinds of costs?

20 MR. BOB PETERS: Let me -- let me
21 rephrase it this way, being more of a lawyer than you --
22 since you're being particular with me, Mr. Stauff, and I
23 don't blame you.

24 MR. MARK STAUFF: Sorry, I don't mean to
25 be.

1 MR. BOB PETERS: But -- but assume --
2 assume Centra says that their WTS administration fees are
3 quantified at approximately seven hundred and fifty
4 thousand dollars (\$750,000) a year.

5 MR. MARK STAUF: Okay.

6 MR. BOB PETERS: Let's assume that was
7 the case.

8 MR. MARK STAUF: Sure, okay.

9 MR. BOB PETERS: Whether it is or not
10 they'll -- they'll tell me that in short order.

11 MR. MARK STAUF: Yeah.

12 MR. BOB PETERS: And those are the costs
13 that -- that Centra incurs so that WTS service can be
14 offered to all of the customers that it is?

15 MR. MARK STAUF: Right.

16 MR. BOB PETERS: Who should pay for that
17 WTS administration fee?

18 MR. MARK STAUF: Well, my view is that
19 those costs should be recovered from the WTS customers
20 through a -- through a fee. Through a -- like an admin
21 charge or -- or a WTS fee that is separately charged to
22 WTS customers.

23 MR. BOB PETERS: Do you -- and -- and the
24 reason you say that is those who cause the cost should
25 pay the cost, is the position you're taking?

1 MR. MARK STAUF: Yes.

2 MR. BOB PETERS: And do you acknowledge
3 that there's another view, that is, those who have access
4 to the benefits and perhaps a WTS program should pay?

5 MR. MARK STAUF: I know that that is the
6 theory that has been advanced, but I think I -- I said
7 earlier that -- I mean the principle should be I -- I
8 think, in economic terms, that you -- you pay the costs
9 that are incurred for the purpose of providing service to
10 you.

11 And that's the sort of highest level rate-
12 making principle that I generally adhere to anytime I
13 give people advice about rates or cost allocations.

14 I mean, I understand the argument but,
15 again, that kind of analysis where you say, well, we
16 should make everybody pay for this service that we don't
17 use -- that they don't use, because they might use it.

18 Well, maybe they will, maybe they won't.
19 I mean, the fact is they don't and they -- they haven't
20 so far. The service has existed for a long time. People
21 that don't use the service presumably do that for a
22 reason because they just don't want to.

23 And I don't see why it's reasonable to
24 make them pay the costs of -- of getting that service
25 particularly if -- if it means that the people that do

1 take the service are not paying part of the costs Centra,
2 in fact, uses to provide or incurs for the purpose of
3 providing service to them.

4 MR. BOB PETERS: Would your answer change
5 if all distribution customers, that is, System Supply and
6 direct purchase contributed to the WTS fee?

7 MR. MARK STAUF: Well, that would be the
8 status quo I think. My understanding is that it's those
9 costs are -- they're not separately stated as a WTS fee,
10 but the costs are nevertheless recover from all customers
11 through the -- the distribution rates, I assume.

12 MR. BOB PETERS: I'm not arguing with
13 that and -- and I think you're correct, Mr. Stauff, but
14 the point that you made was that you would be more
15 concerned if the direct purchase customers weren't paying
16 a share of those costs. And I thought, well, how is that
17 different than what they're presently doing?

18 MR. MARK STAUF: Well, no, sorry, I --
19 maybe I wasn't clear. But they should be paying all of
20 those costs to the extent -- I mean right now they're
21 paying some of them, right, because they're -- the costs
22 are recovered from everybody.

23 So the WTS customers are even now paying
24 some of that seven hundred and fifty thousand dollars
25 (\$750,000). My view is that they should be paying all of

1 it.

2 MR. BOB PETERS: All right. Well let's -
3 - what about the bad debts that are incurred by the
4 customers who are presently served by retailers?

5 Should the bad debts of those customers be
6 visited upon that segment of the -- of the customer base
7 that is served by direct purchase? Or should those costs
8 be borne by all on the system?

9 MR. MARK STAUF: I have to be a little
10 bit cautious here. My understanding, just in my review
11 of Centra's testimony, is that they have a bee in their
12 bonnet about that in relation to the ABC Service and are
13 going to be proposing a change.

14 I have to confess that I didn't -- I
15 didn't spend a lot of time thinking about that because,
16 the way I understood their testimony, is that's sort of
17 the next rate case.

18 I think that, you know, if it were the
19 case that the bad debt expense -- if -- if there's no
20 sort of special bad debt component of a fee charged to
21 ABC customers now, that might make sense if the
22 experience was that the bad debt expense actually arises
23 sort of in equal proportions from WTS customers and
24 system customers.

25 But certainly it seems to me that if their

1 -- if WTS customers are causing more bad debt, or a
2 different proportion of bad debt than system customers
3 generally, then probably it makes sense to track that,
4 and track those expenses through to the customers classes
5 who are actually causing the problem.

6 MR. BOB PETERS: Well, if the direct
7 purchase customers are presently responsible for a
8 percentage of the System Supply customer supply bad
9 debts, is that inappropriate for the same reason?

10 MR. MARK STAUF: Well, it depends --
11 again we're talking at a high level and you really need
12 to be questioning Centra about their -- their plan, but -
13 - and I'm sure you'll get around to that -- but it's a
14 question of the proportions. What I was saying is if --
15 if the bad debts sort of arise equally from both classes,
16 then averaging it across the two classes doesn't make any
17 difference. Right?

18 MR. BOB PETERS: Okay.

19 MR. MARK STAUF: Everybody comes out
20 kind of the same. It's only if -- if you've got a
21 situation where the WTS people are kicking out enormous
22 costs and the system customers are sort of having to pay
23 part of that extra cost, that doesn't seem fair.

24 MR. BOB PETERS: The other area of cost I
25 wanted to talk to you about, Mr. Stauff, was the half a

1 cent a GJ on primary gas purchases from Nexen.

2 Are you familiar with that?

3 MR. MARK STAUF: Yes.

4 MR. BOB PETERS: And that's from the GRA
5 hearing you attended?

6 MR. MARK STAUF: Yes.

7 MR. BOB PETERS: And your understanding
8 is that in the recently concluded two (2) year renewal or
9 extension of the Nexen agreement, there's a provision for
10 Centra to contract out of certain volumes on a monthly
11 basis, when those monthly volumes migrate to direct
12 purchase.

13 MR. MARK STAUF: Yes.

14 MR. BOB PETERS: And your understanding
15 is that the -- the premium or the cost of so doing was
16 quantified at approximately half a cent a GJ or -- I
17 guess on a typical year it could be a hundred and sixty
18 thousand dollars (\$160,000) a year?

19 MR. MARK STAUF: I'll accept those
20 numbers. Yeah, I -- I do recall the half cent.

21 MR. BOB PETERS: All right, and in your
22 view, who should be responsible for the hundred and sixty
23 thousand dollars (\$160,000) a year of the additional
24 Nexen contract costs?

25 MR. MARK STAUF: Again, that is a cost

1 that is being incurred by Centra under its gas purchase
2 contract, primarily or exclusively for the benefit of WTS
3 customers and people that use WTS service. It's not
4 being incurred -- from the perspective of a committed
5 system customer, that's just an extra half cent onto
6 their gas rates for no reason, and --

7 MR. BOB PETERS: But it -- I'm sorry.

8 MR. MARK STAUF: -- my view is that the
9 cost should be, theoretically, at least, allocated to --
10 to WTS people.

11 MR. BOB PETERS: If I'm an existing
12 direct purchase customer of a retailer, that half a cent
13 a GJ premium that has been negotiated does nothing for me
14 then, does it?

15 MR. MARK STAUF: Fair enough. Good
16 point. If you're -- if you're the customer. I was
17 thinking of it in terms of the benefit. If you're trying
18 to stream the benefit to somebody though, the people that
19 really benefit are the brokers themselves who just have
20 more flexibility in the frequency with which they enroll
21 customers.

22 So I was thinking of it -- them as
23 constituting something like a rate class and if those
24 costs are incurred exclusively for people who are in or
25 sort of served through that rate class. So if you have

1 to allocate it somewhere, differentially, it should be to
2 the WTS group as a whole.

3 I appreciate that if I'm an existing long-
4 time WTS customer, I might not think that's quite fair
5 but at same time the -- they're in no worse position than
6 -- than a system customer that's paying a half cent extra
7 for no good reason.

8 MR. BOB PETERS: Except the system --
9 sorry, the system Supply customer currently has the
10 option to contract over with Direct purchase on one (1)
11 month's notice as opposed to three (3) month's notice.

12 MR. MARK STAUF: True.

13 MR. BOB PETERS: So that's the benefit to
14 the existing System Supply customers?

15 MR. MARK STAUF: Well, I mean, you can
16 call that a benefit I guess for those customers but it's
17 also a benefit for -- well, I mean, I guess you can sort
18 of twist it around and think of it that way but as I say,
19 I think of it primarily as a benefit to the brokers.

20 They're the ones that are in a hurry to
21 get people signed up and enrolled as quickly as possible
22 and this kind of thing --

23 MR. BOB PETERS: Would it make --

24 MR. MARK STAUF: -- as I understand it.

25 MR. BOB PETERS: -- would it make any

1 difference to your answer, Mr. Stauff, if the evidence
2 concludes that while the brokers would like more
3 flexibility they never agreed to any premium for that?

4 MR. MARK STAUFF: I can certainly believe
5 that they didn't agree to that and didn't have any input
6 into Centra's decision making or negotiations with Nexen.

7 On the other hand, yeah, they -- my
8 understanding is that the brokers wanted that. They
9 wanted that flexibility that they didn't have before and
10 they got what they asked for.

11 And Centra's now saying, yeah, and in
12 order to give you what you asked for, we had to incur
13 these extra costs. So I don't think they can -- if -- if
14 they were expecting that flexibility to just materialize
15 out of thin air for nothing from Nexen, I -- I think that
16 was -- they weren't thinking it through properly. They
17 shouldn't have -- should not have been expecting that.

18 MR. BOB PETERS: But they got the
19 quarterly nomination changes or the quarterly de-
20 contracting privileges for free prior to this new
21 arrangement.

22 MR. MARK STAUFF: Well, apparently, sure.
23 I mean obviously that flexibility is part of the overall
24 Nexen arrangement but certainly, from this perspective --
25 from the perspective of having this contract in place for

1 a long time, it -- it looks free, yes.

2 MR. BOB PETERS: Mr. Stauff, turning to
3 the changes in nomination process that's been requested,
4 did you immerse yourself in an understanding of the
5 change that is requested by the retailers for the
6 nomination process by the Utility?

7 MR. MARK STAUFF: I would have to say no.
8 The -- my understanding had been, when I wrote my
9 testimony, that there had been complaints about the
10 nomination process or really about the variability of the
11 WTS nominations.

12 And in my testimony I wasn't responding to
13 any particular proposals or -- or detailed plans that
14 might be advanced. I was, instead, talking about at a
15 general level about the reasonableness of flattening out
16 the WTS nomination pattern just gratuitously for the WTS
17 customers.

18 And the analysis in there is all --
19 essentially saying, well, I'm not sure -- I don't think
20 that's probably a good idea because what you're really
21 doing is providing storage to the WTS customers for free
22 and that doesn't seem fair.

23 I -- I can't say that I looked over the
24 previous -- or studied the previous Board proceedings and
25 evidence and so on about that -- it was a more general

1 point than that.

2 MR. BOB PETERS: All right. So thank
3 you. Just so I understand, your general point is that if
4 -- if a nomination process for retailers customers went
5 down to 1/365th of their annual supply per day, you think
6 that would give an unfair advantage to those retail
7 customers using direct purchase because they would be
8 getting a greater option to use the storage or
9 disproportionate storage use than other customers?

10 MR. MARK STAUFFT: That's essentially it.
11 That's -- yeah.

12 MR. BOB PETERS: And if they used storage
13 disproportionately, that would leave the System Supply
14 customers at the -- at the whim of the swing service
15 offered under the Nexen arrangement.

16 MR. MARK STAUFFT: In effect, I think
17 that's the practical affect, yes. There would be less
18 storage available for system purposes and Centra would
19 have to rely more heavily on the swing service. The
20 higher price of swing service.

21 MR. BOB PETERS: In turning to the
22 hypothetical of Centra offering a fixed price offering,
23 Mr. Staufft, can I take from the evidence from you today
24 that the -- the biggest benefit and I'll ask the same
25 question of Dr. Van Audenrode, that the biggest benefit

1 would be that -- that would kind of create some price
2 transparency in the market you feel and everybody could
3 price against the Utility's offering and be judged
4 accordingly?

5 MR. MARK STAUFFT: Yes, I think that's a
6 significant benefit for that as I -- I characterized what
7 I think you're saying as competitive discipline on the
8 brokers.

9 I guess there is another aspect of it in
10 the sense that if the Utility were to offer one (1) and
11 two (2) year, for example, fixed prices, that's a product
12 that is not available in the market right now.

13 And some of the material that I reviewed
14 from the Focus Groups and -- and the customer survey
15 suggested that there probably are people out there that
16 would like that kind of service or that kind of gas
17 purchase arrangement.

18 So, if Centra were to do that, then they
19 would be filling a -- meeting of market demand that
20 appears to exist now and appears not to be -- being met.

21 MR. BOB PETERS: Do -- do you based that
22 last answer of yours, Mr. Staufft, on your interpretation
23 of the Focus Group report or of the quantitative findings
24 in the customer survey report?

25 MR. MARK STAUFFT: I'm not sure I can pick

1 the document. What -- the picture I have in my head is a
2 table in one of those reports where people had kind of
3 ranked what kind of product they'd like.

4 And -- and one (1) and two (2) year
5 products turned up as a --

6 MR. BOB PETERS: Fair enough.

7 MR. MARK STAUF: Rather than me making
8 this up perhaps I should -- right. This is the report on
9 the Focus Groups. Mr. Saxberg has found this for me on
10 page 18.

11 There's a table where people were
12 apparently asked what kind of rate plans they would --
13 they would like to see and then there's various
14 alternatives listed with various scores.

15 And in fact the -- for both hydro
16 customers and marketer customers, the highest score turns
17 up for a plan described as your rate for natural gas
18 changes every year.

19 And then there's various numbers for --
20 for the others as well, so, that was the basis for that.

21 MR. BOB PETERS: Well, did you take from
22 that table that the customers weren't prepared to source
23 those options from retailers and they would only source
24 them from Centra if Centra offered them?

25 MR. MARK STAUF: No, no, I didn't take

1 that at all. But there --

2 MR. BOB PETERS: So you understood that
3 customers -- if customers may have been told that they
4 were available from a retailer other than Centra, they
5 may have been happy with that choice as well?

6 MR. MARK STAUFFT: Oh, yes. They could
7 well have been. I don't think that was the question that
8 was asked. My point was just that right now it's not
9 available from any of the marketers or the retailers.

10 MR. BOB PETERS: Mr. Staufft, is it an
11 assumption that you're making in your evidence that if
12 Centra was allowed to offer a fixed price offering, their
13 price would be lower than that offered by the retailers?

14 MR. MARK STAUFFT: I wouldn't say that
15 that's an assumption. I think that is a possible outcome
16 and perhaps even a likely outcome. We talked before
17 about the concerns that I have about whether competitive
18 pricing is -- or competition is working properly in the
19 very long term markets that the brokers offered -- sorry,
20 the retailers operate in now, said, well, it looks to me
21 like perhaps those prices are a little bit higher than
22 they would be under ideally competitive conditions.

23 The way to test that -- or one way to test
24 that is to go through the exercise of trying to develop a
25 cost based rate for a similar utility product and see how

1 it turns out. I mean, if my suspicions are correct then
2 you would expect the Utility's cost based rate to be
3 lower. If I'm mistaken about that then you wouldn't --
4 they would be presumably the same or higher, they'd be
5 something different.

6 MR. BOB PETERS: Would your utility-based
7 rate include a profit margin, called whatever you wanted
8 to call it but a -- over and above the costs?

9 MR. MARK STAUF: No.

10 MR. BOB PETERS: And --

11 MR. MARK STAUF: I don't -- I don't see
12 any reason to put that in a regulated rate. I mean,
13 Centra already is -- has its financial situation under
14 control through its GRAs, it doesn't -- I don't see why
15 it needs an extra profit margin built in.

16 MR. BOB PETERS: Wouldn't that be an
17 example then of subsidizing the Centra profit by not
18 requiring it to contain a profit margin when you know the
19 brokers' offerings have to include a profit margin?

20 MR. MARK STAUF: I don't see why you
21 would call it a subsidy for the Centra product, though.

22 MR. BOB PETERS: Well, because they're --
23 they're getting their return on whatever you want to call
24 their return, either whether it's a corporate allocation
25 or net income through another means.

1 MR. MARK STAUF: Yeah. Well, they just
2 don't have that cost for supplying the -- for making that
3 gas sale service available, that's why it's not in their
4 rate.

5 MR. BOB PETERS: So when I asked you the
6 question "Is it your assumption that Centra's price for a
7 fixed-price offering would be lower than that offered by
8 a retailer," I'm now concluding that your answer is
9 probably, yes, you conclude it would be?

10 MR. MARK STAUF: Yeah, you're right. If
11 you look at that -- at that factor, that would tend to --
12 to suggest that it would be lower. But, again, I haven't
13 investigated how -- you don't know what the scale of
14 these things is, right. If you're talking at about a
15 thirty (30) cent rate, I'm, for these purposes, sort of
16 ignoring things like the point one (.1) cent cost
17 elements in these cents. There's so much more noise in
18 the market and so many other factors, it might be that
19 these things just kind of get lost in the rounding.

20 But directionally, you're probably correct
21 that because of the return element and the -- I'm sure
22 Centra has lower O&M costs and so on associated with
23 providing those services so, in that sense, probably
24 that's right.

25 And that, again, is a benefit to the

1 consumers; they get a lower price.

2 MR. BOB PETERS: When -- let's just again
3 be hypothetical about this, Mr. Stauff. If 60 percent of
4 Centra's residential volumes were recovered by the
5 Utility through a fixed price offering, shouldn't 60
6 percent of the return, which includes the corporate
7 allocation on the net income, also be recovered from that
8 60 percent and only that 60 percent?

9 MR. MARK STAUFF: Again, my understanding
10 -- unless I'm completely misunderstanding how these rates
11 are done, my understanding is that whatever quasi return
12 we're talking about for Centra here is associated with
13 its business of owning and operating a distribution
14 system. It has nothing to do with its -- or practically
15 nothing to do with its activities in buying and selling
16 gas. It's all -- that return is all an -- return on
17 investment; it's got nothing to do with the gas sales
18 thing.

19 MR. BOB PETERS: In your answers to me,
20 Mr. Stauff, do I take it you assume that -- and your
21 recommendation to the Board is that any competitive
22 offerings by Centra to compete with those that could be
23 offered by retailers should be conducted inside the
24 regulated Utility?

25 MR. MARK STAUFF: Yes.

1 MR. BOB PETERS: And not outside the
2 regulated utility?

3 MR. MARK STAUF: Correct.

4 MR. BOB PETERS: And would the price be
5 different to the consumer if it was offered outside of
6 the regulated utility compared to inside the regulated
7 utility?

8 MR. MARK STAUF: Well, I mean, it might
9 be.

10 If it was -- if it was conducted outside
11 the regulated Utility, that would be just -- then Centra
12 or some subsidiary or affiliate of Centra would be just
13 in the same position as Direct or Energy Savings. They'd
14 be just another player in the market offering whatever
15 products they liked at whatever prices they liked, taking
16 their chances in the market.

17 MR. BOB PETERS: Is it your
18 understanding, Mr. Stauff, that since Board Order 110/96,
19 Centra could put together an affiliate that's unregulated
20 and compete with the retailers?

21 MR. MARK STAUF: I have to say I just
22 don't know. I'm not familiar --

23 MR. BOB PETERS: You don't --

24 MR. MARK STAUF: -- with that.

25 MR. BOB PETERS: You don't remember the

1 front end of the 15/98 proceedings? I'll have to get Mr.
2 Stephens --

3 MR. MARK STAUF: Not at that level of
4 detail apparently, no, I'm afraid.

5 MR. BOB PETERS: Okay. Well, I have one
6 more chance at it.

7 But do you think there's any impediment
8 today from Manitoba Hydro having an unregulated affiliate
9 offering primary gas options to consumers in Manitoba?

10 MR. MARK STAUF: Do I -- I don't know
11 whether there's a legal impediment or not. I mean, there
12 may --

13 MR. BOB PETERS: Do you agree with me,
14 Mr. Stauf, that whether it's inside the Utility or
15 outside of the Utility, there should be under no
16 circumstances any cross-subsidization of the offerings on
17 the fixed price side by the default customers?

18 MR. MARK STAUF: Yes, I agree with that.

19 MR. BOB PETERS: Dr. Van Audenrode, you
20 also support that, I would take it?

21 DR. MARC VAN AUDENRODE: Yes.

22 MR. BOB PETERS: And therefore, if -- Dr.
23 Van Audenrode, what difference does it make to you
24 whether Centra's fixed price offering is inside the
25 Utility or outside in an unregulated affiliate?

1 DR. MARC VAN AUDENRODE: Well, ease of
2 management. If you had -- if you had both activities
3 being regulated, it would make life of the Board much
4 easier to precisely figure out whether no cross-
5 subsidization is happening there. That's the only reason
6 I could think of.

7 MR. BOB PETERS: And you agree with Mr.
8 Stauff that all of the costs that are incurred or accrued
9 to any fixed price offering inside the Utility should be
10 recovered from those customers who avail themselves of
11 the fixed price offering?

12 DR. MARC VAN AUDENRODE: Yes. Consumers
13 should pay the real price of the goods they are
14 receiving.

15 MR. BOB PETERS: Do you agree with me,
16 Dr. Van Audenrode, that presently Centra has monopoly or
17 market power in the natural gas industry in Manitoba?

18 DR. MARC VAN AUDENRODE: Well, he is, in
19 effect, the only -- the only player on the short run --
20 short term flexible -- short term flexible rate. To
21 qualify that as a monopoly -- so, suppose he's the only
22 player, does he have a monopoly in a sense that, you
23 know, there are barriers to entry? My understanding is
24 that, no, there is nothing that, if I understand
25 correctly, that prevents retailers from referring similar

1 products to the one that Centra is currently offering.

2 MR. BOB PETERS: They'd have the
3 advantage of name recognition if they were using the same
4 name?

5 DR. MARC VAN AUDENRODE: Name recognition
6 is a very important thing for any incumbent, but it has
7 been shown not to be an impediment. It's a hurdle, it
8 makes things more difficult to potential entrant, but,
9 you know, any potential entrant can overcome this.

10 MR. BOB PETERS: If Centra was to offer a
11 fixed price contract in the regulated Utility and used
12 regulated assets, you would want this Board to ensure
13 that those assets were costed out and charged through to
14 the specific contract?

15 DR. MARC VAN AUDENRODE: Yes.

16 MR. BOB PETERS: Doesn't that add
17 additional regulatory burden to the process, where if
18 there was a complete separation the Board wouldn't have
19 to concern itself with those costs? Much like right
20 now, the Board doesn't have access to or concern itself
21 with Direct Energy or Energy Savings costs?

22 DR. MARC VAN AUDENRODE: I totally agree
23 with you. It's -- yeah, it would add some burden to the
24 regulatory process.

25 But, I mean, keep in mind that the reason

1 why -- one of the reasons why I offered -- made that
2 suggestion is because my feeling as an economist today
3 that, you know, consumers would benefit from having a
4 benchmark for these kind of products, long-term
5 offerings.

6 And the only way that you can make sure
7 that whatever product Centra is offering in these long-
8 term rates is truly a benchmark I think is through
9 regulation, to having them regulated.

10 MR. BOB PETERS: If there was additional
11 regulatory burden that translated into additional
12 regulatory costs, should those costs be borne by the
13 fixed price contract customers?

14 DR. MARC VAN AUDENRODE: Again, there is
15 -- and my economist policy that, you know, people should
16 bear the cost. But I would doubt that these costs would
17 be huge in this case.

18 MR. BOB PETERS: If the Utility was
19 allowed to offer a fixed price contract in the regulated
20 entity, do you think they should be allowed to use their
21 existing marketing channels that they have inside the
22 Utility?

23 DR. MARC VAN AUDENRODE: My
24 understanding, and here again, I have that information
25 from discussion with Mr. Stauff, that the Utility is not

1 supposed to market its products currently. So they could
2 -- you know, they have to offer their products somehow to
3 their customers and, yeah, instead of offering the rate,
4 they could be offering two (2), three (3) or four (4)
5 different rates and many of choice but that --

6 MR. BOB PETERS: If there were additional
7 costs for the marketing of the products, you would want
8 those again recovered from the customers who took
9 advantage of the fixed price --

10 DR. MARC VAN AUDENRODE: Yes.

11 MR. BOB PETERS: -- contract from the
12 Utility?

13 DR. MARC VAN AUDENRODE: Yeah.

14 MR. BOB PETERS: Would you think, Dr. Van
15 Audenrode, that if the Utility was permitted to offer a
16 fixed price contract that it should comply with the same
17 code of conduct that the retailers have to comply with in
18 the marketplace?

19 DR. MARC VAN AUDENRODE: Well, I have no
20 knowledge of the code of conduct but, you know, if I had
21 to give an answer without having read that code of
22 conduct, I would certainly support a plain level field
23 for competitors.

24 MR. BOB PETERS: In case you're not going
25 to the junior hockey game tonight, it's at tab 12 of the

1 Book of Documents and you could maybe read it later. And
2 if you have any comments, I'm sure there will be an
3 opportunity tomorrow for you to do that.

4 When you say in that last answer you would
5 support a level playing field, you think that that's
6 mandatory for Centra entering in the fixed price
7 contract; would that be fair?

8 DR. MARC VAN AUDENRODE: Yes.

9 MR. BOB PETERS: Can you tell the Board
10 how would they ensure that there was a level playing
11 field?

12 DR. MARC VAN AUDENRODE: Well, the single
13 most important aspect would be no cross-subsidization of
14 any kind and people paying -- paying the right price for
15 the right product that they are buying.

16 MR. BOB PETERS: And that would be dealt
17 with by the Board through a review of the cost allocation
18 methodology --

19 DR. MARC VAN AUDENRODE: Yeah.

20 MR. BOB PETERS: -- if it got down to the
21 Utility offering a regulated product?

22 DR. MARC VAN AUDENRODE: Yes.

23 MR. BOB PETERS: Any other concerns or
24 how -- any other ways to ensure there would be a level
25 playing field?

1 DR. MARC VAN AUDENRODE: Well, as an
2 economist, that's the single most important one for me.

3 MR. BOB PETERS: Well, what about -- you
4 did indicate before that there could be a market power or
5 advantage through name recognition.

6 DR. MARC VAN AUDENRODE: Yeah.

7 MR. BOB PETERS: How is that overcome or
8 how is there a level playing field if the --

9 DR. MARC VAN AUDENRODE: Well, you --

10 MR. BOB PETERS: -- Utility can use the
11 same --

12 DR. MARC VAN AUDENRODE: You can -- can't
13 penalize people to have a name recognition; you can't
14 people for being good at what they do.

15 What -- you know the two things being two
16 different things here, not, you know, I don't see them
17 necessarily as being the same thing.

18 The fact is that, you know, if you try to
19 enter a market where you have a strong incumbent with a
20 very strong name recognition, well, you have to worker
21 harder and that's reality and you can't change that.

22 MR. BOB PETERS: Do you not think, Dr.
23 Van Audenrode, that the name "Centra" or the monopoly
24 power that it connotes has been earned while it's a
25 monopoly and it's been paid for by all ratepayers?

1 DR. MARC VAN AUDENRODE: Yeah, that's
2 true.

3 MR. BOB PETERS: Is that an item that
4 would be needed to be assessed by the Board and valued or
5 costed and charged back through to that fixed price
6 offering by the Utility?

7 DR. MARC VAN AUDENRODE: Well, yeah, they
8 still have name recognition but, if I understand
9 correctly, it's been ten (10) years now that competition
10 is allowed. Are the Manitoba consumer going to have to
11 pay for that implicitly for the next fifty (50) years or
12 sixty (60) year or one hundred (100)? I mean, what was -
13 - what's a reasonable period of time? I would think that
14 ten (10) years is the -- is a lot of time.

15 MR. BOB PETERS: Are you saying then there
16 should be no charge back to the fixed price offering
17 customers for the benefit they received for the monopoly
18 Utility?

19 DR. MARC VAN AUDENRODE: I'm not sure I
20 understand your question. I don't see the benefit they
21 receive from the monopoly Utility. First, I have a
22 problem characterizing Centra as a monopoly; and 2, I
23 don't see the benefit.

24 What I see Centra maybe having its life a
25 little bit easier in getting these new customers because

1 of its name recognition but I don't see any advantage to
2 the customer for that.

3 MR. BOB PETERS: Do you see an advantage
4 for the customers if by offering a fixed price offering
5 through the Utility the retailers leave the province and
6 discontinue service in Manitoba?

7 DR. MARC VAN AUDENRODE: Well, once
8 again, competition is not an objective per se;
9 competition is there because you want competitors to --
10 customers to have the lowest possible price.

11 If retailers are able to sell their
12 product at a lower price than Centra, they will stay in
13 the market.

14 If they are not able to sell their product
15 at a price that is competitive with Centra, they will
16 leave and the consumer will still benefit from the lowest
17 possible price.

18 MR. BOB PETERS: Well, Dr. Van
19 Audenrode, with respect, you say that competition is not
20 an objective in and of itself or per se, but isn't that
21 the only reason that you're suggesting that Centra enter
22 the market and, that is, to provide more competition?

23 DR. MARC VAN AUDENRODE: No. It is
24 because we want competition because we believe that in
25 many circumstances competition is the way, the simplest

1 possible way to lead to the lowest possible prices to the
2 consumers.

3 What I am saying in the situation that I
4 see here, having an additional regulated rate for this
5 product for which there are -- there is no regulated rate
6 and there are only two players now acting in that market
7 and offering a product that is very different from the
8 one that Centra is offering, might be an easy way to
9 provide a benchmark to see whether consumers are getting
10 the best possible deal in that market.

11 MR. BOB PETERS: Mr. Chairman, I estimate
12 I have maybe thirty (30) minutes left of questioning that
13 I could either complete today or first thing tomorrow
14 morning, at the Board's pleasure.

15 THE CHAIRPERSON: You're going to the
16 hockey game tonight, aren't you?

17 MR. BOB PETERS: Is it obvious?

18 THE CHAIRPERSON: Okay, we'll carry on
19 tomorrow. We'll see you all tomorrow at 9:00.

20

21 --- Adjourned at 4:05 p.m.

22 Certified Correct,

23

24

25 _____
Wendy Warnock, Ms.