

UNITED STATES OF AMERICA 115 FERC ¶61,343
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 284

(Docket Nos. RM05-23-000, AD04-11-000; Order No. 678)

Rate Regulation of Certain Natural Gas Storage Facilities

(Issued June 19, 2006)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final Rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is amending its regulations to establish criteria for obtaining market-based rates for storage services offered under Part 284. First, the Commission is modifying its market-power analysis to better reflect the competitive alternatives to storage. Second, pursuant to the Energy Policy Act of 2005, the Commission is promulgating rules to implement new section 4(f) of the Natural Gas Act, to permit underground natural gas storage service providers that are unable to show that they lack market power to negotiate market-based rates in circumstances where market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services, and where customers are adequately protected. These revisions are intended to facilitate the development of new natural gas storage capacity while protecting customers.

EFFECTIVE DATE: The rule will become effective [insert date 30 days after publication in the **FEDERAL REGISTER**].

FOR FURTHER INFORMATION CONTACT:

Sandra Delude
Office of the General Counsel
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426
(202) 502-8583

Robert McLean
Office of General Counsel
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426
(202) 502-8156

Ed Murrell
Office of Energy Markets and Reliability
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426
(202) 502-8703

Berne Mosley
Office of Energy Projects
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426
(202) 502-8625

SUPPLEMENTARY INFORMATION:

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Rate Regulation of Certain Natural Gas
Storage Facilities

Docket Nos. RM05-23-000
AD04-11-000

ORDER NO. 678

FINAL RULE

(Issued June 19, 2006)

I. Introduction

1. The Final Rule reforms the Commission's current pricing policies to ensure access to storage services on a nondiscriminatory basis at just and reasonable rates and to ensure that sufficient storage capacity will be available to meet anticipated increases in market demand. To achieve these goals, the Commission is modifying its market-power analysis to permit the consideration of close substitutes to storage in defining the relevant product market. This will ensure that market-based rates are not denied because of an overly narrow definition of the relevant market. Second, the Commission is adopting regulations implementing section 312 of the Energy Policy Act of 2005 (EPAct 2005 or the Act),¹ which permits the Commission, in appropriate circumstances, to authorize storage providers to charge market-based rates for service utilizing new capacity even

¹ Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

when the storage providers cannot (or do not) demonstrate that they lack market power.

The revisions adopted in the Final Rule are intended to facilitate the development of new natural gas storage capacity while protecting customers.

II. Background

2. On August 8, 2005, EPAct 2005 was signed into law. Section 312 of the Act, adding a new section 4(f) to the Natural Gas Act (NGA),² permits the Commission to allow a natural gas storage service provider placing new facilities in service to negotiate market-based rates even if it is unable to show that it lacks market power if the Commission determines that market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services, and that customers are adequately protected.³

3. The enactment of EPAct 2005 added momentum to efforts already underway at the Commission to adopt policy reforms that would encourage the development of new natural gas storage facilities while continuing to protect consumers from the exercise of market power. On September 30, 2004, the Commission issued a staff report that examined underground natural gas storage.⁴ On October 21, 2004, the Commission held a public conference with representatives of the industry to discuss the Staff Storage

² 15 U.S.C. 717, et seq. (2000).

³ Energy Policy Act of 2005, Pub. L. No. 109-58, section 312, 119 Stat. 594, 688 (2005).

⁴ Current State of and Issues Concerning Underground Natural Gas Storage, FERC Staff Report, Docket No. AD04-11-000 (Sept. 30, 2004) (Staff Storage Report).

Report and issues relevant to underground storage.⁵ The Commission received oral and written comments in connection with the Staff Storage Report and conference.

4. On December 22, 2005, the Commission issued a notice of proposed rulemaking (NOPR) in which it proposed a two-prong approach for reforming its current storage pricing policy.⁶ First, the Commission proposed modifications to its traditional market-power analysis to permit the consideration of close substitutes to storage in defining the relevant product market. Second, the Commission proposed regulations to implement section 312 of EAct 2005 that permits the Commission, in appropriate circumstances, to authorize storage providers to charge market-based rates for service utilizing new

⁵ State of the Natural Gas Industry Conference, Docket No. PL04-17-000, October 21, 2004; see State of Natural Gas Industry Conference; Staff Report on Natural Gas Storage; Notice of Public Conference, 69 FR 59917 (Oct. 6, 2004) (summarizing the issues to be discussed at the conference).

⁶ Rate Regulation of Certain Underground Storage Facilities, Notice of Proposed Rulemaking, 70 FR 77079 (Dec. 22, 2005), FERC Stats. & Regs., Regulations Preambles ¶ 32,595 (Dec. 29, 2005).

capacity even when the storage providers cannot (or do not) demonstrate that they lack market power.

5. The Commission received numerous comments from a variety of entities.⁷ Based on careful consideration of the comments submitted in response to the NOPR, the Commission adopts a Final Rule that generally follows the approach of the NOPR with certain exceptions.

6. First, the Final Rule modifies the Commission's market-power analysis to better reflect the competitive alternatives to storage. Specifically, we adopt a more expansive definition of the relevant product market for storage to explicitly include close substitutes for gas storage services, including pipeline capacity, local production, and liquefied natural gas (LNG) supplies. The Commission will evaluate potential substitutes in the context of individual applications for market-based rates. The Final Rule eliminates the NOPR's requirement that storage providers granted market-based rates on the basis of a market power analysis file updated market-power analyses every five-years. Instead, storage providers with market shares of ten percent or less would generally be exempt from such a requirement. We will consider in individual cases whether the specific facts and circumstances presented require additional reporting for other storage providers.

7. Second, the Final Rule adopts regulations implementing section 312 of EPCA 2005, which permits the Commission to authorize market-based rates even if a lack of

⁷ A list of the commentors is included as an appendix to this Final Rule. We have not considered the supplemental reply comments filed by INGAA on May 31, 2006, due to the lateness of the filing.

market power has not been demonstrated, in circumstances where market-based rates are in the public interest and necessary to encourage the construction of storage capacity in the area needing storage services and that customer are adequately protected. Finding that the definition of facilities eligible for treatment under new NGA section 4(f) is ambiguous, the Commission defines “facilities” as it traditionally has for purposes of the certification requirements of section 7(c). However, to receive market-based rate authorization, the storage provider will still need to satisfy the other requirements of section 4(f).

III. Need and Purpose for the Rule

8. The underground storage of natural gas is critical in assuring that overall demands and specific requirements of natural gas customers are met. Currently, there are approximately 200 storage facilities subject to the Commission’s jurisdiction, with an aggregate working gas capacity of approximately 2.5 Tcf. Estimates of total domestic working gas capacity (both subject to and exempt from NGA jurisdiction) range up to 4.7 Tcf.⁸ Considering future storage needs of the United States and Canada together, the National Petroleum Council (NPC) estimates an additional 700 Bcf will be required by

⁸ The Department of Energy’s Energy Information Administration (EIA) reports that in 2002 working gas storage capacity varied between 4.4 and 4.7 Tcf, whereas the Department of Energy’s Office of Fossil Energy reports that in 2003 there were 415 underground storage facilities with a working gas capacity of 3.9 Tcf. The Staff Storage Report considered the range of estimated aggregate existing working gas and concluded that the present working gas capacity is 3.5 Tcf, of which 2.5 Tcf is subject to NGA jurisdiction, and that by improving existing storage reservoirs (*i.e.*, by reengineering existing facilities to enhance efficiency, rather than by expanding cavern capacity), there is the potential to obtain another 200 to 500 Bcf. See Staff Storage Report at 7-10.

2025.⁹ Although current and projected storage development is keeping pace with aggregate national storage demands, underground storage development in some market areas, such as New England¹⁰ and the Southwest, is not.¹¹

9. Over the last several years, there has been a marked increase in the cost of natural gas and sharp swings in gas prices. Storage can have a moderating influence on gas prices. As a physical hedge, customers can build up underground inventories during times of lower demand, and then rely on these supply stores to avoid paying high spot market gas prices. Among the key findings highlighted by the Staff Storage Report is that the “continued commodity price volatility indicates that more storage may be appropriate” and that storage “may be the best way of managing gas commodity price, so

the long-term adequacy of storage investment depends on how much price volatility customers consider ‘acceptable.’”¹²

10. In consideration of these factors, the Commission is amending its regulatory policies in the Final Rule in order to facilitate the development of new natural gas storage

⁹ Balancing Natural Gas Policy – Fueling the Demands of a Growing Economy, NPC, Volume II at 261 (2003).

¹⁰ New England appears to have little geologic potential for the development of underground storage facilities.

¹¹ See, e.g., Southwestern Gas Storage Technical Conference, Docket No. AD03-11-000, Transcript at 23, lines 10-14 (Aug. 26, 2003).

¹² Staff Storage Report, at 1 (Sept. 30, 2004).

capacity to ensure that adequate storage capacity will be available to meet anticipated market demand and to mitigate natural gas price volatility, while continuing to protect consumers from the exercise of market power.

IV. Discussion

A. Market-Power Test

11. The Commission evaluates requests to charge market-based rates for storage services under the analytical framework of its 1996 Policy Statement on Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines (Policy Statement).¹³ In the NOPR, the Commission observed that in applying its market-concentration and market-share screens in these cases to date, the Commission has looked only to the availability of other storage alternatives (in the relevant geographic market), in assessing whether a storage provider can exercise significant market power. Noting that its current approach to analyzing market power may be too limiting in some circumstances in today's natural gas markets, the Commission proposed to reform its market-power test for natural gas storage operators to more accurately reflect the competitive conditions in the market for gas storage services. The Commission proposed to adopt a more expansive definition of the relevant product market for storage to explicitly include close substitutes for gas

¹³ Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 74 FERC ¶ 61,076 (1996), reh'g and clarification denied, 75 FERC ¶ 61,024 (1996), petitions denied and dismissed, Burlington Resources Oil & Gas Co. v. FERC, 172 F.3d 918 (D.C. Cir. 1998).

storage service, such as appropriate combinations of available pipeline capacity, and local gas production or LNG terminals, on a case-by-case basis in the context of individual applications for market-based rates. We posited that consideration of these alternative products will ensure that the Commission's market-power analysis accurately reflects whether a storage applicant is able to exercise significant market power.

12. We explained that, as a general matter, competition to a storage provider can come from entities that have the ability to deliver gas in the same market as the storage facility. In producing areas, storage may compete with production or LNG supply, in addition to other storage facilities. In market areas, there may also be local production or LNG available. In addition, available pipeline capacity can function as a close substitute by delivering gas at peak times to compete with storage. For these reasons, we suggested it would be appropriate to permit applicants to present evidence that both available pipeline capacity and local production/LNG supply in the geographic market area can reasonably be considered as alternative products to storage services.

13. In addition, we suggested that firm capacity available through capacity release can be a good alternative in appropriate circumstances. Under the Commission's capacity release regulations, holders of firm capacity are free to release the capacity to other shippers, as well as to make bundled sales at alternate delivery points. Because of this flexibility, some portion of firm, contracted-for capacity may have a sufficiently elastic demand (a willingness to re-sell firm capacity when price rises) to serve as a good

alternative to an applicant's storage service. While pipeline capacity held by a local distribution company (LDC) that is needed to meet state-mandated service obligations for captive retail customers may not be considered a good alternative during peak periods, LDCs and marketers also serve industrial and other customers under interruptible contracts. That portion of the LDC's capacity might constitute a reasonable alternative.

14. Moreover, we stated that, in some circumstances, an applicant may be able to show that even when firm capacity on a pipeline is reserved for captive customers, e.g., residential and small commercial customers, potential product or service substitution in downstream markets might result in capacity becoming available in upstream markets to compete with storage while captive customers continued to be served. Under the Commission's open-access program, competition in a downstream market may create competition in upstream markets, particularly due to Order No. 636's requirement that pipelines provide flexible receipt and delivery points and segmentation including backhaul. Thus, an LDC's ability to buy capacity from another pipeline or storage facility or to purchase gas in the downstream market may free it to release upstream capacity to compete with storage in the upstream market. This ability to buy capacity from another pipeline or storage facility or to buy gas in the market area is present in the large downstream markets in the United States including California, Chicago and the Northeast.

15. The Commission requested comments on these alternatives, as well as suggestions regarding other approaches for quantifying the amount of pipeline capacity that might be

available to compete with an applicant's storage services.

1. Expansion of the Product Market Definition

Comments

16. A number of commentors generally support the Commission's proposal to liberalize the Commission's market-power test for market-based rate authorization by expanding the kinds of storage alternatives that it will consider in analyzing an applicant's market power with certain proposed changes discussed below.¹⁴ They agree with the Commission that available pipeline capacity, capacity release, local gas production and LNG terminals all may serve as adequate substitutes for gas storage in appropriate circumstances. These commentors also state that they believe that the Commission's proposal should provide further incentives for the development of new natural gas storage capacity that will improve gas service reliability and promote price stability in the future. The NYPSC agrees with the Commission that local gas production, pipeline capacity and LNG potentially can be offered as alternatives to storage service but requests the Commission to adhere to the case-by-case approach and to allow for consideration of whether there are realistic alternatives available on a firm and long-term basis.

17. On the other hand, several commentors oppose changes to the current market-power standards on grounds that liberalizing these standards is unnecessary and

¹⁴ Comments of INGAA, Northern Natural, Duke, Williston Basin, the NiSource Pipelines, Dominion, Sempra, DTE, NYPSC, Falcon, EnCana, Bridgeline, Unocal, Enstor and Jefferson Storage. The full names of commentors and the abbreviations used in this document are shown in the appendix.

potentially harmful to customers. AGA, APGA, NGSAs, SGR and UET all question whether the proposed changes would actually encourage meaningful development of new storage facilities. APGA questions the NOPR's assumption that a storage capacity shortage exists. APGA states that while the NOPR discusses the upcoming need for an additional 700 Bcf of storage capacity by 2025, the NOPR does not suggest, much less demonstrate, that the need will not be fulfilled. NGSAs submit that there is little evidence to suggest that the Commission's current pricing policies have had a major influence on developers' decisions to move forward with potential storage projects. Rather, NGSAs contend that there are multitudes of technical and commercial factors that influence a potential storage developer's decision to build storage that are equal or paramount to the Commission's regulatory pricing policies including geological limitations, environmental requirements and NIMBY issues.

18. AGA and SGR assert that the proposed changes would simply provide existing storage providers the opportunity to charge higher prices for services already available to the market and create opportunities for cross-subsidies between storage and transportation services. AGA also fears that liberalizing the market-power standards would vastly increase the scope and complexity of the market-power determination, while APGA submits that the NOPR's proposal to expand the definition of the relevant product market for storage would diminish substantially the showing required to obtain market-based rates.

19. APGA also argues that the proposal is inconsistent with the Policy Statement that defines a “good alternative” as one that must have the same qualities of timeliness, price and quality of the storage service it would replace. Specifically, APGA submits that pipeline capacity (and local production/LNG and released capacity) are not good alternatives, much less “close substitutes” in terms of quality of service to the high deliverability storage service that the NOPR seeks to promote. Similarly, APGA argues that in terms of price, pipeline capacity is not a good alternative or close substitute to storage service, because pipeline capacity is more expensive than storage capacity.

20. NGSAs submit that the expansion of the relevant product market will not provide customers with the equivalent services uniquely offered by new storage facilities and examining market elasticity to determine whether product substitution can occur in downstream markets, as suggested in the NOPR, is simply not realistic. NGSAs and PGC stress that the criteria and framework that the Commission utilizes to review market-based rate applications have proven to be effective and flexible, resulting in the approval of market-based rates for the majority of applicants. Moreover, NGSAs point out there are flexible cost-based rates available to promote new storage capacity without making wholesale changes to the Commission’s existing market-power analysis. NGSAs urge the Commission to consider whether it would be more appropriate instead to adopt changes that will rectify the unique problems identified in specific regions by undertaking a generic proceeding to: (1) identify where new storage capacity is needed; (2) document known proposals in these regions; (3) determine what specific obstacles may exist; and

(4) establish regulatory policies to encourage additional storage construction in those areas.

21. IPAA expresses concern with the Commission's proposal to adopt a more expansive definition of the relevant product market for storage to explicitly include close substitutes for gas storage services. IPAA urges the Commission to carefully consider the potential impact of this expanded definition of relevant product market for storage on other cost-based services regulated by the Commission. (e.g., the regulation of interstate pipeline transportation rates). For example, IPAA states that if pipeline capacity and released capacity can serve as possible substitutes for competing storage, then the potential exists for storage to serve as a substitute for the availability of competing pipeline capacity in evaluating applications for market-based transportation rates. IPAA states it most likely would have concern with efforts to expand the acceptance of market-based transportation rates. Thus, IPAA strongly encourages the Commission to consider the effect the expanded definition of relevant product market could have on all services under the Commission's jurisdiction, not just within the confines of an individual application by a storage operator. NGSA requests that the Commission clarify that these changes will not be used for the future evaluation of market power for interstate transportation services but only for new storage facilities as it has proposed for the EPAct 2005 provisions.

22. UET asserts that the Commission has not demonstrated that the proposed change in the market-power analysis is needed to reduce natural gas price volatility because price

volatility is mitigated on a national, as opposed to a regional basis, and storage development is keeping pace with national demands. UET also argues the proposed change is not necessary to solve regional storage capacity shortages in underserved markets such as New England and the Southwest, because proposals for new storage in these areas have failed for reasons other than rate treatment. Finally, UET asserts that the proposed rule is not necessary to cater to power generation load because the Commission is able to meet the needs of power generation customers by developing rate designs that would permit storage operators to earn higher revenues from short-term services during peak periods.

23. UET also maintains that changing the market-power analysis as proposed could discourage rather than encourage expansion of existing storage facilities. It asserts that cost-based rates treat the storage company fairly and also enable storage customers to participate sufficiently in the natural gas value chain that runs from the wellhead to the burner tip. UET alleges that market-based rates may disrupt the value chain to such an extent that potential storage customers, particularly marketers, will simply choose to exit the market rather than serve as the vehicle for funneling market-based rate revenues to storage providers. Thus, UET maintains that storage projects, for which there is a demand at cost-based rates, may not be built because the demand is not there for a project that would qualify for market-based rates under the relaxed proposed standards. In addition, noting that price volatility has increased as the number of major marketers has decreased, UET urges the Commission to exercise care in embracing market-based rates

to encourage new storage in the name of price volatility mitigation when those rates may actually increase price volatility by further decreasing the number of marketers.

24. Finally, AGA, NGSAs and Process Consumers argue that the NOPR is unnecessary given the alternative of section 4(f) of the NGA. For example, AGA asserts that the proposed regulations pursuant to new NGA section 4(f) fully address the need to provide incentives for new storage services and there is no need to provide more latitude for qualifying for market-based rates for existing storage facilities. At most, AGA asserts the Commission should consider broadening the market-power test only after it has had an opportunity to assess the impact and outcome of the new rules under section 4(f), a minimum of two years after implementing regulations under section 4(f). Similarly, NGSAs while supporting the Commission's goal of maximizing storage believes that liberalizing the traditional market-power test is unsupported and unnecessary. Given that Congress enacted EPCA 2005 as the primary vehicle to encourage the development of new storage facilities, NGSAs urge the Commission to focus its attention in this proceeding on properly implementing EPCA 2005, and not engaging in an unnecessary effort to provide incentives for new storage by revising the existing market-power test. At a minimum, NGSAs urge the Commission to take an incremental approach and maintain the existing market-power procedures, at least until it can assess whether its implementation of the EPCA 2005 provisions can provide a sufficient and workable program that provides a valid incentive to potential new storage developers.

Commission Determination

25. The Commission finds it is appropriate to adopt a more expansive definition of the relevant product market for storage to explicitly include close substitutes for gas storage services, including pipeline capacity and local production/LNG supplies. As explained below, this modification to our market-power analysis better reflects the competitive alternatives to storage and is supported by changes in the natural gas markets that have occurred since the mid 1990s. In today's markets, these non-storage products may well serve as adequate substitutes for gas storage in appropriate circumstances.

26. As we explained in Order No. 637, the deregulation of wellhead natural gas prices, the advent of open-access transportation and the requirement that interstate pipelines offer unbundled open-access transportation service, has increased competition and efficiency in both the gas commodity and transportation market.¹⁵ Market centers have developed both upstream in the production area and downstream in the market area, providing shippers with greater gas and capacity choices. The wholesale market has grown with new participants that have the ability to deliver gas into many markets. The expansion of the product market definition to include close substitutes simply recognizes that buyers and sellers have a greater number of alternatives from which to choose in order to obtain and deliver gas supplies. From an end-use customer's perspective, gas is fungible, whether it comes from storage, local production or more distant supplies

¹⁵ Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, Order No. 637, FERC Stats. & Regs., Regulations Preambles (July 1996 - December 2000) ¶ 31,091 at 31,249-63 (Feb. 9, 2000).

transported by pipelines. Competition with storage can come from any of these sources that can deliver gas in the same market as the storage facility. For these reasons, we will permit a storage applicant to include non-storage products and services, including pipeline capacity and local production/LNG supply in the calculation of its market concentration and market share.

27. The Commission recognizes, however, that local production, LNG and pipeline capacity may not be good alternatives to an applicant's storage services in all circumstances. For a non-storage product to be a good alternative it must be available soon enough, have a price low enough and have a quality high enough to permit customers to substitute the alternative for the applicant's services. For this reason, we will evaluate potential substitutes in the context of individual applications for market-based rates. In those proceedings, the applicant will have the burden to demonstrate that the non-storage products and services, as well as the other storage services, used in its calculation of market concentration and market share are good substitutes. Any party to the proceeding can challenge the inclusion of a particular product on the grounds that it does not meet the qualifications for a good alternative. Based on the record in the proceeding, the Commission will determine if the proposed product is in fact a good alternative that will limit the exercise of significant market power by the applicant.

28. In the NOPR, we noted that although current and projected storage development is keeping pace with aggregate demands, underground storage development in some market

areas, such as New England and the Southwest, is not.¹⁶ We also acknowledged that our rate policies will not guarantee the proliferation of new storage projects because storage projects fail to for reasons other than rate treatment.¹⁷ A few commentors claim that the proposed expansion of the product market is not supported because we have not shown that a storage capacity shortage exists or that market-based rates will ensure that storage gets built. We disagree that such findings are necessary to support the proposed change to our market-power analysis. The courts have permitted the Commission to institute flexible pricing to improve market efficiency so long as the overall regulatory scheme protects against the exercise of market power and protects and results in just and reasonable rates.¹⁸ Where the Commission determines that an applicant lacks market power, the Commission may depart from a strictly cost-based determination of rates, and approve rates reached as the result of competition. The Commission's authority to approve market-based rates has been approved by the courts when the Commission has found sufficient protection against the exercise of market power.¹⁹

29. The Commission finds that its proposed regulatory change will protect against the

¹⁶ NOPR at P 8.

¹⁷ Id. at P 14.

¹⁸ Environmental Action v. FERC, 996 F.2d 401, 410 (D.C. Cir. 1993).

¹⁹ Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870-71 (D.C. 1993) (Elizabethtown); Louisiana Energy and Power Authority v FERC, 141 F.3d 364, 369-370 (D.C. Cir. 1998); Interstate Natural Gas Association of America V. FERC, 285 F.3d 18, 31-34 ((D.C. Cir.) 2002); California ex rel. Lockyer v. FERC, 383 F.3d 1006, 1013-1014 (9th Cir. 2004).

exercise of market power. In analyzing market-based rate storage proposals, the Commission will continue to address whether the applicant has market power; that is, can the applicant: (1) withhold or restrict services to increase price a significant amount for a significant period of time, or (2) discriminate unduly in terms of price or conditions. Before the Commission can conclude that a seller cannot exercise market power it must either: (1) find that there is a lack of market power because customers have sufficient “good alternatives,” or (2) mitigate the market power (i.e. permit market-based pricing only if specified conditions are met that prevent the exercise of market power). The only change the Commission is adopting in this Final Rule is to recognize that in today’s market, a storage applicant’s ability to exercise market power can be constrained not only by other storage services but also by some combination of pipeline and other gas supply alternatives.

30. Similarly, we do not share commentors’ views that we should not adopt the proposed revisions to the product market definition because it may result in more complex proceedings or that there are flexible cost-based rates available to storage providers. The Commission’s proposal is justified because it better reflects the competitive alternatives to storage.

31. We also find that commentors’ assertion that our action here will inappropriately raise rates ignores the connection recognized by the courts between competition and just and reasonable rates. In Elizabethtown, the court concluded that because of the competition in the pipeline’s sales market it appeared that the pipeline would not be able

to raise its price above the competitive level without losing substantial business to other sellers. “Such market discipline provides strong reason to believe that Transco will be able to charge only a price that is ‘just and reasonable’ within the meaning of section 4 of the NGA.”²⁰ Granting market-based rates in situations where there are sufficient alternatives prevents the exercise of significant market power. A new entrant found to lack market power offers another choice to existing customers, and in the Commission’s experience, more choice frequently leads to lower, not higher, rates.

32. We also reject commentors’ claim that Congress’ enactment of section 312 of EAct 2005 bars the Commission from expanding the product market definition for storage applicants seeking a finding that the applicant does not possess market power. These commentors fail to cite to any provision in section 312 of the Act that suggests Congress intended to limit in any way the Commission’s ability to revise or modify its traditional market-power analysis. Rather in section 312, Congress established an alternative procedure to permit storage service providers that are unable to show that they lack market power to negotiate market-based rates if the Commission determines that market-based rates are in the public interest, are necessary to encourage needed storage infrastructure and that customers are adequately protected. The Commission finds it is reasonable to proceed under both prongs.

33. As to IPAA’s and NGSA’s concern that our actions here not prejudice the issue of whether storage can serve as a substitute for the availability of competing pipeline

²⁰ 10 F.3d 866, at 871 (D.C. Cir. 1993).

capacity in evaluating applications for market-based transportation rates, we clarify that it is not our intent. Our actions here only address what non-storage products may be considered a good alternative to storage services, and should not be construed to address what products may be considered a good alternative to transportation services.

34. Finally, we do not share UET's views that our action here will negatively impact the number of marketers. Marketers, too, will have choices in contracting for service from a newly authorized storage service provider authorized to charge market-based rates and, as discussed above, the price will remain just and reasonable within the meaning of section 4 of the NGA due to the absence of significant market power.

2. Scope of Applicability of Expanded Product Market Definition

Comments

35. Bay Gas requests that the Commission revise proposed § 284.501, Applicability, to clarify that the newly proposed subpart M requirements do not apply automatically to previously-ordered market-based rate authorizations. Specifically, Bay Gas requests that the Commission add the following language to the end of that section: "provided, if such pipeline or storage service provider was authorized to charge market-based rates before subpart M effective date, it need not conform under that authorization to subpart M."

36. Should the Commission decide to adopt its proposal to expand the product market, AGA and NGSA urge the Commission to expressly limit the application of any revised market-power regulations to new storage capacity rather than to existing storage capacity

that is currently subject to cost-based rates.

37. NiSource Pipelines request that the Commission clarify whether existing storage providers are permitted to seek market-based rate authority using the proposed modified market-power analysis.

Commission Determination

38. As requested by Bay Gas, we clarify that applicants previously granted market-based rates need not resubmit an application under the broader definition of product market we are adopting in the Final Rule. If an applicant has demonstrated a lack of market power under the traditional definition of product market, it follows that the applicant would qualify for market-based rates using an expanded definition of product market that includes additional substitutes. However, we do not agree that a revision to the regulatory text is necessary.

39. We find that NGS and AGA have provided no support for their request to limit the applicability of the expanded product market definition to only new storage capacity. Pursuant to the Policy Statement, an entity can file an application for market-based rates for storage services if it can demonstrate that it does not have significant market power or has sufficiently mitigated that market power. Where a company can show a lack of market power, then competition in the market will ensure that the company's rates will be just and reasonable and the purpose of the NGA is met. Accordingly, existing storage

providers are permitted to seek market-based rate authority using the proposed modified market-power analysis. However, the Commission will consider in the case of existing storage all relevant facts of the applicant's potential to exercise market power, including for example, impacts on existing customers and the applicant's relationship with transmission service providers in the relevant market.

3. Determination and Quantification of a Good Alternative

40. In order to show that a non-storage product or service such as transportation is a good alternative, the Commission stated that the storage applicant would need to meet the criteria set forth in the Commission's Policy Statement. A good alternative is one that is available soon enough, has a price that is low enough, and has a quality high enough to permit customers to substitute the alternative for the applicant's services.

Comments

41. SCE stresses that the Commission needs to adopt an analysis that is as robust as its analysis of the electric markets and takes into consideration the interdependence of gas and electric markets' competitiveness. SCE urges the Commission to seriously examine the limits on "substitutability" among the various products in each market, noting the complex dynamic relationships involved in determining this. SCE states that storage serves three basic functions: price arbitrage, balancing and peak reliability, and customers consider different kinds of storage and transportation products to perform each function. Thus, each alternate product must be examined in the context of its ability to provide

competitive discipline on the operation of an applicant's storage facility. Depending on the market structure, SCE asserts that some facilities or products may only be able to perform one of the three storage functions while others might serve all of these functions. In addition, SCE stresses that the Commission also must be willing to examine whether, and the extent to which, an exercise of market power in the storage market may ultimately result in supracompetitive prices elsewhere in the gas markets, i.e., other geographic markets or other products.

42. Enstor urges the Commission to provide more clarity as to what is, and is not, a good alternative, and how a market-based rate applicant can demonstrate the same. In addition, Enstor seeks further Commission amplification on whether an alternative is "available." For example, Enstor asks in regards to LNG terminals in service, will availability depend on the terminals' capacity or their deliverability?

43. EEI supports the Commission's proposal to include alternatives to storage in its market-power analysis. EEI submits that this analysis is fact specific and should be applied in the context of the region of the country and the users that would be supplied by the proposed storage services. With regard to released capacity as a competitive alternative to storage, EEI asserts that the applicant should be required to demonstrate that there is a viable market in released capacity. In making this determination, EEI urges the Commission to rely on historic information on the extent of trading in released capacity on a relevant pipeline because such information is a better indicator of

substitutes for storage service than a theoretical analysis of possible releases in the future.

44. With respect to quantifying firm transportation capacity that could be available to compete with an applicant's storage service, DTE recommends that all firm transportation capacity on all pipeline systems that serve the applicant's geographic market that is not committed to meeting the state-mandated obligation of LDCs to serve captive customers be considered as available to compete with the applicant's storage services, particularly during swing periods when deliverability is most critical. DTE explains that capacity not under LDC contract is generally held by marketers, end users, and producers who are in a position to divert gas on short notice from contractual primary delivery points to higher-valued markets in response to rapidly changing market conditions.

45. Given that non-LDC shippers are in the best position to respond to swings in the market and control where gas is delivered, DTE recommends that firm transportation capacity be quantified on a shipper-by-shipper basis for the purpose of calculating swing period deliverability market shares and a Herfindahl-Hirschman Index (HHI). Under this approach, each pipeline shipper would be considered a potential competitor to the applicant. On the other hand, DTE claims that market-power studies should not assume that pipelines control deliverability and can use shipper deliverability to respond to market swings in a manner and time period that is competitive with storage. That is, pipeline deliverability should not be quantified and assigned to each individual pipeline for the purpose of calculating market shares and HHIs. Pipelines are purely transporters

and are not in a position to divert gas on short notice to higher valued markets in response to changes in market conditions.

46. DTE agrees with the Commission's statement in the NOPR that to the extent an LDC holds pipeline capacity in order to meet state-mandated service obligations to captive customers, it is not likely that such pipeline capacity would be available to respond to market needs nor would it be a good substitute for storage capacity and deliverability. Similarly, DTE urges the Commission to exclude storage capacity and deliverability associated with storage fields owned by LDCs and used to meet state-mandated service obligations to captive customers from market share and HHI calculations contained in market-power studies submitted by applicants seeking market-based rates. DTE states that like firm transportation used to meet LDC market needs, firm storage capacity and deliverability associated with storage fields owned by LDCs are committed to meet captive retail customer needs and should not be considered available to the market to meet changing economic conditions.

Commission Determination

47. As we have stated above, we intend to continue to evaluate requests for market-based rates for storage on a case-by-case basis. An applicant is required to identify "the specific products or services and the suppliers of those products and services that provide good alternatives to the applicant's ability to exercise market power."²¹ A good alternative has been defined as one that is available soon enough, has a price that is low enough, and

²¹ Policy Statement at 61,230-231.

has a quality high enough to permit customers to substitute the alternative for the applicant's service. The burden is on the applicant to "show how each of the substitute services in the product market are adequate substitutes to the applicant's service in terms of quality, price, and availability."²² Therefore, we will not endorse any particular method for determining the substitutability of a product here, but rather base our determination on the record developed in individual proceedings. Regarding Enstor's request that we clarify whether the availability of LNG terminal service will depend on the terminal's capacity or deliverability, we find that both elements would be relevant in analyzing the availability of LNG supply.

48. In order for an applicant to show that non-storage products are a good alternative to storage, they must demonstrate that for peak demand periods customers will be able to choose the non-storage product as a comparable substitute for storage services offered by the applicant. This demonstration must show that in terms of quality, timeliness, and price that non-storage products will be able to serve customers' needs as well as storage service. For example, an applicant may be able to demonstrate that pipeline capacity in combination with spot market purchases and appropriate financial market instruments, such as futures contracts, can reasonably be expected to be available at prices competitive with storage service so that it can act as a substitute for storage gas purchased, stored and/or redelivered when needed. Applicants may also be able to show that available park and loan services or liquid market-center spot markets provide sufficient liquidity during

²² Id.

peak periods to constitute an adequate substitute to storage for balancing purposes or to serve peak demand.

4. Additional Revisions to Market-Power Test

a. Inclusion of Other Gas Supply Alternatives in the Product Market

Comments

49. In addition to the pipeline capacity and LNG supply identified by the Commission in its NOPR, Duke urges the Commission to recognize that other gas supply alternatives may be available in a given market, such as financial instruments, that can compete with storage. Duke explains that storage allows a consumer of natural gas to manage price risk by allowing the consumer to choose a price at which to buy natural gas, store it, and then withdraw that gas as needed. According to Duke, there are an increasing number of financial instruments that can be used to manage this same natural gas price risk.

Williston Basin claims that other types of alternatives may exist as well, and accordingly market-based rate applications should be looked at individually, to determine what types of alternatives are available.

Commission Determination

50. As discussed above, we will continue to evaluate requests for market-based rates

on a case-by-case basis. An applicant may propose to include other non-storage products as alternatives to storage services to the extent it can demonstrate the proposed alternatives can be delivered into the relevant geographic market and otherwise meet the criteria of a good alternative.

b. Modification to HHI Threshold

51. Under the Policy Statement, the Commission's initial screening tool for significant market power is the HHI, a formula that focuses on the relevant market's concentration as an indicator of the potential of an applicant to act together with other sellers to raise prices.²³ The Commission uses an HHI of 1,800 as an indicator of the level of scrutiny to be given to an applicant for market-based rates. An HHI at this level indicates that there are four to five good alternatives to the applicant's service in the relevant market. An HHI below 1,800 suggests limited market concentration with less potential for any participant to exercise significant market power. However, an HHI above 1,800 suggests a higher level of concentration, and will cause the Commission to increase its scrutiny of other factors such as the applicant's market share, ease of entry into the market, the relative size of the applicant's capacity, and/or the sustainability of a potential attempt by the applicant to exercise market power.²⁴

²³ The HHI is the sum of the squared market shares. For example, in a market with five equal size firms, each would have a 20 percent market share. For that market, $HHI = (20)^2 + (20)^2 + (20)^2 + (20)^2 + (20)^2 = 400 + 400 + 400 + 400 + 400 = 2,000$.

²⁴ Policy Statement at 61,235-36.

Comments

52. INGAA and KM urge the Commission to adopt an HHI level of 2,500 rather than the 1,800 that it currently employs as a benchmark for measuring market concentration. INGAA asserts the current level is far too conservative and is inconsistent with standards recommended by the Antitrust Division of the Department of Justice (DOJ) for analogous oil pipeline cases.

53. KM asserts that the Commission's reliance on the 1,800 HHI level inappropriately relies on the DOJ's and the Federal Trade Commission's (FTC) Horizontal Merger Guidelines (Merger Guidelines) which apply to merger cases where two companies are merging and the number of competitors is reduced. KM argues that the 1,800 threshold is too conservative as applied to potential new storage entrants seeking market-based rates because, in this situation, the number of competitors will be increasing and the Commission will exercise regulatory oversight. KM also points out that the Commission applies the 2,500 threshold to oil pipelines where there is no merger issue and the adoption of that threshold was supported by DOJ in filed comments. Similarly, KM argues the Commission should adopt a 2,500 HHI threshold for applicants seeking market-based rate authority for gas pipelines where continued regulation of an industry rather than a merger is at issue. KM also asserts that adherence to the 1,800 HHI threshold is at odds with the actual DOJ and FTC enforcement decisions regarding horizontal merger review, where it states that out of 11,263 challenges initiated by the

agencies, only 175 involved markets with HHIs under 2,500.²⁵

54. Finally, KM asserts that in today's markets, purchasers of storage capacity are generally large LDCs or even larger and more powerful marketing arms of large producers and the presence of this buyer power is not accounted for in the Commission's HHI analysis. According to KM, use of a higher initial screen would partially take into account other factors such as buying power.

Commission Determination

55. We are not persuaded by the commentors' arguments that there is a need to change the HHI threshold level. Significantly, as recognized by KM and INGAA, the 1,800 HHI level is not a bright-line test below which an applicant would automatically qualify for market-based rates, or above which an applicant would be excluded from market-based rates. Rather, the Commission uses the 1,800 HHI level as an indicator of the level of scrutiny to be given to the applicant. As explained in the Policy Statement, if the HHI is above 1,800 the Commission will give the applicant closer scrutiny because the index indicates that the market is more concentrated and the applicant may have significant market power. Conversely, an HHI below 1,800 would result in less scrutiny of the applicant's potential to exercise significant market power because it would indicate that the market is less concentrated.²⁶ The Commission has applied this policy in its analysis

²⁵ Citing Federal Trade Commission and the U.S. Department of Justice, Merger Challenges Data, Fiscal years 1999-2003, December 18, 2003.

²⁶ Policy Statement at 61,235.

of individual cases and has approved market-based rates for several applicants with HHIs above 1,800 after examining other competitive factors. For example, in Avoca Natural Gas Storage (Avoca),²⁷ the Commission approved market-based rates despite an HHI for deliverability of 4,100 in the relevant New York/Pennsylvania market, specifically noting the small size of Avoca's market share and the apparent ease of entry into the market as factors mitigating the market concentration reflected in the HHI.²⁸

56. We disagree with INGAA's and KM's assertion that the 1,800 HHI level is too conservative. First of all, it is not true that applicants seeking market-based rates will always increase the number of competitors in a market. For example, a storage provider may apply for market-based rates for existing cost-based service. More importantly, we believe that use of the more conservative approach will ensure that the impact of other competitive factors will be given careful scrutiny when the market is relatively concentrated (less than four or five good alternatives). In addition, contrary to KM's assertion, we have not adopted a generic 2,500 HHI level in analyzing whether an oil pipeline has market power.²⁹ Moreover, the use of HHI levels in determining whether an

²⁷ 68 FERC ¶ 61,045 (1994).

²⁸ The Commission reached a similar result analyzing storage services in Steuben Gas Storage Co., 72 FERC ¶ 61,102 (1995); New York State Electric and Gas Corp., 81 FERC ¶ 61,020 (1997); N.E. Hub Partners, L.P., 83 FERC ¶ 61,043 (1998); Seneca Lake Storage, Inc., 98 FERC ¶ 61,163 (2002); and Honeoye Storage Corp., 91 FERC ¶ 62,165 (2000).

²⁹ Market-Based Ratemaking for Oil Pipelines, Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192 (Oct. 28, 1994) ("[T]he Commission is not proposing any particular HHI level, such as 1,800 or 2,500, as a screen or presumption, rebuttable or otherwise. All factors must be considered in determining whether an oil pipeline lacks

oil pipeline has market power in individual cases reflects the specific competitive circumstances affecting oil pipelines. Specifically, oil pipelines face competition not only from other oil pipeline providers but also from other modes of delivering oil such as rail, barges and trucks.³⁰ In general, there are not similar alternative modes of delivering or storing natural gas. Further, as common carriers, oil pipelines operate in a different regulatory context.

57. Additionally, we do not agree with KM that a higher initial screen is appropriate to take into account the fact that purchasers of storage capacity are generally large LDCs or marketing arms of large producers. First of all, the purchasers of storage services are not always large LDCs and marketers and to implement an analysis premised on the assumption that they are is not appropriate. Under the Policy Statement we consider issues related to buyer power separately (outside the context of the HHI threshold) which permits the Commissions to consider the specific facts presented in a case. We find this approach superior to the approach advocated by KM.

c. Entry and Other Competitive Factors

Comments

58. Duke asserts that while the inclusion of currently available competitive alternatives in the definition of the market for the purposes of calculating market concentration and market share values, as advocated above, is a good starting point, such

significant market power.”).

³⁰ Id. at 31,191.

a revision alone, while necessary, will not address the barriers to development faced by markets with little existing gas supply infrastructure. To promote the development of additional storage infrastructure in these areas, Duke urges the Commission to shift the overall focus of its market-based rate analysis away from requiring evidence of an existing market to an analysis of the extent to which a new entrant increases the potential gas supply options available to market participants. Duke states the Commission's market-based rate policy should focus on: (1) whether the new entrant adds new storage options to the market, and (2) whether there are further opportunities for additional entrants to take similar risks and develop competitive storage. Duke urges the Commission to adjust its existing approach to focus less on the status of existing competition and more upon the potential benefits of adding additional storage by: (1) making it clear that applicants may rely upon evidence of potential developments of storage in circumstances where there is little or no existing competition, or (2) by making a generic determinations concerning the potential competitiveness of particular areas of the country.

Commission Determination

59. The Commission believes that the analytical framework for establishing market-based rates set forth in the Policy Statement already adequately accommodates other competitive factors such as the ability of other entities to enter the market. In the Policy Statement, the Commission specifically recognized that having a large market share in a concentrated market does not constitute market power if ease of entry and other

competitive factors can prevent the applicant from exercising significant market power.³¹

In a recent order in Rendevous Gas Services, L.L.C., the Commission granted market-based rates for hub transportation service based on the ease of entry into the market center and the fact that the proposed pipeline was a new entrant with no captive customers.³² Similarly, when requesting market-based rates for storage services, an applicant is permitted to establish that it lacks market power by demonstrating that if it increases its price, ease of entry by other providers into the market will make such a price increase unprofitable. Moreover, in response to Duke's assertion that we should focus more on the benefits of new entry than market concentration statistics, we recognize that there are significant benefits to competition and customers from new storage and note that, under our policy, HHI calculations of market concentration are used as a screening tool and are not dispositive of whether we will grant a request for market-based rates. Instead, we will consider all relevant factors, including the benefits of new entry, in determining whether to approve market based rates. The Commission will evaluate such proposals on a case-by-case basis.

d. Definition of Geographic Market

Comments

³¹ Policy Statement at 61,235.

³² Rendevous Gas Services, L.L.C., order issuing certificates, 112 FERC ¶ 61,141; reh'g. denied, 113 FERC ¶ 61,169 (2005). See also Avoca, 68 FERC ¶ 61,045 (1994); Steuben Gas Storage Co., 72 FERC ¶ 61,102 (1995); New York State Electric and Gas Corp., 81 FERC ¶ 61,020 (1997); N.E. Hub Partners, L.P., 83 FERC ¶ 61,043 (1998); Seneca Lake Storage, Inc., 98 FERC ¶ 61,163 (2002); and Honeoye Storage Corp., 91 FERC ¶ 62,165 (2000).

60. DTE states that while the Commission's NOPR takes the important step of presenting an expanded definition for storage substitutes, the NOPR does not clarify how an applicant seeking to demonstrate a lack of market power should define its geographic market. DTE seeks Commission guidance as to how to define the relevant geographic storage market in order to provide more certainty to an applicant seeking market-based rates for new storage capacity in more competitive markets needing new capacity or improved service flexibility. DTE recommends that, in developing a geographic market definition for a market power study, the Commission should base its geographic market definition on the ability of storage customers to access storage providers in various regions. In addition, DTE argues that customer access to alternative storage providers can be confirmed by reviewing the applicant's potential shippers or shippers accessed by comparably located and situated storage providers, for example, as shown in a shipper index.

Commission Determination

61. In the Policy Statement, the Commission provided guidance on defining the geographic market. In general, the relevant geographic is the geographic area containing those suppliers that can affect any attempt by the applicant to exercise market power. Since we are not changing the geographic definition in the Final Rule, the Policy Statement's guidance regarding the geographic market is still applicable.

e. Treatment of Affiliate Capacity

62. In § 284.503(b)(4) we proposed to codify our current practice³³ that capacity on pipeline systems owned or controlled by the applicant's affiliates should not be considered among the customers' alternatives and should be included in the market share calculated for the applicant.

Comments

63. A number of commentors request that the Commission amend its proposed regulations in § 284.503(b) to eliminate the requirement that the capacity of a market-based rate applicant's affiliates is automatically to be included in the market share calculated for the applicant.³⁴ They argue that this requirement is unnecessary in light of the Commission's Standards of Conduct for Transmission Providers promulgated in Order No. 2004 which requires interstate pipelines to function independently from their affiliates.³⁵ For example, Dominion submits that Order No. 2004 is a comprehensive and effective regulatory regime governing the relationship between a pipeline and its energy affiliates such that there is no realistic possibility for an interstate pipeline with storage and its affiliates with storage assets to collude to exercise market power in the provision

³³ See Policy Statement, 74 FERC ¶ 61,076 at 61,234 (1996).

³⁴ Comments of INGAA, Dominion, Duke, NiSource Pipelines, Dominion LDCs and Jefferson Storage.

³⁵ Standards of Conduct for Transmission Providers, Order No. 2004, 105 FERC Stats. & Regs., Regulation Preambles ¶ 31,155 (2003), order on reh'g, Order No. 2004-A, FERC Stats. & Regs. ¶ 31,161 (2004), order on reh'g and clarification, Order No. 2004-B, FERC Stats. & Regs. ¶ 31,166 (2004), order on reh'g and clarification, Order No. 2004-C, FERC Stats. and Regs. ¶ 31,172 (2004), order on reh'g., Order No 2004-D, 110 FERC ¶ 61,320 (2005).

of storage services. Additionally, INGAA states the Commission's rules regarding price transparency, and the requirement that an open-access pipeline must make all capacity publicly available, under the terms, conditions, and rates specified in the tariff, provide further assurances that a storage applicant cannot control or manipulate the capacity of its affiliated companies.

64. Several commentors also maintain that the notion that capacity held by an affiliated company cannot provide a competitive alternative is inconsistent with the Commission's open-access policies.³⁶ Specifically, they assert that under the Commission's open-access regime, an interstate pipeline cannot control storage capacity that is subscribed. Rather, they submit it is the shipper with the contractual rights who determines when or if the capacity is used and if, when and to whom it is released. The Dominion LDCs assert that the Commission itself has concluded that current regulatory controls minimize the ability of pipelines to use market power to force captive customers to enter into longer term contracts than would be required in a competitive market.³⁷ Thus, the Dominion LDCs assert the Commission should find that a pipeline has neither the legal ability to withhold existing capacity nor an incentive to refuse to build new capacity, and that this, together with the fact that pipeline activity to act with an affiliated LDC to exercise market power by withholding capacity would violate other Commission rules and be actionable, leads to the conclusion that a pipeline and its affiliated LDC are

³⁶ Comments of INGAA, Duke, Dominion and Dominion LDCs.

³⁷ Citing Order No. 637, 101 FERC ¶ 61,127 at 61,522.

unlikely to be able to jointly exercise market power.

65. These commentors conclude that there is not sufficient justification for requiring a pipeline to include the capacity of its affiliates when calculating market share. In recognition of the effect of shipper control over contracted pipeline capacity, INGAA urges the Commission to establish a rebuttable presumption that such capacity is properly considered as a substitute for the storage service at issue in a market-based storage rate application, assuming the capacity otherwise meets the “substitutability” criteria. Duke states that only storage and transportation capacity controlled by the affiliates of a storage applicant should be aggregated with the capacity of the applicant’s proposed storage facility for the purposes of the market concentration measure and the market share calculated for the applicant. At a minimum, these commentors urge the Commission to eliminate the per se rule, and evaluate on a case-by-case basis whether affiliated capacity presents a competitive alternative. Several commentors claim that adoption of the proposed rule will discourage otherwise meritorious storage applicants and undermine the Commission's goal of stimulating the construction of vital new storage infrastructure.³⁸

66. To the extent the Commission does not delete this requirement, INGAA requests that the Commission clarify proposed § 284.503(b)(4) that reads in pertinent part, that “[a]vailable capacity . . . owned or controlled by affiliates of the applicant in the relevant market shall be clearly identified and may not be considered as alternatives competing

³⁸ Comments of INGAA, Dominion and the NiSource Pipelines.

with the applicant”, to clarify that while the pipeline affiliate’s capacity is to be included in the market share calculated for the applicant, it should also be reflected in the total market share for the geographic area.

67. On the other hand, Falcon urges the Commission to recognize that the storage services being evaluated for market power may well be affiliated with the “storage surrogate” services permitted to be considered in the evaluation. Falcon maintains that the Commission should provide for additional safeguards to prevent the affiliated storage providers from exercising market power in such a situation and/or avoid, through separate treatment and analysis of the affiliated services, the actual market power or market share associated with the alternative affiliated services and providers.

Commission Determination

68. The requirement that the capacity of a market-based rate applicant’s affiliates is to be included in the market share calculated for the applicant is consistent with our established practice and is supported as discussed below.

69. We disagree with commentors’ claim that the fact that the Commission has adopted Standards of Conduct for Transmission Providers which require interstate pipelines to function independently from affiliates removes the necessity of requiring that the capacity of the applicant and its affiliates be combined. While affiliates are required to act independently under the Commission’s rules, this does not mean that affiliates will compete for the same service or product in a given market. As recognized by the Supreme Court in Copperweld Corporation v. Independence Tube Corporation,

“[a] parent and its wholly-owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one.... With or without a formal ‘agreement,’ the subsidiary acts for the benefit of the parent, its sole shareholder.”³⁹

70. We are also not persuaded by commentors arguments that only affiliate capacity that is not held under firm contracts should be attributable to the applicant. This proposal ignores the fact that pipelines control the conditions under which transportation and storage services are provided through the operation of their systems. We are not willing to create situations in which the pipeline, the dominant owner of capacity, does not have an incentive to build new capacity because it or an affiliate can benefit from an artificial shortage of capacity. As noted in Order No. 637, the Commission has carefully tailored its regulations so that pipelines will not have an incentive to use their monopoly power to create scarcity.⁴⁰ We see no compelling reason to deviate from that policy here. For these reasons, we find it is appropriate to attribute affiliate capacity to the storage provider even though the capacity is contracted for by a shipper under a firm contract. We have made revisions to § 284.503(b)(4) of the regulations to clarify our intent.

³⁹ 467 U.S. 752, 771 (1984) (holding that a parent and its wholly-owned subsidiary were incapable of conspiring with each other for purposes of section 1 of the Sherman Act).

⁴⁰ Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, Order No. 637, FERC Stats. & Regs., Regulations Preambles (July 1996 – Dec. 2000) ¶ 31,091 at 31,270-71 (Feb. 9, 2000).

71. As requested by INGAA, we clarify that the applicant's affiliate's capacity that is included in the market share calculated for the applicant should also be reflected in the total market share for the relevant geographic area.

72. Finally, we find that Falcons's concerns over affiliate capacity are adequately addressed by the requirement that the capacity of a market-based rate applicant's affiliates is to be included in the market share calculated for the applicant.

f. Filing Procedures

73. The Commission proposed to add a new subpart M to part 284 that requires, among other things, that applications by storage providers requesting market-based rates contain certain information. The Commission stated it would continue its practice of approving market-based rate proposals on a prospective basis only. We also noted that approval of blanket certificate authority to provide open-access storage services at market-based rates will subject the storage service provider to the existing reporting requirements applicable to open-access service providers under § 284.13 of the Commission's regulations.

Comments

74. Sempra asserts that it is unnecessary to impose on market-based rate storage providers the full panoply of 18 C.F.R. § 284.13 reporting requirements applicable to pipelines operating under cost-based regulation, given that the requisite showing of absence of, or mitigation of, market power has already been made. Instead, Sempra urges

the Commission to utilize a lighter-handed reporting regime modeled after the electronic quarterly reports applicable to holders of electric market-based rate authority. Sempra asserts that these are sound requirements for the Commission to require of entities holding market-based rate authority.

75. Enstor submits that the Commission's statement that storage operators cannot charge market-based rates until the Commission determines that they lack market power or have established adequate customer protections conflicts with our current policies implementing section 311 of the NGPA. Enstor states that under the Commission's current regulations, section 311 service providers may begin charging (subject to refund) their proposed rates, including market-based rates, upon the filing of a petition for rate approval with the Commission. Enstor urges the Commission to reconcile this discrepancy and to leave intact the current rate filing regime that governs section 311 service providers in § 284.123(b)(2)(i). Enstor also seeks express clarification that nothing in the NOPR is intended to upset the current 150-day window within which the Commission must act on rate petitions filed by section 311 service providers, or otherwise the proposed rates are deemed fair and equitable.

76. Enstor further requests that the Commission allow flexibility in its proposed requirements for market-based rate filings under new § 284.503. While Enstor agrees that such information may be necessary in certain circumstances, Enstor urges clarification in the Final Rule that some or all of these procedural requirements may be waived for good cause when an applicant files for market-based rates.

77. Finally, Enstor urges the Commission to incorporate some sort of time limitation for its review of rate filings in the Final Rule. For example, Enstor states the Commission can adopt a five-month review period, beginning from the date on which a complete rate application is filed under proposed Rule 503, during which it could evaluate the application and any responsive protests. At the end of the five-month period, the proposed rates would be deemed approved in the absence of a formal Commission ruling.

Commission Determination

78. Regarding the applicability of § 284.13 reporting requirements, we disagree with Sempra that we should not impose these requirements on storage providers granted market-based rates, but rather impose a reporting regime modeled after the electric quarterly reports. Under the Commission's Part 284 program, all open-access transporters and storage providers are required to post or file with the Commission transaction reports, quarterly index of customer reports, and semi-annual storage reports. These reports are required of all open-access service providers and provide crucial transparency. This information allows both the Commission and market participants to monitor the market and detect undue discrimination. Sempra has provided no reasonable basis to exempt market-based storage service providers from the § 284.13 reporting requirements.

79. As requested by Enstor, we clarify that section 311 service providers may begin charging (subject to refund) their proposed rates, including market-based rates, upon the filing of a petition for rate approval with the Commission pursuant to § 284.123(b)(2)(i) and that the 150-day time frame in that section is applicable to such requests. In § 284.502, we are adopting regulations that provide that applicants providing service under subpart C (transportation by intrastate pipelines under section 311) of part 284 must file in accordance with that section.

80. However, we reject Enstor's additional request that we impose a time limitation on our review of market-based rate filings by interstate storage providers, after which time the proposed rate would be deemed approved. It would be unreasonable to approve a market-based rate proposal without a specific finding that the applicant lacks market power. However, the Commission intends to process any request for market-based rates as expeditiously as possible.

81. Finally, the Commission clarifies, as requested by Enstor, that it may file to waive the procedural requirements in § 284.503 for good cause shown.

g. Periodic Review

82. Proposed § 284.504 of the regulations requires storage applicants receiving market-based rates on the basis of a market-power analysis to file updated market-power analyses within five years of the date of the Commission order granting authority to charge market-based rates, and every five years thereafter. The Commission stated that imposition of a periodic review is necessary to ensure that our grant of market-based rates to an applicant remains just and reasonable.

Comments

83. Several commentors including the majority of interstate pipelines and independent storage providers urge the Commission to eliminate its proposal for an automatic five-year market-power review under § 284.504 for storage operators that have demonstrated they lack market power. These commentors assert that this requirement is unduly burdensome, not necessary to protect customers and will deter new storage development.⁴¹ Specifically, the commentors submit that the current requirement that market-based rate grantees report any changes in circumstances that are pertinent to their original absence-of-market-power showing, along with ongoing reporting obligations under existing regulations, are adequate to protect consumers. DTE also notes that it is unaware of any abuse complaints submitted by customers of storage companies granted market-based rate authority in the past that would necessitate the imposition of a five-year market-power review requirement.

⁴¹ Comments of INGAA, Dominion, KM, DTE, Duke, SGR, Honeoye, Bridgeline, Unicol, Falcon, SGR and Jefferson Storage.

84. A number of these commentors assert that an automatic review is unnecessarily burdensome in this context for the same reasons proffered by the Commission in support of reliance on regular monitoring of posted information and the NGA section 5 complaint processes for market-based storage rates under new NGA section 4(f). For example, Duke submits that if regular monitoring and the section 5 complaint provisions are sufficient to protect consumers in instances where the Commission presumes that a storage provider has market power under new NGA section 4(f), these same provisions in addition to the Commission's existing policy of conditioning its certificate authorization with a notice of changed circumstance requirement are more than sufficient to protect consumers in circumstances where the Commission has found the applicant not to possess market power.

85. If the Commission adopts an automatic review requirement, several commentors urge the Commission to make clear that the new requirement does not apply to projects that have previously received market-based rate approval,⁴² arguing that any required periodic review must be prospective only and not affect existing contractual terms and conditions agreed upon in light of the Commission's initial grant of market-based rate authority to a service provider.⁴³ Duke argues that placing a new periodic-review condition on existing market-based rate authorizations would constitute an impermissible

⁴² Comments of Bay Gas, INGAA, EnCana, Bridgeline, and Unocal.

⁴³ Comments of INGAA, KM, and Haddington Ventures. SGR argues that such a modification must be made in accordance with the Mobile-Sierra doctrine, with the Commission determining, on the basis of substantial record evidence, that the public interest requires such modification.

retroactive revision of the certificate authorizations for the underlying facilities, frustrate the investment expectations of the owners of those facilities, and undermine investor confidence in the storage market.

86. INGAA submits that the threat of revocation of market-based rate authority in the middle of a contract term may present an unacceptable level of risk to potential storage developers. In order to minimize the uncertainty that would be created by a new periodic review requirement, SGR argues the Commission must make it clear that any review of a storage provider's market-based rate authorization will be conducted under NGA section 5, with the Commission bearing the burden of showing that the market-based rate authorization and the rates it permits a storage provider to charge have become unjust and unreasonable, and the further burden of establishing prospectively the ratemaking methodology that would yield just and reasonable rates.

87. If the periodic review is adopted, Honeoye and SGR propose that the first such update should not be due until the later of five years after the effective date of proposed § 284.504 or the date the relevant storage facilities are placed in commercial operation. Honeoye also seeks confirmation that an existing holder of market-base rate authority can comply with this requirement by demonstrating that the facts that permitted the Commission to authorize market-base rates in the first instance are still true.

88. On the other hand, NGSA, EEI and PGC support the Commission's proposal to require storage applicants granted market-based rates to file an updated market-power analysis every five years. PGC asserts that without such periodic reviews, the

Commission is unable to perform the regulatory oversight necessary to prevent unjust and unreasonable rates against captive gas customers. EEI notes that there is a similar requirement for electric utilities that sell at market-based rates, and suggests this requirement is necessary to protect customers from changes in the marketplace that may no longer justify market-based rate authority.

89. SCE also supports the Commission's five-year periodic report requirement in § 284.504 and submits that this review should also consider any cost-of-service facilities and interconnected facilities that could serve as substitutes for one another and should assess the competitive functioning of the market and impose remedial measures such as adjustments to mitigation measures or the complete withdrawal of market-based rate authority as necessary to ensure just and reasonable rates.

Commission Determination

90. We will not impose a generic five-year reporting requirement on storage providers granted market-based rates although we reserve the option of imposing a reporting requirement in any individual case. We have carefully considered the comments and have concluded that any benefits that would be achieved by a generic requirement are outweighed by the additional costs that such a generic requirement would create. The Commission believes that existing reporting requirements and its ongoing market monitoring programs generally give us sufficient information to know whether storage markets where applicants have been authorized to charge market-based rates remain competitive, and the Commission has the ability to take appropriate action if market-

power issues arise.

91. A central factor in the Commission's decision is the fact that in the majority of cases where we have authorized market-based rates for storage services, the applicant has not had a large presence in the market. For example, the Commission has approved all requests for market-based rates where the applicant was located in the production area based on findings that that HHIs in that geographic region are well below 1,800 and the market shares of the applicants were small.⁴⁴ In consuming regions, such as the Northeast portion of the United States, where there are fewer providers, some with large market shares whose services are regulated, the Commission has approved requests to implement market-based rates by considering factors other than market concentration including the small size of the applicant's market share.⁴⁵ In these situations, we find that market-power concerns are low. Additionally, in individual cases the Commission has imposed on applicants permitted to charge market-based rates for storage services the requirement to notify the Commission when there have been changes of circumstances

⁴⁴ See, e.g., Caledonia Energy Partners, L.L.C., 111 FERC ¶ 61,095 (2005) (market share of working gas capacity and deliverability each approximately two percent); Copiah County Storage Co. 99 FERC ¶ 61,316 (2002) (market share of working gas capacity and deliverability each less than two percent).

⁴⁵ See, e.g., Avoca Natural Gas Storage, 68 FERC ¶ 61,045 (1994). Steuben Gas Storage Co., 72 FERC ¶ 61,102 (1995) (market share of working gas capacity and deliverability each less than four percent); New York State Electric and Gas Corp., 81 FERC ¶ 61,020 (1997) (working gas capacity and deliverability each less than one percent); N.E. Hub Partners, L.P., 83 FERC ¶ 61,043 (1998) (working gas capacity and deliverability each less than five percent); Seneca Lake Storage, Inc., 98 FERC ¶ 61,163 (2002) (working gas capacity and deliverability each less than two percent); and Honeoye Storage Corp., 91 FERC ¶ 62,165 (2000) (working gas capacity and deliverability each less than two percent).

that affect the applicant's ability to exercise market power,⁴⁶ and we will codify this requirement in §284.504(b). For storage providers with market shares of ten percent or less, we believe that the notice of change of circumstance requirement, together with the transparency provided by the existing reporting requirements in § 284.13, are adequate to permit the effective monitoring of market-power concerns related to storage providers charging market-based rates and enable the Commission to initiate section 5 proceedings where appropriate.⁴⁷ For storage providers with a market share greater than ten percent, we intend to consider in individual cases whether the specific facts and circumstances presented require additional reporting. We believe that this approach achieves an appropriate balance between the need to monitor for market power and the goal of creating a regulatory environment that will promote infrastructure.

92. However, the Commission wishes to emphasize that the failure to timely file a change in circumstance report or failure to comply with reporting requirements as required by the regulations would constitute a violation of the Commission's regulations.

A storage provider would be subject to disgorgement of profits and/or civil penalties from the date on which the violation occurred. Such storage provider may also be

⁴⁶ See, e.g., Caledonia Energy Partners, L.L.C., 111 FERC ¶ 61,095 (2005) (requiring that Caledonia notify the Commission of future circumstances affecting its present market power status within ten days of acquiring knowledge of any such changes).

⁴⁷ ? This approach is similar to the Commission's proposal to exempt sellers of wholesale electric power who own or control 500 MW or less of generating capacity in aggregate from filing triennial reviews. Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,602 at P 152 (2006).

subject to suspension or revocation of its authority to sell at market-based rates (or other appropriate non-monetary remedies). Additionally, if subsequent experience with the changes enacted here demonstrates a need for a generic five-year market-power analysis requirement, we reserve the right to initiate such a change.

h. Cross Subsidies and Customer Protection

Comments

93. Xcel states that it is concerned that the proposed rule does not sufficiently protect storage customers served by a storage provider under cost-based rates from bearing costs associated with storage services provided by the same provider at market-based rates.

Xcel explains that the temptation to increase revenues by misallocating costs will be difficult to resist and difficult for customers and the Commission to detect in a rate proceeding. Therefore, Xcel requests that the Commission protect customers by modifying the regulations to require storage service providers to account for costs incurred in providing market-based rate storage services separately from cost-based storage services. Xcel maintains this requirement is similar to the Commission's policy of requiring pipelines to account separately for the revenues received under negotiated rate agreements.

94. Falcon asserts that pipeline and utility affiliated storage providers (collectively, "Affiliated Storage Providers") have a natural advantage over independents because of their ability to provide a rate subsidy, bundling, or other preference, enabling them to charge lower rates for their storage services and placing independent storage providers at

a distinct competitive disadvantage. Accordingly, Falcon requests that the Commission take steps to minimize any subsidization or preference afforded Affiliated Storage Providers by requiring Affiliated Storage Providers to: (1) unbundle storage and transportation services, and (2) allocate the appropriate level of fixed and variable costs to storage and transportation services. Absent such actions, Falcon alleges that independent storage providers will never be able to effectively compete on a “level playing field” with Affiliated Storage Providers, to the detriment of the ultimate consumer.

95. Similarly, SGR submits that the broader availability of market-based rate authority proposed in the NOPR could increase the possibility that pipeline-owned storage could take advantage of a liberalized market-power test to gain an unfair competitive advantage over independent storage developers/operators. It argues that pipeline-owned storage enjoys considerable advantages in the marketplace; given the ability pipeline-owned storage has to share a customer base with the pipeline, to benefit from operational integration with the pipeline and to enjoy revenue support offered by pipeline transportation services. If left unchecked, SGR submits that these advantages could present insurmountable barriers to entry for independent storage developers.

96. UET asserts that moving from cost-based rates to market-based rates for existing storage facilities and expansions of existing storage facilities would be unfair to existing storage customers. For example, UET submits that in many cases cost-based rates have

paid for facilities with the potential for cheap expansibility. If, as the result of the proposed change in market-power analysis, the expansion capacity is offered only at market-based rates, UET alleges that the storage provider will reap the benefits of the cheap expansibility for which the customers have paid.

97. Finally, APS requests that the Commission take all available steps to encourage the development of independent storage facilities in the southwest including eliminating barriers to entry such as the “bundled” pipeline storage and transmission services being offered by El Paso.

Commission Determination

98. In granting market-based rates for pipelines that provide cost-based services, the Commission intends to ensure that no subsidization by existing cost-based shippers takes place. To date, when granting market-based rates in these circumstances, the Commission has required that the applicant separately account for all costs and revenues associated with facilities used to provide the market-based services.⁴⁸ We intend to continue this practice and will codify in new § 284.504 of the regulations the requirement that pipelines that provide cost-based services must separately account for all costs and revenues associated with facilities used to provide the market-based services. This will ensure that market-based services are not subsidized by cost-based services, as well as ensure that pipeline-owned storage is not afforded an unfair rate advantage over

⁴⁸ See, e.g., Gulf South Pipeline Co., 101 FERC ¶ 61,204 (2002); Koch Gateway Pipeline Co., 66 FERC ¶ 61,385 (1994).

independent storage providers.

99. Regarding Falcon's request to require unbundling, we note that our regulations already require that pipelines offer their customers firm and interruptible storage on an open-access contract basis.⁴⁹ Issues regarding whether a pipeline has sufficiently

unbundled its services in compliance with our policies should be raised in individual pipeline proceedings.⁵⁰

i. Additional Incentives

Comments

100. As an alternate to market-based rates, Dominion urges the Commission to consider offering incentives to promote the development of new storage facilities reflecting the increased investment risk of these projects, including: (1) authorizing higher rates of return on equity for new cost-of-service storage projects as compared to new pipeline projects to reflect the increasingly riskier nature of identifying new geologic structures and the shorter-term contracts that customers are entering into; (2) allowing the authorized rate of return for a new cost-of-service project to remain unchanged over the

⁴⁹ See 18 CFR 284.1(a) of the Commission's regulations that defines transportation as including storage. Thus, storage is included within the nondiscriminatory access and other requirements of Part 284 for interstate pipelines.

⁵⁰ APS' request that the Commission take steps to encourage the development of independent storage facilities in the southwest including eliminating the bundled pipeline storage and transmission services being offered by El Paso is outside the scope of this proceeding. This issue has been raised in El Paso's rate proceeding in Docket No. RP05-422-000 and will be addressed there.

duration of the initial shipper contract as revenue certainty is necessary to provide good incentives for new investment; (3) offering regulatory incentives to compensate for the enormous cost of purchasing base gas for a new facility, particularly reservoir and aquifer types of storage facilities, such as permitting the roll in of the costs of base gas associated with a new incrementally-priced storage facility into its system-wide rates in its next rate case with a five percent cap placed on the increase to system rates from this roll-in; and (4) permitting interstate pipelines to recover the prudently incurred development cost of storage facilities that are cancelled or abandoned prior to being placed into service, similar to the initiative being considered in the rulemaking to promote the construction of new transmission facilities in the electric utility industry.

Commission Determination

101. The Commission agrees with Dominion that there may be alternatives to market-based rates that would appropriately address the risk faced by storage applicants. We note that the Commission's policies already incorporate considerable flexibility in deriving cost-based pricing options that are responsive to the market pressures faced by jurisdictional companies. For example, in Order No. 637 the Commission revised its regulatory policies to enable pipelines to file for peak/off peak and term differentiated rates.⁵¹ In addition, rates for storage services can be negotiated between the storage

⁵¹ See Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, Order No. 637, FERC Stats. & Regs., Regulation Preambles July 1996-Dec. 2000 ¶ 31,091 (Feb. 9, 2000).

provider and a shipper under the Commission's negotiated rate policies.⁵² The Commission is willing to entertain requests to implement other cost-based pricing proposals that may serve to add flexibility and efficiency to storage services on a case-by-case basis.⁵³

B. Energy Policy Act of 2005

102. Section 312 of EAct 2005 adds new NGA section 4(f), which permits the Commission to authorize new natural gas storage projects (i.e., projects placed in service after the passage of the Act) to provide service at market-based rates notwithstanding the fact that the applicant is unable to demonstrate that it lacks market power. New NGA section 4(f) requires that, to authorize market-based rates, the Commission must find that "market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services" and "customers are adequately protected." The Act further requires that the Commission "ensure that reasonable terms and conditions are in place to protect consumers" and that the Commission "review periodically whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential." Intrastate pipelines also provide storage

⁵² Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 74 FERC ¶ 61,076 (1996), reh'g and clarification denied, 75 FERC ¶ 61,024 (1996), reh'g denied, 75 FERC ¶ 61,066 (1996); petition for review denied, Burlington Resources Oil & Gas Co. v. FERC, 172 F.3d (D.C. Cir. 1998); Modification of Negotiated Rate Policy, 104 FERC ¶ 61,134 (2003), order on reh'g and clarification, 114 FERC ¶ 61,042 (1996).

⁵³ See, e.g., Saltville Gas Storage Company L.L.C., 109 FERC ¶ 61,200 (2004) (approving a modified Equitable method for designing firm storage rates).

services, and new NGA section 4(f)(1) extends the market-based rate authority to intrastate pipelines subject to Commission authority under the Natural Gas Policy Act of 1978.⁵⁴ We discuss below the relevant aspects of new NGA section 4(f).

1. Storage Capacity Eligible for Market-Based Rates

103. New NGA section 4(f) states that the Commission may authorize “market-based rates for new storage capacity related to a specific facility placed in service after the date of enactment of the Energy Policy Act of 2005.” In the NOPR, the Commission posited that the phrase “placed in service after the date of enactment” modifies the term “facility,” not the term “capacity,” such that it is the facility which must be placed into service after August 8, 2005, rather than the storage capacity. Noting that the statute does not define the term “specific facility,” the Commission proposed to interpret that term to consider a new cavern, reservoir or aquifer that is developed after August 8, 2005, as a facility potentially qualifying for market-based rates under the Act. However, the Commission requested comments on alternative constructions of the Act. Moreover, the Commission also invited comments concerning how, if the Act is construed differently, the Commission may adequately protect other customers already receiving service under cost-based authorizations that pre-date the Commission’s new NGA section 4(f) authority.

⁵⁴ 15 U.S.C. 3301-3432 (2000). We note that the Commission has authorized Hinshaw pipelines to be treated the same as LDCs and we intend the same here. See Certain Transportation, Sales and Assignments by Pipeline Companies not Subject to Commission Jurisdiction Under Section 1(c) of the Natural Gas Act, Order No. 63, FERC Stats. & Regs., Regulations Preambles (1997-1981) ¶ 30,118 (Jan. 9, 1980).

Comments

104. A number of commentors argue that the statutory language concerning the capacity eligible for market-based rates under section 4(f) is ambiguous and open to alternative interpretation. Thus, they assert the Commission has discretion in implementing the language.

105. INGAA argues that the Commission interprets new NGA section 4(f) too narrowly, so as to exclude new storage capacity resulting from the expansion of existing fields or reservoirs. INGAA submits interstate pipelines and pipeline affiliates, which own substantial amounts of existing storage capacity, should be allowed to apply for market-based rates to develop either new or expanded storage fields. Northern concurs with INGAA and argues that a broader statutory interpretation is necessary. DTE maintains that there is no reason to treat expansion facilities any differently than entirely new storage fields. Duke adds that the best assurance against the exercise of market power is the creation of a competitive marketplace and that granting market-based rate treatment to only entirely new storage facilities may place existing storage at a significant disadvantage and discourage the expansion of existing storage.

106. Williston Basin argues that there is no material distinction between expanding existing storage facilities and developing a new, separate storage facility, and that the Commission's interpretation might unnecessarily influence companies to choose construction of a new facility over expansion of an existing facility. Northern asserts that the risks involved in developing new storage capacity, whether at a new or existing

facility, are greater than those involved in constructing new pipeline capacity and justify the use of market-based rates. It states that a broader interpretation of the subject

provision will recognize the risk of storage expansions and provide a proper incentive for developers.

107. Northern maintains that existing storage customers served by a pipeline will not be harmed by including expansions of existing capacity because customers' existing storage service will not be affected by the expansion. In this vein, Williston Basin asserts that, in the case of an expansion of existing storage facilities, existing customers under cost-based authorizations can be adequately protected if the incremental capacity and associated costs are accounted for separately and addressed in each storage service provider's next rate proceeding.

108. KM states that granting market-based rates to expansions of capacity will remove economic distortions associated with limiting this provision to new storage fields. KM asserts that it is faster and more cost-effective to expand existing storage facilities rather than to construct new storage facilities and that such expansions should be placed on equal footing with greenfield projects.

109. Other commentors support the interpretation of the Act proposed in the NOPR.⁵⁵ AGA argues that broadening the definition of "facility" would largely benefit interstate pipelines, and potentially harm existing customers of cost-based storage service. AGA

⁵⁵ AGA, Falcon, EnCana, Enstor, NGS, PGC, and SCE.

asserts that the Commission's policies should not encourage storage owners to invest in reshaping the operations of existing storage facilities in order to maximize the scope of market-based services. APGA agrees, and contends that the NOPR's interpretation is required by the language in the statute and is reasonable because there is no reason to provide financial incentives to a storage provider for an expansion of a facility that has already been constructed. PGC agrees arguing that interpreting section 4(f) to apply only to new facilities is most consistent with the goal of increasing storage capacity.

110. Falcon requests that the Commission ensure that new gas storage projects that are developed by Affiliated Storage Providers do not receive any direct or indirect subsidy from their affiliated companies. NGSA and EnCana assert that if the provision is interpreted to permit storage services made possible by incremental capacity at an existing, cost-based facility to be priced on a market basis, there would be no set of conditions that would adequately protect customers against the risk of abuse.

111. Beyond the risk of cross-subsidy, EnCana is also concerned that there is nothing to prevent a storage service provider with both cost-based rate facilities and market-based rate facilities from placing its marketing emphasis on the market-based rate side in order to ensure that those storage services are fully subscribed at the highest possible rate, while, at the same time, deemphasizing the sale of their regulated cost-based services, which are theoretically underwritten by the regulated ratepayers. ESGI asserts that, in order to provide safeguards against such practices, the Commission would need to vigilantly review the provider's marketing efforts in section 4 rate cases.

112. Enstor contends that allowing expansion capacity at existing storage facilities to qualify for market-based rate treatment under section 4(f) would place new storage projects (many of which are developed by independent operators) at a competitive disadvantage relative to market incumbents such as interstate pipelines. Enstor argues that allowing virtually all new capacity to fall within the scope of section 4(f) would enable interstate pipelines to use their cost-based transportation monopoly to subsidize new services offered under this authority.

113. The NiSource Pipelines assert that the Commission's interpretation of the phrase "specific facility placed in service after the date of enactment to mean "a new cavern, reservoir or aquifer that is developed after August 8, 2005" is not consistent with the gas industry's or the Commission's own definition of that term, which defines "in service" to mean when the facilities are actually placed into service. NiSource advocates that the Commission revise its interpretation to incorporate the more appropriate definition of "in service."

Commission Determination

114. The meaning of new NGA section 4 (f) is ambiguous. Early drafts of bills stated that the Commission could authorize a natural gas company "to provide storage and storage-related services at market-based rates for new storage capacity placed in service after the date of enactment of the Energy Policy Act of 2005, notwithstanding the fact that the company is unable to demonstrate that it lacks market power . . ."⁵⁶ Under these

⁵⁶ S. 10, 109th Cong. sec. 382 (2005). See also, H.R. 6, 109th Cong. sec 382 (with engrossed amendment as agreed to by the Senate, June 28, 2005); H.R. 6, 109th Cong.

early versions of the Act, it was clear that all new storage capacity would have been eligible for market-based rates. However, in the final bill, the phrase, “related to a specific facility” was added so that the subject language read, “to provide storage and storage-related services at market-based rates for new storage capacity related to a specific facility placed in service after the date of enactment of the Energy Policy Act of 2005 . . .”⁵⁷ The addition of the specific facility language indicates that it is the facility, not the storage capacity, that must be placed in service after the date of the Act.⁵⁸

115. Congress, however, provided no definition of the term facility. Upon review of the comments and further consideration, the Commission concludes that a more traditional interpretation of “facility” than that posited in the NOPR may be more consistent with Congressional intent and existing precedent, and better serve to further the Commission’s goal of facilitating the development of new natural gas storage capacity. The Commission recognizes that significant and substantial enhancements to storage capacity can be achieved at existing fields and finds that it is unnecessary to exclude service from such expansions from consideration for market-based rates by narrowly interpreting the term “facility” in the context of section 4(f). For purposes of implementing the certification requirements of section 7(c) of the NGA, the Commission

sec. 382 (as passed and ordered to be printed by the Senate, July 14, 2005).

⁵⁷ H.R. Rep. No. 109-190, at 97 (2005) (Conf. Rep.).

⁵⁸ See Jama v. Immigration & Customs Enforcement, 543 U.S. 335, 343 (2005) (noting the “‘grammatical ‘rule of the last antecedent,’ according to which a limiting clause or phrase . . . should ordinarily be read as modifying only the noun or phrase that it immediately follows.” (quoting Barnhart v. Thomas, 540 U.S. 20, 26 (2003))).

defined “facilities” broadly, in exclusionary terms – everything except “auxiliary installations” and certain facilities constituting replacement facilities are “facilities” for which a natural gas company must obtain a certificate.⁵⁹ Applying that same definition here, in the context of section 4(f), would be consistent with our longstanding practice in applying that term under the NGA and therefore consistent with the rule that Congress is deemed to be aware of existing administrative interpretations when amending a particular statute that contains such interpretations.⁶⁰ This definition would enable storage providers to seek market-based rates for service associated with capacity related to any “specific facility” requiring certification placed in service after the date of the Act, be it a new storage cavern or a facility which expands capacity at an existing cavern or reservoir. However, to receive such authorization, the storage provider will still need to satisfy the other requirements of section 4(f) discussed below. In addition, such rates will only be found to be in the public interest if the storage provider demonstrates that the market-based services will not be subsidized by existing customers and that customers receiving cost-based service from expanded facilities will be adequately protected.

⁵⁹ See 18 CFR 2.55 (2005).

⁶⁰ See *Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) (when administrative and judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its administrative and judicial interpretations as well).

116. Regarding the NiSource Pipelines' concern over the Commission's definition of "in service," we clarify that our intent is to define "in service" to mean when the facilities are actually placed into service.

2. **Market-Based Rates Are in the Public Interest and Necessary to Encourage the Construction of Storage Capacity in the Area Needing Storage Services**

117. Section 4 (f) of the NGA states that in order to allow a company to charge market-based rates under this section, the Commission must determine that: "market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services."⁶¹ In the NOPR, the Commission stated that applicants for authorization under section 4(f) will bear the burden of showing that in its specific circumstances, market-based rates are necessary to encourage the construction of storage capacity and that storage services are needed in the area. To make this showing, the Commission suggested that the applicant could present evidence that it had offered its capacity at cost-based rates through an open season and was unable to obtain sufficient long-term commitments at those cost-based rates. However, the Commission invited comments concerning other ways a project applicant might make these showings.

Comments

118. AGA supports the suggestion that an applicant under this section might

⁶¹ Energy Policy Act of 2005, Pub. L. No. 109-58, section 312, 119 Stat. 594, 688 (2005) (to be codified at 15 U.S.C. 717c(f)(1)(A)).

demonstrate the need for market-based storage rates by showing that the market failed to subscribe under long-term contracts at cost-based rates offered through an open season. INGAA also supports the Commission's suggestion, but suggests such a showing should not be required. Rather, the Commission should allow the applicant substantial discretion as to how to make the requisite showing based on the facts of its project. EEI agrees that the applicant should have the burden to show that market-based rates are necessary to encourage construction of storage capacity; specifically, EEI urges the Commission to require an applicant to show why such capacity cannot be developed under cost-based rates. SCE asserts that in the event an applicant relies on a failed open season as evidence of need, other parties must have the opportunity to contest the open season's reasonableness.

119. The NYPSC expresses concern that the NOPR did not discuss "public interest" as a standard separate and apart from "need," as the language of section 4(f) treats these as separate standards. The APGA also states that the Commission must revise § 284.505 to require a specific public interest demonstration.

120. NYPSC acknowledges that the "public interest" standard could encompass a broad range of factors. It argues, however, that while the Commission may find it is in the "public interest" to authorize market-based rates to encourage the entrance of independent, third party storage providers into the market, it may not be in the public interest to encourage the construction of new storage facilities by a pipeline with a dominant market share.

121. Haddington Ventures asserts that the Commission should recognize three distinct, categories of new storage projects and treat each differently under its section 4(f) policy. The three categories are: (1) independent storage projects owned by entities unaffiliated with existing natural gas infrastructure subject to cost-based rate regulation; (2) storage projects owned by entities affiliated with existing natural gas infrastructure subject to cost-based rate regulation, but which are not physically connected to such existing infrastructure; and (3) storage projects owned by entities affiliated with existing natural gas infrastructure subject to traditional cost-based rate regulation to which such storage projects are connected or upon which such storage projects otherwise rely.

122. Haddington Ventures submits that the Commission's proposal adequately addresses Category 2 projects, but should be adjusted to better account for Category 1 and Category 3 projects. With regard to Category 1 projects, Haddington Ventures asserts that the consumer protection required will be satisfied by: (a) the Commission's rate regulation of existing infrastructure, which establishes a ceiling on the price that the facility owner can command for storage, and (b) the relative ease of entry by potential competitors.

123. Haddington Ventures asserts that a Category 3 project should be granted market-based rates only after the project has met the burden of demonstrating that (a) no mechanisms remain that could be exploited to unfairly advantage such projects, and (b) any safeguards imposed are administrable. Category 3 projects should be required to demonstrate annually and whenever material changes in the market or of the project may

undermine customer protections. In addition, Haddington Ventures maintains that Category 3 projects that do not achieve the desired level of return at market-based rates should not be allowed to fold the costs of the project back into a regulated rate structure, except where (a) a bona fide change of circumstances has occurred that eliminates the original grounds for granting the market-based rate authority, and (b) the Commission is satisfied that the regulated rate would be lower than the market rate.

124. Enstor takes a different approach, asserting that those that oppose market-based rates should have the burden of showing that such rates are not “necessary to encourage the construction of the storage capacity in the area needing storage services.” Enstor proposes that the Commission establish a presumption that storage capacity will not be built in the absence of market-based rate authorization. Enstor asserts that, in the alternative, if the Commission does not adopt such a presumption, the objective financial criteria that the applicant’s lenders are requiring for the development of the particular project should be the basis for the required determination of need.

Commission Determination

125. In order to authorize market-based rates under section 4 (f), the Commission must determine that: (1) market-based rates are in the public interest; (2) market-based rates are necessary to encourage the construction of the storage capacity; and (3) the area in which the storage project is proposed needs storage services. We agree with the NYPSC and APGA that the public interest requirement is a separate standard under the Act and we have revised § 284.505 accordingly. The Commission will expect each applicant to

address each of these requirements in its applications explaining and supporting its contentions with respect to each element.

126. In determining whether market-based rates for a particular project are in the public interest, the Commission will consider, among other things, the risk of the project, and the investment required to fund it. Generally, the Commission would expect that for market-based rates to be in the public interest for services proposed under section 4(f), market-based rates would be necessary for the project sponsor to secure financing and move forward with the project. In the Commission's view, it is unlikely that market-based rate authorization would be necessary, or in the public interest, to encourage relatively risk-free expansions of storage.

127. We also agree with the NYPSC and Haddington that another factor to consider in determining whether market-based rates are in the public interest is whether the applicant is a new independent storage provider or an existing pipeline in the relevant market. In general, we believe that an existing pipeline will face fewer difficulties in securing financing for incremental expansions of existing storage facilities. As a going concern with existing customers and financial relationships, the risk associated with acquiring financing is lower for incremental expansions than the risk associated with a greenfield project undertaken by a new entrant in the market. Therefore, we believe it may be more difficult for an existing pipeline to meet the public interest standard than it will be for a new independent storage provider.

128. Ultimately, the Commission's finding that market-based rates are in the public interest will reflect its consideration of all aspects of 4(f) proposals, including, but not limited to, the risk faced by the project sponsors, the extent to which additional capacity is needed in the area of the project, and the strength of the applicant's showing that the facilities would not be built but for market-based rate treatment.

129. In order to receive authorization to charge market-based rates under section 4(f), each applicant must make a showing as to why market-based rates are necessary to encourage the construction of the storage capacity. As the Commission stated in the NOPR, one way that the applicant could make such a showing is to present evidence that it offered its capacity at cost-based rates through an open season and was unable to obtain sufficient long-term commitments at those cost-based rates. On the basis of the record, we believe such an open season is the best means of demonstrating that cost-based rates will not be sufficient. However we are open to applicants making another type of showing. Applicants may also cite to other marketing factors to explain why market-based rates are necessary. As suggested by SCE, parties will have an opportunity to comment upon this evidence.

130. The Commission will not establish a presumption that storage capacity will not be built in the absence of market-based rate authorization, as suggested by Enstor. The statute requires that the Commission make an affirmative finding that market-based rates are necessary to encourage the construction of storage. Also, in the Commission's experience, storage has been built in the absence of market-based rate authorization.

Regarding Enstor's assertion that the objective financial criteria that the applicant's lenders are requiring for the development of the particular project should be the basis for the determination of the necessity of the project, the Commission will afford applicants significant discretion in demonstrating that market-based rates are necessary to encourage the development of additional storage. Enstor can cite to requirements imposed by its lenders if it believes that such requirements justify the authorization of market-based rates. The Commission cannot make a generic determination on such issues, but must look at the positions of the parties in individual cases.

131. Applicants will also have to show that storage services are needed in the area in which they are proposing a project. An applicant can demonstrate need by including evidence of a general lack of storage in the area or that existing storage capacity is fully utilized, pipeline constraints leading into the area, projected increased demand for natural gas in the area to be served, customer interest, high natural gas prices and/or volatility and other information the applicant believes supports its determination that additional storage is needed. As noted above, the Commission will balance the strength of an applicant's showing of need with the other requirements of the Act in determining whether to approve a request for market-based rates under NGA section 4(f).

132. The Commission notes that the subject of this rule is whether and in what circumstances authorization of market-based rates would be appropriate pursuant to NGA section 4(f). To the extent an applicant is also requesting authority to construct and operate new storage facilities pursuant to NGA section 7(c), the applicant will be subject

to the full range of requirements of the Commission's certificate process.⁶²

3. Customer Protection

133. New NGA section 4(f) requires that the Commission, as a prerequisite for granting market-based rate authority, determine that customers are adequately protected, and requires the Commission to ensure that reasonable terms and conditions are in place to protect them. In the NOPR, the Commission proposed to allow the applicant to propose a relevant method of protecting customers.

134. The Commission stated that in general, customers will be better off if more storage infrastructure is constructed. Therefore, the Commission sought a balance in considering requests for market-based rate authority under new NGA section 4(f), between the obvious benefits of additional storage capacity in areas needing storage services against adverse impacts which might arise from the potential exercise of market power by the storage provider. In doing so, the Commission stated that it remained mindful of the fact that to the extent unnecessary conditions are imposed, the additional storage infrastructure and the additional service options would be lost to potential customers. Accordingly, the Commission sought comments concerning how to achieve this balance.

⁶² Pursuant to § 157.20(b) of the Commission's regulations, any authorization granted for the construction of a proposed project will establish a time within which construction of the facility must be completed and made available for service. We have in the past granted extensions of time within which to complete construction of proposed projects. With regard to projects for which NGA section 4(f) authorization is sought, we note that we would not anticipate granting an extension of time to complete construction based on an argument that market demand for the project has not materialized.

135. The Commission stated that the appropriate method of customer protection may vary according to the facts and circumstances of the individual project proposals and therefore, the Commission proposed to allow each applicant to propose a method of protecting customers best suited to its project. However, the Commission sought comments on whether it would be beneficial to identify certain acceptable approaches to protect customers. The Commission reasoned that the establishment of generic safeguards would facilitate the application process for NGA section 4(f) market-based rate authority, but stated that each applicant would retain the right to propose other methods of protecting customers that might better fit the circumstances of its project.

136. Therefore, in addition to seeking suggestions for possible generic safeguards, the Commission outlined two generic safeguards for comment. The Commission reasoned that entities with market power can exercise that power in two general areas: (1) the withholding of capacity; and (2) the extraction of monopoly rents. Therefore, the Commission set forth two approaches to protecting customers against the exercise of market power. The first approach would involve conditions that limit the withholding of capacity and the second approach would involve rate protections.

137. The Commission reasoned that market power can be exercised in circumstances where a storage operator can withhold capacity from the market and thereby raise prices. The Commission stated that as long as storage capacity has not been withheld, “the fact that shippers may at times bid up contract length likely reflects not an exercise of [the

pipeline’s] market power, but rather competition for scarce capacity.”⁶³ The Commission requested that comments address whether by ensuring that the storage operator has sold or made available to the market all of its capacity (and thus it is not withholding capacity), customers can be assured that market power is not being exercised by the storage service provider and that any increase in price is due to customers’ demand for storage relative to the available supply.⁶⁴

138. The Commission recognized that one difficulty in applying this standard is defining when withholding should be found to be indicative of the exercise of market power. Therefore, the Commission requested comment on how to apply a prohibition against withholding which balances the competing needs of the project sponsor to secure revenues adequate to attract necessary investment in new infrastructure and of the needs of customers to be protected from the abuse of market power.⁶⁵

139. The Commission also pointed out that market power can be exercised in those circumstances where a storage operator can extract monopoly rents and stated that rate

⁶³ Process Gas Consumers Group v. FERC, 292 F.3d 831, 837 (D.C. Cir. 2002).

⁶⁴ Id. (affirming Commission determination that prices determined through an uncapped bidding process were the product of competitive forces, not the exercise of market power).

⁶⁵ ? The Commission sought comment on several consumer protection questions including: (1) whether allowing the storage operator to set a reserve price would provide an appropriate balance; and (2) whether a withholding prohibition should apply all the time, or only during periods of peak demand for storage services? The Commission also request comment on how terms such as “reserve price” and “period of peak demand” should be defined, if such conditions were to be adopted. The Commission also requested comment on whether a formal auction process under which the applicant is obligated to sell all capacity above a reserve price should be considered?

protections could take several forms. The Commission stated that rate caps could be designed to provide adequate customer protection while also supporting the financing of new storage projects. The Commission sought comment on whether there are certain approaches to rate caps that could be adopted as a generic safeguard. The Commission also proposed that it allow an applicant to establish a long-term (e.g., 5-10 years) recourse rate that was cost-based and allow the applicant to negotiate contracts under market-based rates for shorter-term transactions and requested comment on this approach or whether there were other cost-based rate designs or price cap methodologies that the Commission should consider.

Comments

140. With respect to the “customer protection” findings required under section 4(f)(1) (B), INGAA and Williston Basin submit that the Commission can rely on the same reporting requirements and NGA section 5 complaint process that it proposes with respect to compliance with the statutory periodic review requirement. INGAA and Williston Basin also support the Commission's suggestion that it may rely on a showing that a storage operator has sold or made available all of its capacity.

141. INGAA asserts that the focus of customer protection should be those customers receiving storage service at cost-based rates. Other commenters, including AGA, APGA, and NGSAA, place the focus on storage customers seeking service under market-based rates authorized pursuant to section 4(f). EGSI requests the Commission to also ensure protection for competitors.

142. Williston maintains that the applicant should be allowed to propose an adequate method of protecting customers and the Commission should address each application individually. Duke also asserts that the Commission should not adopt any generic safeguards that will be the equivalent of price controls. Duke argues that imposing on storage participants an obligation to sell available capacity is unworkable and, if adopted, would eliminate any of the potential advantages that would result from market-based rates. Duke explains that for an obligation to sell to be meaningful, that obligation must be imposed with respect to some price, which inevitably leads to the imposition of price controls.

143. Northern, Sempra, INGAA and Enstor state that the circumstances of a project should determine the appropriateness of any given customer protection. Northern maintains there are some additional protections that should apply, including an open season bidding process with or without a minimum reserve price, known terms and conditions of service defined in the storage provider's tariff, a restriction on the storage provider requesting during a contract term that the market-based rates it agreed to be increased, a commitment by the pipeline to existing customers that it will not allocate incremental costs associated with a market-based storage expansion to existing shippers receiving storage services under cost-based rates in a general rate case proceeding, and a requirement that market-based rates should be subject to the Commission's reporting and posting requirements. SCE urges the Commission to perform a contemporaneous market-wide analysis in determining whether to grant market-based rate authority as well

as considering mitigation methods tailored to the specifics of each application.

144. Dominion supports both the case-specific approach to reviewing the adequacy of customer protections, and establishing generic protections that will expedite the process. Dominion submits that customers will be protected from the exercise of market power if they are offered long-term, cost-based storage rates as a recourse service option.

Dominion asserts that this will prevent a storage provider from extracting monopoly rents because a customer can always opt for the long-term recourse service. Withholding of capacity is therefore not possible, Dominion stresses, because the services will be offered under open-access, non-discriminatory FERC-approved tariffs.

145. PGC states it is appropriate to establish a general rule requiring the use of certain pre-established safeguards where market-based rate authority is granted. However, because some concerns may be case-specific, PGC supports requiring individual applicants to carry the burden of demonstrating that consumers are adequately protected, separate and apart from their compliance with any universally established safeguards. PGC supports the requirement that all capacity be offered for sale and made available to customers on a non-discriminatory basis.

146. NYPSC supports the establishment of generic safeguards. Specifically, the NYPSC maintains that a condition prohibiting the withholding of capacity would serve to protect consumers. It states that the Commission could address the pricing issues associated with this condition by allowing applicants to propose and support a reasonable recourse rate on a case-by-case basis. The NYPSC also supports allowing intervenors to

propose other protective conditions on a case-by-case basis. NASUCA asserts that restrictions on withholding of capacity would limit the ability of a storage operator to exercise market power. NASUCA urges the Commission to require the storage applicant to post, both continuously and on a real-time basis, the amount of contracted storage service and storage capability for each storage service offered, the identified differences being considered an offer to sell.

147. AGA urges the Commission to lift the cap on capacity releases in order to permit greater competition with storage operators to place downward pressure on prices.

148. APGA maintains that the NOPR errs in its assumption that the consumer will be protected by requiring that a market-based-rate storage service provider sell all of its existing capacity. APGA contends that the Commission's reliance on Process Gas is misplaced because that decision relied on the fact that the rates for the capacity in question were regulated and thus the pipeline would have no incentive for refusing to build additional capacity. This is not the situation the Commission faces in the instant case. APGA also contends that the NOPR erred in fashioning customer and consumer protections that disregard the statutory requirement that rates and services cannot be unduly discriminatory or preferential.

149. To prevent the imposition of either excessive or unduly discriminatory rates, APGA proposes that: (1) the Commission cap the price of long-term storage service (i.e. contracts with a term of one year or more) and require tariff terms and conditions for this

service; (2) these long-term contracts be subject to the right-of-first-refusal; (3) storage operators be allowed to sell any excess capacity as short-term storage service; (4) an auction be used to award storage capacity where the storage operator must make all capacity available at or above a reserve price (a rate no higher than the cost-based rate for short-term capacity); (5) storage operators be required to continually provide timely information on storage capacity availability and to initiate an auction upon a prospective customer request; (6) storage providers be required to maintain a record for three years of the quantities, rates, terms and conditions and date of each market storage purchase; (7) the Commission review, every three years, whether the availability and rates offered are just and reasonable and not unduly discriminatory or preferential; (8) the Commission be allowed to proceed sua sponte or based on a complaint to determine whether the rates, terms and conditions were or are just and reasonable; (9) the Commission be granted the authority to require the disgorgement of unjust profits, invoke civil fines, and suspend or revoke the certificate or market-based rate authority where it determines that the availability or rates charged for market-based rates were or are not just and reasonable or are unduly preferential or discriminatory; and (10) the costs of the storage capacity for which market based rates are sought be prohibited from inclusion in recourse rates.

150. EGSI urges the Commission to be sensitive to the need to protect competitors as well as customers, because a storage provider that has market power and market-based rates could use that market power in anti-competitive ways. EGSI agrees that one way of

guarding against such an abuse of market power is the establishment of a minimum "reserve" rate or rate floor. EGSi suggests that such rate floor be set at or above the facility's short-term marginal costs.

151. Enstor does not support the adoption of the Commission's suggested generic consumer safeguards. Enstor asserts that the Commission's proposed prohibition on the withholding of capacity, and its suggested rate protections, would upset the balance between the customer and the storage provider such that new storage projects would never get built. INGAA also rejects the "rate cap" protections suggested by the Commission as simply incompatible with market-based rates. Enstor would support an approach where the rate applicant would state upfront whether it would be willing to submit to an annual reporting requirement detailing the agreements and rates that it negotiated during the preceding 12 months, similar to those that section 311 service providers submit. Enstor advocates that the Commission adopt a 60-day "safe harbor" review period during which the market-based rate arrangements could be evaluated. If the Commission took no action during this time frame, the arrangements would be left intact.

152. NGSA suggests that the Commission take the following steps to ensure consumer protection: (1) assess whether the applicant has provided sufficient evidence that its rates will be just and reasonable by examining whether the proposed rates are "in line" with other storage rates within the region that are charging market-based rates; (2) assess other specific safeguards as proposed by the applicant that indicate that the applicant is willing

to mitigate market power, including whether the applicant has negotiated contracts that permit customers to ratchet down levels or permit mandatory “out” clauses or contracts that include indexed-based rates where the risk is shared by the applicant and the customer; (3) require the applicant to hold an open season, which if structured correctly, will provide transparency and enhance the Commission’s ability to analyze and review the conduct of the storage operator; (4) apply generic customer safeguards which would include a no withholding requirement requiring that all storage capacity be available at all times with a “reserve price” based on the range of rates charged for storage area facilities with market-based rates; (5) reaffirm existing policies including the filing of a tariff that contains all terms and conditions of service, as well as standard forms of service agreements, and the ability of customers to release capacity and application of the affiliate rules under Order No. 2004; and (6) employ several prospective generic actions for all applications which would include the monitoring of an applicant’s compliance with the implementation of the safeguards and acting swiftly upon receiving a customer complaint.

Commission Determination

153. As a prerequisite for granting market-based rate authority, new NGA section 4(f) requires that the Commission, determine that customers are adequately protected, and requires the Commission to ensure that reasonable terms and conditions are in place to protect them. The Commission will require an applicant for this authorization to show

that granting its application can be done consistent with the requirement of section 4(f)(1)(B).⁶⁶ This may be done in different ways, and as the NOPR proposed, we will leave applicants with the discretion to fashion proposals that will operate effectively given the unique situations involved. However, we will also describe methods that an applicant might employ to satisfy the Commission that the customer protection requirement has been met.

154. Customer protection starts with potential storage customers having a fair and open opportunity to contract for proposed new capacity. One way for an applicant requesting section 4(f) authority to demonstrate that interested customers were given non-discriminatory access to new storage capacity would be to show that it had conducted a fair and transparent open season. The industry has conducted open seasons for quite a few years, and the Commission has provided guidance in individual cases on issues that have arisen.⁶⁷ A properly conducted open season will allow a project sponsor to test the market, attempt to negotiate mutually agreeable rates which support the project financially, and provide a means to give the market fair notice of and open access to potential new services. Allegations that the process offered by an applicant failed to

⁶⁶ In its comments, NYPSC requests the Commission allow interveners to propose other protective conditions on a case-by-case basis. While the burden rests with the applicant, interveners may also propose protective conditions. The Commission will give full consideration to such proposals when it considers an individual case.

⁶⁷ See, e.g., Ouachita River Gas Storage Co., L.L.C., 68 FERC ¶ 61,402 (1994); Avoca Natural Gas Storage, 68 FERC ¶ 61,045 (1994); Northwest Pipeline Corp., order denying reh'g, 61 FERC ¶ 61,047 (1992); Pacific Gas Transmission Co., 54 FERC ¶ 61,291 (1991).

provide such fair notice and access can be raised by potential customers in individual proceedings.

155. APGA argues that the NOPR erred in disregarding the statutory requirement that rates and services cannot be unduly discriminatory or preferential. The Commission disagrees. With respect to rates, nothing in this Final Rule transgresses the statutory requirement that they be “just, reasonable and not unduly discriminatory or preferential.” With respect to services, every Part 284 transporter, which includes storage service providers, must comply with the non-discriminatory access requirements of those regulations.⁶⁸ This rule deals with the setting of rates and does not disturb nor set aside other provisions of the Commission’s open-access requirements.

156. Another necessary component of customer protection is ensuring that existing customers are not subject to additional costs, risks, or degradation of service resulting from new services provided under section 4(f). Potentially, existing storage service providers, including interstate pipelines and intrastate pipelines, may request authority to charge market-based rates pursuant to section 4(f). Any applicant which already serves customers under prior authorization must ensure that existing customers will not be subject to additional costs, risks, or degradation of service as a result of a section 4(f) authorization, and must explain how its application is consistent with this requirement.

157. In addition, successful applicants will be required to separately account for the costs, services, and commitments provided pursuant to section 4(f) authorizations, and to

⁶⁸ 18 CFR 284.7(b), 284.7(c) and 284.9(b) (2005).

retain these records for as long as they may be required under the Commission's existing practices for pipelines operating under the Uniform System of Accounts.⁶⁹

158. A third fundamental protection is an open-access tariff stating the terms and conditions of service offered. While the rates would be left to individual negotiation, within the customer protections offered by that provider and accepted by the Commission, the terms and conditions of service must be provided in a generally-applicable tariff. As acknowledged and supported in the comments of Northern and NGSAs, a tariff provides essential transparency and basic knowledge about the nature and quality of service to be provided. It is also a touchstone by which all customers may be assured that the quality of service provided is comparable for all customers.⁷⁰ Although the NOPR did not refer to tariff-filing requirements, we note that the context of these authorizations is the provision of open-access storage and storage-related services offered under Part 284 of the Commission's regulations. While parts of these regulations are routinely waived in market-based rate authorizations upon applicant's request and for good cause shown, the Commission has consistently required generally applicable tariffs for these services and intends to continue this practice for authorizations pursuant to section 4(f). This will also allow the Commission to "ensure that reasonable terms and conditions are in place to protect consumers" as required by new section 4(f).

⁶⁹ 18 CFR Part 225 (2005).

⁷⁰ For transporters offering service pursuant to NGPA section 311, their statement of operating conditions will provide similar transparency and consistency of service for all customers.

159. EGSI asks the Commission to expand customer protection to require that competitors also be protected. While the Commission does not generally require that competitors be protected, and does not read the customer protection requirement of new section 4(f) to require such protection, the Commission agrees that as a general matter, storage service providers, like other natural gas companies, should not charge rates less than their marginal costs.⁷¹ However, the Commission is not here requiring that a storage service provider authorized to collect market-based rates under section 4(f) state a minimum average variable cost rate below which it would not be allowed to charge. Rather, in the event of a complaint, the Commission will require the storage service provider to demonstrate that marginal costs were recovered under every rate charged.

i. Withholding

160. In the NOPR, the Commission requested comment on whether customers can be assured that market power is not being exercised if all capacity is made available to the market, and how to apply a prohibition against withholding. NiSource Pipelines assert that the Commission's Part 284 regulations already contain a generic safeguard against withholding of capacity.⁷² INGAA states that an auction process with an appropriate

⁷¹ See Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, FERC Stats. and Regulations, Regulations Preambles 1982-1985 ¶ 30,665, at 31,543-45 (1985) (permitting the discounting of transportation rates between the maximum and minimum approved rates with the minimum rate based on average variable costs).

⁷² Citing, Process Gas Consumers Group v. FERC, 292 F.3d 831, 837 (D.C. Cir. 2002) (Process Gas) and Natural Gas Pipeline Negotiated Rate Policies and Practices, 114 FERC ¶ 61,042 at P 10 (2006).

reserve price would be an appropriate means of complying with a no-withholding rule. However, INGAA urges the Commission not to attempt to establish generic requirements for how such a reserve price should be established. Northern believes that an open season with or without a reserve price (and with other stated conditions) would be an appropriate method of compliance.

161. PGC, NYPSC and NASUCA all support the concept of prohibiting withholding. PGC and NYPSC would leave the method for achieving this result to be worked out in individual cases. NASUCA would impose continuous and real-time posting requirements on capacity, contracted capacity and available capacity. APGA would also require more capacity postings, and would require the storage operator to initiate an auction upon customer request.

162. Williston and Duke, on the other hand, argue that a formal auction requirement with a reserve price would reduce or eliminate the incentive for storage service providers and customers to enter into market-based rates contracts and they urge the Commission to allow the applicant to propose an adequate method of customer protection. They argue that any mandated reserve price would constitute de facto cost-based rate regulation and would nullify any benefits offered by market-based rates under these circumstances. Enstor objects to any generic requirements or prohibitions.

163. The Commission believes that an applicant's proposal that adequately prevents withholding is one good way to meet the customer protection requirement. The Commission's existing Part 284 open access regulations require interstate pipelines to

provide service on a non-discriminatory basis to the extent capacity is available and a qualified shipper is willing to pay the maximum tariff rate. In the absence of proof that the service provider lacks market power and a just and reasonable rate, the Commission has no reason to believe (and no basis for reasonably deciding) that an applicant for section 4(f) market-based rates does not have the potential to exercise market power. In this context, a proposal that acts to prevent withholding as a method of exercising substantial market power, tempered with a reasonable reserve price which would allow a section 4(f) applicant to recover its investment appears to be the best way to satisfy the test.

164. Several commenters have suggested specific methods for setting reserve prices. For example, NGSAs suggests use of the range of rates charged for other area storage facilities with market-based rates. APGA would require a cost-based rate to be used. However, the Commission acknowledges the objections of Williston and Enstor that a mandatory reserve price is tantamount to indirect cost-based ratemaking. Many other commenters advocate leaving it to the individual applicant to establish a reasonable method of compliance. The Commission believes that the most reasonable course is to allow the individual applicant to propose a method that balances adequate customer protections against withholding as a tool for exercising significant market power against the applicant's need for revenue sufficiency.

165. In its application for section 4(f) authority to charge market-based rates, the

applicant must demonstrate how it intends to comply with the no-withholding requirement, and must also specify whether, and if so, how it will establish a reserve price. The Commission will entertain reserve prices which represent a reasonable price in the market to be served. A few examples of how this price may be set include: prices offered by competing storage sellers in the same market, as suggested by NGS; applicant's total costs; applicant's other already agreed upon rates (e.g., the highest initial rate agreed to at arms-length with a non-affiliate in the initial open season); or another type of reserve price for which the applicant can provide a just and reasonable basis convincing to the Commission based on the facts of a specific case. Applicants proposing a method of forestalling attempts to withhold capacity in an effort to exert market power which does not include a reserve price must convincingly demonstrate how the proposal will prevent the withholding of capacity.

ii. Other Rate and Service Protections

166. In the NOPR, the Commission also sought comments on rate caps that might provide protection against the extraction of monopoly rents. In response, Dominion advocates that the offer of a long-term cost-based storage service as a recourse service offering, would satisfy the customer protection requirement. APGA proposes a two-prong approach where long-term storage services are first offered at price-capped rates, with unbooked capacity available to be auctioned for short-term services; the short-term auction would be subject to a reserve price no higher than the cost-based rate for short-term capacity. Many of the pipelines and storage operators oppose any cost-based

pricing restraints as nullifying the incentives to build new storage infrastructure.

167. The Commission will not mandate cost-based price controls as a method for ensuring customer protection. On balance, we agree with the comments that a mandated price cap would undermine and perhaps nullify the incentive to build new storage infrastructure, which is the Commission's primary goal here, and is otherwise tantamount to imposing a cost-based rate, rather than granting authority to sell at market-based rates. However, the Commission views the suggestion of a long-term cost-based recourse storage service as a viable approach that an applicant may propose. In addition, some of the concepts discussed above on the reserve price issue may offer other methods of capping prices which an applicant may use in its proposal. For example, a price cap based on the range of prices offered by competing sellers in the same market could be adopted without an auction process.

4. Periodic Review

168. In the NOPR, we suggested that regular Commission monitoring of market-based storage operators based on existing forms and data postings, supplemented as necessary with more specific information, would satisfy the periodic review requirement of the new NGA section 4(f). Appropriate action under section 5 of the NGA would be available should the Commission determine, based on its own review or in response to a complaint, that rates charged by the storage operator were not just and reasonable.

169. The Commission requested comments on this approach, whether further reporting or transparency requirements should be imposed, and whether the applicant's proposed

customer protection requirements should be reviewed every five years.

Comments

170. Several commentors generally agreed with the approach described in the proposed rule to rely on existing reporting requirements, and NGA section 5, to comply with the periodic review requirement.⁷³ INGAA submits that the information currently reported, along with the public information regularly reviewed by Commission staff and the information provided in response to any specific complaint, as well as the existing compliance regulations, are sufficient to ensure compliance with the statute. Williston Basin and Enstor state that a more formal review process, such as every five years, would add unnecessary expense and is unlikely to present any additional information than is already publicly distributed on a regular basis. Sempra states that the reporting requirements should be designed to provide information that updates the information that was initially relied upon by the Commission in concluding that market-based rates were appropriate and to assure that such rates remain just and reasonable.

171. AGA, on the other hand, supports a periodic review of market-based rates every five years in addition to the proposed Commission monitoring of public postings by storage operators. AGA suggests that the Commission provide an opportunity every five years for customers and interested parties to submit comments regarding storage rates and consumer protection measures. Similarly, NGSA also suggests that the Commission institute a periodic review at least every five years or earlier if potential issues are

⁷³ Comments of INGAA, Williston Basin, Enstor, Dominion, and DTE.

detected as a result of the Commission's monitoring or a filed complaint. APGA disagrees with the Commission's suggestion that a section 5 complaint complies with the section 4(f) mandate that the Commission periodically review whether the market-based rate is just and reasonable and not unduly discriminatory or preferential. According to APGA, a section 5 complaint procedure suggests that the Commission can impose only a prospective remedy, which would fall short of the consumer and customer protections mandated by section 4(f).

Commission Determination

172. We find that the regular Commission staff monitoring based on existing forms and data postings, supplemented as necessary with more specific information required during the course of any necessary inquiry, coupled with our authority under NGA section 5 will satisfy the periodic review requirement of the new NGA section 4(f). Ongoing review of storage operations, capacity subscription, and transaction details would provide a greater degree of customer protection than would a formal review on a multi-year periodic cycle. Ongoing review, as part of the Commission's regular market oversight and enforcement efforts, would identify potentially problematic situations faster and initiate solutions sooner than a formal periodic proceeding.

173. Existing reporting requirements provide a wide range of information regarding storage service operations and rates. The Index of Customers filing under § 284.13(c) reports contract entitlements quarterly. The semi-annual storage report under § 284.13(e) filed at the end of the injection and withdrawal seasons identifies the capacity applicable

to each storage customer, the actual volume injected or withdrawn, the revenues received, and any discounts permitted. The information in these reports, supplemented with ad-hoc staff inquiries will provide tools to identify potential unlawful withholding of storage capacity.

174. Storage operators are also required to post a daily report of available storage on their electronic bulletin board or Web site under § 284.13(d). This data will allow the detection of daily storage operating patterns inconsistent with appropriate market operations.

175. Storage providers also must report the rates and terms of storage service transactions under § 284.13(b) at the time service commences. These reports will provide the opportunity to detect potential undue discrimination or preference in storage rates or services. The Commission reminds storage operators that this requirement will be monitored closely by our oversight and audit staff to assure full compliance.

176. Financial and operational data reporting in Form 2 or 2a is another source of information useful in monitoring section 4(f) storage operations, rates, and services. We will require section 4(f) storage companies to fully comply with the financial and accounting information required for Forms 2 and 2a. While we have waived these requirements for storage operators found to lack market power, we will not do so for firms seeking market-based rates under section 4(f). Full compliance is necessary to provide the Commission with a more complete picture of market-based storage

operations for firms presumed to possess market power.

177. The above sources of information are available for regular monitoring by the Commission staff and current or potential storage service customers. These sources, plus the ability of the Commission staff to seek further information as needed, will provide for more timely review and remediation of section 4(f) storage rates and service that might fall outside of a range of reasonableness or fail to meet the just and reasonable standard than a formal periodic review proceeding.

178. While the ongoing review of section 4(f) storage operations by the Commission staff would not be a formal proceeding in which customers could file comments, as suggested by the AGA, customers would still have the opportunity to make their views known in several ways. Customers could contact the Commission's Enforcement Hotline to bring problem situations to the attention of the Commission. Interventions in proceedings involving section 4(f) operators provide another venue for communication. Alternate dispute resolution processes are available through the Dispute Resolution staff. The formal complaint process under section 5 is available for more serious concerns.

179. Although we believe that these reporting requirements will be sufficient to allow the Commission and other interested parties to ensure that customer protections remain adequate over time, as required by the Act, in the event it is demonstrated that this is not the case for a particular project, we will take whatever additional steps are necessary to ensure that the periodic review provision of the statute is satisfied.

180. We disagree with the assertion by the APGA that a section 5 complaint procedure

would fall short of the consumer and customer protections mandated by section 4(f) because under section 5 remedies can only be prospective remedy. There is nothing in the new section 4(f) that implies a remedial procedure for rates under this section other than the prospective remedy afforded by section 5 of the NGA.

181. Finally, as noted infra, failure to comply with the § 284.13 filing requirements would constitute a violation of the Commission's orders and regulations. A storage provider would be subject to disgorgement of profits and/or civil penalties from the date on which the violation occurred. Such a storage provider may also be subject to suspension or revocation of its authority to sell at market-based rates (or other appropriate non-monetary remedies).

5. Presumption of Market Power

182. Proposed § 284.505(b) provides that any storage service provider seeking market-based rates for storage capacity pursuant to section 4(f) will be presumed to have market power.

Comments

183. INGAA urges the Commission to eliminate proposed § 284.505(b) that establishes a presumption that an applicant has market power. INGAA submits that new NGA section 4(f) does not require it and without a clear picture of the implications of the presumption, potential applicants may be dissuaded from pursuing otherwise meritorious storage projects.

184. Similarly, the NiSource Pipelines claim that this presumption is not consistent

with section 312 of EPCRA 2005. They submit that applying the presumption would create precedent for all subsequent proceedings that the applicant possesses market power, regardless of the fact that no market power analysis has ever been performed.

185. EnCana argues that consistent with the intent of Congress, the Commission should revise proposed § 284.505(b) by: (i) removing the presumption of market power, and (ii) adding language which requires a traditional market power study to be filed by a storage service provider as part of its § 284.505 application. EnCana argues that the presumption of market power is not present in section 4(f); rather, EnCana asserts that Congress contemplated that a traditional market power analysis would be filed in connection with a market-based rate authorization granted under that section. EnCana maintains that the Commission should use this market power study to determine what terms and conditions to impose upon a given authorization in order to provide the protection required by section 4(f) of the NGA. EnCana asserts that the terms and conditions imposed by the Commission should be proportionate to the results of the market power study; the strictest terms and conditions should be imposed when a storage service provider fails both parts of the market power test, namely that the market it plans to enter is found to be heavily concentrated, or it will have a high market share in that market. Where a storage service provider fails the first part of the test (high market concentration due to the small number of participants), but shows that it will, in that concentrated market, have low market share, EnCana asserts that the Commission should be able to impose more lenient conditions based on a finding that, despite having market power, admitting the new

entrant into the market would increase competition by diluting the market concentration of the dominant player(s) in the market area.

Commission Determination

186. In implementing new section 4(f) of the NGA, we find that the establishment of a presumption of market power is warranted in order to meet our consumer protection obligation under the NGA to protect ratepayers from excessive rates.⁷⁴ Because new section 4(f) permits market-based rates without a finding that the applicant lacks significant market power, we can not rely on competition to ensure that rates remain just and reasonable as we do under our traditional market power analysis. Rather, in order to ensure that the rates we authorize under section 4(f) will be just and reasonable, it is necessary to establish a presumption of market power in implementing the consumer protection provision of the Act. However, we clarify that the presumption of market power is intended to apply only for the purpose of implementing section 4(f); and is not a generic finding that would apply in other situations.

187. We reject EnCana's request that we require section 4(f) applicants to submit a market power study. We find that implementation of such a requirement is inconsistent with the intent of Congress in implementing section 4(f) which specifically permits the Commission to authorize market-based rates notwithstanding the fact that the applicant is unable to demonstrate that it lacks market power. Under the Final Rule, an applicant can choose whether to file a market power study under the traditional approach for

⁷⁴ See generally FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944).

obtaining market-based rates or by submitting an application under the provisions of section 4(f) that does not require a showing of a lack of market power but requires the applicant to meet other requirements including that market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services and customers are adequately protected.

6. Applicability of section 4(f) Treatment

Comments

188. Enstor seeks clarification that the Commission's requirements related to implementation of section 4(f) are not applicable to an applicant that seeks a determination that it lacks market power.

189. Dominion seeks clarification that new section 4(f) applies only to rate treatment and not to the storage service itself. Dominion states that it utilizes all of its storage assets together to achieve operational efficiency. Dominion seeks confirmation from the Commission that should it receive market-based rate authority for a new storage project under section 4(f), it will be able to operate that field on an integrated basis in conjunction with the other storage assets that are subject to cost-based rates.

Commission Determination

190. We clarify that the requirements adopted in § 284.505 related to implementation of section 4(f) are not applicable to applicants seeking a finding that they lack market power. Rather, those applicants are subject to the requirements set forth in §§ 284.503

and 284.504 which require an applicant to submit a traditional market power analysis.

An applicant is free to choose the procedures it wishes to be subject to.

191. We do not have a sufficient basis to rule on Dominion's request that we find that if Dominion receives market-based rate authority for a new storage project under section 4(f), it will be able to operate that field on an integrated basis in conjunction with its other storage assets. Dominion may file and support such a request in any proceeding it files pursuant to section 4(f).

C. Other Issues

1. Section 284.126(d) Notification of Termination

Comments

192. Bay Gas requests that the Commission remove § 284.126(d), Notification of termination, from its regulations consistent with Order No. 581.⁷⁵ Bay Gas asserts the Commission stated it was removing that provision in the preamble of Order No. 581 but failed to delete that section from the regulations.

Commission Determination

193. Bay Gas's request is beyond the scope of this proceeding. However, we note that on March 23, 1999, an errata was issued in Docket No. RM95-4-000 modifying the regulatory text to Order No. 581 to include the deletion of § 284.126(d). We have placed Bay Gas' request in the rulemaking docket in which Order No. 581 was issued and will

⁷⁵ Revisions to Uniform System of Accounts, Forms, Statements, and Reporting Requirements for Natural Gas Companies, FERC Stats. & Regs., Regulations Preambles (January 1991-June 1996) ¶ 31,026 (Sept. 28, 1995).

correct the matter there.

2. Encouragement of Certain Types of Storage

Comments

194. Falcon Gas is concerned that statements made in the NOPR regarding the operations of salt caverns v. reservoir storage may be read to favor one storage project over another. Falcon maintains that the Commission should be clear with respect to its comments and intentions and let the market determine which form of gas storage capacity is best suited to any particular area of need. Falcon submits that reservoir storage, with the appropriate reservoir characteristics and equipped with the appropriate number of properly-configured wells and attendant surface facilities, can very closely match the operating characteristics of salt cavern storage, typically at a fraction of the unit development cost.

Commission Determination

195. The Commission clarifies that it did not intend by its statements in the NOPR to prejudge whether one form of gas storage capacity is better suited to any particular area of need. Rather, our intent was to provide a general statement of the function of certain types of storage capacity. We affirm our intent to continue to evaluate the merits of a particular storage project on a case-by-case basis.

3. Storage and Related Services Eligible for Market-based

Rates

196. The NiSource Pipelines contend that the Final Rule should not limit the availability of market-based rates to firm storage services. Noting that the Commission has typically approved market-based rate authority for small storage projects, not storage services provided by major interstate pipeline companies, the NiSource Pipelines contend that the Commission should broaden the two methods proposed in the NOPR for obtaining market-based rates to include interruptible storage services, short-term firm and seasonal storage services. They also state that the Commission should consider applications for market-based rates for park and loan services and other services that provide storage-type imbalance management functions.

Commission Determination

197. We clarify that the applicability of the provisions we are adopting in subpart M are not limited to firm storage services. An applicant may seek market-based rate treatment for any storage services that it proposes to provide. We will grant requests to charge market-based rates for storage services to the extent the applicant is able to meet the requirements set forth in the regulations.

V. Summary of Regulations

198. The Commission, therefore, is revising its Part 284 regulations as follows. New subpart M will be added, which addresses applications for market-based rates for storage. Within new subpart M, § 284.501, Applicability, explains which pipelines or storage service providers are eligible to apply for market-based rates under subpart M, § 284.502,

Procedures for applying for market-based rates, explains what procedures must be followed for submitting an application. Section 284.503, Market-power determination, explains what must be submitted as part of an application for market-based rates, including what information must be submitted related to an applicant's market power. Section 284.504, Requirements for market-power authorizations, requires storage service providers granted the authority to charge market-based rates who also provide cost-based service(s) to separately account for all costs and revenues associated with facilities used to provide the market-based services. This section also requires storage providers to notify the Commission of significant changes occurring in its market power status. Section 284.505, Market-based rates for storage providers without a market-power determination, explains what a storage service provider that does not seek a market-power determination must submit to the Commission in an application for market-based rates.

VI. Information Collection Statement

199. The Office of Management and Budget (OMB) regulations require that OMB approve certain reporting, record keeping, and public disclosure (collections of information) imposed by an agency.⁷⁶ Accordingly, pursuant to OMB regulations, the Commission is providing notice of its proposed information collections to OMB for

⁷⁶ 5 CFR 1320.11 (2005).

review under section 3507(d) of the Paperwork Reduction Act of 1995.⁷⁷

200. The Commission identifies the information provided under Part 284 subpart M as contained in FERC-545, FERC-546 and FERC-549.

201. The Commission did not receive specific comments concerning its burden estimates and uses the same estimates here in the Final Rule, as modified to reflect the elimination of the requirement that applicants granted market-based rate approval after the effective date of a Final Rule file an updated market power analysis once every five years. The burden estimates for complying with additional filing requirements of this rule pursuant to the procedures in proposed new sections 284.503 and 284.505 are set forth below. For the most part, the burden on applicants seeking market-based rates for open-access storage services will not be changed by this proposed rule. Since 1996, applications for authority to charge market-based rates have been filed under the Commission's procedures applicable to NGA section 7 initial rate determinations, NGA section 4 rate changes, or NGPA section 311 rate determinations under the Commission's existing data collection authorities. This rule codifies application procedures and filing requirements which are little changed from the process followed since 1996.

Codification of filing requirements will allow applicants to know what information must be filed with such an application and should reduce the need for staff to send out follow-

⁷⁷ 44 U.S.C. 3507(d) (2000).

up data requests and respondents to file data responses. To the extent respondents seek market-based rate authority under the new NGA section 4(f) authorization process, also codified in these regulations, the burdens may be lower than if they had filed to seek authorization under the Commission’s 1996 Policy Statement. On average, we expect the burden of making an application for authority to charge market-based rates under this proposed rule to be 350 hours.

202. Over the past several years the Commission has approved market-based rates for storage services at an average pace of about 4.5 per year. The Commission is issuing this Final Rule in hopes that more storage will be constructed and operated, especially in underserved areas. In reflection of this policy goal, the Commission estimates that up to 8 filings may be made in a typical year. While this estimate may be high, in light of recent experience, at worst the Commission is overestimating the burden.

Data Collection	No. of Respondents	No. of Responses Per Respondent	Hours Per Response	Total Annual Hours
FERC-545, FERC-546, or FERC-549	8	1	350	2,800

Total Annual Hours for Collection: 2,800 hours.

203. Information Collection Costs: The Commission sought comments on the cost to

comply with these requirements. No comments were received. The Commission has projected the average annualized cost for all respondents to be \$280, 000 (3,500 hours x \$80.00 per hour).

204. Title: Gas Pipeline Rates: Rate Change (FERC-545); Certificated Rate Filings: Gas Pipeline Rates (FERC-546); and Gas Pipeline Rates: NGPA Title III Transactions (FERC-549).

205. Action: Proposed Information Collection.

206. OMB Control Nos.: 1902-0154, 1902-0155 and 1902-0086

207. The applicant shall not be penalized for failure to respond to these collections of information unless the collections of information display valid OMB control numbers.

208. Respondents: Business or other for profit.

209. Frequency of Responses: On occasion.

210. Necessity of Information: On August 8, 2005, Congress enacted EPAAct 2005.

Section 312 of EPAAct 2005 amends the NGA to insert a new section, 4(f), which allows the Commission to permit natural gas storage service providers authority to charge market-based rates, subject to conditions and requirements set forth in the statute. The Commission considers the issuance of these regulations necessary to implement this Congressional mandate and to encourage the development of new natural gas storage facilities. The proposed rule updates the Commission's market power analysis to better reflect the competitive alternatives to storage available in today's wholesale natural gas

marketplace. These changes should ease the applicant's burden in showing that a Commission grant of market-based rate authority is appropriate, thus encouraging the construction and operation of needed new storage infrastructure. The proposed rule in implementing EPCRA 2005 creates regulations that allow qualifying storage providers to seek authority to charge market-based rates when the providers cannot or do not demonstrate they lack market power. The proposed rule revises the requirements contained in 18 CFR Part 284 to add a new subpart M to require that applications by storage providers requesting market-based rates contain certain information showing why market-based rates are necessary to encourage storage services and including a method for protecting customers.

211. Internal Review: The Commission has assured itself, by means of internal review, that there is specific, objective support for the burden estimates associated with the information requirements. The Commission staff will review the data included in the application to determine whether the proposed rates are in the public interest as well as for general industry oversight. The Commission staff will review periodically the transactional and operational information provided by those granted authority to charge market-based rates pursuant to NGA section 4(f) to determine "whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential." These requirements conform to the Commission's plan for efficient information collection, communication and management within the natural gas industry.

212. Interested persons may obtain information on the reporting requirements by

contacting the following: Federal Energy Regulatory Commission, 888 First Street, NE, Washington, D.C. 20426 (Attention: Michael Miller, Office of the Executive Director, 202-502-8415, fax: 202-273-0873, e-mail: michael.miller@ferc.gov).

213. For submitting comments concerning the collection of information and the associated burden estimate(s) including suggestions for reducing this burden, please send your comments to the contact listed above and to the Office of Management and Budget, Room 10202 NEOB, 725 17th Street, N.W., Washington, D.C. 20503 (Attention: Desk Officer for the Federal Energy Regulatory Commission, 202-395-4650, fax: 202-395-7285).

VII. Environmental Analysis

214. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.⁷⁸ The Commission has categorically excluded certain actions from these requirements as not having a significant effect on the human environment.⁷⁹ The actions proposed to be taken here fall within categorical exclusions in the Commission's regulations for rules that are clarifying, corrective, or procedural, for information gathering, analysis, and dissemination, and for sales, exchange, and

⁷⁸ Order No. 486, Regulations Implementing the National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs. Preambles 1986-1990 ¶ 30,783 (1987).

⁷⁹ 18 CFR 380.4 (2005).

transportation of natural gas that requires no construction of facilities.⁸⁰ Therefore, an environmental review is unnecessary and has not been prepared in this rulemaking. We note that environmental review will be prepared in each proceeding in which an applicant requests authority to construct facilities that might become subject to the rate-setting requirements of this rule.

VIII. Regulatory Flexibility Act Certification

215. The Regulatory Flexibility Act of 1980 (RFA)⁸¹ generally requires a description and analysis of the impact the proposed rule will have on small entities or a certification that the proposed rule will not have significant economic impact on a substantial number of small entities. The Commission concludes that the Final Rule would not have such an impact on small entities. The amendments to our regulations would apply only to natural gas companies, most of which are not small businesses. Accordingly, pursuant to section 605(b) of the RFA, the Commission certifies that the regulations proposed herein will not have a significant adverse impact on a substantial number of small entities.

IX. Document Availability

216. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business

⁸⁰ See 18 CFR 380.4(a)(2)(ii), 380.4(a)(5), 380.4(a)(27) (2005).

⁸¹ 5 U.S.C. 601-612.

hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426

217. From FERC's Home Page on the Internet, this information is available in the Commission's document management system, eLibrary. The full text of this document is available in eLibrary, in PDF and Microsoft Word format for viewing, printing, and downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

218. User assistance is available for eLibrary and the FERC's website during normal business hours from our Help line at (202)502-8222 or the Public Reference Room at (202) 502-8371 Press 0, TTY (202)502-8659. E-Mail the Public Reference Room at public.referenceroom@ferc.gov

X. Effective Date

219. These regulations are effective [insert date 30 days after publication in the **FEDERAL REGISTER**]. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of OMB, that this rule is not a major rule defined in section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996.⁸² The Commission will submit the Final Rule to both houses of Congress and the General Accounting Office.⁸³

⁸² See 5 U.S.C. 804(2) (2000).

⁸³ See 5 U.S.C. 801(a)(1)(A) (2000).

List of subjects in 18 CFR part 284

Continental shelf, Natural gas, Reporting and recordkeeping requirements.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

In consideration of the foregoing, the Commission amends part 284, Chapter I, Title 18, Code of Federal Regulations, as set forth below.

PART 284 -- CERTAIN SALES AND TRANSPORTATION OF NATURAL GAS UNDER THE NATURAL GAS POLICY ACT OF 1978 AND RELATED AUTHORITIES

1. The authority citation for part 284 continues to read as follows:

Authority: 15 U.S.C. 717-717w, 3301-3432; 42 U.S.C 7101-7352; 43 U.S.C 1331-1356.

2. New subpart M is added to read as follows:

Subpart M – Applications for Market-Based Rates for Storage

Sec.

284.501 Applicability.

284.502 Procedures for applying for market-based rates.

284.503 Market-power determination.

284.504 Standard requirements for market-power authorizations.

284.505 Market-based rates for storage providers without a market-power determination.

§ 284.501 Applicability. Any pipeline or storage service provider that provides or will provide service under subparts B, C, or G of this part, and that wishes to provide storage and storage-related services at market-based rates must conform to the requirements in subpart M.

§ 284.502 Procedures for applying for market-based rates.

(a) Applications for market-based rates may be filed with certificate applications. Service, notice, intervention, and protest procedures for such filings will conform with those applicable to the certificate application.

(b) With respect to applications not filed as part of certificate applications,

(1) Applicants providing service under subpart B or subpart G of this part must file a request for declaratory order and comply with the service and filing requirements of part 154 of this chapter. Interventions and protests to applications for market-based rates must be filed within 30 days of the application unless the notice issued by the Commission provides otherwise. An applicant providing service under subpart B or subpart G of this part cannot charge market-based rates under this subpart of this part until its application has been accepted by the Commission. Once accepted, the applicant can make the appropriate filing necessary to set its market-based rates into effect.

(2) Applicants providing service under subpart C of this part must file in accordance with the requirements of that subpart.

§ 284.503 Market-power determination. An applicant may apply for market-based rates by filing a request for a market-power determination that complies with the following:

(a) The applicant must set forth its specific request and adequately demonstrate that it lacks market power in the market to be served, and must include an executive summary of its statement of position and a statement of material facts in addition to its

complete statement of position. The statement of material facts must include citation to the supporting statements, exhibits, affidavits, and prepared testimony.

(b) The applicant must include with its application the following information:

(1) Statement A--geographic market. This statement must describe the geographic markets for storage services in which the applicant seeks to establish that it lacks significant market power. It must include the market related to the service for which it proposes to charge market-based rates. The statement must explain why the applicant's method for selecting the geographic markets is appropriate.

(2) Statement B--product market. This statement must identify the product market or markets for which the applicant seeks to establish that it lacks significant market power. The statement must explain why the particular product definition is appropriate.

(3) Statement C--the applicant's facilities and services. This statement must describe the applicant's own facilities and services, and those of all parent, subsidiary, or affiliated companies, in the relevant markets identified in Statements A and B in paragraphs (b) (1) and (2) of this section. The statement must include all pertinent data about the storage facilities and services.

(4) Statement D--competitive alternatives. This statement must describe available alternatives in competition with the applicant in the relevant markets and other competition constraining the applicant's rates in those markets. Such proposed alternatives may include an appropriate combination of other storage, local gas supply,

LNG, financial instruments and pipeline capacity. These alternatives must be shown to be reasonably available as a substitute in the area to be served soon enough, at a price low enough, and with a quality high enough to be a reasonable alternative to the applicant's services. Capacity (transportation, storage, LNG, or production) owned or controlled by the applicant and affiliates of the applicant in the relevant market shall be clearly and fully identified and may not be considered as alternatives competing with the applicant. Rather, the capacity of an applicant's affiliates is to be included in the market share calculated for the applicant. To the extent available, the statement must include all pertinent data about storage or other alternatives and other constraining competition.

(5) Statement E--potential competition. This statement must describe potential competition in the relevant markets. To the extent available, the statement must include data about the potential competitors, including their costs, and their distance in miles from the applicant's facilities and major consuming markets. This statement must also describe any relevant barriers to entry and the applicant's assessment of whether ease of entry is an effective counter to attempts to exercise market power in the relevant markets.

(6) Statement F--maps. This statement must consist of maps showing the applicant's principal facilities, pipelines to which the applicant intends to interconnect and other pipelines within the area to be served, the direction of flow of each line, the location of the alternatives to the applicant's service offerings, including their distance in miles from the applicant's facility. The statement must include a general system map and

maps by geographic markets. The information required by this statement may be on separate pages.

(7) Statement G—market-power measures. This statement must set forth the calculation of the market concentration of the relevant markets using the Herfindahl-Hirschman Index. The statement must also set forth the applicant's market share, inclusive of affiliated service offerings, in the markets to be served. The statement must also set forth the calculation of other market-power measures relied on by the applicant. The statement must include complete particulars about the applicant's calculations.

(8) Statement H--other factors. This statement must describe any other factors that bear on the issue of whether the applicant lacks significant market power in the relevant markets. The description must explain why those other factors are pertinent.

(9) Statement I--prepared testimony. This statement must include the proposed testimony in support of the application and will serve as the applicant's case-in-chief, if the Commission sets the application for hearing. The proposed witness must subscribe to the testimony and swear that all statements of fact contained in the proposed testimony are true and correct to the best of his or her knowledge, information, and belief.

§ 284.504 Standard requirements for market-power authorizations.

(a) Applicants granted the authority to charge market-based rates under § 284.503 that provide cost-based service(s) must separately account for all costs and revenues associated with facilities used to provide the market-based services. When it files to change its cost-based rates, applicant must provide a summary of the costs and revenues

associated with market-based rates with applicable cross references to §§ 154.312 and 154.313 of this chapter. The summary statement must provide the formulae and explain the bases used in the allocation of common costs between the applicant's cost-based services and its market-based services.

(b) A storage service provider granted the authority to charge market-based rates under § 284.503 is required to notify the Commission within 10 days of acquiring knowledge of significant changes occurring in its market power status. Such notification should include a detailed description of the new facilities/services and their relationship to the storage service provider. Significant changes include, but are not limited to:

- (1) The storage provider expanding its storage capacity beyond the amount authorized in this proceeding;
- (2) The storage provider acquiring transportation facilities or additional storage capacity;
- (3) An affiliate providing storage or transportation services in the same market area; and
- (4) The storage provider or an affiliate acquiring an interest in or is acquired by an interstate pipeline.

§ 284.505 Market-based rates for storage providers without a market-power determination.

(a) Any storage service provider seeking market-based rates for storage capacity, pursuant to the authority of section 4(f) of the Natural Gas Act, related to a

specific facility put into service after August 8, 2005, may apply for market-based rates by complying with the following requirements:

(1) The storage service provider must demonstrate that market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services; and

(2) The storage service provider must provide a means of protecting customers from the potential exercise of market power.

(b) Any storage service provider seeking market-based rates for storage capacity pursuant to this section will be presumed by the Commission to have market power.

Note: The following appendix will not be published in the Code of Federal Regulations.

Appendix

Commentors Filing Initial Comments

American Gas Association (AGA)
American Public Gas Association (APGA)
Arizona Public Service Company (APS)
Bay Gas Storage Company, LTD (Bay Gas)
Bridgeline Storage Company LLC (Bridgeline)
Columbia Gas Transmission Corporation, Columbia Gulf Transmission Company,
Crossroads Pipeline Company, and Granite State Gas Transmission, Inc. (collectively
NiSource Pipelines):
Dominion Transmission Inc. (Dominion)
DTE Gas Storage, Pipelines, and Processing Company (DTE)
Duke Energy Gas Transmission, LLC (Duke)
EnCana Gas Storage Inc. (EnCana)
The East Ohio Gas Company, d/b/a Dominion East Ohio, The Peoples Natural Gas
Company, d/b/a Dominion Peoples, and Hope Gas, Inc. d/b/a Dominion Hope
(collectively, Dominion LDCs)
Edison Electric Institute and the Alliance of Energy Suppliers (together, EEI)
Enstor Operating Company, LLC (Enstor)
Falcon Gas Storage Company, Inc. (Falcon Gas)
Haddington Ventures, LLC (Haddington Ventures)
Honeoye Storage Corporation (“Honeoye”)
Independent Petroleum Association of America (IPAA)
Interstate Natural Gas Association of America (INGAA)
Kinder Morgan Interstate Pipelines (KM)
National Association of State Utility Consumer Advocates (NASUCA)
Natural Gas Supply Association (NGSA)
New York Public Service Commission (NYPSC)
Northern Natural Gas Company (Northern)
Port Barre Investments, LLC (Port Barre)
Process Gas Consumers Group (PGC)
Sempra Energy (Sempra)
SGR Holdings, L.L.C. (SGR)
Southern California Edison Co. (SCE)
Williston Basin Interstate Pipeline Company (Williston Basin)
United Energy Trading LLC (UET)
Unocal Keystone Gas Storage, LLC (Unocal)

Xcel Energy Services, Inc. (Xcel)

Commentors Filing Reply Comments

Duke Energy Gas Transmission LLC (Duke)

El Paso Natural Gas Company (El Paso)

Enstor Operating Company, LLC (Enstor)

Interstate Natural Gas Association of America (INGAA)

Jefferson Island Storage & Hub, L.L.C. (Jefferson Storage)

Natural Gas Supply Association (NGSA)

Southern California Gas Company (SoCal)