

**ONTARIO ENERGY BOARD**

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O.1998, C.15, Schedule B;

AND IN THE MATTER OF a proceeding initiated by the Ontario Energy Board to determine whether it should order new rates for the provision of natural gas, transmission, distribution and storage services to gas-fired generators (and other qualified customers) and whether the Board should refrain from regulating the rates for storage of gas.

**Final Argument of**  
**Market Hub Partners Canada L.P.**

**August 11, 2006**

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## 1. INTRODUCTION

This Argument is submitted on behalf of Market Hub Partners Canada L.P. ("MHP Canada"). It responds to Issue II - "Storage Regulation" of the Natural Gas and Electricity Interface Review ("NGEIR") proceeding (EB-2005-0551) which stipulates that the Ontario Energy Board ("OEB" or "Board") should determine whether to refrain, in whole or part, from exercising its power to regulate the rates charged for the storage of gas in Ontario, by considering whether, as a question of fact, the storage of gas in Ontario is subject to competition sufficient to protect the public interest.<sup>1</sup>

In its Procedural Order No. 1, the Board identified four "considerations" that would help in making this determination<sup>2</sup>:

- (i) Do gas utilities (and/or their affiliates) either collectively or individually have market power in the provision of storage services for all or some categories of customers in Ontario?
- (ii) If gas utilities (and/or their affiliates) do have market power in storage, is it appropriate for them to charge "market rates" for transactional and long term storage services?
- (iii) If gas utilities (and/or affiliates) do not have market power, is it in the public interest that all or some customers continue to pay storage rates at cost as opposed to market rates? How should the extra revenue from storage services at market rates be allocated?
- (iv) If the Board determines, based on considerations of market power and the public interest more generally, that some customers should pay for storage services at cost and others should pay for storage services at market prices, how should the line be drawn between the two types of customers, and, specifically, should there be a constraining allocation of physical storage facilities to some types of customers based on measures such as aggregate excess or whether customers are considered "in-franchise" or "ex-franchise"? How should the extra revenue from storage services at market rates be allocated?

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<sup>1</sup> Notice of Proceeding on Natural Gas Electricity Interface Issues and Determination to Refrain from Regulating Rates Charged for the Storage of Gas, EB-2005-0551, December 29, 2005.

<sup>2</sup> EB-2005-0551, Procedural Order No. 1, January 24, 2006.

## 2. SUMMARY

MHP Canada maintains that the storage market in Ontario is workably competitive. When an appropriate market power analysis, based on appropriately defined product and geographical markets, and the presence of significant mitigating factors are considered, it is clear that neither the gas utilities nor their affiliates, either collectively or individually, wield market power.<sup>3</sup>

The existence of this workably competitive market is sufficient to protect the public interest, signaling that the Board should refrain from exercising its power to regulate storage rates and services and, in MHP Canada's case, the companies that participate in that competitive market. MHP Canada believes therefore, that sufficient conditions exist for the Board to forbear in relation to the market as a whole. MHP Canada would support a determination by the Board to forbear in part, provided that forbearance extends to all but the "in-franchise allocated" portion of the market and/or extends to MHP Canada specifically.

Under forbearance, whether in whole or part, affected market participants would, at a minimum, avoid the need to obtain rate and contract approval under sections 36 and 39(2) of the *Ontario Energy Board Act, 1998* ("*OEB Act*"), respectively. Storage providers such as MHP Canada would charge market-determined prices that are *not* subject to a range or cap. There would be no need for these storage providers to seek approval of "range rates" as currently required under market-based rate authority, nor a requirement to seek approval of terms and conditions of service or for individual storage services contracts. The Board would however, continue to exercise its authority over other significant matters with respect to natural gas storage development such as public health and safety, the environment, licensing and permitting.

While MHP Canada steadfastly believes that sufficient conditions exist for the Board to refrain from regulating the Ontario storage market, short of forbearance, MHP Canada believes that market-based rate authority subject to a range or cap, as well as contracting flexibility should be

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<sup>3</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 44.

extended to all market participants, or as a last resort, to all but the "in-franchise allocated" portion of the market and/or MHP Canada specifically.<sup>4</sup>

As a potential new entrant in the highly competitive Ontario storage market, MHP Canada's principal interest is in affording additional choice to market participants in Ontario and the surrounding regions. The development of additional market-area storage can only enhance the reliability of gas delivery infrastructure, add to market liquidity and assist in dampening gas price volatility. As such, MHP Canada respectfully submits that the development of additional storage accessible to Ontario market participants is positive and very much in the Ontario public interest. Virtually no new market area storage, including that of MHP Canada, will be developed without market-determined pricing, or at a minimum, market-based rate authority.<sup>5</sup>

Market-based pricing for storage services is nothing new in Ontario. The Board has relied upon a market-based pricing regime for defined storage and transactional services for the past seventeen years. Indeed, the recent Natural Gas Forum Report affirmed the Board's commitment to market-based pricing for new storage entrants. But for the fact it shares a common corporate parent with Union Gas Limited ("Union Gas"), MHP Canada would automatically have been afforded market-based rate authority. It is significant that this authority would have been granted without the need for any market power demonstration.<sup>6</sup>

In MHP Canada's respectful submission, the Board has acknowledged the highly competitive nature of the dynamic Ontario storage market throughout this period. Had market power existed, the relevant storage or transactional services would have been priced at the highest end of the

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<sup>4</sup> Practices in the United States were discussed at length during the proceeding. It is worth noting that market-based rates as referred to under FERC are typically not subject to a range or cap. This should be distinguished from market-based rates as referred to in Ontario. See: Technical Conference Transcript ("TC Transcript"), EGD, May 19, 2006, page 18, lines 12-18 and Union Gas, pages 84, 85 and 88.

<sup>5</sup> EB-2005-0551, Exhibit X.4.1 Enbridge Inc Evidence, page 1: "EEDI believes that market rates will be required to support the costs of any such new storage development and believes that it is appropriate that competitive market forces be the determinant as to if, or when, any such new storage development is undertaken"; and Hearing Transcript, 11T142, lines 7-15 and 11T149-150. See also: MHP Canada, TC Transcript, May 18, 2006, page 12 ("I think it's fair to say that we'd be looking for a rate of return higher than the utility cost-of-service return); and Exhibit X.7.2.1 MHP Canada Reply Evidence, page 3.

<sup>6</sup> The right of independent storage operators to charge market-based rates was specifically confirmed by the Board in "Natural Gas Regulation in Ontario: A Renewed Policy Framework, Report on the Ontario Energy Board Natural Gas Forum" ("NGF Report"). The Board concluded at page 50 that: "...it will not fix COS rates for new storage developed by independent storage operators – that is, those storage operators that have no affiliation with gas distributors or transmitters. Stakeholders offered widespread support for this approach. The storage proceedings will therefore focus on storage as it relates to storage operators that are affiliated with distributors and transmitters."

range persistently throughout this period. That did not happen. With respect, that should be dispositive of the issue at hand.<sup>7</sup>

Equally determinative of the issue at hand is the fact that there has never been any proceeding convened before this Board, nor the relevant competition authorities with respect to alleged anti-competitive behaviour wielded by the utilities for the storage or transactional services in question. Notwithstanding the assertion of IGUA/AMPCO that its members are subject to monopoly power in these respects, both in Ontario and in Quebec<sup>8</sup>, there has never been an instance where a complaint has been registered or any investigation pursued in respect of any alleged anti-competitive conduct on the part of the storage service providers in Ontario.<sup>9</sup>

As the Board reflects upon the past seventeen years of Ontario experience with market-based pricing for such services, in the knowledge that actual pricing has operated at less than maximum levels and that no one has complained about it, there ought not to be any cause for concern. Clearly the public interest has been protected by the interplay of competitive market forces.

For seventeen years, therefore, the Board clearly concluded that it was unnecessary to employ regulation to proxy competition in the relevant storage and transactional service market since workable competition already existed. In these circumstances, MHP Canada respectfully submits that any party seeking to overturn the long established practice of market-determined pricing for unbundled storage and transactional services must bear the practical onus of demonstrating why such a marked departure is warranted in the public interest. As discussed by Mr. Reed, that onus in the United States would fall on any party seeking to change the status quo.<sup>10</sup>

To facilitate development of MHP Canada's storage prospects, thereby enhancing choice, reliability and liquidity in the market, MHP Canada is further requesting interim relief from the Board in the form of an expedited decision, approving its Core Points which were set forth in its

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<sup>7</sup> EB-2005-0551, Mr. Baker, Hearing Transcript, 4T144-145.

<sup>8</sup> EB-2005-0551, Exhibit X.9.1 - IGUA/AMPCO Pre-filed Evidence.

<sup>9</sup> EB-2005-0551, Hearing Transcript, 5T17, lines 18-19.

<sup>10</sup> See: EB-2005-0551, Hearing Transcript, 5T19-20, 5T42, and 5T149. See also: Ms. McConihe, Hearing Transcript, 8T211. Though the onus would be upon the applicant for any new rate for a new service proposed.

evidence.<sup>11</sup> An expedited decision confirming the Core Points would recognize that MHP Canada does not wield market power. It would also grant MHP Canada, the minimum regulatory constructs (i.e. market-based rate authority and contracting flexibility) it requires to proceed with the timely development of the St. Clair Pool storage facility, and, depending upon timing of the NGEIR decision, the Sarnia Airport Pool, without prejudging forbearance.

In the sections that follow, MHP Canada details the underlying policy rationale for forbearance and market-determined pricing and proceeds to set out in clear terms what MHP Canada is requesting of the Board in these proceedings.

### **3. COST OF SERVICE RATES VS. MARKET-DETERMINED PRICING**

MHP Canada's principal interest is in affording additional choice to market participants in Ontario and surrounding regions. As stated by Mr. Redford in his testimony, MHP Canada has a simple business plan and intends to offer Dawn-based merchant storage services at market-determined prices, targeting wholesale customers.<sup>12</sup> More particularly, MHP Canada plans to leverage the fruits of its investment over the past ten years to: (i) provide 1.1 Bcf of working storage capacity to the market in 2007 through development of the St. Clair Pool; (ii) develop an additional 5.3 Bcf of working gas storage capacity for 2008 in-service through its partnership in the Sarnia Airport Pool; and (iii) seek viable storage development opportunities to increase its working gas capacity to 10 Bcf by 2010.<sup>13</sup>

#### **a. Ontario Storage Development Potential**

As the record clearly demonstrates, a significant amount of storage development potential exists in Ontario. Attempts to minimize, indeed trivialize, that potential are without foundation. The Sproule Associates Limited (“Sproule”) report indicates that up to 120 Bcf of potential reef reservoir storage exists in Ontario through the conversion of depleted reservoirs.<sup>14</sup> As stated by Mr. Redford:

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<sup>11</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 4.

<sup>12</sup> EB-2005-0551, Hearing Transcript, 5T71, lines 8-21, and TC Transcript, May 18, 2006, page 31, lines 6-24.

<sup>13</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, pages 5 and 6.

<sup>14</sup> EB-2005-0551, Board Hearing Team Undertaking 7e, Sproule Associates Limited Report, January 15, 2001.

Our view is that certainly 50 Bcf, we view it as very realistic. We also would believe that it is possible that there is 120 Bcf out there and not necessarily limit that to reservoir development.<sup>15</sup>

Two of the active storage developers in the province testified that their development programs were focused upon a subset of that potential. Others, such as Tribute Resources, did not present evidence. In fact, the combined potential capacity of Enbridge Gas Distribution ("EGD") (2 Bcf<sup>16</sup>), Enbridge Inc. (20-25 Bcf<sup>17</sup>) and MHP Canada (10 Bcf) along with the Goderich-area capacity of 18 Bcf<sup>18</sup> represents an additional 50 Bcf of storage capacity – nearly half of the total value reported by Sproule. No independent studies were offered to dispute these storage potential estimates.<sup>19</sup> Indeed, Ms. McConihe's own Acres Management study attested to the significant untapped potential of Ontario's salt formations. Elsewhere, salt storage development has provided high deliverability storage service though it has been expensive to develop. The MHP Canada storage potential of 10 Bcf represents its development target to the end of the decade and clearly should not be construed as the extent of the MHP Canada business plan or its view on long-term storage potential in Ontario.

While storage potential exists within Ontario, the storage developers, or potential storage developers, noted that storage development feasibility is typically dependent upon geology, access to supply sources, access to consuming markets, access to adequate pipeline transportation infrastructure, development and operating costs, market demand and environment. Geology, base or cushion gas costs and project development risks present a unique challenge to storage developers in achieving desired rates of return and constitute significant and different risks as compared to pipeline development.<sup>20</sup> In particular, return on investment for merchant storage operators, like MHP Canada, is at risk to the market rather than recovered from captive franchise customers.<sup>21</sup>

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<sup>15</sup> EB-2005-0551, Hearing Transcript, 4T191, lines 18-21.

<sup>16</sup> EB-2005-0551, Mr. Grant, Hearing Transcript, 6T62, lines 20-23.

<sup>17</sup> EB-2005-051, Mr. Craig, Hearing Transcript, 11T144, lines 8-11.

<sup>18</sup> RP-2003-0253; EB2003-0314/0315/0316/0317 (Tribute Application), Written Evidence of W. Farquhar on behalf of Northern Cross Energy Limited, July 21, 2004, page 2. References to Tribute capacity are also found in TC Transcript, May 19, 2006, page 168, lines 25-27 (Mr. Poredos); and Hearing Transcript, 11T143-144 (Mr. Craig).

<sup>19</sup> EB-2005-0551 Hearing Transcript, Mr. Stauf, 9T216-217; Ms. McConihe, 9T35-36; Mr. Craig, 11T143; and Mr. Grant, 7T89.

<sup>20</sup> EB2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, pages 6-7. See also: TC Transcript, Mr. Grant, May 18, 2006, page 222; May 19, 2006, page 36; and Hearing Transcript, Mr. Baker, 3T151-152, 6T96-98; Mr. Craig, 11T147, 153-154, 157-158; Mr. Reed, 5T114.

<sup>21</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 10. See also: Mr. Reed, Hearing Transcript, 5T114.



The development of Ontario's natural gas storage infrastructure requires investor confidence in a policy framework that recognizes financial rewards commensurate with development and marketing risks. For MHP Canada, and other storage developers, rate structure is a critical component in assessing viability and feasibility.

**b. Rate Structure**

Cost-of-service rates do not provide a sufficient rate regime in this regard.<sup>22</sup> Cost-of-service rates do not compensate for the risk of developing storage by providing the necessary flexibility to capture the true value of storage services. Cost-of-service rates are typically designed on the basis of an annual working gas cycle and do not reflect the actual and fluctuating market value of storage. For these reasons, as Mr. Redford noted in his testimony, MHP Canada is not seeking a specific rate of return.<sup>23</sup>

Market-determined pricing, including market-based rates, do provide such flexibility by allowing storage operators to match rates and services to market demand.<sup>24</sup> As such, storage developers are able to obtain rates of return based on the actual and fluctuating value of storage. For part of the year, for example, there may be a very wide margin over cost whereas during other portions of the storage season, the values obtained in the market may be less than cost. As Mr. Redford noted in his testimony, market-determined and market-based rates provide the flexibility to capture value when storage market prices are highest including tailoring services to customers' specific needs to capture such value.<sup>25</sup> The key to ensuring economic feasibility is the ability to capture those values whenever they might become available, since the storage developer also bears a significant amount of risk when prices fall below cost. For that reason, increasing the allowed rate of return under a cost-based rate regime or even providing differential rates from season to season does not permit the requisite flexibility. Accordingly, MHP Canada urges the Board to encourage storage development by permitting market-determined pricing through

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<sup>22</sup> EB-2005-0551, Exhibit X.4.1 Enbridge Inc Evidence, page 1 "EEDI believes that market rates will be required to support the costs of any such new storage development and believes that it is appropriate that competitive market forces be the determinant as to if, or when, any such new storage development is undertaken"); Mr. Redford, Hearing Transcript, 5T134, lines 5-6 ("As far as market-based rates, as I said before, that is our minimum to move forward"); TC Transcripts, May 19, 2006, Mr. Henning, page 169, lines 17-21, and page 223, lines 17-22; Mr. Grant, page 36, lines 15-24; and Mr. Poredos, page 185.

<sup>23</sup> EB-2005-0551, Hearing Transcript, 5T113, lines 14-19.

<sup>24</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, pages 1-2.

<sup>25</sup> EB-2005-0551, Hearing Transcript, 5T179, lines 16-19.

forbearance, or at a minimum, granting market-based rate authority, for all storage service providers.

The development of additional market-area storage can only enhance the reliability of gas delivery infrastructure, add to market liquidity and assist in dampening gas price volatility.<sup>26</sup> As such, it seems beyond reproach that the development of additional storage accessible to Ontario market participants is a good thing and very much in the Ontario public interest. No evidence was offered to dispute that additional market storage would be beneficial to Ontario natural gas users.

One thing is certain: The Ontario storage development potential will not be realized without market-determined rates or, at a minimum, market-based rate authority. MHP Canada respectfully submits therefore, that reversion to a cost-based rate regime in Ontario would be uniquely disadvantageous to the public interest.<sup>27</sup> As a threshold matter, MHP Canada requires market-determined pricing, or market-based rate authority at a minimum, in order to continue to pursue storage development opportunities in Ontario.

#### **4. FORBEARANCE**

MHP Canada believes that based on the evidence, the Board should find as a question of fact that the storage of natural gas in Ontario is subject to competition sufficient to protect the public interest and on this basis refrain, in whole or in part, from exercising its power to regulate the rates charged for the storage of natural gas.

While MHP Canada believes forbearance is the right outcome, it recognizes that consideration of this issue will require the Board to determine not only whether to forbear, but also the extent to which it will forbear.

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<sup>26</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 8, Exhibit X.7.2.1, MHP Canada Reply Evidence, page 1.

<sup>27</sup> EB-2005-0551, Exhibit X.7.2.1, MHP Canada Reply Evidence, page 2. Exhibit 7.1.2, CEA Evidence, pages 50-51.

**a. Scope of Forbearance**

Section 29 of the *OEB Act* clearly confers on the Board the power to refrain, in whole or in part, in relation to not only products and services but also amongst other things, "any person selling, transmitting, distributing or storing gas":

Refrain from exercising power

29(1) On an application or in a proceeding, the Board shall make a determination to refrain, *in whole or part*, from exercising any power or performing any duty under this Act if it finds as a question of fact that a *licensee, person, product, class of products, service or class of services* is or will be subject to competition sufficient to protect the public interest.

Scope

(2) Subsection (1) applies to the exercise of any power or the performance of any duty of the Board in relation to,

- (a) any matter before the Board;
- (b) any licensee;
- (c) any person who is subject to this Act;
- (d) *any person selling, transmitting, distributing or storing gas*; or
- (e) any product or class of products supplied or service or class of services rendered within the province by a licensee or a person who is subject to this Act.

[emphasis added.]

As such, MHP Canada considers there to be two facets to the "scope of forbearance". First, the Board must determine the specific powers and/or duties under the *OEB Act* from which it will forbear. Second, the Board must determine whether to forbear to this extent in relation to the market as a whole or only in part.

In respect of the former, it is the position of MHP Canada that the Board should refrain from regulating both the rates charged for storage services and the terms and conditions under which such services are provided. Under forbearance, therefore, market participants would, at a minimum, avoid the need to obtain rate and contract approval under sections 36 and 39(2) of the *OEB Act*, respectively - the result being that storage providers such as MHP Canada would charge market-determined prices and have contracting flexibility. Individual contracts entered into by storage operators would therefore be binding without requiring Board approval of that individual contract. Additionally, storage operators would therefore not seek approval of "range rates", as required under market-based rate authority, or of terms and conditions of service. The Board would, however, continue to exercise its authority over other significant matters with respect to natural gas storage development such as public health and safety, the environment, licensing and permitting.

In respect of the latter, it is the position of MHP Canada that the Board forbear from regulating the Ontario storage market as a whole. As discussed in detail below, the evidence of Concentric Energy Advisors ("CEA") and others clearly supports the proposition that competition in the Ontario storage market is ample and robust enough to allow market forces to govern storage rates and services regardless of the provider. Under these circumstances, it is submitted that all market participants should be subject to forbearance. Therefore, in this regard, MHP Canada supports the "Proposed OEB Findings and Policy Recommendations" outlined in the written evidence submitted by CEA on May 1, 2006 in this proceeding ("CEA Evidence"). A fully competitive market where all customers are subject to market-determined pricing will send clear signals providing the efficient development and utilization of storage services.<sup>28</sup>

While MHP Canada believes that sufficient conditions exist for the Board to refrain from regulating the market as a whole, it recognizes that the elimination of the bifurcated market may require a transition.<sup>29</sup> As such, based on the positions advanced by the utilities and other parties, the Board may be inclined at this time to limit the extent of forbearance and refrain from regulating storage rates and services only in part. That being the case, MHP Canada would support a determination by the Board to forbear in part, provided this extends to all but the "in-franchise allocated" portion of the storage market and/or extends to MHP Canada specifically.

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<sup>28</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 2. See also: Exhibit X.7.1.2, CEA Evidence, page 3,

<sup>29</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 2.

The utilities have indicated that they would have the option of developing their own new storage or purchasing storage services from the market to serve growth in any "in-franchise allocated" requirements.<sup>30</sup> However, MHP Canada would advocate as part of the transition that the Board adopt as a policy direction to move to full forbearance in the storage services market.<sup>31</sup>

Thus, regardless of whether the Board decides to forbear from regulating the storage market in whole or in part, MHP Canada, and other independent storage operators, would be included in that segment of the market subject to forbearance. Such a result, it is submitted, would appropriately recognize that there is no reason to distinguish MHP Canada from any other independent storage developer operating within the province.

## **5. MARKET POWER ANALYSIS**

To be granted market-determined pricing, as would be the effective rate structure under forbearance, regulators typically require applicants to demonstrate that they are not able to exercise market power. The market power analysis therefore, acts as a "screen" or initial test to see whether there exists the potential for market power abuse. As set out in the CEA Evidence, this analysis generally consists of: (i) establishing the relevant product market; (ii) establishing the relevant geographic market; (iii) calculation of market share and market concentration; and (iv) consideration of mitigating factors, including the existence of affiliate standards.<sup>32</sup>

MHP Canada notes that in principle, all parties agreed on the methodology for completing a market power analysis.<sup>33</sup> In applying that principled methodology, however, several parties took an unrealistically narrow view of the relevant product and geographic markets.

### **a. Relevant Product Market**

The first step in evaluating potential market power is to define the relevant product market. There is no disagreement in this proceeding that the relevant product market is intended to include services that are similar enough to the product or service being offered by the party seeking market-determined pricing such that those products are considered ready substitutes.

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<sup>30</sup> EB-2005-0551, Hearing Transcript, Mr. Baker, 4T147; and Mr. Grant, 6T62.

<sup>31</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 2.

<sup>32</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, pages 29 and 30.

<sup>33</sup> EB-2005-0551, Mr. Smead, Hearing Transcript, 6T16, lines 2-4.

Substitutability is the key element because a party seeking market-based rates would not be able to sustain a price increase if other firms offer services that can be substituted for those offered by that party. Additionally, the parties in this proceeding have also all agreed that, at a minimum, firm and interruptible underground storage services are included in the relevant product market. The primary area of disagreement concerning the relevant product market is whether substitutes to underground storage should be considered for purposes of evaluating potential market power.

As the Board is aware, there are numerous substitutes to physical firm and interruptible storage services utilized to meet peak period natural gas requirements. As Mr. Reed testified, storage is not an end in itself, but a means to an end, with the “end” being defined as the ability to take gas out of the pipeline on demand, and there are many different means of meeting this end.<sup>34</sup> Mr. Acker of BP Marketing, an active secondary market participant in Ontario, shared similar views of the storage product service.<sup>35</sup> Typically delivery/redelivery service associated with underground storage provides a customer price arbitrage, load balancing and/or reliability functionality.<sup>36</sup>

In its evaluation of the potential for market power for storage services, CEA conservatively considered three additional substitutes to underground storage services: (i) local production in the relevant geographic market; (ii) pipeline capacity held by marketers; and (iii) on-system LNG facilities.<sup>37</sup> The inclusion of these substitutes by CEA in its analysis is appropriate and consistent with the FERC’s recently issued policy statement on market-based rates for storage.<sup>38</sup> With respect there is little or no credible evidence to the contrary.

Financial products are also widely utilized in the natural gas industry for hedging purposes. However, CEA did not separately evaluate the quantitative impact of financial products as a substitute for storage services since the financial markets are generally considered workably competitive.<sup>39</sup> Thus, CEA’s analysis was even more narrowly focused and still concluded that there were no market power concerns in the relevant geographic market. In addition, Union Gas,

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<sup>34</sup> EB-2005-0551, Hearing Transcript, 4T165-166, lines 12-28 and 1-3; and 4T181-182, lines 25-28 and 1-7.

<sup>35</sup> EB-2005-0551, Hearing Transcript, 13T20, lines 27-28; and 13T34-37. See also: Mr. Smead (Navigant), TC Transcript, May 19, 2006, page 38-40; and Mr. Henning (EEA), TC Transcript, page 153, lines 19-21 and 219, lines 6-24.

<sup>36</sup> EB-2005-051, Exhibit X.7.1.2, CEA Evidence, pages 21-22.

<sup>37</sup> EB-2005-051, Exhibit X.7.1.2, CEA Evidence, pages 39-40.

<sup>38</sup> EB 2005-0551, Exhibit J.4.3 (FERC Order No. 678, June 19, 2006 and Chairman's Statement, June 15, 2006)

<sup>39</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 39.

Gaz Metro and BP Marketing witnesses, all of whom actively trade in these services and products, have testified that financial products are widely utilized as ready substitutes for physical storage services.<sup>40</sup> Moreover, Energy and Environmental Analysis Inc. ("EEA")<sup>41</sup>, CEA<sup>42</sup> and Navigant Inc. ("Navigant")<sup>43</sup>, all with extensive experience in consulting with marketers and storage service providers all confirm the same factual conclusions.

Beyond not including financial products in its market power analysis, CEA's treatment of product substitutes was conservative in many respects.<sup>44</sup> Due to the conservative nature of its analysis, the resulting market concentration shown was overstated, yet market power was still not a concern. However, it is important to recognize that it is not necessary to include any of these substitute products for purposes of a market power evaluation for storage services in Ontario in order to determine that the Ontario market is workably competitive. Rather, even if the product market is limited solely to underground storage and does not include any substitutes, the Ontario market would still be considered workably competitive.

To be clear, with respect to the relevant product market, some care should be taken not to confuse product substitutes with the availability of flexible transportation options sufficient to connect physical storage facilities. Capacity release, backhauls, exchanges and displacements, for example, are all product substitutes as well as means by which physical storage facilities located in the same market as the Dawn Hub are connected.

#### **b. Relevant Geographic Market**

In terms of defining the relevant geographic market, MHP Canada notes that there is agreement that the relevant geographic market should be defined as an area in which all providers of same/similar products are economically competitive. However, the extent of the geographic market that should be used for purposes of evaluating market power was a matter of debate.

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<sup>40</sup> EB-2005-051, Union Gas (Mr. Isherwood), TC Transcript, May 19, 2006, pages 237-238; Gaz Metro, Hearing Transcript, 10T92; BP Marketing (Mr. Acker), Hearing Transcripts, 13T22, lines 7-15, and 13T37-38, lines 19-28 and 1-3.

<sup>41</sup> EB-2005-0551, Union Gas Storage Regulation Evidence, Exhibit C, Tab 4, Tab 1, Appendix B – "Analysis of Competition in Natural Gas Storage Markets for Union Gas Limited", April 28, 2006 ("EEA Pre-filed Evidence"), pages 26-29. See also: TC Transcript, May 19, page 176, lines 25-27, page 177, lines 12-14; and page 235-236, L25-28 and 1-5.

<sup>42</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 39.

<sup>43</sup> EB-2005-0551, EGD Evidence, Exhibit E, Tab 3, Schedule 1 - "Competitiveness of Natural Gas Storage Market Analysis Based on a Report for Union Gas", ("Navigant Pre-filed Evidence"), page 5.

<sup>44</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, pages 39-40.

CEA has provided extensive written and oral testimony in this proceeding, as have other parties, that the relevant geographic market for storage services in Ontario should be defined, at a minimum, as Ontario, Michigan, New York and Pennsylvania. The relevant geographic market for storage services in Ontario, however, could be even more broadly defined to include Ohio, Indiana and Illinois as well.<sup>45</sup>

In fact, both quantitative and qualitative evidence has been provided in this proceeding demonstrating that the Ontario storage market is a broad geographic market. Like other parties, CEA defined the geographic market after evaluating numerous examples of *actual* recent market evidence.<sup>46</sup> These actual market transactions clearly indicate that both storage suppliers and customers in and around Ontario participate in a geographic storage market that encompasses not only Ontario, but the broader regional market surrounding Ontario including the northeastern and upper Great Lakes regions of the United States. Furthermore, EEA provided quantitative evidence demonstrating through its review of the correlation of historical natural gas prices that Ontario is definitively linked to the broader natural gas market since there are no binding pipeline transportation constraints that would limit the ability of storage outside of Ontario from competing with storage located in Ontario to serve customers in the province.<sup>47</sup> In other words, storage providers throughout this region are capable of competing with one another and are not segregated into distinct markets as a result of transmission constraints. In fact, the OEB, NEB and FERC have all recognized the integrated nature of the natural gas storage and transportation market of the upper Great Lakes, Ontario and northeastern United States.<sup>48</sup> Therefore, there are no barriers to competition for storage providers outside of Ontario seeking to serve markets within Ontario, or for Ontario storage providers seeking to serve markets outside the province.

The position that the relevant geographic market should be solely limited to Ontario as presented in the evidence submitted on behalf of the Board Hearing Team (“BHT”) by Ms. McConihe and on behalf of various parties by Mr. Stauff is completely unsupported and contradictory to actual storage transactions occurring on a daily basis in the marketplace. Again, the primary rationale in both the BHT Evidence and the Stauff Evidence for limiting the geographic market, i.e., a lack

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<sup>45</sup> EB-2005-0551, Exhibit X.7.1.2 CEA Evidence, pages 41 and 42.

<sup>46</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, pages 40-41; and Exhibit X.7.2.2, CEA Reply Evidence, page 9.

<sup>47</sup> EB-2005-0551, EEA Pre-filed Evidence, pages 34-36.

<sup>48</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 41.



of available pipeline transportation capacity into/out of Ontario, is entirely misplaced. Both the BHT Evidence and the Stauff Evidence purport to rely on the FERC's methodology for reviewing and ultimately limiting the geographic market to only Ontario. However, as noted, the FERC's standard of review for market-based storage rates appropriately does not consider available pipeline transportation capacity as a rationale for limiting the geographic market for storage services. Both the BHT Evidence and Stauff Evidence suffer from this fatal flaw and in turn narrowly define the relevant geographic market.

In addition, the Stauff Evidence claims that storage outside of Ontario is uneconomic and cannot compete with storage in Ontario, however, this is also incorrect and a critical misrepresentation of FERC's methodology for comparing the economics of market alternatives. The Stauff Evidence is premised on the view that market power should be defined as the ability to profitably maintain prices at a level 10% or greater above the existing *cost-based* regulated rates. However, market power is defined as the ability to sustain prices above a *competitively determined* rate in the market.<sup>49</sup> In fact, Union Gas provided the actual market prices from their most recent short-term (i.e. term of one year or less) storage open season. These prices represented third-party bids by the marketplace without rate setting by Union, and were in excess of the cost-based, legacy storage prices, clearly highlighting the disconnect of Mr. Stauff's analysis that rates somehow in excess of 10% above the cost-based rate are indicative of market power.<sup>50</sup> Thus, the definition of market power relied upon by the Stauff Evidence is incorrect, and thus the framework used in the Stauff Evidence for evaluating potential market power in Ontario is also incorrect. With respect, his lack of formal training and experience in market power analysis in these respects is telling.<sup>51</sup>

Perhaps most telling is the fact that the BHT's witness, Ms. McConihe, recently prepared evaluations of the Ontario storage market (i.e. the PA Consulting and Acres Management Consulting studies) and concluded that the relevant geographic market for storage to be at least Ontario and Michigan, if not even broader, and determined that storage market power was not a concern in these markets.<sup>52</sup> Additionally, neither the FERC market power analyses conducted by

<sup>49</sup> EB-2005-0551, Exhibit X.7.2.2, CEA Reply Evidence, pages 17-18; and Mr. Reed, Hearing Transcript, 5T22-25, and 5T110. See also: Avoca Natural Gas Storage, 68 FERC ¶61, 045 at 61, 148 (1994).

<sup>50</sup> EB-2005-0551, Union Gas Pre-filed Evidence, Exhibit C, Tab 1, Attachment 3.

<sup>51</sup> EB-2005-0551, TC Transcript, May 18, 2006, pages 148-149, 186-188 and 192-193.

<sup>52</sup> EB 2005-0551, Exhibit I.8.1 (Tab 7b – PA Consulting Report, January 8, 2001 and Acres Management Consulting Report, July 2002)

Ms. McConihe for storage projects in the northeastern United States, nor the FERC's orders approving those projects, ever even addressed availability of pipeline capacity in the relevant geographic market as an issue. Therefore, it is not appropriate in this proceeding for the argument to be made that limited available pipeline capacity should be a factor for limiting the relevant geographic market for storage services in Ontario.

In light of the foregoing, since the more narrowly defined storage market is clearly workably competitive and the Ontario storage services providers do not exercise market power in respect of it, it is not necessary to determine the ultimate extent of the workably competitive market in which Ontario participates. This is also consistent with the FERC's market power determinations, whereby if a narrowly defined market can be shown to be workably competitive then it is presumed that a more broadly defined market would be workably competitive as well.

Accordingly, with respect, the evidence of CEA, EEA and Navigant, as well as Dr. Schwindt, are to be strongly preferred to that of Ms. McConihe and Mr. Stauff. Indeed, Ms. McConihe's participation in the earlier PA Consulting and Acres Management Consulting studies, which concluded that the Ontario storage market was workably competitive with a relevant geographic market including both Ontario and Michigan (and could encompass a broader market beyond that) should be preferred to her current testimony in this proceeding. It is unsupported on the evidence and illogical to demand that un-subscribed transportation capacity must exist between storage facilities in order to find that there is a workably competitive storage market. As noted above, there was absolutely no discussion or analysis of the extent to which un-contracted capacity in Ontario/Michigan existed in either the PA Consulting or the Acres Management Consulting reports. Ms. McConihe's suggestion that it all turned on Vector capacity defies credibility when no discussion of the issue at all appears in either of the consultant reports on which she worked.

There is also no evidence that the FERC has ever revisited or conditioned its approval of market-based rates in the United States for storage operators where all of the available capacity to and from the storage facility was subsequently fully subscribed either during peak periods or at all times during the course of the year.<sup>53</sup> If the absence of un-subscribed pipeline capacity to and

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<sup>53</sup> EB-2005-0551, Hearing Transcript, Ms. McConihe, 8T209-210.

from storage was proof of monopoly market power, as Ms. McConihe and Mr. Stauff contend, one would have expected the FERC to suspend market-based rate authority under those circumstances. In fact, FERC has not conditioned approvals of market-based rates for market-area storage projects subject to changes in un-subscribed capacity levels, or indicated in any manner that un-subscribed capacity made any difference to its conclusions at all. With respect, the fact that the FERC has never taken such action, demonstrates that it was never a predicate to the grant of market-based rate authority in the first place.

In MHP Canada's respectful submission, the fact that limited available pipeline capacity is not a concern for the Ontario storage market is consistent with the evidence of CEA, EEA and Navigant, as well as GazMetro and BP Marketing. It also accords with the evidence of the Union Gas and Enbridge witnesses, who have been active in the storage market for many years. Capacity release programs, assignments, exchanges, displacements, and drop-offs continue to operate to ensure ready substitution of storage service or its substitutes whenever any particular storage service provider might attempt to raise prices by withholding its service. The significance of this basic fact should not be understated. A finding that these services do in fact exist in and around Ontario leads directly to the conclusion that the geographic market is not limited to Ontario and dispels any suggestion of market power.

Consequently, another issue that was raised by Ms. McConihe was the matter of the proposed Red Lake Storage facility in Arizona, and the FERC's denial of market-based rates for that facility. However, it is important to understand that there are clear and material differences between the Ontario storage market and the circumstances in the Red Lake proceeding. The primary difference between the Red Lake case and the current evaluation of the Ontario storage market is the characteristic of the relevant geographic market – the Red Lake storage facility was located in a separate geographic market than the other storage market participants that it was claiming were its competitors, and thus could not demonstrate a lack of market power, which as noted above, is clearly not the case for the Ontario storage market. To apply the outcome in the Red Lake case to the Ontario storage market when the circumstances are materially different would be inappropriate. To do so would also ignore what may be characterized as the perverse

results which arose from Red Lake and the significant public policy initiatives, which resulted therefrom.<sup>54</sup>

In addition, since the FERC's new approach to market power analysis has been expanded to include a broader range of product substitutes, it is unreasonable to assert, as Ms. McConihe did, that the FERC would end up acting as restrictively as it had in the Red Lake case, even though it now employs the broader range of product substitutes. This Board should recognize the significant differences between the Ontario storage market and the circumstances in the Red Lake proceeding, as well as conclude, consistent with U.S. Congress and the FERC, that the restrictive approach used in the Red Lake case was contrary to the broader public interest. Sound public policy demands that storage development be encouraged wherever possible.

**c. Market Concentration and Market Share**

The CEA Evidence clearly addresses whether market power concerns exist in the marketplace. Based on the appropriate definition of the relevant product and geographic markets, CEA concluded that MHP Canada individually, and when its forecast storage capacity and maximum deliverability are combined with affiliated companies (i.e., Union Gas and Texas Eastern), has a market share far below the Merger Enforcement Guidelines' ("MEG") suggested 35% market share threshold.<sup>55</sup> The EEA/Schwindt Evidence and the Navigant Evidence both support the CEA analysis.<sup>56</sup> In addition, the relevant market is not considered concentrated based on the MEG threshold of 65% market share for the four largest suppliers combined.<sup>57</sup>

MHP Canada submits that the screening of market shares and concentration indicate that MHP Canada cannot exercise market power, either individually or collectively with its affiliates. Since its affiliate, Union Gas, is the largest supplier of storage services in Ontario, it is clear based on this analysis that none of the Ontario storage providers have a market share sufficient for market power concerns to exist. Further, the analysis supports the conclusion that a lack of concentration is inherent in the market.

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<sup>54</sup> EB 2005-0551, Exhibit J.4.3 (FERC Order No. 678, June 19, 2006 and Chairman's Statement, June 15, 2006).

<sup>55</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 44

<sup>56</sup> EB-2005-0551, EEA Pre-filed Evidence, Page 1; and Navigant Pre-filed Evidence, page 12.

<sup>57</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 44.

**d. Mitigating Factors**

As CEA notes in its evidence, regulators in both Canada and the United States recognize that a review of market shares and market concentrations do not provide a "comprehensive view of all important factors" for determining whether market power may be exercised and that other factors are relevant for making such a determination."<sup>58</sup> Mitigating factors, including the existence of affiliate standards, should also be considered and MHP Canada submits that the presence of those mitigating factors enable and enhance the competitive market in Ontario.

That existing protections are adequate is clear from the experience gained over the last seventeen years. The Board itself appears to have concluded over this period that market-based rates for a large portion of the Ontario storage market are sufficient to protect the public interest from the exercise of market power. Moreover, the evidence discloses that under market-based pricing, rates charged have not reached the approved upper limit of the approved range.<sup>59</sup> Nor were any complaints of potential market abuse registered. The Board can and should, therefore, refrain from regulation of gas storage services in the knowledge that market forces and other mitigating factors will protect against the potential for market abuse.

*i. Affiliate Relations*

MHP Canada was formed to independently hold and develop storage assets, and has committed to significant investment in Ontario with the intention of entering the storage services market. As stated above, MHP Canada submits that consideration of market shares and concentrations alone is enough to disclose that MHP Canada cannot exercise market power either individually or collectively with its affiliates. However, even if the potential did exist for MHP Canada to influence the market by acting in concert with Union Gas, which MHP Canada denies, it is clear from the evidence that there are factors that effectively mitigate these risks. Adequate protections against concerns such as undue preference exist under the Affiliate Relationships Code ("ARC").<sup>60</sup>

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<sup>58</sup> EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 30.

<sup>59</sup> EB-2005-0551, Mr. Baker, Hearing Transcript, 4T144-145.

<sup>60</sup> Affiliate Relationships Code for Gas Utilities (ARC), Revised on December 9, 2004 with Effect June 9, 2005. The ARC was adopted as a rule of the Board pursuant to sections 44 and 45 of the *Ontario Energy Board Act, 1998* ("OEB Act").

The ARC was put in place to enhance the competitive market while keeping ratepayers unharmed from utilities dealing with affiliates. Specifically, the ARC aims to minimize the potential for cross-subsidization, protect the confidentiality of information and eliminate preferential access to regulated utility services.<sup>61</sup> The standards specifically provide rules around degree of separation, sharing of resources, transfer pricing and cost information disclosure, financial transactions, equal access to services, confidentiality of information, compliance measures, record keeping and reporting requirements, as well as providing for a complaint mechanism.

As detailed more fully in its evidence, MHP Canada is currently subject to the ARC as an "affiliate" of Union Gas. As and when MHP Canada becomes a storage services provider, however, it will become a "utility" in its own right under the ARC, with a primary obligation to comply with its terms.<sup>62</sup> This means that MHP Canada will be subject to the various standards of conduct under the ARC with respect to its interaction with affiliated companies (regulated and non-regulated alike).

To be clear, the structure of MHP Canada's marketing activities and the existing protections afforded by the regulatory scheme, particularly the ARC, effectively protect against potential affiliate abuse. No specific recommendations for changes to the ARC have been made by other parties. The protections contained in the ARC obviously have been determined to be sufficient to protect the public interest in the face of all types of inter-affiliate dealing. The acquisition of storage services from affiliates should be no different.

As stated by Mr. Redford, MHP Canada's marketing function will be conducted independently of its regulated affiliates.<sup>63</sup> MHP Canada will not provide storage marketing or other commercially sensitive information to its affiliates, such that only necessary non-confidential information will be shared. MHP Canada expects affiliates to honor the ARC in return. As part of its M16 transportation agreement negotiations, for instance, MHP Canada expects that Union Gas will only provide specific system design and operation information necessary to complete the

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<sup>61</sup> ARC, Section 1.1. The standards under the ARC are specifically intended to: (i) minimize potential for cross-subsidization; (ii) protect confidentiality of customer information; and (iii) eliminate preferential access to regulated utility services.

<sup>62</sup> See for example, ARC, Section 1.2 (definition of "utility") and Section 1.4 (to whom the ARC applies).

<sup>63</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, pages 1 and 12; TC Transcripts, May 17, 2006, pages 243-244, lines 28 and 1-3; TC Transcript, May 18, 2006, page 33, lines 17-18; and page 58, lines 8-12. See also: Hearing Transcript, 5T68, lines 11-12.

commercial agreements required for MHP Canada to interconnect with the Union Gas system. This is the extent of commercial activities and information sharing that will be required and permitted.<sup>64</sup>

In accordance with the ARC, copies of Master Services Agreements have been filed with the Board in this proceeding.<sup>65</sup> Service Agreements taken with individual departments within the Union Gas organization were filed as part of the 2007 Union Gas rate case (EB-2005-0550).<sup>66</sup> Any future services will be provided in accordance with the standard terms stipulated for inter-affiliate dealing. This means that contracts for storage capacity with affiliates, for example, will be subject to applicable transfer pricing and cost information disclosure requirements. With respect to these requirements and particularly those under sections 2.3.4-2.3.9 of the ARC however, MHP Canada assumes that under market-determined or market-based rates, the Board would not require disclosure of MHP Canada's costs and revenues where any storage services contracted with an affiliate result from a fair and open competitive bidding process such as an open season tender. Likewise, in relation to section 2.3.10, it is assumed that market-determined pricing or market-based rates would signal that a reasonably competitive market is deemed to exist, and this provision would not apply. The Board's confirmation of this interpretation of the transfer pricing and cost information disclosure requirements would be helpful.<sup>67</sup>

Non-discriminatory, open access practices to ensure fair and equal treatment through open season and negotiated rate processes will also be adopted consistent with the ARC.<sup>68</sup> The mandatory obligation to comply with the ARC therefore, should form part of the MHP Canada tariff and adequately address any concerns with preferential access or cross-subsidization arising from inter-affiliate dealings. As Mr. Redford explained:<sup>69</sup>

There are rules in place, and they're very clear in the ARC with respect to affiliate dealings. I'm not really sure we have an advantage. In fact, if I were Tribute, I might be closer to being in service at this point.

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<sup>64</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, pages 12-13.

<sup>65</sup> EB-2005-0551, Technical Conference, May 19, 2006, Undertaking MHP 3.

<sup>66</sup> See: EB-2005-0551, Exhibit X.7.1.2, CEA Evidence, page 26; and Hearing Transcript, Mr. Redford, 5T67-68.

<sup>67</sup> EB-2005-0551, MHP Canada Undertaking K 4.6

One of our disadvantages might be that we are affiliated, and it wasn't clear to us whether we were independent or where we fit in. So I think the constructs are there for any player to enter the market, and I can tell you that there are people out there that are interested.

Therefore, any "presumption" that MHP Canada acts in concert with its affiliate, Union Gas, in the marketing of the storage and transactional services in question, or in such a way as to influence the market is clearly rebutted by the evidence. The protections of the ARC have been in place since 1999 and the market has functioned well without cause for concern under a market-based rate regime. MHP Canada submits that the ARC is sufficient to protect the public interest and any positions to the contrary are unfounded. As stated by Ms. Worthy of BP Marketing, concerns with respect to affiliate dealings can be mitigated through appropriate codes of conduct, necessary oversight of the Board and complaint mechanisms that would allow for any issues to be addressed on a timely basis.<sup>70</sup> Simply put, MHP Canada cannot appropriately be denied the ability to charge market-determined prices on the basis of potential inter-affiliate dealings.

Even if the potential existed for MHP Canada to exert market power by acting in concert with its affiliate the Board should not deny market-determined pricing or market-based rates simply due to this potential concern. Rather, the Board should allow parties to price storage services according to market-determined or market-based rates, and establish any additional provisions that the Board deems appropriate to provide sufficient assurance to the Board that affiliates cannot act in concert to exert market power.<sup>71</sup>

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<sup>68</sup> Section 2.5.5 of the ARC requires that all Rate Orders and rate schedules be applied to an affiliate in the same manner as any similarly situated non-affiliated party. Likewise, Section 2.5.6 requires that requests for service be processed and provided in the same manner as for any similarly situated non-affiliated party.

<sup>69</sup> EB-2005-0551, Hearing Transcript, 5T181, lines 1-10.

<sup>70</sup> EB-2005-0551, Hearing Transcript, 13T15, lines 19-23.

<sup>71</sup> EB-2005-0551, Exhibit X. 7.2.1, MHP Canada Reply Evidence, page 3; and TC Transcript, May 18, 2006, page 6, lines 3-15.



ii. *Complaint Processes*

Many witnesses recognized that an important element of a functioning market is an efficient and effective complaint resolution process. As Mr. Reed noted, a complaint process for market abuse, if not currently available, would be appropriately added.<sup>72</sup>

Should concerns arise with respect to market power or affiliate abuse, there are protocols in place to rectify the impugned conduct. The existing ARC complaint process (through the Board Compliance Program) is available for market participants in the event that issues cannot be resolved voluntarily.<sup>73</sup> For complaints regarding non-affiliate behaviour in the marketplace, the Board offers a Market Participation Hotline under the OEB Compliance Program. This complaint process is well documented on the Board's web-site and is consistent with the processes of the FERC and other industry regulators. In fact, the Board's general powers are also framed broadly to deal with affiliate/market abuse and issues of non-compliance.<sup>74</sup> Moreover, the general fabric of Canadian commercial law sets standards for all commercial activity across Canada, including laws of general application such as the *Competition Act*. The complaint process under the jurisdiction of the Competition Bureau is well described on the Competition Bureau's web-site and is designed specifically for investigation of alleged market abuse. Under forbearance, as a minimum, storage market participants would have the opportunity to engage the processes of the Competition Bureau.

MHP Canada submits that the complaint systems available are suitable for the purposes of investigating alleged market abuse and are effective at assisting the Board in monitoring the health and competitive state of the market. No specific suggestions were made by other parties regarding the available complaint processes.

iii. *Monitoring of the Market*

The Board has many means by which to monitor the market. Transactions with the utilities (i.e. Enbridge Gas Distribution and Union Gas) are subject to not only the ARC, but also the Board's

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<sup>72</sup> EB-2005-0551, TC Transcript, May 18, 2006, pages 59-60.

<sup>73</sup> ARC, Section 2.9.

<sup>74</sup> *OEB Act*, Part VII.1 – Compliance.

general powers to review processes regarding rate setting.<sup>75</sup> More specifically, any utility seeking to contract for storage services obtained from an affiliate or independent storage operator in the normal course would be subject to a review of the prudence of its actions. This is a standard feature of the Board's ratemaking function and is more than adequate to deal with any issues that may arise.<sup>76</sup>

The Board can also monitor new entrants to the storage services markets through the approvals required for construction or sale of a storage asset. In fact, the Board can encourage new market entrance and storage development by adopting clear and efficient guidelines for filing requirements to streamline approval processes for new storage facilities.<sup>77</sup>

As MHP Canada has suggested, additional comfort exists if storage services contracts are submitted in confidence to the Board after the fact and an affidavit is submitted to the Board confirming that all storage services provided are in compliance with Board approved structures. Should the Board decided to, it would be consistent with forbearance principles for the Board to require market participants to provide their confidential market-related transactional information on a confidential basis to assist the Board in monitoring the competitive state and health of the market. Such information should not be shared with any other party.<sup>78</sup>

The FERC Standards of Conduct and the public posting of certain information, including an Index of Customers, have been a matter of some discussion in this proceeding. MHP Canada believes that the existing regulatory constructs, such as the ARC, existing complaint processes, general laws of applicability and the general powers of the Board, are adequate for the Board to monitor the health and competitive state of the market and are adequate to protect the public interest. In the event that the Board adopts a portion of the FERC Standards of Conduct, as addressed by other parties in this proceeding, MHP Canada would support publicly posting information necessary for the market to understand the services and operating capability of the storage facilities. However, no confidential market information should be publicly posted. MHP Canada disagrees that it is necessary to publicly post prices obtained in the market for storage services, regardless of whether the end regulatory regime includes forbearance or market-based

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<sup>75</sup>This further protection of the public interest is the "caveat" registered by the representatives for IGUA/AMPCO during the Technical Conference and referred to on a number of occasions at the hearing itself. EB-2005-0551, TC Transcript, May 18, 2006, 122-123. See also: Mr. Reed, Hearing Transcript, 4T167.

<sup>76</sup>EB-2005-0551, MHP Canada Undertaking K 4.6.

<sup>77</sup>EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 9, lines 5-7.

rates. Price transparency and discovery for all market participants is attainable through a sufficiency of offers in the vigorous primary and secondary markets.<sup>79</sup> As stated by Mr. Acker, BP Marketing has never been frustrated in either being able to sell gas or to buy gas at the Dawn Hub for any reasonable amount of volume or for any reasonable amount of time.<sup>80</sup>

iv. *Non-Discriminatory, Open Access Services*

MHP Canada is satisfied with the open access culture developed in the market place through the existing utilities, including the requirements of section 5 of the ARC. MHP Canada will be an M16 transportation customer and seeks to be treated by Union Gas like similarly-situated customers. Union Gas indicated that it would afford the same nomination windows to the M16 transportation customers as it would afford under other transmission rates such that third-party storage operators could provide service on the same terms as Union Gas.<sup>81</sup> As stated by Mr. Redford, MHP Canada has no immediate concerns with access and encourages the Board through its jurisdictional powers to maintain non-discriminatory, open-access transportation policies such that regulated utility services are offered at just and reasonable rates.<sup>82</sup>

In summary, MHP Canada submits that in light of all of these mitigating factors, the combined effect of which has a cautionary effect upon the behaviour of all regulated utilities and their non-regulated affiliates alike, a level playing field can be created and maintained to encourage new entry by utilities, their affiliates and other independent storage providers. There is no cause for concern. The market has functioned in a satisfactory manner under a market-based rate regime for many years. Therefore, MHP Canada does not believe that the adoption of additional measures is necessary at this time to protect against potential storage market power abuse.

**e. Policy Rationale**

So where does this leave forbearance? Forbearance recognizes that for storage services there is no need for regulation. There is no monopoly abuse to be curbed because monopoly power does not exist in this workably competitive environment. The public interest is safeguarded from the exercise of monopoly power.

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<sup>78</sup> EB-2005-0551, Exhibit X. 7.1.1, MHP Canada Pre-filed Evidence, pages 8 and 9, lines 28-30 and 1-4.

<sup>79</sup> EB-2005-0551, TC Transcripts, May 18, 2006, page 27, lines 7-20.

The longstanding utilization of market-based pricing for storage service in Ontario and the very significant liquidity it has helped to create at the Dawn Hub make it obvious that a highly competitive market for storage services and its substitutes exists in Ontario. It follows therefore, that market pricing has been sufficient to protect the public interest for many years. Were that not the case, MHP Canada suspects the Board would have been requested long ago to revoke that authority.

As noted, arrayed against this longstanding rate rule stand experts retained by the BHT and IGUA/AMPCO. With respect, their solutions to the issues raised would substantially worsen matters. Indeed, the evidence discloses that the BHT's recommendations would lead to the "worst of all worlds".<sup>83</sup> Primary amongst its shortcomings is its failure to spur incremental storage development in the province.<sup>84</sup>

There would appear to be little point in creating a highly prescriptive regulated regime for the pricing of storage service where market forces and competition have been more than satisfactorily ensuring a fair and reasonable pricing result without complaint for many years. On the basis of this competitive framework, one of the largest most vibrant energy marketing hubs in North America has grown. Still, price volatility remains an overriding concern, not just in Ontario but also across North America. No one doubts the serious harm it represents to all gas users notwithstanding the inability to quantify that harm.<sup>85</sup>

As a matter of public policy, this Board, as has the FERC, should look with favour upon whatever is necessary to encourage the development of incremental storage capacity in the Ontario market. While the effects of price volatility cannot be quantified, there exists a clear policy imperative that these effects be attenuated wherever possible. The development of incremental storage and the enhancement of market liquidity are two sound steps in that direction. The adverse effects of price volatility touch every single gas consumer. While there may be some loss of economic rents transferred to ratepayers as a result of forbearance, the benefits of an open competitive market should not be underestimated. With the development of

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<sup>80</sup> EB-2005-0551, Hearing Transcript, 13T19, lines 8-12.

<sup>81</sup> EB-2005-0551, TC Transcript, April 5, 2006, pages 241-243; and Hearing Transcript, Mr. Reed, 5T73, lines 16-23.

<sup>82</sup> EB-2005-0551, TC Transcript, May 18, 2006, page 3, lines 13-27.

<sup>83</sup> EB-2005-0551, Hearing Transcript, 8T218.

<sup>84</sup> EB 2005-0551, Exhibit X.7.2.1, MHP Canada Reply Evidence, page 3.

accurate price signals, new supplies of physical storage and new storage substitutes will be developed, limited only by the ingenuity of the market. The Dawn Hub itself represents considerable ingenuity and innovation. With respect, the Board should, as it has in the past, continue to rely upon a market-determined pricing regime to secure the public interest with respect to the relevant storage services.

As the record demonstrates, there is significant additional storage development potential in the Province of Ontario. For certain, investors, storage developers and other market participants all require the Board's assurance of a stable regulatory environment and none of this storage development potential will be realized without market-determined pricing.

## **6. CONTRACTING FLEXIBILITY**

While market-determined pricing may be the critical regulatory construct to encourage further storage development in Ontario, contracting flexibility is an important component of an effective and efficient market and key element of the MHP Canada business plan.

Currently, Section 39(2) of the *OEB Act* requires that the Board approve the party, term and volume subject to a storage contract. Although the benefactor of a Blanket Storage Order (E.B.O. 166), Union Gas correctly observed in its evidence that under Section 39(2) requirements, customers are constrained in their ability to commercially operate and manage storage contracts until Board approval has been granted.<sup>86</sup> Not surprisingly, the process and time involved is not consistent with the needs of the competitive market, particularly the short-term storage or transactional market. As stated by Mr. Redford in his testimony, the results are predictable - lost market opportunities and discounted value due to regulatory and pricing risk.<sup>87</sup>

MHP Canada submits that, in such a liquid and competitive market, and given the jurisdictional powers of the Board with respect to storage contracts entered into by the utilities, the Board should adopt regulatory policy that allows flexible contracting such that contracts for storage services between a storage operator and a customer can be binding without requiring Board approval of individual contracts under Section 39(2). As noted above, MHP Canada is prepared

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<sup>85</sup> EB-2005-0551, Hearing Transcript, Ms. McConihe, 9T8, lines 3-27.

<sup>86</sup> EB-2005-0551, Union Gas Storage Regulation Evidence, Exhibit C, Tab 1, page 17.

to file contracts in confidence following execution to assist the Board in its effort to monitor the market. This is consistent with forbearance and, in the event that the Board maintains rate regulation for storage services by granting market-based rate authority, MHP Canada submits that the request for contracting flexibility remains valid provided that storage companies operate within a base set of service terms and conditions approved by the Board.

## 7. CORE POINTS

As discussed in detail above, while MHP Canada believes that the Board should ultimately forbear from regulating storage rates and services in the relevant market, it is anticipated that a decision on this critical issue will not be available for some time. Coincidentally, MHP Canada has the opportunity to bring 1.1 Bcf of new natural gas storage capacity to the Ontario market in 2007 and, in anticipation, has re-activated its St. Clair Pool Application.<sup>88</sup>

As a result, MHP Canada is requesting interim relief from the Board in this proceeding in the form of an expedited decision, approving its Core Points, which were set forth in its evidence<sup>89</sup> and discussed in detail during testimony.<sup>90</sup> The Core Points specifically request a finding from the Board confirming that:

- MHP Canada cannot exercise market power;
- MHP Canada, similar to independent storage developers, will be granted authority to charge market-based rates for its services; and
- MHP Canada will be allowed flexibility to contract for services without requiring approval of individual contracts, provided that MHP Canada operates within a base set of service terms and conditions approved by the Board.

As further clarified in its July 20, 2006 letter to the Board, a determination made with respect to the Core Points in this proceeding can, subject to appropriate conditions of approval, satisfy the

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<sup>87</sup> EB-2005-0551, Hearing Transcript, 5T134-135, lines 26-28 and 1-18.

<sup>88</sup> MHP Canada requested re-activation of the St. Clair Pool Application (EB-2006-0162/ EB-2006-0163/ EB-2006-0164/ EB-2006-0165/ EB-2006-0166/ EB-2006-0167) in a letter to the Board, June 30, 2006.

<sup>89</sup> EB 2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence, page 4 and Exhibit X 7.2.1, MHP Canada Reply Evidence.

<sup>90</sup> EB-2005-0551, Hearing Transcript, 5T132-137 and 4T197-202.

EB-2006-0162 (rate authority) and EB-2006-0165 (contract approval) requirements of its St. Clair Pool Application.<sup>91</sup>

**a. Significance of the Core Points**

The Core Points represent issues of commercial significance to the MHP Canada business plan represent minimum requirements for MHP Canada to move forward with the St. Clair Pool Application and the execution of its business plan.<sup>92</sup>

Confirmation that MHP Canada cannot exercise market power is required to ensure that a determination is made based on the detailed record of this proceeding and is not subsequently re-tried in the St. Clair Pool proceeding. The other two elements of the Core Points (i.e. market-based rate authority and contracting flexibility) represent minimum regulatory constructs that MHP Canada requires to enter the market and proceed with storage development in Ontario.

To be clear, MHP Canada's request for an expedited decision on the Core Points is intended only to provide MHP Canada the confidence to move the St. Clair Pool project plans forward such that incremental storage services can be offered to the market commencing in 2007. The request for an expedited decision does not substitute in any way for the forbearance determination, which the record fully supports in this proceeding. MHP Canada, in making this request for an expedited decision, fully expects that the Board will render its decision on Issue II, including whether to forbear from regulating storage rates and services, in due course.<sup>93</sup>

**b. Need for an Expedited Decision**

The expedited decision that MHP Canada seeks regarding the Core Points will facilitate development of the St. Clair Pool project for a June 30, 2007 in-service date. Imminently, in order to achieve that in-service date, MHP Canada will need to commit to necessary project materials and well drilling contractors, conduct its open season for storage services, and continue with the regulatory approval process.<sup>94</sup> Prior to making these commitments, MHP Canada requires some assurance that the St. Clair Pool Application will be processed efficiently and that

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<sup>91</sup> MHP Canada clarified the specific relief it is seeking in NGEIR and the St. Clair Pool Application in a letter to the Board, July 20, 2006.

<sup>92</sup> EB-2005-0551, Hearing Transcript, 5T136, lines 20-26.

<sup>93</sup> EB-2005-0551, Exhibit X.7.1.2, MHP Canada Reply Evidence, pages 1-2.

the regulatory constructs of the Core Points, at a minimum, will be made available. Based on the current NGEIR schedule, this necessitates MHP Canada requesting an expedited decision on the Core Points, rather than awaiting issuance of the Board's full decision on Issue II. As stated in the MHP Canada evidence, a decision on the Core Points is required no later than August 2006.<sup>95</sup>

Specifically, this expedited decision is required for the following reasons:<sup>96</sup>

- (i) MHP Canada must soon make financial commitments for materials, drilling contractors and equipment. While MHP Canada is prepared to accept the regulatory risks associated with the technical aspects of the St. Clair Pool Application, for which a decision is not expected until November 7, 2006, MHP Canada is not prepared to make significant commitments without clarity regarding critical regulatory policy, i.e. market-based rate authority and contracting flexibility.
- (ii) MHP Canada expects that long delivery materials will need to be ordered in late summer in order to meet the project schedule. While some materials required for the MHP Canada facilities are considered long-lead time items, Union Gas will be required to order long-lead time items for the construction of the interconnecting station and for any upgrades to existing compression associated with providing MHP Canada firm M16 transportation service. Accordingly, a lack of definition of the regulatory treatment has halted M16 transportation negotiations with Union Gas.
- (iii) The high level of drilling activity across North America, the current availability of drilling and support contractors in Ontario and the relatively small scope of the St. Clair Pool project provide a significant challenge to securing services for the St. Clair Pool project. Late August/early September is the latest date by which it is anticipated that drilling contractors and equipment can reasonably be secured to commence drilling operations in January 2007.

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<sup>94</sup> EB-2005-0551, Exhibit X 7.1.1, MHP Canada Pre-filed Evidence, page 4; and Hearing Transcript, 5T133, lines 3-20.

<sup>95</sup> EB-2005-0551, Exhibit X 7.1.1, MHP Canada Pre-filed Evidence, page 4. Also at Hearing Transcript, 4T202, lines 11-26 and 5T133, lines 18-20.

<sup>96</sup> EB-2005-0551, Exhibit X.7.1.1, MHP Canada Pre-filed Evidence; and X.7.2.1, MHP Canada Reply Evidence. See also: Mr. Redford, Hearing Transcript, 5T132-135.



- (iv) MHP Canada plans to conduct its open season for storage services in the fall of 2006. MHP Canada cannot undertake extensive marketing activities, however, until as a minimum, some of the critical aspects of the regulatory structure are determined. It is premature to contact prospective customers absent regulatory certainty in relation to the basic economic parameters of its storage business.
- (v) MHP Canada has re-activated the regulatory process for the St. Clair Pool project and needs to receive timely approvals in order to achieve the June 30, 2007 in-service date. As noted herein, MHP Canada believes that the issue of market power should be fully addressed in this proceeding and is not willing to advance the St. Clair Pool Application without confirmation that this issue will be excluded from the scope of the St. Clair Pool proceeding. MHP Canada is also not willing to advance the St. Clair Pool Application too far, risk another adjournment of that proceeding and incur the related costs, until confirmation of the Core Points is received.

**c. Determination**

Simply put, the workably competitive nature of the Ontario storage market, combined with the protections afforded by the existing affiliate protocols, the Board's jurisdictional powers and other mitigating factors, fully justify the Board forbearing from regulating storage rates and services in the relevant market.

In making its request for an expedited decision on the Core Points, MHP Canada is merely asking the Board to extend existing rate authority under Section 36 of the *OEB Act* rather than fashion any new or innovative regulatory rule. In that regard, MHP Canada again stresses that the Board appears to have concluded that market-based rates for a large portion of the storage market are sufficient to protect the public interest since it has already approved their use for a large part of the market.<sup>97</sup> Market-based rates for storage services have been in effect in Ontario for some seventeen years without complaint and as noted in the NGF Report, the Board has already determined that market-based rates will be afforded to independent storage operators.<sup>98</sup> An extension of the Board's existing market-based rate authority would allow MHP Canada to

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<sup>97</sup> EB-2005-0551, Exhibit X 7.1.1, MHP Canada Pre-filed Evidence, page 2; and TC Transcript, May 18, 2006, Page 14, lines 15-24.

<sup>98</sup> NGF Report at page 50.

proceed on the basis that, at least in the interim, rates for storage services can be charged within the Board approved Union Gas C1 range.<sup>99</sup> MHP Canada submits that there is no reasoned basis to distinguish it from any other independent storage developer within the province. A full Issue II decision favouring forbearance would likely then enhance MHP Canada's pricing flexibility.

The contracting flexibility and relief sought under Section 39(2) of the *OEB Act* is consistent with existing practices and only requires extension of the practices established under the Blanket Storage Order in E.B.R.O. 166. Simply put, MHP Canada believes it to be disadvantageous for the Board to require storage operators to obtain approval before contracts become binding, resulting in lost contracting opportunities and discounted pricing.<sup>100</sup>

In MHP Canada's respectful submission, there is simply no rational basis upon which to contend that the award of market-based rate authority and contracting flexibility described in the Core Points would not be "sufficient to protect the public interest".

Accordingly, MHP Canada respectfully submits that it should be possible to expedite the decision on the Core Points while the Board continues to deliberate as to whether the Ontario utilities exercise market power in the provision of the storage and transactional services at issue in this proceeding.

The expedited approvals requested, if granted by the Board, will provide MHP Canada with the confidence to advance the St. Clair Pool project implementation. MHP Canada is specifically requesting that an expedited decision be issued after all parties have presented their argument in this proceeding but prior to reply from Enbridge Inc., Enbridge Gas Distribution and Union Gas. The latter three parties already have indicated their support for MHP Canada's proposal.<sup>101</sup>

In this regard, MHP Canada notes that through its Counsel, all those who filed Issue II evidence in this proceeding were canvassed to determine support for extension of existing market-based rate authority to MHP Canada subject to the protection of the ARC. There was substantial support for the grant of such authority subject to the ARC protections and subject further to the

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<sup>99</sup> EB-2005-0551, Exhibit X.7.2.1, MHP Canada Reply Evidence, page 1.

<sup>100</sup> EB-2005-0551, Hearing Transcript, 5T134-135, lines 26-28 and 1-18.

<sup>101</sup> EB-2005-0551, TC Transcript, May 18, 2006, Mr. Craig, page 90, lines 17-21; TC Transcript, May 19, 2006, Mr. Grant, pages 2-3, lines 28 and 1-6; and TC Transcript, May 19, 2006, Mr. Poredos, pages 107-108, lines 20-28 and 1-7.

clear understanding that any potential storage service contracted by an affiliate or, with a utility, would be subject to a Board prudence-type review in the normal course.<sup>102</sup>

The workably competitive nature of the Ontario storage market, combined with the protections afforded by the existing affiliate protocols and other mitigating factors as well as the Board's general powers, in MHP Canada's view, justify forbearance, and most certainly justify an extension of existing market-based rate authority and contracting flexibility. Approval of these components of the Core Points therefore, recognizes the timing requirements of MHP Canada and simply constitutes the minimum acceptable conditions to develop incremental storage in the province. Confirmation that MHP Canada cannot exercise market power and elimination of that issue from the St. Clair Pool Application provides the basis for an efficient facility application process.<sup>103</sup>

Should an expedited decision approving the Core Points be issued, MHP Canada would proceed to make the financial commitments necessary to ensure that new storage service could commence in 2007.<sup>104</sup> It is anticipated that marketing of the prospective capacity would begin around the same time as well.

Should the Core Points decision not be issued until the full Issue II decision is available or should the Board not provide determination on all components of the Core Points, MHP Canada would alter the timing of the St. Clair Pool project activities and plan for 2008 in-service.<sup>105</sup> Failure to expedite the Core Points decision in light of the evidence on record in this proceeding, including seventeen years of market-based pricing with no market abuse complaints and past experience with Blanket Storage Orders, would tend to indicate that the Board has substantive issues with the market-determined pricing and contractual flexibility MHP Canada requires. Development of other MHP Canada storage projects, such as the next planned storage development, Sarnia Airport Pool, would inherently be impacted. In such circumstances, MHP Canada would not be prepared to incur the risk of further expenditures.<sup>106</sup>

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<sup>102</sup> EB-2005-0551, TC Transcript, May 18, 2006, GazMetro, Ms. Brochu, page 78, lines 8-10; TC Transcript, May 18, 2006, IGUA/AMPCO, Mr. Thompson, pages 122-123, lines 11-28 and 1-6; and TC Transcript, May 18, 2006, Mr. Stauff, pages 182-185.

<sup>103</sup> MHP Canada letter to the Board dated July 20, 2006.

<sup>104</sup> EB-2005-0551, TC Transcript, May 17, 2006, page 255, lines 14-17; and Hearing Transcript, 5T133, lines 3-11.

<sup>105</sup> EB-2005-0551, Hearing Transcript, 5T177, lines 18-23.

<sup>106</sup> EB-2005-0551, Hearing Transcript, 5T136, lines 6-12.

Accordingly, MHP Canada respectfully requests that the Board, on an expedited basis, make determination on the Core Points under Sections 36 and 39(2) of the *OEB Act* as it relates to the St. Clair Pool project. This will allow MHP Canada to proceed with confidence in the interim in a viable economic model for developing storage projects. As set out in MHP Canada's letter to the Board dated July 20, 2006, if a determination regarding the Core Points, or EB-2006-0162 and EB-2006-0165, can be made with respect to the St. Clair Pool in this proceeding, then MHP Canada submits that the remaining "non-commercial" aspects (EB-2006-0163, EB-2006-0164, EB-2006-0166 and EB-2006-0167) could be dealt with in a subsequent proceeding, which hopefully could be accomplished without the time and expense of an oral hearing.<sup>107</sup>

## 8. CONCLUSION

MHP Canada maintains that the Ontario storage market is competitive sufficient to protect the public interest and that forbearance from regulating storage rates and transactional services in this highly competitive market is the right outcome. While MHP Canada believes that sufficient conditions exist for the Board to forbear in relation to the market as a whole, it would support a determination by the Board to forbear in part, provided the forbearance extends to all but the "in-franchise allocated" portion of the market and/or extends to MHP Canada specifically.

MHP Canada strongly prefers forbearance to the market-based rate authority and contracting flexibility reflected in its "Core Points" since it provides greater predictability and certainty for future investment decisions, as well as the greatest flexibility for its future storage development. MHP Canada believes however, that if the Board is not willing to forbear, it should extend market-based rate authority and contracting flexibility to all market participants, or as a last resort, to all but the "in-franchise allocated" portion of the market and/or MHP Canada specifically.

Finally, to facilitate development of MHP Canada's storage prospects, it is requesting interim relief from the Board in the form of an expedited decision, approving its Core Points. Such a decision would among other things, grant MHP Canada the minimum regulatory constructs (i.e. market-based rate authority and contracting flexibility) it requires to proceed with the timely

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<sup>107</sup> MHP Canada July 20, 2006 letter to the Board clarifying the relief sought in NGEIR and the St. Clair Pool Application.

development of the St. Clair Pool storage facility, and, depending upon timing of the NGEIR decision, the Sarnia Airport Pool, without prejudging forbearance.

All of which is respectfully submitted this 11<sup>th</sup> day of August 2006.