

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Rate Regulation of Certain Natural Gas
Storage Facilities

Docket Nos. RM05-23-001
and AD04-11-001

ORDER NO. 678-A

ORDER ON CLARIFICATION AND REHEARING

(Issued November 16, 2006)

1. On June 19, 2006, the Commission issued Order No. 678¹ amending its regulations to establish criteria for obtaining market-based rates for storage services offered under Part 284 of the Commission's regulations. Timely requests for rehearing and/or clarification of Order No. 678 were filed by the American Gas Association (AGA), Enstor Operating Company, LLC (Enstor), and jointly by the Natural Gas Supply Association, American Public Gas Association, Process Gas Consumers Group, and American Forest & Paper Association (Joint Associations).² The requests for rehearing are denied, and clarification is granted, in part, as discussed below.

I. Background

2. In Order No. 678, the Commission adopted a two prong approach for reforming its current storage pricing policies. First, the Commission modified its market-power

¹ *Rate Regulation of Certain Natural Gas Storage Facilities*, 115 FERC ¶ 61,343 (2006).

² On September 9, 2006, the Interstate Natural Gas Association of America (INGAA) filed leave to answer and an answer to the requests for rehearing and clarification. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits answers to rehearing requests unless otherwise ordered by the decisional authority. We do not find good cause to accept INGAA's answer and therefore will reject it.

analysis to permit the consideration of close substitutes to gas storage in defining the relevant product market. We explained that this will ensure that market-based rates are not denied because of an overly narrow definition of the relevant market. Second, the Commission adopted regulations implementing section 312 of the Energy Policy Act of 2005 (EPAct 2005 or the Act),³ which permits the Commission, in appropriate circumstances, to authorize storage providers to charge market-based rates for service utilizing new capacity even when the storage providers cannot (or do not) demonstrate that they lack market power. The purpose of the rule is to reduce natural gas price volatility and improve adequacy of gas supply during periods of peak demand by encouraging expansions of storage capacity while protecting customers from the exercise of market power.

II. Discussion

A. Market Power Test

1. Expansion of the Product Market Definition

3. The first part of Order No. 678 addresses reforms of the Commission's market-power test to more accurately reflect the competitive conditions in the market for gas storage services. Order No. 678 provides that in individual applications, the Commission will consider potential substitutes for gas storage, such as available pipeline capacity, local gas production, liquefied natural gas (LNG), and released transportation capacity. The Commission explained that in today's markets, these products may well serve as adequate substitutes for gas storage in appropriate cases.

4. AGA and the Joint Associations request that the Commission reverse its decision to broaden the product market definition in analyzing applications to charge market-based rates for existing storage facilities. They assert that this change in the market power analysis fails to advance or support the stated goal of the rule, which is to facilitate the development of new storage capacity.

5. If rehearing is not granted as requested, the Joint Associations and AGA seek additional protections for existing customers. The Joint Associations request the Commission to clarify that existing customers of storage facilities authorized to change from cost-based to market-based rates would have the option of having their cost-based contracts grandfathered or be given an early termination right. AGA requests that the Commission clarify that following a finding that a storage provider lacks significant

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

market power, customers with long-term contracts subject to *Memphis* clauses will not be subject to market-based rates and, such customers' right of first refusal will not be subject to market-based rate caps.

Commission Conclusion

6. We reject petitioners' arguments on rehearing that we should not apply the expanded product market definition to existing storage facilities. While it is true that our overall regulatory goal in Order No. 678 was to promote additional infrastructure, it is not our only policy consideration. Where markets are shown to be competitive, market-based rates are appropriate because they will provide the most efficient allocation of resources. 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.⁴ The Commission fully explained how its proposed regulatory change meets this requirement in Order No. 678.⁵

7. As to the petitioners' alternative requests, we note that a *Memphis* clause in a contract authorizes the pipeline to make unilateral NGA section 4 filings to change the rates, terms, and conditions under which the pipeline will provide the service included in the customer's contract.⁶ Therefore, a *Memphis* clause in a contract would permit a pipeline to file to change a customer's existing cost-based rate to a market-based rate. However, in order to support a finding by the Commission that a pipeline's proposal to charge market-based rates is just and reasonable, the pipeline has the burden of demonstrating that it lacks significant market power or has adequately mitigated such market power over the shippers who would be subject to market-based rates. The Commission finds that it is more appropriate to address the specific issues raised by petitioners in individual proceedings based on the facts and circumstances in each proceeding. Based on the record developed, the Commission will ensure that a pipeline's

⁴ *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. 1993); *Louisiana Energy and Power Authority v FERC*, 141 F.3d 364, 369-70 (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, 1013-14 (9th Cir. 2004).

⁵ See Order No. 678, 115 FERC ¶ 61, 343 at P 29-31.

⁶ See *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division*, 358 U.S. 103 (1958).

proposal to charge market-based rates is just and reasonable. Accordingly, petitioners' alternative requests for rehearing and/or clarification are denied without prejudice to our further consideration of these issues in individual cases.

2. Determination and Quantification of a Good Alternative

8. In order to show that a non-storage gas 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.⁷ 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.

9. AGA requests that the Commission clarify that capacity held by local distribution companies under long-term firm contracts will not be considered as a competitive alternative in a market power determination.

10. The Joint Associations request that the Commission afford greater protections to storage service customers by finding that non-storage products, such as local gas production, LNG suppliers and pipeline capacity under the expanded market power analysis, are not good alternatives for customers that use storage service to physically store gas; or in the alternative, clarify that a market-based rate applicant using a market power analysis that includes non-storage products must show that such products are good alternatives for all customers, including customers that use storage services to physically store gas. In addition, they seek clarification that in order for a non-storage product to be considered a good alternative, it must be available for customers that use storage service to physically store gas during the periods in which such customers seek to inject gas, not just during peak demand periods.

Commission Conclusion

11. As the Commission stated in Order No. 678, 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

⁷ *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) (*Policy Statement*), *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).

power.⁸ 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."⁹ The rehearing requests do not convince us that we should foreclose, or alternatively mandate, any particular method for determining the substitutability of a product here; rather, we will base our determination on the record developed in individual proceedings. 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.

3. Periodic Review

12. Order No. 678 did not adopt the proposal in the notice of proposed rulemaking (NOPR)¹⁰ to require those authorized to charge market-based rates on the basis of a market power analysis to file once every five years to demonstrate their continued lack of market power. For storage providers with market shares of ten percent or less, the rule finds that the existing posting and reporting requirements, change-in-status reports required in this rule and ongoing market monitoring programs will allow the Commission to take appropriate action when needed. For storage providers with market shares greater than ten percent, the Commission stated it will consider in individual cases whether periodic reports are necessary.

13. The Joint Associations request that the Commission require all storage providers with market-based rates that have a ten percent or greater market share to file updated market power analyses every five years. They disagree with the Commission's conclusion that existing reporting requirements and ongoing market monitoring generally provide sufficient information to know whether storage markets remain competitive. In support, they claim that the Commission does not have accurate information regarding the entire storage market because the Commission only has jurisdiction over approximately one-half of the underground storage facilities in the United States. They also maintain that the change of status filing requirement does not provide a comprehensive look at the conditions in the market because the reporting requirements

⁸ *Policy Statement* at 61,230-231.

⁹ *Id.*

¹⁰ *Rate Regulation of Certain Underground Storage Facilities*, Notice of Proposed Rulemaking, FERC Stats. & Regs., Regulations Preambles ¶ 32,595 (2005).

only focus on changes within the control of the storage provider. Finally, they challenge the Commission's statement in the rule that its decision not to impose a generic periodic review requirement was 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.¹¹ To be consistent, they maintain that the Commission should limit the class of storage providers not subject to a periodic filing requirement to those not affiliated with an entity with captive customers and impose the periodic filing requirement on all storage providers that do not meet the requirements for the exemption.

14. On the other hand, Enstor requests that in light of the Commission's decision not to adopt a generic five year rate review requirement, it should lift similar conditions, as appropriate, that have already been imposed on existing market-based rate authorizations. Specifically, Enstor requests that the Commission eliminate the requirement to file an updated market power analysis that was imposed on its Grama Ridge Facility.¹²

Commission Conclusion

15. We deny the Joint Associations' request to adopt a generic periodic filing requirement for all storage providers with market-based rates that have a ten percent or greater market share. We continue to believe that a determination on whether to impose a periodic filing requirement for this class of storage providers should be decided on a case-by-case basis. As the Commission stated in Order No. 678, this approach will permit it to balance the need for a periodic review in order to monitor for market power with other considerations, including the goal of creating a regulatory environment that will promote infrastructure, based on the particular facts presented in individual cases. If the record developed in an individual proceeding indicates that the existing reporting requirements and change of status filing requirement will not provide sufficient

¹¹ *Citing 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).

¹² *See Grama Ridge Storage and Transportation, LLC*, 113 FERC ¶ 61,301 (2005).

information concerning the relevant storage market to enable the Commission and interested parties to effectively monitor the storage provider, we will adopt additional reporting requirements as deemed appropriate.¹³

16. In addition, we find the argument that we must adopt a generic filing requirement for gas storage providers granted market-based rates because we proposed to retain a generic filing requirement for certain classes of power producers is unavailing. In comparison to requests for market-based rates from sellers of wholesale electric power, we receive few requests for market-based rates for gas storage services. Moreover, in the majority of these cases where we have granted market-based rates, the applicant has not had a large presence in the market nor is the applicant typically affiliated with entities owning transmission facilities in the geographic market. For these reasons, we concluded that there was no need to impose a generic filing requirement on any class of market-based rate storage applicants. Rather, we found that for the class of storage providers with a market share greater than ten percent, we could best balance our regulatory goals by considering in individual cases whether the specific facts and circumstances presented require additional reporting. Additionally, if subsequent experience demonstrates a need for a generic five-year market-power analysis requirement, we reserve the right to initiate such a change.

17. We also deny Enstor's request to lift the periodic reporting requirements imposed by the Commission on its Grama Ridge Facility in this generic proceeding. This finding is without prejudice to Enstor filing such a request in the proceeding in which the periodic filing requirement was adopted.¹⁴

¹³ Generally, we find that the fact that we do not regulate the entire storage market does not unreasonably inhibit our monitoring efforts. First, certain non-jurisdictional storage data is publicly available. Second, in monitoring for significant market power, a lack of non-jurisdictional storage data would result in a storage provider appearing to have a larger market share than it really has which would result in closer scrutiny of that storage provider by the Commission. We note that, to the extent that our initial finding of lack of market power for a particular applicant was based in part on applicant-submitted data on competing non-jurisdictional storage to which we would not normally have access, we would consider on a case-specific basis whether additional reporting requirements are needed.

¹⁴ Consistent with the Commission's finding in Order No. 678, Enstor claims that a periodic reporting requirement is unnecessary for the Grama Ridge Facility because the market share of the facility is less than ten percent.

4. Change of Status Requirement

18. AGA requests that the Commission clarify that customers will have an opportunity to provide comments or otherwise participate with respect to filings made by storage providers following a significant change in competitive circumstances. The Commission clarifies that it is our intent to provide notice and comment on any change of status filing we receive.

B. Energy Policy Act of 2005

19. The second part of Order No. 678 implements section 312 of EAct 2005. That provision amends the NGA to include a new section 4(f) that permits the Commission to authorize market-based rates for storage and storage-related services related to a specific facility placed in service after August 8, 2005, if the Commission determines that:

- (1) 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) customers are adequately protected.

1. Definition of Facilities

20. In implementing the new NGA section 4(f), Order No. 678 takes a different approach to defining the term “facility” than was proposed in the NOPR.¹⁵ After review of the comments, Order No. 678 defines the term “facility” consistent with the Commission’s long-standing practice to define “facilities” under the NGA 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.¹⁶

21. All three petitioners request that the Commission interpret new NGA section 4(f) to apply only to new storage caverns, reservoirs or aquifers and not to expansions of existing facilities. The Joint Associations and Enstor argue that the Commission’s

¹⁵ Noting that the statute does not define the term “specific facility,” in the NOPR 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. FERC Stats. & Regs., Regulations Preambles ¶ 32,595 at P 37 (2005).

¹⁶ See 18 C.F.R. § 2.55 (2006).

interpretation of the word “facility” is inconsistent with the plain meaning and legislative history of section 4(f). Specifically, they assert that by adopting the expanded definition, the Commission has read the phrase “related to a specific facility” completely out of the statute which is inconsistent with its obligation to construe a statute to give every word some operative effect.¹⁷ AGA asserts that the Commission failed to adequately address the potential harms of the broader definition to both new and existing customers.

22. If the Commission does not grant rehearing, Joint Associations request that the Commission explicitly require applicants under new NGA section 4(f) to adopt certain minimum measures to ensure that market-based rate authority will not adversely impact existing customers, including requiring applicants to: (1) ensure that existing customers will not be subject to additional costs, risks or degradation of service; (2) separately account for the costs, services, and commitments provided under section 4(f) authorizations; and (3) provide non-discriminatory terms and conditions of service under an open-access tariff.

Commission Conclusion

23. The rehearing requests raise no arguments not already considered by the Commission in Order No. 678. We affirm our decision to define the term “facility” broadly to include expansions of existing facilities. Contrary to the claims of petitioners, the statute is ambiguous because Congress did not define the term “facility” in the Act. In addition, while the legislative history shows that 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 . . .,”¹⁸ this added phrase does not add clarity to the meaning of “facility.” In these circumstances, the Commission found in Order No. 678, and reiterates here, that interpreting the word broadly, to include expansions of existing facilities for purposes of NGA section 4(f), is reasonable. Such an interpretation is consistent with our longstanding practice in applying that term under the NGA. As courts have noted when interpreting new or amended statutes that repeat existing statutory language, Congress is deemed to be aware of existing administrative interpretations of the existing language it

¹⁷ *Citing Cooper Industries, Inc. v. Aviall Services, Inc.*, 543 U.S. 157, 167 (2004).

¹⁸ H.R. Rep. No. 109-190, at 97 (2005) (Conf. Rep.).

incorporates into the new or amended statute.¹⁹ Further, it is reasonable to read the phrase “related to a specific facility” to mean not only completely new storage facilities but also specific new portions of existing facilities, especially when considering the expressed intent of Congress in new section 4(f) to “encourage the construction of . . . storage capacity in . . . area[s] needing storage services.” Recognizing that significant and substantial enhancements to storage capacity can be achieved at existing fields, we find that continuing to use our long-standing definition of the word “facility” is more consistent with Congressional intent, and better serves to further the goal of both Congress and the Commission to facilitate the development of new natural gas storage capacity. This interpretation also allows for the possibility of optimizing the efficient use of existing infrastructure.

24. We do not share AGA’s view that we have not adequately addressed the potential harms of the broader definition to both new and existing customers. We reiterate that a storage provider seeking market-based rates under new NGA section 4(f) needs to satisfy the other requirements of section 4(f) including the requirement that customers are adequately protected. In this regard, as requested by the Joint Associations, we clarify that in order to demonstrate that market-based rate authority will not adversely impact existing customers, an applicant would be required to: (1) ensure that existing customers will not be subject to additional costs, risks or degradation of service; (2) separately account for the costs, services, and commitments provided under section 4(f) authorizations; and (3) provide non-discriminatory terms and conditions of service under an open-access tariff. The Commission will review the appropriateness of additional requirements on a case-by-case basis.

2. Periodic Review

25. In Order No. 678, the Commission found that regular Commission monitoring of market-based storage operators based on existing forms and data posting, supplemented as necessary with more specific information, coupled with our authority under NGA section 5, meets the periodic review requirement of NGA section 4(f).

26. The Joint Associations request that the Commission require applicants under new NGA section 4(f) to report at least every five years on the adequacy of the customer

¹⁹ See, e.g., *Bragdon v. Abbott*, 524 U.S. 624, 645 (1998) (holding that 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).

protections put into place as a condition of market-based rate authority. They assert that staff monitoring of reports does not satisfy the statutory requirement because the Commission does not have information regarding the entire storage market, again noting that the Commission only has jurisdiction over approximately one-half of the underground storage fields in the United States. In addition, they assert that the rule inappropriately shifts the periodic review requirement of the Act from the Commission to storage customers by relying on monitoring by storage customers, customer contacts to the Commission's Enforcement Hotline, and customer complaints under section 5 of the NGA.

Commission Conclusion

27. We do not find that it is necessary to adopt a generic five-year filing requirement, as requested. The statute requires the Commission to "review periodically whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential," but does not include any rigid rules prescribing how the Commission must discharge this responsibility. We continue to believe that the ongoing review of storage operations adopted in Order No. 678 will provide a greater degree of customer protection than would periodic filings and meets the statutory obligation imposed in NGA section 4(f).

28. We disagree with the Joint Associations' assertion that the existing forms and reporting requirements are inadequate to effectively monitor the storage market. As we explained in Order No. 678, the storage providers are required to provide a wide range of information regarding storage operations, rates, terms and conditions of service, and financial and accounting data. This information is sufficient to allow the Commission and current or potential storage customers to monitor a storage provider with market-based rates to identify potential unlawful withholding of storage capacity and to detect potential undue discrimination or preference in storage service or rates. This monitoring effort will focus on the specific rates and practices of the section 4(f) storage provider. Since a section 4(f) storage company is already presumed to have market power, further analysis of market shares or concentration is not relevant to the periodic review.

29. We also disagree with the Joint Associations' assertion that we are shifting our responsibility under the Act to conduct a periodic review to storage customers. As we clearly explained in Order No. 678, the Commission will regularly monitor storage providers with market-based rates and based on our findings will take further action as necessary to ensure that customer protections are adequate over time. In addition to our monitoring activity, we also explained in Order No. 678 that customers can also raise concerns through several procedural avenues. We believe this ongoing review will identify potential problems faster and resolve issues sooner, than the periodic five-year report advocated by the Joint Associations.

30. Finally, the Commission will consider whether any additional reporting is appropriate on a case-by-case basis to ensure that customer protections remain adequate over time, as required by the Act.

The Commission orders:

The requests for rehearing are denied and clarification is granted in part, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.