M A N I T O B A	)	**Order No. 111/04**
	)	
THE PUBLIC UTILITIES BOARD ACT	)	**August 30, 2004**

BEFORE: Graham F. J. Lane, C.A., Chairman
Monica Girouard, C.G.A., Member
Mario J. Santos, B.A. L.L.B., Member

AN APPLICATION BY SWAN VALLEY GAS CORPORATION FOR AN ORDER OF THE BOARD APPROVING:

1. **AN INCREASE IN THE GAS CONSUMPTION CHARGE FOR EACH SALES RATE CLASS; and**

2. **THE USE OF FINANCIAL DERIVATIVES TO MANAGE NATURAL GAS PRICE VOLATILITY.**

1.0 Abstract

Swan Valley Gas Corporation (SVGC) applied to the Manitoba Public Utilities Board (the Board) for changes to customer billing rates, price schedules and practices related to its commodity costs. It forecast that approval of its proposal would increase annual customer costs by 7% to 26% annually.

After a thorough review of SVGC's application, a meeting with officials from SVGC and SaskEnergy (SVGC's parent company), and the developing of supporting information through exchanges of communication with SVGC, the Board decided to grant SVGC's application.

While rate increases of the magnitude involved in SVGC's application would normally require a full public hearing, being mindful of the costs associated with such hearings and the reasons supporting the proposed increases the Board chose to invite comments from customers and, subsequently, determined to grant the application on an interim basis. The Board is willing to meet with the community to discuss SVGC and the natural gas outlook at its request.

SVGC serves communities in Manitoba's Swan Valley, and though its customer base has not and is not expected to reach the levels forecast when its franchise was granted, it continues to ensure effective, reliable and safe natural gas service. SVGC's efforts have been hampered by sharply increased gas commodity costs, resulting in many prospective customers opting to remain fully or partially with other energy sources for their space heating requirements.

2.0 Background

Prior to this matter, by its May 30, 2003 Order (90/03), the Board approved and/or directed:

a) a change in pricing methodology for SVGC;
b) revisions to the SaskEnergy – SVGC contract (SaskEnergy being the SVGC's parent company and the supplier of natural gas to SVGC);
c) an increase in SVGC's gas consumption charge for each sales rate class;
d) for TransGas Energy Pool ("TEP") pricing to be based on prevailing market prices, rather than SaskEnergy's gas consumption charge as approved by the Saskatchewan regulator. (This change increased the gas consumption charge for each rate class by $1.062 per Gigajoule ("Gj") to $6.441 per Gj, effective June 1, 2003.); and
e) that SVGC establish a natural gas commodity rate based on the forward AECO 12-month price strip daily index. From June 1, 2003 SVGC was not responsible for SaskEnergy's Purchase Gas Variance Account ("PGVA") balance. (In essence, this change eliminated the need for SVGC to purchase natural gas and storage services to balance supply with demand from SaskEnergy's regulated supply. SVGC now purchases gas needed for its customers and its own internal operations based on the posted AECO daily price plus the AECO to TEP differential.)

Also by Order 90/03, the fee for the procurement and management of gas supply was increased from $0.03 per Gj to $0.065 per Gj. The requested fee of $0.065 per Gj was estimated to yield an annual charge, based on the 2003/04 forecast consumption of 46,915 Gj, of $3,049.00.

A supply contract between SVGC and SaskEnergy to incorporate the above changes arising out of Order 90/03 was approved.

Subsequently, Order 162/03 of October 31, 2003 gave approval to reset SVGC's residential delivery rate on a revenue neutral basis. The Basic Monthly Charge became $15.00 per month, the Delivery charge per unit of usage $0.078 per cubic metre.

SVGC is a wholly owned subsidiary of SaskEnergy Incorporated, a Saskatchewan Crown Corporation. SVGC acquired the natural gas distribution franchise rights for the Swan Valley region of Manitoba on July 4, 2000 through Board Order 93/00.

That year Many Islands Pipe Lines (Canada) Limited (MIPL, also a subsidiary of SaskEnergy), completed construction of a federally regulated transmission pipeline from Norquay, Saskatchewan to Benito, Manitoba; the TransGas system did not extend to the Saskatchewan-Manitoba border.

The transmission line is dedicated to SVGC and its customers, including Louisiana Pacific ((an Oriented Strand Board manufacturer). SVGC simultaneously completed a trasmission line from Benito, past Swan River and Minitonas to Louisiana Pacific which is the anchor customer for the project consuming approximately 88% of the troughput of MIPL.

SVGC rates recover the cost of providing both gas supply service and delivery service. Gas supply service encompasses gas purchasing as well as transportation arrangements to deliver natural gas to Swan Valley Gas in Manitoba. The Gas Consumption Charge recovers upstream gas supply and transportation costs up to the Saskatchewan-Manitoba border.

Once inside Manitoba, SVGC recovers the cost of delivery service from the border, through the distribution network, and to the customer meter via its delivery rates. Costs are recovered through a Basic Monthly Charge plus a Delivery Charge applied to each unit of usage.

Alternative sources of space heat in the serviced community include propane, fuel oil, electricity and wood. Recent increases in natural gas costs to SVGC customers ($3.50 per Gj in June 2000 rising to $7.738 per Gj in August 2004) have significantly impacted SVGC’s ability to gain additional customers through conversions.

3.0 The Application

On June 25, 2004, SVGC applied to the Board for:

a) an increase in the gas consumption charge for each sales rate class of $0.85 per cubic metre, to be effective August 1, 2004. The proposed increase reflects increased commodity costs forecast at the TEP, as well as partial recovery of the PGVA including interest in the amount of $51,969.
b) approval of the use of financial derivatives to manage natural gas price volatility on behalf of SVGC customers.
c) approval to be granted on an expedited and ex parte basis. Ex parte Orders usually are accompanied by lower regulatory costs. Regulatory costs are passed on to the customers of the utility.

4.0 Forecast Cost of Gas

Currently, SVGC:

- Purchases gas at market prices based upon the AECO daily index;
- Pays the market's AECO to TEP basis differential; and
- Purchases gas only as needed each day to meet customer and internal operational use requirements.

The proposed Cost of Gas for the Test Year (August 1, 2004 to July 31, 2005) was calculated using a forward price curve of monthly natural gas prices at AECO, and a forecast of purchases. The forecast of purchases is derived from the monthly sales forecast as well as the forecast for gas used internally for SVGC line heaters. The Cost of Gas model allocates the appropriate monthly price to estimated sales volumes, month by month. All costs of acquiring supply, including SaskEnergy's gas management fee, are included in calculating the total cost of gas forecast.

The prices utilized were as of close of business June 22, 2004; TEP is priced at a basis differential to AECO, with the current market price of this differential at $0.04/Gj. SVGC applied to recover increased gas costs at TEP. The unit commodity cost was derived by dividing the estimated sales volume into the total cost of purchasing gas supply as follows:

Table 1

For August 1, 2004 to July 31, 2005	
Total cost of purchase gas at TEP	$429,475
Less: cost of internal usage (delivery)	(8,606)
Cost of purchase gas available for sale	$420,869
Forecast sales volume	54,390 Gj
Unit cost of purchase gas available for sale	**$7.738/Gj**
TEP costs imbedded in current rate	$6.441/Gj
Cost increase at TEP to be recovered	**$1.297/Gj**
	($0.049/$m^3$)

5.0 Recovery of PGVA/Rate Rider

SVGC's PGVA is in a deficit position, projected at $388,227 (excluding interest) as of July 31, 2004. Customers owe SVGC $388,227 for the natural gas consumed over the period December 2000 to July 31, 2004, during which period the billed rate did not account for the full costs.

SVGC sought to recover only the 13% non-MIPL share owed to SVGC by its customers; this amounts to $50,373 plus $1,596 in interest costs, for a total recovery of $51,969. The recovery of this amount over a one year period was expected to further increase the rate charged SVGC customers by $0.955/Gj ($0.036/m^3).

6.0 Rate Change Requested

By its application, SVGC sought to recover costs by a rate increase as follows:

Table 2

Cost Recovery	**$/Gj**	**$/m^3**
Increased Gas Costs at TEP	1.297	0.049
$51,969 of the PGVA	0.955	0.036
Proposed Rate Increase	2.252	0.085

6.1 Sales Forecasts

The most recent sales forecast projects average residential consumption at 65.5 Gj/year (compared to the forecast consumption of 111 Gj/year in the franchise filing). For commercial customers, forecast consumption is 250.9 Gj/year (309 Gj/year in the franchise filing).

At the end of 2003, only 216 customers were purchasing natural gas from SVGC, this being less than 20% of the forecast in the franchise filing.

In addition, 336 customers who had committed and paid for installation of their service chose to forfeit their $300 activation rebate rather than commencing service. The November 1, 2003 resetting of the Residential rate (Order 162/03) and SVGC marketing initiatives resulted in only a nominal increase in the number of residential customers.

7.0 Customer Impacts

Though it is seeking commodity price increases and a recovery of PGVA, SVGC is not seeking a change to the Basic Monthly Charge or the Delivery Charge. The forecast annual increases related to SVGC's application for customer classes are shown in the following table:

Table 3

Rate Classification		Present Annual Bill/Year	Proposed Annual Bill (for August 1, 2004)/Year	Increase ($/Year)	Change
Residential	**Average**	**869.52**	**1,019.80**	**150.28**	**17.3%**
	Small	570.00	655.00	85.00	14.9%
	Large	1,740.00	2080.00	340.00	19.5%
Commercial	**Average**	**2,608.09**	**3,175.04**	**566.95**	**21.7%**
	Small	1,349.28	1,604.28	255.00	18.9%
	Large	2,924.00	3,604.00	680.00	23.3%
General Service	**Average**	**12,820.41**	**16,020.75**	**3,200.34**	**25.0%**
	Small	6,960.28	8,660.28	1,700.00	24.4%
	Large	23,420.00	29,370.00	5,950.00	25.4%
Institutional	**Average**	**25,641.61**	**32,431.24**	**6,789.63**	**26.5%**
		32,020.28	40,520.28	8,500.00	26.5%
		47,730.00	60,480.00	12,750.00	26.7%

8.0 Natural Gas Price Hedging

SVGC stated its objective for utilizing a fixed price swap to manage gas price risk is to control price volatility. SVGC sought approval from the Board to incorporate a gas price risk management strategy in its natural gas portfolio. Given the increased volatility and level of natural gas prices over the past few years, SVGC opined that it would be desirable to add some stability to customer prices; this being particularly true in the heating season when the most severe price spikes have occurred. Financial instruments would be used to manage natural gas price risks.

SVGC's sales load forecast for the test period is 54.4 terajoules (Tj). Of this load forecast, 42.5Tj or 78% relates to the winter (November through March). Conventional hedges are executed on a Gj/day basis. Due to the relatively small daily volumes that occur in the summer months, SVGC's intent is to hedge only winter volumes. In order to avoid an overhedged position, SVGC would hedge only the minimum daily required volume. It calculates this minimum to be approximately 200 to 250 Gj per day, for the winter period. On an annual basis, hedging 200 Gj/day would equate to 56% of SVGC's gas portfolio having a fixed price; 250 Gj/day would equate to 69% of the portfolio having a fixed price.

As a result of discussions held with financial counterparties, SVGC anticipates that the only tool available to SVGC to manage natural gas price risk is a fixed price swap. Due to the low volumes of gas involved, SVGC would not meet financial counterparties' minimum ticket size requirements for any type of financial transaction involving optionality (i.e. costless collars, call options, etc.). As well, volume size will limit SVGC to executing only one swap transaction for the winter season.

SVGC sought approval from the Board to include any cash payments or receipts that would occur as a result of its proposed gas price management activities. Reflecting the dynamics of the natural gas commodity market, SVGC would not ask the Board for prior approval of the specifics of its hedging actions.

The same procedures and controls used in the execution of SaskEnergy's gas price risk management strategies would apply to a transaction executed on behalf of SVGC. And, approval to hedge would first be obtained from the SVGC Board of Directors. The transaction would be initiated by the Manager (Cost of Gas), and then executed and recorded in SaskEnergy's Risk Management System by its Natural Gas Traders. SaskEnergy's Mid-Office personnel would then verify the transaction details with the counterparty through its Confirmation Process.

SaskEnergy and SVGC's administration (Back Office) would be responsible for settlement of the transaction; this would include verification of settlement amounts with counterparties, as well as the payment and receipt of cash flows. Once a transaction is executed, the hedge would remain in place until settlement.

The transaction would be designated as a hedge for SVGC at the time of execution, and it would be recorded in a portfolio set up specifically for SVGC separately from SaskEnergy transactions. Documentation from the counterparty would be attached to the transaction to provide confirmation of the price obtained under the swap. The SVGC hedging transaction would be examined by SaskEnergy's external auditor at year end for compliance with policy and procedures.

The "triggering" of the swap would be at the discretion of the Manager (Cost of Gas), who would take into account the following:

1. Current market price in relation to historical prices. (A price below the short-term mean would constitute strong support for execution, of a swap.)
2. Current fundamentals of supply/demand including current storage inventory levels.

3. Analyst forecasts for natural gas prices.
4. Time of year; the swap would be executed at a point in time between May 1 and September 30.
5. If none of the above considerations have triggered the execution of a swap by September 30, regardless of price a swap would be executed.

SVGC opined that the benefit of the swap would be the addition of rate stability for SVGC customers through the fixing of a portion of the costs of the winter gas supply. The downside of executing a swap would be that in the event of a cash outflow (realized prices are lower than the swap price), SVGC's cost of gas would be higher than if the utility had not entered into the hedge.

SVGC sought assurance from the Board that both cash inflows and outflows resulting from a swap would be included in the cost of gas.

9.0 Board Findings

The Board reviewed and approved, after changes were made, an information notice sent to SVGC customers. Customers were requested to submit any comments in writing to the Board by no later then August 20, 2004, no comments were received. SVGC advised the Board that it received a small number of inquiries on the issue, but no indication that a public hearing was required.

The Board is aware that the difficulties facing SVGC are due to fewer than anticipated customers consuming natural gas, resulting in lower than estimated throughput volumes. This situation is related to the increased and high cost of natural gas supplies, and forecasts of continuing high natural gas prices.

During the franchise hearings, the Board expressed its concern about forecast customer attachments in view of the fact that natural gas prices had begun to rise. The price of gas, now estimated by SVGC to average $7.738 per Gj, was estimated at $3.50 per Gj at the hearing in June 2000.

The Board remains of the view that commodity rates should reflect the best estimate of market prices at any given point in time. Although the increases are significant, the Board considers that any alternative to market pricing will send false price signals to the consumers, and would erode the financial integrity of SVGC to the detriment of its customers and community.

The change in price will also allow SVGC a greater opportunity to more effectively manage the disposition of PGVA balances.

The Board will therefore approve the request for a commodity charge of $7.738 per Gj to be effective for all gas consumed on and after September 1, 2004, on an interim basis.

A PGVA balance is created when primary gas costs differ from the revenues provided by customers. The Board considers SVGC's request to recover by way of a rate rider a PGVA amount of $51,969, that being associated only with commodity costs, to be reasonable. Accordingly, the Board will therefore also approve a PGVA rate rider of $0.955 per Gj, to be in effect from September 1, 2004 to August 31, 2005.

The Board has considered SVGC's request for permission to use a fixed price swap to manage gas price risk. The Board notes the policies and procedures outlined in SVGC's application, as well as SVGC's responses to clarifying questions asked by the Board. The Board notes that the same procedures and controls used in the execution of SaskEnergy's gas price risk management strategies would apply to a transaction executed on behalf of SVGC. The Board also notes that the SVGC hedging transaction would be examined by SaskEnergy's external auditor at year end, for compliance with SaskEnergy's policy and procedures.

The Board agrees with SVGC that the benefit of the swap would be to add a degree of rate stability for SVGC customers by fixing the price of a portion of the winter supply. The Board will therefore approve SVGC's request to use financial derivatives in keeping with the policies and procedures as outlined by the applicant.

In doing so the Board notes that pre-approval of any transaction will not be granted by the Board, the prudence of all transactions will be assessed on a post facto basis. The Board also notes that transactions will be subject to a subsequent review, and that the external auditor's view of any related SVGC transaction may be requested. SVGC will be required to track on a monthly basis the impact of such transactions on the PGVA.

The Board reminds SVGC of its continuing concern with respect to the PGVA balance; in the Board's view this application addresses only a small component of the problem. Commodity related gas costs comprise only approximately 13% of the projected PGVA balance at July 31, 2004. The Board notes the PGVA balance of $388,227 as of July 31, 2004, with only $50,373 to be recovered through this Order; even with the increase in rates the balance may grow to in excess of $580,000 by July 31, 2005.

The Board has concerns about the magnitude of the balance, the potential impact on SVGC and its customers, and the issue of inter-generational inequity. The Board anticipates and expects that SVGC will develop a long-term plan to address this matter, one that takes into account the objectives of restraining price volatility for customers and preserving or increasing the customer base.

While the Board was satisfied with its testing of SVGC's Application and considered the interests of its customers would be better served by this process rather than a costly public hearing and process, it is prepared to meet with the community to discuss the situation and prospects for SVGC and its service to its Swan Valley communities, at the request of the community, if the community so desires.

10. IT IS THEREFORE ORDERED THAT:

1. SVGC's request to increase the gas consumption component of the sales rates charged by SVGC to $7.738 per Gj, effective September 1, 2004 BE AND IS HEREBY APPROVED.
2. SVGC's request to recover $51,969 of the PGVA by way of a rate rider of $0.955 per Gj ($0.036/m^3), effective September 1, 2004 to August 31, 2005 BE AND IS HEREBY APPROVED.
3. The Rate Schedule attached as Appendix "A" reflecting the above changes BE AND IS HEREBY APPROVED.

4. The request to use Financial Derivatives in a manner consistent with the Procedures and Policies as filed and in response to the Board's questions to provide for a degree of rate stability for customers BE AND IS HEREBY APPROVED.
5. SVGC to provide full monthly details of the financial impacts of financial derivatives on the PGVA annually.
6. Public Utilities Board Order No. 90/03 BE AND IS HEREBY CONFIRMED AS FINAL.
7. This interim Order shall be in effect until confirmed or otherwise dealt with by a future Order of the Board.

THE PUBLIC UTILITIES BOARD

"GRAHAM F. J. LANE"
Chairman

"H. M. SINGH"
Associate Secretary

Certified a true copy of Order No. 111/04
issued by The Public Utilities Board

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Associate Secretary

Swan Valley Gas Corporation
A SaskEnergy Company

Monthly Natural Gas Rates
September 1, 2004

For customers who purchase their natural gas and delivery service from Swan Valley Gas:

Rate Class (Code)	Applicable To	Monthly Natural Gas Rates: Basic Monthly Charge ($)	Delivery Charge ($/$m^3$)	Gas Consumption Charge ($/$m^3$)	2000 to 2009 Project Price Customer Contribution* ($)
Residential:					
Residential (M01, M11, M21)	Residence, Cottage, Farm up to 10,000 m^3/yr	15.00	0.078	0.397	877.40
Commercial:					
Commercial (M02)	0 to 10,000 m^3/yr	26.69	0.031	0.397	1,016.50
General Service (M03)	10,001 to 100,000 m^3/yr	26.69	0.031	0.386	7,490.00
Institutional (M04)	100,001 to 1,000,000 m^3/yr	26.69	0.023	0.379	16,317.50

***Includes GST**

Minimum Bill: **Basic Monthly Charge**

Taxation: **Any taxes, levies or surcharges which may be lawfully imposed by or at the request of any municipal, provincial, or federal authority will be charged to the customer as required.**

For Contract Industrial Service:
See next page

Swan Valley Gas Corporation
A SaskEnergy Company

Monthly Natural Gas Rates
September 1, 2004

For industrial customers who contract for delivery service from Swan Valley Gas, but who purchase their natural gas from a supplier other than Swan Valley Gas:

Rate Class	Applicable To	Monthly Delivery Rates: Basic Monthly Charge ($)	Delivery Charge ($/m^3)	Demand Charge ($/m^3/Day)
Industrial:				
Delivery Service	**100 % firm and Over 1,000,000 m^3/yr**	**250.00**	**N/A**	**0.351**
Minimum Bill:	**Basic Monthly Charge plus Demand Charge plus Apportionment of upstream transportation requirements**			
Interruptible Service	**Interruptible (In conjuction with Delivery Service contract)**	**250.00**	**0.015**	**N/A**
Minimum Bill:	**Basic Monthly Charge plus Delivery Charge plus Apportionment of interruptible upstream transportation requirements**			

All terms and conditions of service and rates are defined in and contained in a contract.

Taxation: **Any taxes, levies or surcharges which may be lawfully imposed by or at the request of any municipal, provincial, or federal authority will be charged to the customer as required.**