UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Unocal Keystone Gas Storage, LLC — Docket No. PR03-17-000

ORDER APPROVING RATE FILING SUBJECT TO CONDITION

(Issued January 23, 2004)

1. Unocal Keystone Gas Storage, LLC (Keystone) filed a rate petition seeking market-based rate authorization for a new interruptible wheeling service and continued authority to charge market-based rates, approved in a prior Commission certificate order, for storage and park and loan services following the planned expansion of its storage facility. For the reasons discussed below, the Commission will authorize Keystone to charge market-based rates for its storage and hub services on the condition that Keystone notify the Commission if its current market power status changes in the future.

2. This order will benefit the public by providing Keystone's current and potential customers with additional market-based rate storage and hub services.

Background

3. Keystone operates an underground salt cavern natural gas storage facility located in Winkler County, Texas. The facility is operated as a Hinshaw pipeline subject to the jurisdiction of the Railroad Commission of Texas (Texas RRC).[1] In an order issued September 24, 2002[2] (certificate order), the Commission described the project as consisting of three storage caverns with working gas capacity of approximately 1 Bcf each to be developed sequentially. Keystone estimated that the three caverns would have

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[1] The RRC approved Unocal Corporation's (Unocal) application in its Oil and Gas Docket No. 08-02222230. Keystone is a subsidiary of Unocal. The facility was permitted in the name of Union Oil Co. of California, a wholly owned subsidiary of Unocal. The ownership of the facility and the permits were later transferred to Keystone.

[2] 100 FERC ¶ 61,310 (2002) (certificate order).

total deliverability of 200 MMcf per day and injection capacity of 100 MMcf per day. In addition, Keystone constructed approximately 3.8 miles of 16-inch pipeline connecting its storage facility to the El Paso Natural Gas Company (El Paso) system. Similarly, Keystone indicated that it also sought a permit from the Texas RRC to construct approximately 2.5 miles of pipeline to interconnect with the facilities of Northern Natural Gas Company (Northern). In addition, Keystone represented that it planned to interconnect with Transwestern Pipeline Company (Transwestern) and as many as four interstate pipelines via the Waha Hub.

4. In the certificate order,[3] the Commission held that Keystone qualified as a Hinshaw pipeline and granted Keystone the requested Section 284.223 blanket certificate. In addition, the Commission also approved Keystone's proposal to charge market-based rates for its storage and park and loan services.[4]

5. The Commission's certificate authorization also directed Keystone to notify the Commission if future circumstances affect its market power status, including, inter alia, an expansion of Keystone's storage capacity beyond the 3 Bcf addressed in the certificate order. Further, the Commission held that if Keystone desires to offer stand-alone transportation service, it must file a petition for rate approval pursuant to Section 284.123 of the regulations.[5]

Description of the Filing

6. Keystone states that it placed its first storage cavern in service on August 29, 2002, approximately one month before the issuance of the certificate order. The second cavern was placed in service on September 25, 2002. The third cavern contemplated in Keystone's certificate application is still under development and is expected to be completed in April of 2004. In addition, Keystone states that it has Texas RRC authority to develop two additional storage caverns at its facility – one is expected to be in service by October 1, 2004 and the other by the beginning of 2006. Once all five caverns are developed, Keystone will operate them on an integrated basis, with approximately 5 Bcf of working gas capacity and 400,000 Mcf per day of deliverability. Keystone states that its existing storage capacity is fully subscribed by firm customers. It also states that its principal customer base is expected to be diversified and would include industrials, electric generators, LDCs and various large end users who will use the facility for cyclical, seasonal and/or short-term storage.

[3] 100 FERC ¶ 61,310 (2002).

[4] Id.

[5] Id.

7. Keystone has constructed three pipeline interconnections to its storage facility. The first two are described above, and the third is approximately 6 miles to the west to connect with Transwestern. The first pipeline, interconnecting with El Paso, has a maximum capacity of 280 MMcf per day; the second, interconnecting with Northern, has a maximum capacity of 200 MMcf per day; and the third has a maximum capacity of 120 MMcf per day.

8. Keystone proposes to offer an interruptible wheeling service on its interconnected pipelines. The proposed interruptible wheeling service will be of lower priority than its firm services, and will be separate from the storage capacity.

9. Keystone seeks Commission approval of the new interruptible wheeling service and requests authority to charge market-based rates for this service. In addition, Keystone requests that the Commission allow it to continue to charge market-based rates for its storage and parking and loaning services as it expands its facility to five caverns.

Market Power Analysis

10. In its application, Keystone provides a market power study to support its contention that it lacks market power when all five caverns are placed in-service. The market power study contains two market power analyses.[6] One is applicable to Keystone's storage services, with limited separate consideration of parking and loaning services. The other is applicable to the new interruptible wheeling service.

a. Storage Services

11. The market power study (1) defines the product and geographic market; (2) measures market shares and market concentration; and (3) examines other mitigating factors such as ease of entry into the market. Keystone defines the relevant product as natural gas storage services. The study focuses on three relevant geographic markets: (1) the Texas market, (2) the Western region from west Texas to California, and (3) the Midwest region extending from west Texas along the route of the Northern system to Illinois and Wisconsin. The study also considers a combined market consisting of those three regional markets.

12. The next step of the study calculates Keystone's market share and the concentration of the relevant markets to quantify Keystone's market power. Market share is measured with respect to total working gas capacity and maximum daily

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[6] We note that this approach is consistent with the Commission's precedent with regard to a pipeline offering different hub services, e.g., Park and Loan service, and Wheeling service. See, e.g., 80 FERC ¶ 61,181 at 61,747 (1997).

deliverability as percentage shares of the total of those storage capacities and deliverability respectively in the identified geographic markets. Market concentration is measured using the Herfindahl-Hirschman Index (HHI), which is calculated summing the squares of the individual market shares of all participants. Keystone states that, in calculating market shares and concentration, the market study follows the Commission's policy of grouping storage fields at the corporate level rather than the individual pipeline or storage company level. Since Keystone is the only natural gas storage facility of its parent company (Unocal Corporation), the consolidation of affiliated companies does not affect Keystone's market share.

13. Keystone states that there are approximately 100 other storage facilities currently existing in the relevant markets. Keystone explains that the direct competition with these other storage facilities limits its ability to exercise market power. The market study shows that Keystone's market share is 0.4 percent of working gas capacity and 1.3 percent of the deliverability in the combined area.[7] In the individual regional markets, Keystone's market share ranges from 0.8 percent (in the Midwest) to 3.4 percent (in the Southwest) of working gas capacity and from 2.6 percent (Midwest) to 7.6 percent (Southwest) of deliverability.[8]

14. According to the market study, all of the markets, except for the Western region, have working gas capacity and deliverability HHIs[9] which are significantly below the 1800 threshold set by the Commission in its Policy Statement,[10] which would indicate that the market is less concentrated. As to the Western region, Keystone explains that the region is concentrated because it is dominated by Southern California Gas Company (SoCalGas).[11] Keystone states that its ability, as a small new entrant, to compete with SoCalGas in the region is very limited, particularly given SoCalGas' advantage of being located in California, where the majority of the gas in the region is consumed.

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[7] See Attachment 1 to the market power study.

[8] See Attachment 2 to the market power study.

[9] See id.

[10] Alternatives to Traditional Cost of Service Ratemaking for Natural Gas Pipelines, Regulation of Negotiated Transportation Services of Natural Gas Pipelines (Policy Statement), 74 FERC ¶ 61,076 (1996).

[11] According to the market study, Southern California Gas Company controls about 80 percent of the working gas capacity and over 70 percent of the deliverability in the Western region.

15. The market study also points out additional alternatives to conventional underground natural gas storage. These include liquefied natural gas and propane-air facilities, seasonal and swing gas supply contracts, and balancing and no-notice services offered by pipelines.[12] Taking all these factors together, Keystone states that it will not have any market power following the expansion of its facility. More specifically, it could not raise its prices above a competitive level for any length of time, nor discriminate unduly in terms of price or terms of conditions of service.

b. Hub Services

16. Keystone states that it currently offers only parking and loaning type of hub services. Keystone explains that parking and loaning services are essentially variations of storage service. This is because parking is a service in which the customer pays a fee to store natural gas on a short-term basis, and loaning is a service in which the customer pays a fee to withdraw gas from storage and is required to repay in kind with similar volumes at an agreed upon date. Thus, the showing (through market power study) that Keystone lacks market power for its storage services also demonstrates that it lacks market power over parking and loaning services.

17. In addition, Keystone proposes to offer a wheeling service using the three lateral pipelines connected to its facility in order to transport gas through Keystone's facilities between or among the interconnected pipelines.[13] The wheeling service will be interruptible, a lower priority than firm storage services. Transportation capacity on the lateral lines for interruptible wheeling customers will be available only when the pipeline capacity is not being used by firm storage customers for injections or withdrawals. Keystone proposes to charge market-based rates for wheeling service. Unlike the existing hub services, wheeling is not a derivative of storage services.

18. The market power study provides a separate market power analysis for Keystone's proposed wheeling service. In testing for market power over the wheeling service a determination is made as to whether there are good substitutes that will constrain any attempt by Keystone to exercise market power. Keystone is located 50 miles from the Waha Hub, which is the largest hub in Texas. Three of the four interstate pipelines connected to Waha are connected to Keystone. In addition, there are four intrastate

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[12] See Attachment 4 to the market power study.

[13] Keystone's Operating Statement defines interruptible wheeling service as "a service that allows Customer to transport Gas, on an interruptible basis, through [Keystone's] Pipeline Facilities between agreed-upon Receipt Point(s) and Delivery Point(s), subject to the obligations and limitations stated in the applicable Service Agreement and the applicable Confirmations(s)." Operating Statement § 2.25.

pipelines connected to Waha. Consequently, each of the three interstate pipelines connected to Keystone has access to the Waha Hub and connects to most of the other five pipelines in the region. The market power analysis provides a "bingo card" showing alternative connections for each combination of these pipelines. The bingo card is completely filled in showing all existing and accessible pipeline connections creating numerous interconnections.[14]

19. In addition to the bingo card analysis, the market power analysis also provides detailed data concerning the capacity of interconnections among all the pipelines directly and indirectly connected to Keystone, the capacity of various production area hubs, the concentration of the hub market, and Keystone's share of that market. In all cases, the analysis focuses on the eight pipelines interconnected at the Waha hub. Keystone states that all the analysis, detailed in various attachments to the market study, indicates that it lacks significant market power in the hub market. Specifically, the analysis shows that there are 79 incoming and 92 outgoing interchange alternatives among the potential interconnecting pipelines that contain total incoming capacity of 11,774 MMcf/d and total outgoing capacity of 11,092 MMcf/d.[15] Using the maximum storage deliverability of 600 MMcf/d, Keystone's computed share of the market defined by pipeline interconnects is in the range of 5.1 percent to 5.4 percent. Keystone states that this result demonstrates a lack of market power.

20. Further, Attachment 9 to the market study analyzes the relevant market. That market is based on the Texas hubs connected to the eight relevant pipelines which, in addition to Waha, include: Moss Bluff, Carthage, and Katy. Using the incoming and outgoing at the Keystone hub of 600 MMcf per day, Keystone has a market share of 11.7 percent and 12.7 percent respectively of the total incoming and outgoing capacity in this relevant hub market. And the total HHI's of the combined Texas hubs including Keystone do not exceed the 1800 threshold. Again, Keystone states that it lacks market power. Keystone further concludes that its interruptible wheeling service will be a small new entrant in an unconcentrated market. As a result, Keystone requests that the Commission authorize it to charge market-based rates for the new interruptible wheeling service.

Public Notice, Intervention and Comments

21. Notice of Keystone's filing was issued September 17, 2003, 68 Fed. Reg. 55,384 (2003), with comments due on or before October 7, 2003. No protests or adverse comments were filed.

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[14] See Attachment 5 to the market power study.

[15] See Attachment 6 to the market power study.

Discussion

22. In the Policy Statement, the Commission established the criteria for evaluating proposals for market-based rates for natural gas companies. The criteria included an examination of the relevant product and geographic markets, firm size and market concentration, and ease of entry into the market.

23. For the Commission to grant Keystone the authority to charge market-based rates, it must first determine that Keystone lacks market power in offering its storage and hub services.[16] The Commission has approved numerous market-based rates for storage services where the applicant has demonstrated that it lacked significant market power, or the applicant has adopted conditions that sufficiently mitigated market power.[17] Further, the Commission has approved market-based rates for wheeling services for other storage facilities.[18] Upon review of Keystone's filing, including the market power study, and Commission precedent, we conclude that Keystone is currently unable to exert market power.

24. Keystone defines its products as natural gas storage services and hub services. As to natural gas storage services, the market power study shows that all of the narrowly defined regional markets except for the Western region have working gas capacity and deliverability HHIs which are significantly below the 1800 threshold set by the Commission in its Policy Statement, which would indicate that the market is less concentrated. With respect to Western region, Keystone explains that the region is concentrated because it is dominated by SoCalGas. The Commission reaffirms its decision pronounced in the certificate order that the concentrated nature of the Western

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[16] See, Koch Gateway Pipeline Company, 66 FERC ¶ 61,007 (1996).

[17] See, e.g., Hill-Lake Gas Storage, L.P.(Hill-Lake), 99 FERC ¶ 61,037 (2002); Transok, L.L.C., (Transok II), 93 FERC ¶ 61,031 (2000); ONEOK Gas Storage, L.L.C. (ONEOK), 90 FERC ¶ 61,283 (2000); LBU Joint Venture (LBU), 88 FERC ¶ 61,035 (1999); Honeoye Storage Corporation (Honeoye), 91 FERC ¶ 62,165 (2000); Central Oklahoma Oil and Gas Corporation (COOG), 80 FERC ¶ 61,250 (1997); Manchester Pipeline Corporation (Manchester), 76 FERC ¶ 61,007 (1996); Equitable Storage Company (Equitable), 75 FERC ¶ 61,081 (1996); Enron Storage Company (Enron), 73 FERC ¶ 61,206 (1995); Steuben Gas Storage Company (Steuben), 72 FERC ¶ 61,102 (1995); Avoca Natural Gas Storage (Avoca), 68 FERC ¶ 61,045 (1994); Transok, Inc., (Transok I), 64 FERC ¶ 61,095 (1995); and Petal Gas Storage Company (Petal), 64 FERC ¶ 61,190 (1993).

[18] E.g., Moss Bluff Hub Partners, 80 FERC ¶ 61,181 (1997); Egan Hub Partners, L.P., 95 FERC ¶ 61,395 (2001).

region does not necessarily mean that Keystone has market power, because the ability of Keystone, as a small new entrant, to compete with SoCalGas in the region is very limited. When the market definition is expanded to include storage from the combined area, concentration reflected in the HHI for Keystone dropped to 930 for working gas capacity, and to 803 for deliverability which indicate that Keystone lacks market power.

25. We note that the Commission has approved market-based storage service rates predominately in cases involving production area storage services.[19] In approving market-based rates for production area services, the Commission has based its findings on the fact that the markets were not concentrated, the market shares of the applicants were small and there were sufficient storage alternatives available for storage service, and the ease of entry was evident by the large number of storage providers in the production areas. Keystone has adequately shown that it does not have market power in any relevant geographic market because its market concentration is below the 1800 level, market shares are relatively small, there are numerous alternatives available for storage services, and ease of entry is evident by the large number of storage providers in the Waha production areas.

26. In addition to considering the HHI figures, there are other factors to consider in determining whether the applicant can exercise market power. As indicated earlier, the market power study shows that Keystone's market share is relatively small. Market shares indicate whether the applicant could hold the price above a competitive level, whereas the HHI indicates whether all providers acting in concert could collude to hold prices at a monopoly level. Similar to the Commission's finding in COOG, Transok I and Manchester, we believe Keystone's small market share would make it difficult for it to hold its price above a competitive level. In addition, Keystone's contention that entry into the storage market is not constrained is supported by the number of approved proposals for storage projects (e.g., Transok II, ONEOK, Equitable, Transok I, and Manchester), and pending projects.[20] As the Commission pointed out in LBU, much of the proposed increase in storage capacity is in the production area, which indicates the ease of entry and level of competition in the storage market. The Commission has previously recognized that the number of depleted gas fields in the production area also contributes to the ease of market entry.[21]

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[19] See, e.g., Transok, LLC, 93 FERC ¶ 61,031 (2000); ONEOK Gas Storage, LLC, 90 FERC ¶ 61,283 (2000); Moss Bluff Hub Partners, 80 FERC ¶ 61,181 (1997); Manchester Pipeline Corporation, 76 FERC ¶ 61,007 (1996); Equitable, 75 FERC ¶ 61,081 (1996); Enron Storage Company, 73 FERC ¶ 61,206 (1995); Quachita River Gas Storage LLC, 68 FERC ¶ 61,402 (1994).

[20] See Attachment 3 to the market power study.

[21] See Manchester Pipeline Corporation, 76 FERC ¶ 61,007 (1996).

27. As to the proposed wheeling service, the market power study includes a bingo card analysis. Keystone points out that this analysis shows that alternative paths exist for gas to move among the pipelines connected to Keystone with up to three direct alternatives for many of the interconnects. We find that the bingo card analysis is consistent with Commission decisions approving market-based rates for wheeling services for other storage facilities.[22] In addition to the bingo card analysis, the market power study contains a market share and concentration analysis applicable to the wheeling service. Using the incoming and outgoing volume at the Keystone hub of 600 MMcf per day,[23] Keystone has a market share of 11.7 percent and 12.7 percent respectively of the total incoming and outgoing capacity in the combined Texas hubs market. And the total HHI's of the combined Texas hubs including Keystone do not exceed the 1800 threshold. This result also indicates that Keystone lacks market power regarding its proposed interruptible wheeling service.

28. Given these circumstances and the fact that Keystone's application is unopposed, we will approve Keystone's request so that it can (1) continue to charge market-based rates for storage services, including parking and loaning, as it expands its facility to five caverns, (2) provide new interruptible wheeling service upon the terms set forth in the filed Operating Statement, and (3) charge market-based rates for its interruptible wheeling service.

29. Finally, Keystone is updating the quality specifications included in its operation statement. Specifically, the quality specifications set forth in Section 15.1 (and the definition of "Gas" in Section 2.20) are being modified to reflect compliance with the most restrictive quality standards of the three interconnected pipelines. Keystone requests that the Commission approve the modified quality specifications. The Commission finds that the proposed gas quality specifications are reasonable. Further, no party opposes the revised Operating Statement. We will accept the revised Operating Statement effective on the date of order issuance.

30. Our approval of Keystone's request for market-based rates applies only to the services described above. Our approval of market-based rates for Keystone is subject to re-examination if a significant change occurs to Keystone's market power status. Examples of such a change include affiliation with an interstate pipeline or local

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[22] Id.

[23] Keystone states that the wheeling service volume will be considerably less than the theoretical design maximum (600 MMcf/d), because transportation capacity on the lateral lines for interruptible wheeling customers will be available only when, and to the extent that, the pipeline capacity is not being used by firm storage customers for injections or withdrawals.

distribution company, expansions, or more concentration of the geographic market.[24] Further, should Keystone desire to offer other transportation services, the Commission will require Keystone to file a petition for rate approval under Section 284.123 of the regulations and Keystone must make a market-power analysis justifying market-based rates for such service.

The Commission orders:

(A) Keystone's request to charge market-based rates on a non-discriminatory basis for its storage and hub services is approved, subject to the conditions and discussion above. Keystone must notify the Commission if a significant change occurs to Keystone's market power status.

(B) Keystone's proposed wheeling service is hereby approved, as discussed in the body of this order.

(C) The quality specifications as revised in the Operating Statement are hereby accepted as of the date of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[24] See, e.g., Petal Gas Storage Company, 64 FERC ¶ 61,190 (1995); Enron Storage Company, 73 FERC ¶ 61,206 (1995); and Equitable Storage Company, 75 FERC ¶ 61,081 (1996).