**CENTRA GAS MANITOBA INC.**
**2015/16 COST OF GAS APPLICATION**
**OVERVIEW OF APPLICATION**

## INDEX

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## 2.0 OVERVIEW

Centra Gas Manitoba Inc. ("Centra") is applying to the Public Utilities Board of Manitoba (the "PUB") for an Order approving changes to its Supplemental Gas, Transportation (to Centra) and Distribution (to Customers) rates to be effective November 1, 2015. These changes reflect the forecast of gas costs for the 2015/16 gas year and the recovery of gas cost deferral balances for the 2014/15 gas year based on the outlook to the end of October 2015, as well as the recovery of the remaining balance in Prior Period Gas Cost Deferral accounts as at October 31, 2015.

Centra' s mandate is to acquire, manage and distribute supplies of natural gas to meet the Manitoba market requirement in a safe, cost-effective, reliable and environmentally appropriate manner. The cost of gas is the most significant cost that Centra incurs. Included in gas costs are upstream transportation and storage costs which are passed directly on to customers in rates without any mark-up or profit.

The actual gas costs for which Centra is seeking final approval in this Application were reasonably and prudently incurred on behalf of customers. While the Supplemental Gas deferral account balance accumulated in 2013/14 is significant, such levels are not unprecedented. The resulting customer bill impacts are modest and reasonable when considering the extreme weather conditions and unusual market circumstances that Centra faced.

## 2.1 CENTRA MEETS THE NEEDS OF THE MANITOBA NATURAL GAS MARKET WITH EXTRAORDINARY RELIABILITY

The planning and operation of Centra's portfolio of gas supply, transportation and storage assets is dictated by the nature and characteristics of the end-use market that it serves.

[redacted]

[redacted]

[redacted]

Centra's customer base in Manitoba is largely comprised of residential and small commercial customers. These customers utilize natural gas predominantly to satisfy their space heating requirements. This large seasonal heating requirement is obviously influenced by the prevailing weather. Simply put, as the weather gets colder, consumption increases and when the weather is warmer, natural gas consumption will decrease.

Manitoba has some of the most extreme and volatile weather in North America. As a result, Centra's load is highly variable on a daily, monthly and seasonal basis. The high variability in local weather and the sensitivity of natural gas load to changes in temperature create significant challenges for the forecasting, planning and operation of a natural gas supply, transportation and storage portfolio. Due to this variability, not all of Centra's supply, transportation and storage portfolio can be utilized at a high load factor.

A major consideration in planning and operating Centra's natural gas supply, transportation and storage assets is the requirement to serve all of Centra's firm sales customers (both system supplied and marketer supplied customers) on the coldest day that may be experienced in a winter heating season. Centra's arrangements must combine both reliability and flexibility in providing for the ability to respond to day-to-day and intra-day load variation in order to ensure that the Manitoba firm market requirement for natural gas is met at all times.

Another major consideration for Centra's operations is the fact that it is limited, or captive, to TCPL's Mainline for all natural gas supplies delivered to Centra's distribution system. As such, Centra's gas supply planning and operations are significantly influenced and affected by the current and future business environment of the Mainline.

[redacted]

## 2.2 THE USE OF GAS COST PASS-THROUGH MECHANISMS IS APPROPRIATE IN THE GAS DISTRIBUTION INDUSTRY

The natural gas industry in North America can be generally characterized as having a significant level of disaggregation between the local distribution companies ("LDCs") that provide utility service to end-users and the entities that produce, market, transport and store the natural gas commodity.
Centra owns, maintains and operates natural gas distribution facilities to serve customers in its service territory in Manitoba. The majority of the natural gas required to serve the Manitoba load is sourced from the Western Canadian Sedimentary Basin and is transported from this producing region to the Manitoba market area by way of the TransCanada Mainline system. In addition, Centra has access to contracted natural gas storage services which provide significant benefits with respect to the cost-effective planning and operation of the full portfolio of natural gas supply and transportation arrangements that Centra holds.

Natural gas commodity costs are determined in the competitive wholesale natural gas market in North America and are outside the control and influence of any one LDC. As with other market traded commodities, the price for natural gas is largely unpredictable and may exhibit significant volatility over particular time periods. In addition, the cost of acquiring, transporting and storing natural gas is generally the most significant component of an LDCs overall cost of operations and revenue requirement.

Another feature of the natural gas industry in North America is the general acceptance and application of gas cost pass-through mechanisms in the rate setting and regulatory environment for each LDC. These mechanisms treat the prudently incurred costs of purchasing, transporting and storing natural gas commodity as a "pass-through" to end-use customers.

Under a gas cost pass-through mechanism, LDCs do not "mark-up" or make a profit on the purchase and subsequent re-sale of natural gas and other upstream costs to their end-users. Natural gas costs and the revenues obtained from the sales of the commodity to end-users are tracked and recorded in Purchased Gas Variance Accounts (also referred to as PGVAs). PGVAs serve to reconcile the costs of acquiring, transporting and storing gas supplies against the gas-related revenues received from customers during a particular period of time. The resulting accumulated net balances in these variance accounts are then recovered from (or returned to) customers in a subsequent time period by way of the inclusion of "rate riders", which are added to base rates upon receiving regulatory approval that those costs were prudently incurred by the LDC.

Gas cost pass-through mechanisms shift the supply price risk from the LDC to the end-user. This is appropriate, as the rate of return or net income earned by a regulated LDC is intended to compensate only for the risks inherent in gas distribution, not the commodity cost. The rate of return or net income of an LDC would need to be significantly increased to fairly compensate it for assuming the price related risk of purchasing natural gas commodity and upstream transportation and storage capacity for its customers. Given this fact, it is recognized that it is less costly in the long-run for customers to assume the supply price risk.

In its findings in Order 12/15, the PUB noted that Centra's net income for the 2013/14 fiscal year was $20 million, which is higher than the $2.5 million net income approved by the PUB in the 2013/14 GRA on a normal weather basis. The PUB acknowledged that the cold winter of 2013/14 was the predominant reason for the substantial increase in Centra's net income and retained earnings. The PUB also noted that the cold winter was a major reason for the sizeable 2013/14 Supplemental Gas deferral account balance. In Order 12/15, the PUB indicated that it expected Centra to consider, in this Application, whether a portion of its retained earnings should be used to reduce the negative impact on customers from the further recovery of the Supplemental Gas PGVA.

Centra's position on this issue is that it is not appropriate to offset prudently incurred gas related costs with the financial reserves of the Corporation. In Centra's view, the gas cost pass-through mechanism (PGVA) that was approved by the PUB in Order 10/93 has served the interests of natural gas customers in Manitoba and should continue to function as originally intended.

Centra's position on this issue is supported by the expert testimony of Mark Drazen of Drazen Consulting Group, Inc., which is contained in Appendix 2.2 of this Application. On pages 11 & 12 of his report, Mr. Drazen's concludes that:

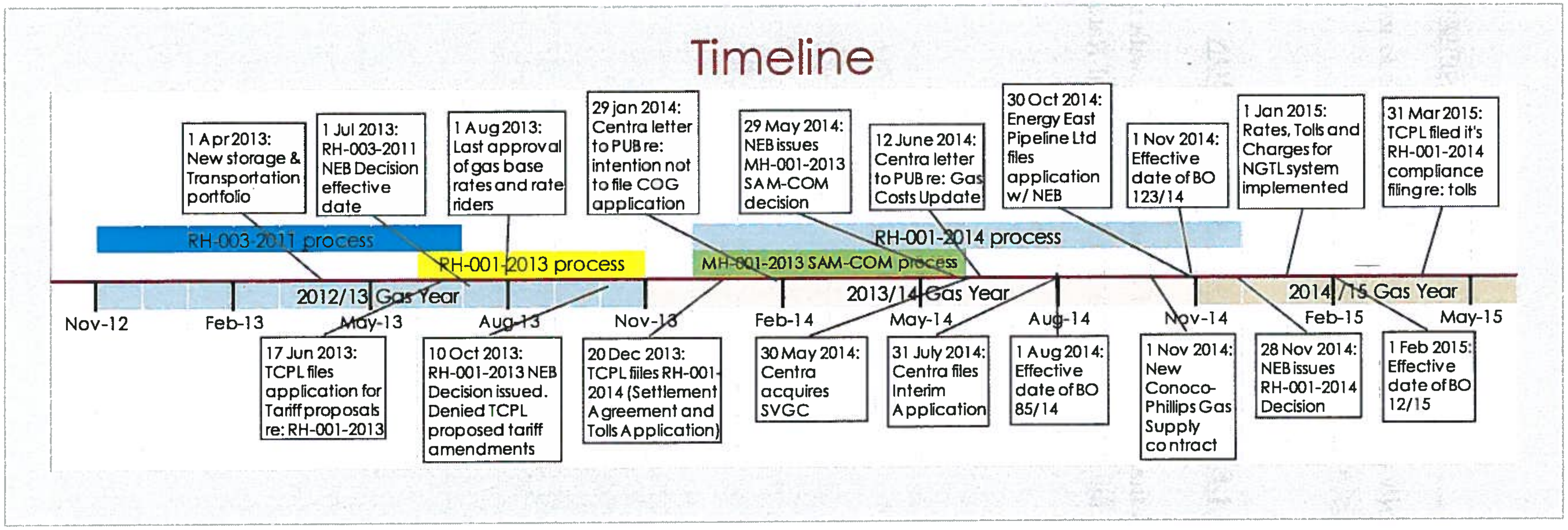
*"...given that Centra has not sought–nor has any party proposed–that PGVA rider charges be increased in years when earnings are much*

*lower than expected (especially losses), it would be inappropriate to use higher-than-expected earnings to offset PGVA rider charges".*

## 2.3 CHRONOLOGY OF EVENTS LEADING TO THIS APPLICATION

The following timeline describes the chronology of events associated with the approvals for Non-Primary Gas rates from the time of Centra's 2013/14 General Rate Application through to this filing.

**Figure 2.2**


Timeline
1 Apr 2013: New storage & Transportation portfolio
1 Jul 2013: RH-003-2011 NEB Decision effective date
1 Aug 2013: Last approval of gas base rates and rate riders
29 jan 2014: Centra letter to PUB re: intention not to file COG application
29 May 2014: NEB issues MH-001-2013 SAM-COM decision
12 June 2014: Centra letter to PUB re: Gas Costs Update
30 Oct 2014: Energy East Pipeline Ltd files application w/ NEB
1 Nov 2014: Effective date of BO 123/14
1 Jan 2015: Rates, Tolls and Charges for NGTL system implemented
31 Mar 2015: TCPL filed it's RH-001-2014 compliance filing re: tolls
RH-003-2011 process
RH-001-2013 process
MH-001-2013 SAM-COM process
RH-001-2014 process
2012/13 Gas Year
2013/14 Gas Year
2014/15 Gas Year
Nov-12
Feb-13
May-13
Aug-13
Nov-13
Feb-14
May-14
Aug-14
Nov-14
Feb-15
May-15
17 Jun 2013: TCPL files application for Tariff proposals re: RH-001-2013
10 Oct 2013: RH-001-2013 NEB Decision issued. Denied TCPL proposed tariff amendments
20 Dec 2013: TCPL fiiles RH-001-2014 (Settlement Agreement and Tolls Application)
30 May 2014: Centra acquires SVGC
31 July 2014: Centra files Interim Application
1 Aug 2014: Effective date of BO 85/14
1 Nov 2014: New Conoco-Phillips Gas Supply contract
28 Nov 2014: NEB issues RH-001-2014 Decision
1 Feb 2015: Effective date of BO 12/15

As illustrated in the timeline above, the relevant key dates and events to consider as part of this Application are as follows:

- **April 1, 2013-** Commencement of operations for Centra's new Transportation and Storage Portfolio;
- **July 1, 2013-** Effective date of RH-003-2011 NEB Decision approving unlimited pricing discretion for TCPL;
- **August 1, 2013-** Centra's 2013/14 General Rate Application resulting in new base rates and rate riders as approved in Orders 85/13 and 89/13;
- **December 20, 2013-** TCPL files Mainline Settlement Agreement and 2013-2030 Tolls Application with the NEB (RH-001-2014 Application);
- **January 29, 2014-** Centra advised the PUB that, based on market pricing obtained by a November 2013 strip, that its forecast net deferral account balance owing at October 31, 2014 was $0.3 million;
- **January-March 2014-** Manitoba and North America experience one of the coldest winters on record and dramatic increases in winter natural gas prices at market hubs served either directly or indirectly by the TCPL Mainline;
- **June 12, 2014-** Centra advised the PUB of significantly higher forecast net deferral account balance recoverable from customers of $45.7 million as October 31, 2014;
- **July 31, 2014-** Centra files its Interim Application for Non-Primary Gas Rate Riders Effective November 1, 2014;
- **September 9, 2014-** RH-001-2014 oral proceeding commences to review TCPL's Mainline 2013-2030 Settlement Application. Centra participated and intervened throughout the entire proceeding on behalf of Manitoba ratepayers;
- **November 1, 2014-** Effective date of new non-Primary Gas rate riders approved in Order 123/14, as well as commencement of Centra's new 2-year gas supply contract with Conoco-Phillips;
- **December 18, 2014-** NEB issues RH-001-2014 Decision with Reasons;
- **February 1, 2015-** Effective date of revised Supplemental Gas rate rider approved in Order 12/15 to accelerate recovery of the previously approved deferral account recovery approved in Order 123/14;
- **May 25, 2015-** Centra files its 2015/16 Cost of Gas Application.

## 2.4 SUMMARY OF GAS COSTS FOR WHICH RELIEF SOUGHT IN THIS APPLICATION

In this Application, Centra is requesting approval of changes to its Supplemental Gas, Transportation (to Centra) and Distribution (to Customers) rates to be effective November 1, 2015. Centra's forecast of its non-Primary Gas costs for the 2015/16 Gas Year totals $84.9 million, as discussed in Tab 3 of this Application.

Centra is not applying for a change to non-gas costs in this Application. The Distribution (to Customers) base rates in this Application reflect the non-gas costs approved in Order 89/13.

The overall impact of these changes is an increase of approximately 3.2% or $26 on the annual bill for a typical residential customer, while the annual bill impacts for customers in the Large General Service ("LGS"), High Volume Firm, Mainline and Interruptible customer classes range from decreases of 0.4% to increases of 6.0%. These impacts are summarized in the tables included in Tab 6 of this Application.

Sections 2.4.1 to 2.4.3 summarize Centra's three primary requests in this Application.

### 2.4.1 Adjustments to Base Rates for 2015/16 Forecast Gas Costs

Figure 2.3 below compares requested non-Primary Gas costs for the 2015/16 Gas Year with the revenues that would be generated by existing approved non-Primary Gas base rates. Revenue at existing rates are calculated based on the 2014 Load Forecast, with Weighted Average Cost of Gas based on the non-Primary Gas costs embedded in base rates. Revenues produced at existing rates are insufficient to fully recover the forecast of non-Primary Gas costs for 2015/16 with a resulting revenue deficiency of $11.5 million.

**Figure 2.3**

| Non-Primary Gas Costs ($000s) | Revenue at Existing Base Rates | Forecast Non-Primary Gas Costs for 2015/16 | Revenue Deficiency |
|---|---|---|---|
| Supplemental Gas | $22,922 | $23,257 | $335 |
| Transportation | $48,096 | $59,230 | $11,134 |
| Distribution | $2,315 | $2,375 | $61 |
| **Total Non-Primary Gas Costs** | **$73,333** | **$84,862** | **$11,530** |

Increased Transportation costs on the TCPL Mainline is the primary driver of increased costs in the forecast 2015/16 Gas Year. The forecast non-Primary Gas costs for the 2015/16 Gas Year are discussed in more detail in Section 3.7 of Tab 3.

Centra will provide an updated forecast of its non-Primary Gas costs for the 2015/16 Gas Year as part of its fall pre-hearing update.

### 2.4.2 Recovery of the Outlook of 2014/15 Gas Cost Deferral Account Balances through Rate Riders

Figure 2.4 below summarizes the outlook of Centra's 2014/15 Gas Cost Deferral account balances as at October 31, 2015 to be recovered through rate riders.

**Figure 2.4**

| 2014/15 Gas Year Deferral Account Balances ($000s) | |
|---|---|
| Supplemental PGVA | $1,456 |
| Transportation PGVA | $11,194 |
| Distribution PGVA | $279 |
| Heating Value Margin Deferral | $605 |
| **Total Gas Cost Deferral Account Balance** | **$13,534** |

Increased transportation costs are the primary contributor to the $13.5 million outlook Gas Cost deferral account balance owing to Centra on October 31, 2015. The outlook of 2014/15 Gas Cost deferral account balances are discussed in more detail in Section 3.4 of Tab 3. Centra will update these amounts as part of its fall pre-hearing update.

Centra will update its outlook of 2014/15 Gas Cost deferral account balances as part of its fall pre-hearing update.

### 2.4.3 Recovery of Prior Years Gas Cost Deferral Account Balances through Rate Riders

Figure 2.5 below summarizes Centra's current outlook for its Prior Years Gas Cost Deferral account balances as at October 31, 2015 to be recovered through rate riders. Centra will update these amounts as part of its fall pre-hearing update.

**Figure 2.5**

| Prior Years Gas Cost Deferral Account Balances ($000s) | |
|---|---|
| Prior-Period Supplemental Gas Cost Deferral | $46,142 |
| Outlook of Recoveries (at Oct 31, 2015) | ($24,561) |
| Outlook of Carrying Costs (at Oct 31, 2015) | $619 |
| Remaining Prior-Period Supplemental Gas Deferral Account Balance | $22,200 |
| Prior-Period Non-Supplemental Gas Cost Deferral | ($1,274) |
| Outlook of Dispositions (at Oct 31, 2015) | $902 |
| Outlook of Carrying Costs (at Oct 31, 2015) | ($6) |
| Remaining Prior-Period Non-Supplemental Gas Deferral Account Balance | ($379) |
| **Total Prior Years Gas Cost Deferral Account Balance** | **$21,821** |

The primary contributor to the overall Prior Years Gas Cost Deferral balance as at October 31, 2014 was significantly higher than forecast prices for Supplemental Gas during the months of January 2014 through March 2014. This was the result of a combination of extremely cold weather across North America, combined with rapidly depleting continential storage inventories and the effects of TCPL's unlimited pricing discretion on natural gas commodity prices at hubs interconnected with the Mainline.

Further details on the Prior Years Gas Cost Deferral Account balances are provided in Section 3.4 and 3.5 of Tab 3.

[redacted]

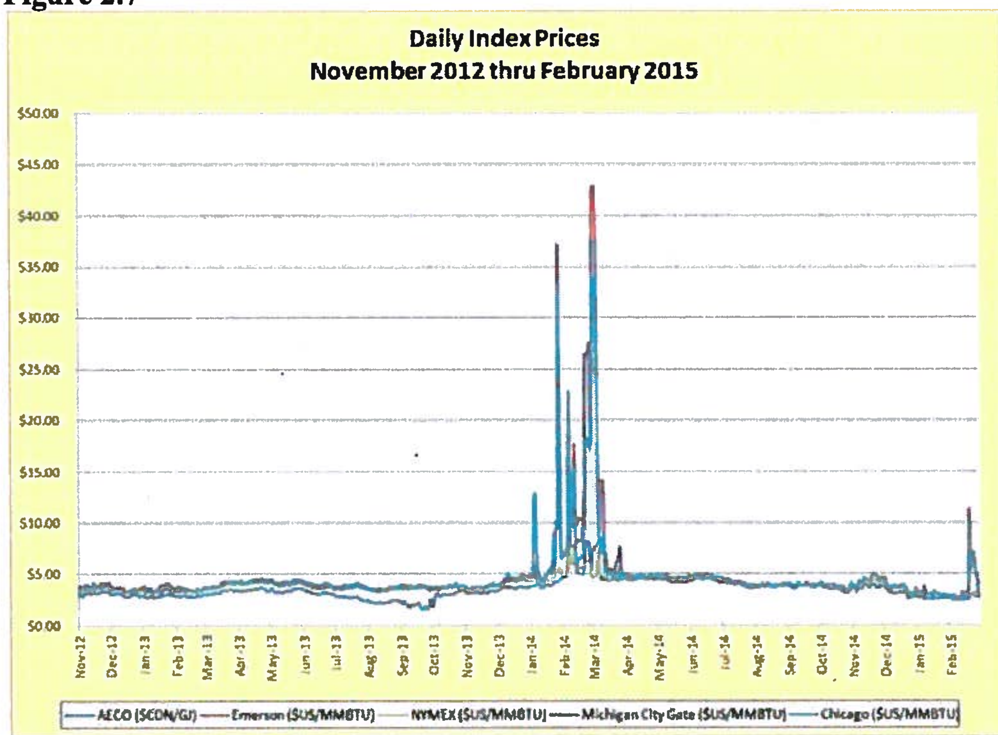
[redacted]

These cold weather conditions resulted in the need for Centra to purchase approximately 10.9 million GJ of Supplemental Gas supplies to serve its customers' needs during the January through March 2014 period compared to forecast, weather-normalized [redacted]

The extremely cold weather also contributed to dramatic increases in natural gas prices at market hubs served either directly or indirectly by the TCPL Mainline. During the months of January through March 2014, TCPL set its minimum Interruptible Transport ("IT") bid floors on the Mainline as high as 55 times its daily equivalent Firm Transportation ("FT") tolls.

To illustrate these dramatic market price increases, please see figure 2.7:

**Figure 2.7**




[redacted]

[redacted]

Centra took prudent steps to mimimize supplemental gas costs during the winter of 2013/14 and as such these gas costs should be fully recovered in rates over a reasonable period of time.

## 2.5 SUMMARY OF PROPOSED CUSTOMER RATE IMPACTS

Figure 2.8 summarizes the rate impacts by customer class for both base and billed rates.

**Figure 2.8**

| 2015/16 Cost of Gas | | Annual Impact Base Rates | | Annual Impact Billed Rates | |
|---|---|---|---|---|---|
| Customer Class | Bill Impact | $ Impact | % Change | $ Impact | % Change |
| SGS | low | $9 | 2.0% | $12 | 2.6% |
| | typical | $20 | 2.6% | $26 | 3.2% |
| | high | $99 | 3.2% | $130 | 3.9% |
| LGS | low | $84 | 2.6% | $119 | 3.4% |
| | high | $5,031 | 3.6% | $7,154 | 4.6% |
| HVF | low | $2,436 | 1.9% | ($1,528) | -1.1% |
| | high | $7,539 | 4.0% | ($34,582) | -1.3% |
| Mainline | low | $13,048 | 3.1% | ($27,923) | -1.4% |
| | high | $121,121 | 6.0% | $54,550 | 2.4% |
| Interruptible | low | ($528) | -0.4% | $5,768 | 3.9% |
| | high | $1,477 | 0.9% | $11,907 | 7.3% |

A more detailed explanation of proposed rates and customer impacts is provided in Tab 6.

As can be seen in Figure 2.8, the recovery of the prior period deferral account balances results in an additional rate increase of 0.6% for the typical residential customer, or $6 per year. Given the overall impact on billed rates, Centra is proposing to recover all PGVA balances over the 12-month period from November 1, 2015 to October 31, 2016 as discussed in Tab 5.

Centra will provide an updated forecast of proposed rates and customer impacts as part of its fall pre-hearing update.