Schuch

~~H2~~

HD2.1

Ontario Energy Board

Commission de l'Énergie de l'Ontario

VT INCEPIT FIDELIS SIC PERMANET

Ontario

EB-2005-0551

NATURAL GAS ELECTRICITY INTERFACE REVIEW

DECISION WITH REASONS

November 7, 2006

With respect to APPrO's position, the Board is not convinced that high deliverability storage service is a different product. High deliverability storage may be a new service, but it is a particular way of using physical storage, which still depends upon the physical parameters of working capacity and deliverability. The Board provides a more detailed consideration of the pricing of high deliverability storage service later in this decision.

3.5 IDENTIFICATION OF THE GEOGRAPHIC MARKET

The geographic market is the area from which suppliers compete effectively for the business of a given group of customers. In the case of gas storage, this amounts to examining whether the market is restricted to Ontario or whether it should be more broadly drawn.

The utilities, their affiliates and Nexen argued for a larger geographic market, one which includes storage in Michigan and parts of Illinois, Indiana, New York and Pennsylvania. The consumer intervenors argued for a geographic market limited to Ontario. The issue centred on whether transportation constraints close off access to storage outside Ontario and included discussion of the secondary market.

Both Ms. McConihe and Mr. Stauft concluded that the storage market was limited to Ontario because there is limited firm uncontracted pipeline capacity joining Ontario to other markets and that, therefore, storage in other areas (such as Michigan) is not a substitute and not part of the same market.

EEA/Schwindt presented a seasonal price analysis and a price correlation analysis in support of a geographic market that includes Ontario, Michigan, northern Illinois, northern Indiana, and the Natural Fuel Gas territory in western New York and Pennsylvania. Energy Probe supported this analysis.

For the price correlation analysis, EEA/Schwindt presented correlation coefficients of daily gas commodity prices at nine North American trading hubs with the daily commodity price at Dawn. Results were presented for several different time periods, and the full sample covers the period 1999 through August 2005. With two exceptions, the correlation coefficients are above 0.99.

For the seasonal price analysis, EEA/Schwindt examined differentials in the marginal value of storage approximated by the differential between the peak (winter) and off-peak (summer) prices. If storage providers at a particular market hub are exercising market power this differential should be greater than at other pricing hubs, but if there are no transportation constraints, then geographic arbitrage will make it impossible to exercise market power in this way. The EEA/Schwindt evidence on these seasonal differentials revealed little or no systematic variation between different pricing locations and in their view supported a conclusion of a broader geographic market.

The consumer intervenors acknowledged that the commodity market is highly integrated but argued that does not lead to the conclusion that the storage market is integrated. The Vulnerable Energy Consumers Coalition (VECC) and Canadian Manufacturers and Exporters (CME) argued that the price correlation analysis has never been accepted by the FERC. Union responded that the FERC rejected the use of the price correlation analysis as a means of demonstrating a lack of market power but that in this case it is being used as a means of defining the scope of the market.

Enbridge pointed out that it is clear that Dawn is physically connected to storage in Michigan and elsewhere through extensive pipeline interconnections. In the utilities' view, the secondary market provides adequate access to substitute storage facilities. They pointed to the evidence of GMi and BP Canada (BP) as being actual market participants who consider, and at times use, these alternative means.

The Board Hearing Team argued a similar position. In its view, the evidence – in particular that of GMi and BP – supports the conclusion that there are adequate substitutes for Ontario storage in the primary and secondary market. The Board

Hearing Team pointed to the MEGs standard and its reference to buyer behaviour and cited the evidence that marketers and utilities do purchase alternative services in Michigan and New York – and that these alternatives are not necessarily more expensive.

Board Findings

Ms. McConihe's conclusion that the market is restricted to Ontario was based on a survey of available firm primary pipeline capacity. This survey concluded that most of the pipeline capacity was under contract. Union and others argued that this is not surprising since pipelines are generally not built or expanded unless there are firm contracts to support the development. They argued that Ms. McConihe failed to understand the secondary market. As Mr. Reed on behalf MHP Canada stated, the existence of pipeline capacity is what is important in terms of integrating markets – not the availability of unsubscribed firm capacity.

There is no significant amount of uncontracted firm capacity to access other storage areas. However, there is strong evidence that the market does view Michigan and other areas as viable alternatives to storage provided by Union.

Ms. McConihe acknowledged the existence and likely significance of the secondary market, but expressed concern that it could not be quantified. While there may not be sufficient transaction level data about total secondary market activity, we certainly have evidence which supports the conclusion that the secondary market is relatively deep and liquid and that the market extends beyond just Ontario. Enbridge referred to this anecdotal evidence as "real-world examples of competitive alternatives". That evidence includes:

- GMi's evidence regarding its assessment of alternatives and the growth of the secondary market;

- the purchases of storage in Michigan and New York by Ontario utilities and marketers;
- the depth and liquidity of the Dawn Hub (as evidenced by the fact that traded volumes far surpass physical volumes);
- BP's evidence regarding its use of storage in Ontario, Michigan and the upper Midwest to offer services in Ontario and its evidence that at least one Union storage customer had switched to BP as a supplier for part of its storage needs;
- BP's evidence regarding its provision of services including swaps, exchanges, park and loans, delivery and re-delivery;
- Enbridge's RFP results included at least response from outside Ontario
- the evidence as to the significant holdings of storage and pipeline capacity by marketers generally;
- open seasons for new capacity on pipelines and for storage.

The Board concludes that the geographic market extends beyond Ontario, even though there is a lack of uncontracted firm pipeline capacity. The Board is satisfied that there are reasonable alternative means for storage customers in Ontario to access a broad market area. This can be done through the secondary markets or through participating in open seasons for new firm capacity. The Board is also satisfied that there is access to suitable substitutes for Ontario storage available in the broader market because there is direct evidence that the alternatives are considered and are being used.

The Board finds that the price correlation analysis, while not in and of itself determinative of this issue, supports this conclusion. The very high level of these correlations, combined with the other evidence about the advanced state of inter-hub trading and the absence of occurrences of "basis blow-outs"[32] at individual hubs, supports the conclusion that the market is highly integrated. The Board also finds that

[32] "Basis blowout" was described by Mr. Henning as "a description of the market conditions whereby the value, market value, of the pipeline services exceeds the maximum regulated costs". (Tr. 4, p. 27)

the seasonal price analysis supports the conclusion that storage facilities outside Ontario are part of the same market.

For these reasons, the Board agrees with EEA/Schwindt and concludes that the geographic market includes Ontario, Michigan, northern Illinois, northern Indiana, and the National Fuel Gas territory in western New York and Pennsylvania.

3.6 CALCULATION OF MARKET CONCENTRATION AND MARKET SHARE

The identification of geographic market and product market boundaries allows the calculation of measures of market concentration, both corresponding to individual firms (market share) and measures of concentration for the market as a whole, such as the HHI index. The former gives an indication of the potential for a single firm to exercise market power, whereas the latter is an overall indicator of how competitive the market is likely to be.

Board Findings

Before any calculations are made, an appropriate volumetric measure must first be selected to quantify the capacity of a storage facility. Subject to the availability of data, any of the following measures can be used: working gas capacity, injection capacity, deliverability, or capacity available to third parties. The last of these measures, capacity available to third parties, captures storage that is directly available to the competitive marketplace. However, there is clear evidence of market-based transactions taking place from what is otherwise considered dedicated storage capacity. Therefore, the Board concludes that it is reasonable to use the measures of working gas capacity and maximum daily deliverability. Market share data using these measures were provided by EEA/Schwindt.

The Board has found that the geographic market includes Ontario, Michigan, northern Illinois, northern Indiana, and National Fuel Gas in western New York and