

## **ONTARIO ENERGY BOARD**

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.

IN THE MATTER OF proceeding File No. EB-2005-0551, pursuant to sections 19, 36 and 29 of the *Ontario Energy Board Act*, 1998.

---

**Evidence of Market Hub Partners Canada L.P.**  
**May 1, 2006**

---

## Index

<b>1. INTRODUCTION .....</b>	<b>1</b>
<b>2. MHP CANADA – OVERVIEW .....</b>	<b>4</b>
Ownership Structure of MHP Canada .....	4
<b>3. REGULATORY POLICY AND STABILITY.....</b>	<b>7</b>
<b>4. MARKET NEED AND OPPORTUNITY .....</b>	<b>9</b>
<b>5. MHP CANADA SERVICES.....</b>	<b>10</b>
Dawn Storage Services at Market-Based Rates.....	10
Transportation.....	11
Affiliate Issues .....	12
<b>6. MARKET POWER ANALYSIS .....</b>	<b>13</b>
<b>7. MARKET-BASED RATES .....</b>	<b>14</b>
Economic Reward Matched to Development Risk.....	14
<b>8. CONCLUSION .....</b>	<b>16</b>

## 1. INTRODUCTION

1 Market Hub Partners Canada L.P. (“MHP Canada”) is submitting evidence to the Ontario  
2 Energy Board (“Board” or “OEB”) to address Issue II (“Storage Regulation Review”) identified  
3 in Board Procedural Order No. 2, including expert evidence dated May 1, 2006 prepared by  
4 Concentric Energy Advisors, Inc. (“CEA”) that was commissioned to address the state of the  
5 competitive market in Ontario and whether market power concerns exist (the “CEA Evidence”).

6 As more fully detailed in Section 2 below, MHP Canada is a Duke Energy Corporation  
7 (“Duke Energy”) partnership established to develop, own and market underground natural gas  
8 storage facilities in Ontario. MHP Canada and its predecessor companies have invested over  
9 \$15 million in exploration and project development activities in Ontario over the past 10 years  
10 in pursuit of viable storage development opportunities.

11 MHP Canada will be a new entrant to the natural gas storage market and intends to offer  
12 merchant storage services at market-based rates targeting wholesale customers through a Dawn-  
13 based service. MHP Canada plans to provide 1.1 Bcf of working storage capacity to the market  
14 in 2007 and expects to increase its working gas capacity to 10 Bcf by 2010.

15 The Ontario energy market has benefited as the Dawn Hub developed into a large, active and  
16 liquid market centre. The growth of the pipeline grid and storage assets as well as access to the  
17 eastern Canadian, upper Great Lakes and Northeastern United States markets have been key to  
18 the development of the Dawn Hub. As noted in the CEA Evidence, the need for additional  
19 physical storage capacity in Ontario and the Great Lakes Basin will increase significantly in the  
20 near term and for the foreseeable future. As the demand for natural gas increases, whether  
21 through core market growth or the addition of gas-fired electric generators, further investment  
22 will be required in pipeline infrastructure and storage fields.

23 The development of Ontario’s natural gas storage infrastructure requires investor confidence  
24 in a policy framework that recognizes financial rewards commensurate with development and  
25 marketing risks. Cost-of-service rates do not provide the necessary flexibility to capture the  
26 true value of storage services and do not sufficiently compensate for the risk of developing

1 storage. Market-based rates do provide such flexibility by allowing storage operators to match  
2 rates and services to market demand.

3 As more fully described in the CEA Evidence, the United States government has recently  
4 provided direction to spur the development of critically needed market-area storage by  
5 exploring greater access to market-based pricing for gas storage developers. In a similar vein,  
6 MHP Canada urges the Board to encourage storage development by granting market-based rate  
7 authority to storage service providers regardless of their relationship to existing storage or  
8 utility providers.

9 In that regard, MHP Canada notes that the Board appears to have concluded that market-  
10 based rates for a large portion of the storage market are sufficient to protect the public interest  
11 since it has approved their use for: (i) ex-Ontario customers; (ii) Ontario customers (including  
12 LDCs and gas marketers as well as end-use consumers for demand exceeding allocated  
13 capacity); (iii) transactional services such as park and loans, which act as substitutes for storage  
14 services; (iv) services requiring daily deliverability beyond 1.2% of the storage capacity; and (v)  
15 services provided by independent storage developers (i.e. storage operators that are distributors  
16 and transmitters).

17 MHP Canada supports the “Proposed OEB Findings and Policy Recommendations” outlined  
18 in the CEA Evidence. A fully competitive market where all customers are subject to market-  
19 based pricing will send clear market signals providing the efficient development and utilization  
20 of storage services. MHP Canada recognizes that the elimination of the bifurcated market may  
21 require a transition and encourages the Board to adopt this as a policy direction.

22 The Ontario gas storage market is workably competitive today. Since this market is  
23 competitive to protect the public interest in Ontario, the Board can refrain from regulating rates  
24 and services for this market ("Forbearance"). MHP Canada agrees with CEA that relatively  
25 small market participants such as MHP Canada lack the ability to exercise market power and  
26 influence storage pricing by withholding capacity. Adding MHP Canada’s proposed storage  
27 capacity to that for which market-based rates have already been authorized, as noted above,  
28 only increases customer choice, providing further protection to the public against the potential  
29 for market abuse. As discussed later in more detail, there would be no reason to deny MHP

1 Canada market-base rates solely on the basis of utility affiliation. Short of Forbearance, MHP  
2 Canada requires market-based rates and contracting flexibility, whereby individual contracts for  
3 storage services do not require Board approval, to develop its storage and make those benefits  
4 available to Ontario and the broader market.

5 In addition, to ensure that sufficient storage capacity is available to meet market demand and  
6 to support a liquid Ontario natural gas market, MHP Canada submits that the Board, in its  
7 decision with respect to the Storage Regulation Review, should:

- 8 ♦ Adopt clear policies and standards that encourage the efficient development of  
9 new natural gas storage facilities and promote stability in the marketplace;
- 10 ♦ Recognize that there is an immediate and continuing need for the development  
11 of incremental storage capacity in Ontario;
- 12 ♦ Recognize that storage development entails unique and significant risks  
13 requiring commensurate returns on investment;
- 14 ♦ Create a level playing field for all storage market participants, including new  
15 market entrants;
- 16 ♦ Support non-discriminatory access to transportation and storage services at just  
17 and reasonable rates; and
- 18 ♦ Recognize that the existing rules and practices established by the Board to  
19 govern affiliate behaviour are adequate to protect the public interest such that  
20 market-based rates should not be withheld from storage operators on the basis  
21 of their affiliation with utility service providers.

22 Further, in order to meet its target of bringing new storage capacity to market by mid 2007,  
23 via the St. Clair Pool, MHP Canada will be required to resume the regulatory process for this  
24 project in advance of the final decision of the Storage Regulation Review in order to meet the  
25 development schedule. A number of issues specific to storage developers with utility affiliates  
26 were raised during the St. Clair Pool Storage Project (“St. Clair Pool”) interrogatory process  
27 and through Board comments made in the March 2005 Natural Gas Regulation in Ontario: A  
28 Renewed Policy Framework, Report on the Ontario Energy Board Natural Gas Forum (the  
29 “NGF Report”). As indicated when MHP Canada suspended the St. Clair Pool application in  
30 September 2005, these issues require resolution through the Storage Regulation Review to  
31 permit MHP Canada to proceed with its plans to bring its storage services to market.

1 Therefore, MHP Canada respectfully requests findings from the Board during the course of the  
2 Storage Regulation Review confirming the following (“Core Points”):

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

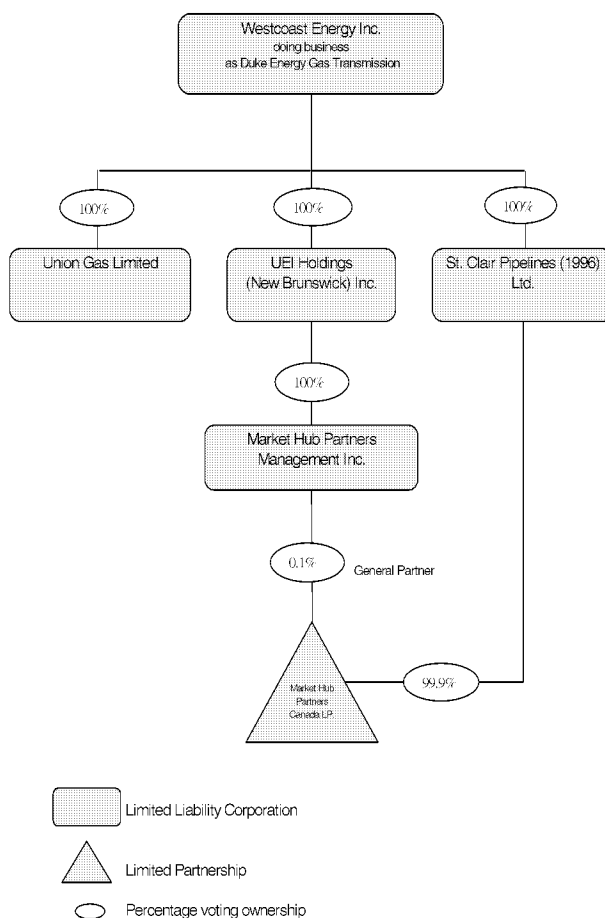
9 A decision on the Core Points is required no later than August 2006. The decision is  
10 required at that time in order for MHP Canada to: (i) commit to necessary project materials and  
11 well drilling contractors; (ii) conduct its open season for storage services; and (iii) continue  
12 with the regulatory approval process. As noted above, MHP Canada has previously expressed  
13 its concerns with respect to timing, and respectfully requests that the Board issue an expedited  
14 decision on the Core Points. This could be by way of a decision with reasons to follow.

## 2. MHP CANADA – OVERVIEW

### 15 **Ownership Structure of MHP Canada**

16 With the Duke Energy purchase of Westcoast Energy Inc. (“WEI”) in March of 2002, WEI,  
17 and its subsidiaries, became Duke Energy companies. WEI operates and does business as Duke  
18 Energy Gas Transmission (“DEGT”) in Canada. St. Clair Pipelines (1996) Ltd. (“SCPL”) is a  
19 subsidiary of WEI. SCPL has been exploring Southwestern Ontario for storage opportunities  
20 since 1996, actively acquiring seismic data, leases and drilling exploratory wells. SCPL  
21 transferred its underground storage assets to MHP Canada in 2002.

22 MHP Canada is a Duke Energy partnership consisting of general partner, Market Hub  
23 Partners Management Inc. and limited partner, SCPL. Corporate ownership is under WEI,  
24 doing business as DEGT in Canada. Functionally, MHP Canada reports to DEGT management  
25 in the United States. The following schematic describes MHP Canada’s corporate ownership.



1

2 MHP Canada was formed for the purpose of independently holding and developing assets  
 3 related to the storage of natural gas and has committed to significant investment in Ontario with  
 4 the intention of entering the natural gas storage market. That investment, which has been borne  
 5 by the shareholders of Duke Energy and its predecessor companies over the past 10 years, has  
 6 resulted in: (i) the specific development of two proposed projects that will provide 6.3 Bcf of  
 7 working gas capacity; and (ii) the accumulation of storage related lease and seismic data assets  
 8 that will assist MHP Canada in achieving its objective of a total of 10 Bcf of working gas  
 9 capacity in Ontario by 2010.

10 In June 2005, MHP Canada filed a facilities application with the Board for approval of the  
 11 St. Clair Pool.<sup>1</sup> This 1.1 Bcf natural gas storage pool is being developed in a depleted reservoir.  
 12 Construction activities are scheduled to commence in January 2007. MHP Canada intends to

<sup>1</sup> In September of 2005, MHP Canada requested that the St. Clair Pool proceeding be adjourned to proceed in a similar timeframe as or immediately following the Board's storage regulation proceeding. Questions posed by intervenors and the Board seemed to indicate that the significant issues in the St. Clair Pool proceeding really related to the forbearance, and specifically market power issues, of storage regulation contemplated by the NGF Report.

1 market its services for the St. Clair Pool storage capacity such that injections will commence  
2 June 30, 2007. To that end, MHP Canada will be required to resume the regulatory process for  
3 this project in advance of the final decision of the Storage Regulation Review in order to meet  
4 the development schedule. Therefore, in order to bring this capacity to market in 2007, MHP  
5 Canada respectfully requests a decision on the Core Points during the course of the Storage  
6 Regulation Review no later than August 2006. The decision is required at that time in order for  
7 MHP Canada to: (i) commit to necessary project materials and well drilling contractors; (ii)  
8 conduct its open season for storage services; and (iii) continue with the regulatory approval  
9 process. Ultimately, the project will also require timely receipt of all necessary permits and  
10 licenses, satisfactory Board conditions of approval and successful marketing of its storage  
11 services.

12 MHP Canada is also proposing to develop a second storage pool, the Sarnia Airport Pool  
13 Storage Project (“Sarnia Airport Pool”), which will provide 5.2 Bcf of additional underground  
14 natural gas storage connected to Dawn. In addition to its currently proposed projects, MHP  
15 Canada plans to continue seeking viable storage development opportunities in Ontario.

16 Storage development feasibility is typically dependent upon geology, access to supply  
17 sources, access to consuming markets, access to adequate pipeline transportation infrastructure,  
18 development and operating costs, market demand and environment. Storage development  
19 project economics tend to be influenced on a macro scale by the geology, location of the project  
20 and access to consuming markets.

21 Geology typically presents the most significant risk to a storage developer. Geological and  
22 engineering properties, such as formation geology and reservoir size, porosity and permeability,  
23 are often assessed using production and seismic data. This data is used to model and estimate  
24 the expected performance of a reservoir. Storage developers are at risk as reservoir  
25 performance cannot be directly assessed until storage wells have been drilled, flow tests  
26 completed and the pool has been operated through one complete injection and withdrawal  
27 cycle. In addition, assessment of the long-term capabilities of a reservoir requires the pool to be  
28 operated through several injection and withdrawal cycles. Capital and operating costs as well  
29 as ability to meet storage service contract demand can be significantly impacted by reservoir  
30 performance.



1 Capital and operating costs are also influenced by the location of a project with respect to  
2 proximity to pipeline infrastructure and surface facility requirements. Base gas costs have  
3 significantly increased to, or near, historical high levels in a volatile commodity market putting  
4 pressure on storage development costs and project economics. Drilling and construction  
5 activity in the industry also add development cost and timing uncertainty.

6 MHP Canada believes that merchant storage development entails unique and significant  
7 risks, particularly when compared to pipeline development. Geology, cushion or base gas and  
8 project development risks present a unique challenge to merchant storage developers in  
9 achieving desired rates of return.

### 3. REGULATORY POLICY AND STABILITY

10 MHP Canada believes that the Board should adopt clear policies and standards that  
11 encourage, not restrict, the efficient expansion of natural gas storage capacity in Ontario.  
12 Regulators and policy makers in other jurisdictions have recognized the need to reform policy  
13 to encourage the development of critically needed storage.

14 The United States Congress has recently recognized the pressing need for incremental  
15 storage capacity and suggested to the Federal Energy Regulatory Commission (“FERC”) that  
16 the present regulatory scheme falls short of adequately addressing this need.<sup>2</sup> In response to  
17 this direction from Congress, the FERC has commenced a process whereby industry  
18 participants and interested parties can comment on rulemaking changes for reforms that would  
19 encourage development of natural gas storage, particularly storage that is located in market  
20 areas:<sup>3</sup>

21 *Taken together, the intent of these reforms is to facilitate the expansion of gas*  
22 *storage capacity to, among other things, mitigate natural gas price volatility,*  
23 *while continuing to protect consumers from the exercise of market power.<sup>4</sup>*

24 The FERC policy review seeks to achieve these reforms, in part, through a more liberal  
25 authorization of market-based rates. As a general matter, the FERC favours customer

---

<sup>2</sup> Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005)

<sup>3</sup> *Rate Regulation of Certain Underground Storage Facilities*, “Notice of Proposed Rulemaking”, FERC Stats. & Regs. 113 FERC \*\* 61,306 (2005) (“FERC NOPR”)

<sup>4</sup> FERC NOPR, at p. 3

1 protections that are clear, easy to implement and oversee, and provide certainty to an applicant  
2 sufficient to support financing of a storage project.<sup>5</sup> More storage, not less, is a key objective of  
3 this initiative.

4 MHP Canada believes that the drivers for policy change in the United States apply equally to  
5 the Ontario market. Current regulatory policy could do more to facilitate the development of  
6 new storage capacity. A clear and stable market-priced regulatory regime will enhance  
7 liquidity, choice and reliability. That regulatory structure should focus on the continued  
8 development of competitive markets as the best protection of the public against the potential  
9 exercise of market power and to encourage the development of new infrastructure.

10 The market is best positioned to determine the timing, location and size of additional storage  
11 capacity. Accurate price signals to prospective storage developers are required to ensure  
12 facilities are efficiently developed. MHP Canada supports the findings of the CEA Evidence  
13 that market-based pricing will send clear signals to storage developers and suppliers of products  
14 and services that may substitute for storage capacity. Investors, storage developers and other  
15 market participants will require the Board's assurance of a stable regulatory environment based  
16 upon market-pricing.

17 That stable and efficient regulatory framework can be established through the following:

- 18 ♦ Effective monitoring of the market, including investigating alleged market  
19 power abuse, to ensure that the public interest is protected through the Board's  
20 existing reporting requirements and an effective complaint process to address  
21 individual concerns.
- 22 ♦ Allowing flexibility to contract for service without requiring Board approval of  
23 individual storage service contracts, provided that storage operators operate  
24 within a base set of terms and conditions approved by the Board.
- 25 ♦ Future review of market-based rate authorization should be limited to a review  
26 of mitigation measures necessary to protect the public rather than a repeal of  
27 market-based rate authority.

28 MHP Canada will be entering into agreements that are commercially sensitive in nature.  
29 Public disclosure of an individual agreement could cause significant commercial harm to MHP  
30 Canada and its customers. Should the Board require that individual storage services contracts

---

<sup>5</sup> FERC NOPR, at p. 26

1 be filed, MHP Canada submits that such contracts should be filed with the Board in confidence  
2 pursuant to Rule 13 of the Board’s *Rules of Practice and Procedure*. In addition, if necessary,  
3 MHP Canada could provide the Board, on an annual basis, with affidavits confirming that all  
4 storage services provided by MHP Canada are in compliance with Board approved structures.

5 As contemplated in the NGF Report, filing guidelines for storage development projects  
6 should be established by the Board with an expanded scope to include all merchant storage  
7 developers.

#### 4. MARKET NEED AND OPPORTUNITY

8 As noted in the CEA Evidence, there is little debate that storage expansion is necessary to  
9 efficiently serve growing natural gas demand in eastern Canada and the U.S. Northeast markets.

10 In the NGF Report, the Board observed that the following three recent developments put  
11 storage and transportation on the NGF agenda: (i) growth in gas-fired power generation<sup>6</sup>;  
12 (ii) higher natural gas prices and greater price volatility; and (iii) changing structure for natural  
13 gas demand.<sup>7</sup> After reviewing each of these developments, the Board concluded:

14 *Taken together, these factors point to an increasing demand for Ontario’s*  
15 *existing storage capacity, and a probable need for investment in storage*  
16 *capacity, deliverability and transportation.*<sup>8</sup>

17 The Board went on to discuss five of its legislated objectives of particular relevance to the  
18 NGF agenda: (i) to facilitate competition in the sale of gas to users; (ii) to protect the interests  
19 of consumers with respect to prices and the reliability and quality of gas service; (iii) to  
20 facilitate rational expansion of transmission and distribution systems; (iv) to facilitate rational  
21 development and safe operation of gas storage; and (v) to facilitate the maintenance of a  
22 financially viable gas industry for the transmission, distribution and storage of gas.<sup>9</sup>

23 MHP Canada considers market area storage in the Dawn-Michigan region to be well-  
24 positioned to meet this growing storage demand. There is an immediate and continuing need

---

<sup>6</sup> In the NGF, the Board noted that “*Power generators explained that they will be looking for additional storage, and will want to draw on it much more frequently than traditional gas customers.*”, NGF Report, at p. 52.

<sup>7</sup> NGF Report, at pp. 38-40.

<sup>8</sup> NGF Report, at p. 40.

<sup>9</sup> NGF Report, at p. 45.

1 for the development of incremental storage capacity in Ontario. The market area continues to  
2 evolve as supply options mature, considering the imminent introduction of additional LNG  
3 supplies to Northeastern markets and new gas supply from the U.S. Rockies and Northwest  
4 frontier, and as natural gas consumption increases, such that additional storage is required to  
5 support incorporation of these volumes into gas supply portfolios. This will offer continuing  
6 liquidity at the Dawn Hub, and Ontario customers will be better off if more storage  
7 infrastructure is built in Ontario. MHP Canada believes that the market will continue to  
8 develop and offer integrated services to meet increasing demand.

## 5. MHP CANADA SERVICES

### 9 **Dawn Storage Services at Market-Based Rates**

10 MHP Canada intends to participate in the natural gas storage market as a merchant storage  
11 operator by offering Dawn-based services at market-based rates. MHP Canada's storage  
12 services will include firm and interruptible storage capacity and deliverability, and parking and  
13 loan services offered on an open-access basis.

14 Merchant storage operators offer storage services at market-based rates. Unlike utility-based  
15 cost-of-service storage activities, a merchant storage operator accepts the development,  
16 operation and marketing risks such that return on capital is at risk to the market rather than  
17 recovered from franchise customers. Merchant storage operators are not monopoly storage  
18 service providers with captive customers.

19 While MHP Canada is targeting wholesale customers, its storage services will be available  
20 to all buyers, such as regulated utilities, gas marketers, large end-use customers, shippers,  
21 brokers and producers in Canada and the United States through open season processes or  
22 through negotiated rates. Individual storage services contracts will be evaluated to maximize  
23 return and minimize market risk based on term, capacity and deliverability requirements and  
24 price. MHP Canada does not plan to actively participate in commodity trading, except to the  
25 extent MHP Canada may need to hold title to gas as required to operate its storage facilities.

26 If the Board implements Forbearance, then MHP Canada will not require an approved rate  
27 schedule in addition to its standard terms and conditions. Short of Forbearance, MHP Canada

1 proposes the use of market-based rates for its storage services, including a rate for combined  
2 space and interruptible deliverability as well as a rate for firm deliverability. MHP Canada  
3 proposes that regardless of services provided, the resulting revenue divided by the space  
4 quantity under contract must yield an average annual rate that does not exceed the maximum  
5 rate. The proposed market-based rates would apply to any customer who enters into an  
6 agreement for storage services with MHP Canada. The market-based rates would be applied in  
7 any combination of monthly demand charge, injection and/or withdrawal charge and take-or-  
8 pay.

9 In its St. Clair Pool filing, MHP Canada adopted a separate rate range for its services,  
10 although this range was based on the Union Gas Limited (“Union Gas”) C1 rates for non-  
11 franchise customers (utilized by Union Gas as per Rate Order EB-2001-0788 (EB-2005-0232  
12 (February 2005))). MHP Canada understands that Union Gas is seeking approval from the  
13 Board for changes to the C1 rate schedule as part of the 2007 Union Gas rate case (EB-2005-  
14 520). Should Union Gas's C1 rate range be increased in the future, MHP Canada would expect  
15 to operate under a similar range. As such, short of Forbearance, MHP Canada proposes to  
16 simply base its rate range on the Union Gas C1 rate schedule, as it may exist from time to time.  
17 MHP Canada notes that this proposal is consistent with the Board's approval of Tribute  
18 Resources' proposal to adopt the Union Gas C1 rate schedule for gas storage services that  
19 Tribute Resources proposes to market.

## 20 **Transportation**

21 Currently proposed MHP Canada projects require transportation services on the Union Gas  
22 storage and transmission network to offer a Dawn-based service. MHP Canada plans to  
23 transport injection and withdrawal volumes on the integrated Union Gas storage and  
24 transmission system through an M16 transportation agreement and an associated Hub Services  
25 Agreement. While the currently proposed facilities will connect with an affiliate pipeline, this  
26 will not necessarily be the case for future MHP Canada developments, which may require  
27 transportation services from other providers serving the Ontario market, and the Dawn Hub in  
28 particular. In any event, the Union Gas transportation tariff and rates are actively regulated by  
29 the Board, ensuring no undue preference or cross-subsidization in the provision of the  
30 monopoly transmission service. This will also serve to ensure MHP Canada's ability to

1 compete for the gas-fired power generation market on a level playing field with Union Gas,  
2 Enbridge Gas Distribution and independent storage developers.

3 MHP Canada recommends that the Board continue to review transportation services and  
4 associated terms and rates to ensure that merchant storage operators have the ability to compete  
5 for the gas-fired power market, and other markets, on a non-discriminatory basis.

## 6 **Affiliate Issues**

7 While MHP Canada is affiliated with Union Gas, MHP Canada will independently market  
8 its storage services. Any issues arising from MHP Canada's affiliation with Union Gas are  
9 adequately addressed by existing Board protocols governing affiliate behaviour.

10 MHP Canada manages its affiliate relationships in the spirit of the Board Affiliate  
11 Relationships Code for Gas Utilities (the "ARC"), revised on December 9, 2004, with effect  
12 June 9, 2005. The ARC is in place to ensure that regulated utilities do not provide preferential  
13 treatment to their affiliates relative to other competitors. MHP Canada understands that Union  
14 Gas communicates the requirements of the ARC to its employees on an annual basis. MHP  
15 Canada has established Master Services Agreements and Service Agreements with Union Gas  
16 and other affiliated companies. MHP Canada monitors its inter-company transactions, resolves  
17 issues identified, and ensures MHP Canada compliance with the ARC.

18 Neither DEGT nor Union Gas will provide storage marketing or commercially sensitive  
19 services to MHP Canada. MHP Canada will be responsible for marketing its own storage  
20 services. This will include developing customer intelligence, conducting open seasons,  
21 contracting for storage services, developing working relationships with customers, optimizing  
22 the value of MHP Canada storage assets, monitoring activity under current contracts and  
23 achieving revenue targets. MHP Canada will only share necessary information with DEGT,  
24 and/or Union Gas, in order to: secure regulated gas transportation and related services; fulfill  
25 Service Agreements for activities such as capacity planning, gas management services and gas  
26 control; and in compliance with the ARC. MHP Canada expects that Union Gas will provide  
27 specific system design and operation information necessary to complete the commercial  
28 agreements required for MHP Canada to interconnect to the Union Gas system. As noted  
29 previously, MHP Canada plans to market its storage services to all potential buyers, such as

1 regulated utilities, gas marketers, large end-use customers, shippers, brokers and producers in  
2 Canada and the United States.

3 MHP Canada believes it to be unnecessary, therefore, to impose restrictions on MHP  
4 Canada, on the basis of its affiliation with a regulated utility and transmission service provider,  
5 any more onerous than the conditions placed on other competitive service providers and  
6 respectfully submits that there is no reasoned basis to deny MHP Canada market-based rate  
7 authority. Any concerns with preferential access or cross-subsidization are adequately  
8 addressed by existing Board directives, including the requirement to comply with the ARC.

9 As noted in the CEA Evidence, the addition of the proposed MHP Canada storage capacity  
10 at market-based rates to the Ontario market will not lessen competition or prejudice the public  
11 interest. MHP Canada simply seeks to compete on the same terms in the same market. Indeed,  
12 MHP Canada believes that since competition in the market already exists and policy is in place  
13 regarding the provision of storage at market-based rates there is no need to use regulation to  
14 proxy competition in the storage service market.

## **6. MARKET POWER ANALYSIS**

15 MHP Canada commissioned CEA to conduct an assessment of market power for the  
16 projected 10 Bcf of working gas capacity that MHP Canada plans to have available in Ontario  
17 by 2010. CEA had previously been commissioned by MHP Canada to prepare a market power  
18 assessment for the St. Clair Pool, which was filed with MHP Canada's application as part of  
19 RP-2005-0019. The attached CEA Evidence supersedes the earlier filing.

20 MHP Canada agrees with CEA's conclusion that MHP Canada is a relatively small market  
21 participant that lacks the ability to exercise market power and influence storage prices by  
22 withholding capacity, even when the MHP Canada capacity is combined with the affiliate  
23 DEGT capacity in a conservatively defined geographical market.

## 7. MARKET-BASED RATES

### 1 **Economic Reward Matched to Development Risk**

2 MHP Canada intends to be a merchant storage operator providing services at market-based  
3 rates. Market-based rates are determined by the mutual decisions of many buyers and sellers in  
4 a competitive market.

5 Market-based pricing differs from cost-of-service based rates, where a regulatory body  
6 reviews various cost inputs, adds a return and then sets rates and cost recovery systems to  
7 recover the approved cost of service and a regulated return-on-investment. Cost-of-service  
8 rates are typically designed on the basis of an annual working gas cycle and do not reflect the  
9 actual and fluctuating market value of storage.

10 Southwestern Ontario offers the necessary attributes for the development of underground  
11 natural gas storage and the conduct of merchant storage operations. However, the future  
12 development of new gas storage infrastructure will depend upon acceptable financial rewards  
13 relative to development and market risk. For merchant storage operators, return on capital is  
14 wholly at risk to the market. Across North America, merchant storage developers have been  
15 unwilling to invest in projects under traditional cost-based rate design.

16 As the FERC noted:

17 *For storage services used on a short-term or spot basis, cost-of-service rates*  
18 *designed on the basis of an annual working gas cycle may not match up with the*  
19 *market value of storage service during transient periods of peak*  
20 *demand...Storage services used on a short-term or spot basis often do not*  
21 *exhibit the higher level of demand assumed by cost-of-service design.*  
22 *Permitting storage operators to earn higher revenues from short-term services*  
23 *during peak demand periods or through other pricing mechanisms may make an*  
24 *investment in the project economically feasible.*<sup>10</sup>

25 Cost-of-service rates do not provide the necessary flexibility to capture the true value of  
26 storage services and do not compensate for the risk of developing storage. This conclusion is  
27 borne out by the experience in the United States that led Congress to suggest there is a need to  
28 revise the current regulatory regime in order to encourage the development of incremental

---

<sup>10</sup> FERC NOPR, at p. 10.



1 storage capacity. In contrast to cost-of-service rates, market-based rates allow the flexibility to  
2 obtain a rate of return based on the true value of storage and will encourage development where  
3 storage is needed or valued most. Market-based rates also send accurate signals to suppliers of  
4 services or products which substitute for physical storage.

5 The Board, in its recent initiatives endorsing market-based rates for independent storage  
6 operators, has also recognized that utility rates of return on equity do not adequately  
7 compensate storage developers for the risks of their investment. In EB-2003-0314/0317, the  
8 Board approved market-based rates for Tribute Resources with respect to a similarly situated  
9 independent development of storage assets and services. In the NGF Report, the Board  
10 determined it would allow market-based rates for all independent storage operators:

11 *The Board has concluded that it will not fix COS rates for new storage*  
12 *developed by independent storage operators – that is, those storage operators*  
13 *that have no affiliation with gas distributors or transmitters. Stakeholders*  
14 *offered widespread support for this approach. The storage proceedings will*  
15 *therefore focus on storage as it relates to storage operators that are affiliated*  
16 *with distributors and transmitters.*<sup>11</sup>

17 The Board also reaffirmed its position to allow ex-franchise utility storage to be priced at  
18 market-based rates.<sup>12</sup>

19 While market-based rates foster competition in the marketplace, they are, by definition, still  
20 constrained by the marketplace, ensuring that rates are not unjust or unreasonable. As the  
21 FERC noted:

22 *Since the new project's owners assume all market risk and have no captive*  
23 *customers to pass costs on to, they must successfully sell storage in order to*  
24 *cover fixed costs and try to make a profit. Under this theory, customers can*  
25 *always choose to not use the new project and act as they would if the project*  
26 *had not been built. As a result, project sponsors must price their services at*  
27 *rates that are low enough to attract customers. That is, customers are better*  
28 *off paying the market-based rates that they would have been if the project had*  
29 *not been built.*<sup>13</sup>

---

<sup>11</sup> NGF Report, at p. 50.

<sup>12</sup> NGF Report, at p. 41.

<sup>13</sup> Current State Of and Issues Concerning Underground Natural Gas Storage, FERC Staff Report, September 30, 2004, at p. 30.

## 8. CONCLUSION

1 MHP Canada supports the “Proposed OEB Findings and Policy Recommendations” outlined  
2 in the CEA Evidence. MHP Canada agrees with CEA that relatively small market participants  
3 such as MHP Canada lack the ability to exercise market power and influence storage pricing by  
4 withholding capacity. Adding MHP Canada’s proposed storage capacity to that for which  
5 market-based rates have already been authorized, only increases customer choice, providing  
6 further protection to the public against the potential for market abuse.

7 MHP Canada notes that the Board appears to have concluded that market-based rates for a  
8 large portion of the Ontario storage market are sufficient to protect the public interest from the  
9 exercise of market power. It would appear that the Board can refrain from regulation of gas  
10 storage services in the knowledge that market forces will protect against the potential for  
11 market abuse.

12 Short of Forbearance, however, MHP submits that the workably competitive nature of the  
13 Ontario storage market combined with the protections afforded by the existing affiliate  
14 protocols fully justify granting market-based rate authority and the contracting flexibility  
15 necessary for MHP Canada to develop its storage prospects thereby enhancing choice,  
16 reliability and liquidity in the Ontario market.

17 A number of issues specific to storage developers with utility affiliates were raised during  
18 the St. Clair Pool interrogatory process and through Board comments made in the NGF Report.  
19 As indicated when MHP Canada suspended the St. Clair Pool application in September 2005,  
20 these issues require resolution through the Storage Regulation Review to permit MHP Canada  
21 to proceed with its plans to bring its storage services to market. In order to meet its target of  
22 bringing new storage capacity to the Ontario market by 2007, via the St. Clair Pool, a decision  
23 on the Core Points is required no later than August 2006. As such, MHP Canada respectfully  
24 requests that the Board issue an expedited decision on this issue. This could be by way of a  
25 decision with reasons to follow.