

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Katy Storage and Transportation, L.P.

Docket No. PR03-18-000

ORDER APPROVING RATE FILING SUBJECT TO CONDITION

(Issued February 17, 2004)

1. On September 23, 2003, Katy Storage and Transportation, L.P. (KST) filed a petition seeking approval of market-based rates for firm and interruptible storage services performed under Section 311 of the Natural Gas Policy Act (NGPA). KST also seeks similar authorization for new interruptible hub services, and has submitted a revised Statement of Operating Conditions (Operating Statement). For the reasons discussed below, the Commission will authorize KST to charge market-based rates for its firm and interruptible storage and hub services, on the condition that KST notify the Commission if its current market power status changes in the future and also files, within 15 days, a revised Operating Statement consistent with the discussion below.
2. This order will benefit the public by providing KST's current and potential customers with market-based rate storage and hub services.

Background

3. KST¹ is currently providing firm and interruptible storage and storage-related transportation services under Section 311 of the NGPA from an underground natural gas storage reservoir known as the Katy Hub and Gas Storage Facility. The Katy Hub and Gas Storage Facility is also comprised of certain associated lands, injection wells, withdrawal wells and other storage and pipeline facilities (collectively, "Katy Facilities"). The Katy Facilities are located near Katy, Fort Bend County, Texas, twenty miles west of

¹ KST is a subsidiary of ENSTOR, Inc., and ENSTOR, Inc., is a subsidiary of PPM Energy, Inc., (PPM). PPM's parent company is PacifiCorp Holdings, Inc., a subsidiary of Scottish Power plc.

Houston. The Katy Facilities are interconnected with eight Texas intrastate and four interstate natural gas pipelines, and have a total working gas capacity of 20.7 billion cubic feet (Bcf).

4. In December 2002, KST acquired the Katy Facilities from Aquila Storage and Transportation Corporation (Aquila). From April 1999 to December 2002, the Katy Facilities were owned and operated by Aquila. Prior to April 30, 1999, the Katy Facilities were owned and operated by Western Gas Resources Storage, Inc. (Western). Western provided firm storage and storage-related transportation services through the Katy Facilities under Section 311 of the NGPA from 1993-1999.² Accordingly, the Katy Facilities have been providing interstate natural gas storage services for almost a decade at cost-based rates.

5. KST states that since the acquisition of the Katy Facilities in December 2002, there has been significant demand among Texas local distribution companies (LDCs) and electric utilities, merchant power generators, industrial consumers, and producers for KST's high deliverability storage services. In addition, the onset of electricity deregulation in Texas as of January 1, 2002, and the anticipated increase in new gas-fired generation demonstrates the increased need for natural gas storage. KST states that its interconnection with eight Texas intrastate and four interstate natural gas pipelines will give its customers excellent access to the Texas intrastate market, as well as to the interstate natural gas markets.

Public Notice and Protests

6. Public notice of KST's filing was issued on October 2, 2003, with protests due as provided in Section 154.210 of the Commission's regulations.³ ONEOK Energy Marketing and Trading Company, L.P. (OEMT) filed a protest raising issues concerning KST's revised Operating Statement. KST filed an answer (KST Answer) to OEMT's protest on November 7, 2003. Pursuant to Rule 214 all unopposed timely filed motions to intervene and any motions to intervene out-of-time before the issuance date of this order are granted.⁴

² See Western Gas Resources Storage, Inc., 66 FERC ¶ 62,063 (1994); 69 FERC ¶ 62,131 (1994); and 70 FERC ¶ 62,119 (1995).

³ 18 C.F.R. § 154.210 (2003).

⁴ 18 C.F.R. § 385.214 (2003).

Details of the Filing

7. KST requests market-based rate authority for its current firm and interruptible Section 311 storage services, in addition to the interruptible hub services that it proposes here. These services include parking,⁵ loaning,⁶ and wheeling⁷ services. KST states that all of these services are subject to the terms and conditions of KST's Operating Statement. In its application, KST provides two separate market power analyses to support its contention that it lacks market power for its existing storage services and its proposed hub services. KST also filed a revised Operating Statement.

Market Power Analysis - Storage Services

8. KST's market power analysis (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. KST defines the relevant product as natural gas storage services. The study focuses on two relevant geographic markets: (1) the Texas market; and (2) the Gulf Coast (east Texas to Alabama). The study also considers a combined market consisting of those two regional markets.

9. The next step of the study calculates KST's market share and the concentration of the relevant markets to quantify KST's lack of market power. Market share is measured with respect to total working gas capacity and maximum daily deliverability as a

⁵ KST's Operating Statement defines "Parking Service" as a service that provides for the short-term custody of a Customer's gas at the Katy Storage Facility. It involves the delivery of a specified thermally equivalent quantity of gas by Customer to KST at the receipt point, and the subsequent Delivery of an equivalent quantity of gas by KST to Customer at the Delivery Point, in accordance with the terms of the applicable Confirmation(s). Parking Service is interruptible. Section 2.33.

⁶ KST's Operating Statement defines "Loaning Service" as an interruptible service that allows Customer to receive gas from KST for Customer's short-term use and then return a thermally equivalent quantity of gas at a specified time. Customer will receive a stated quantity of gas at the Delivery Point, and after the specified time, Customer will deliver a thermally equivalent quantity of gas to the Receipt Point, in accordance with the terms of the applicable Confirmations. Section 2.24.

⁷ KST's Operating Statement defines "Wheeling Service" as a service that provides for the transfer of Customer's gas at the Katy Storage Facility. It involves the delivery of a specified thermally equivalent Quantity of gas by Customer to KST at the physical transfer point where KST interconnects with several pipelines, and the subsequent delivery of an equivalent Quantity of gas by KST to Customer at the physical transfer point, in accordance with the terms of the applicable Confirmation(s). Wheeling Service is interruptible. Section 2.47.

percentage share of the total of those storage capabilities in the relevant markets. Market concentration is measured using the Herfindahl-Hirschman Index (HHI) calculated by summing the squares of the individual market share of all participants. KST states that in calculating market share and concentration, the analysis follows the Commission's policy of grouping storage fields at the corporate level, rather than at the individual pipeline or storage company level. KST states that the Katy Facilities will be KST's only natural gas storage facilities in the two market regions in which it proposes to operate, so consolidation of affiliated companies does not affect its market share. KST also states it has no other regulated affiliates in the area that would present any issue of potential subsidies.

10. KST states there are over fifty other storage facilities in the Texas and Gulf Coast markets and that these regions as a whole offer working gas capacity of nearly 795 Bcf and daily deliverability of nearly 25,000 MMcf. KST states that its 20.7 Bcf of capacity and 700 MMcf/d deliverability is modest by comparison. As shown in its analysis, KST's market share comprises just 2.6% of the working gas capacity and 2.8% of the deliverability in the combined market area.⁸ In the individual markets, KST's market share ranges from 2.9% to 5.2% of the working gas capacity, and from 3.1% to 5.7% of the deliverability.⁹ Further, the study shows that the individual and combined markets have working gas capacity and deliverability HHIs¹⁰ which are well below the 1800 threshold set by the Commission in its Policy Statement on Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines (Policy Statement).¹¹ KST states it will be a small entrant in each market and to obtain customers, KST will have to compete with established storage providers that charge regulated, cost-based rates.

11. KST states there are other pertinent factors which show that KST satisfies the Commission's standards for market-based rate authorization. For example, entry into the storage market is not difficult in the production region where KST will be located, as evidenced by the numerous new storage projects that have been developed in recent years, and by the several dozen more entities that have announced plans to provide

⁸ See Attachment 1 to the Market Power Analysis.

⁹ See Attachment 2 to the Market Power Analysis.

¹⁰ The combined region's market concentration (HHI) is 921 for working gas and 854 for daily deliverability; in the Texas market, the HHI is 1,466 for working gas and 1,088 for daily deliverability; and in the Gulf Coast market, the HHI is 1,067 for working gas and 963 for daily deliverability. See Attachments 1 and 2 to the Market Power Analysis.

¹¹ Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, *et al.*, 74 FERC ¶ 61,076 at 61,235, *reh'g denied*, 75 FERC ¶ 61,024 (1996).

similar services.¹² KST's analysis also identifies other competitive alternatives to conventional underground natural gas storage, including liquefied natural gas and propane-air facilities, seasonal and swing contracts, and interstate pipeline balancing and no-notice services.

Market Power Analysis - Hub Services

12. KST provided an analysis to demonstrate that KST qualifies for market-based rate authorization for its interruptible hub services. KST states that with a dozen pipelines (four interstate and eight intrastate) interconnecting with the Katy Facilities' storage and header system, KST will be unable to exert any market power in the provision of hub services. KST explained that a study was made of alternative bi-directional interconnects for the twelve pipelines. These interconnections were then evaluated in a "bingo-card" or matrix showing that at least one alternative path exists for every possible combination.¹³ KST states this "bingo card" demonstrates that alternative paths exist for gas to move among pipelines connected or accessible to the Katy Facilities with direct alternatives for some of the interconnects. Further, the pipelines that connect to the Katy Facilities have a significant number of hub and/or market center alternatives.

13. KST also performed an analysis of interconnection capacities among all the pipelines connected to the Katy Facilities, the capacity of connections at various hubs in Texas and Louisiana, the hub market concentration and KST's share of that market. According to the analysis, there are 185 incoming and 173 outgoing interchange alternatives among the twelve interconnecting pipelines.¹⁴ These pipelines contain a total capacity of 25,702 MMcf/d of incoming capacity and 25,411 MMcf/d of outgoing capacity which is approximately 10 times more than the current incoming and outgoing capacity at the Katy Facilities.¹⁵ Further, the study shows that the twelve pipelines that connect to the Katy Facilities have forty-eight direct paths to hubs and market centers in Texas, and eight such paths to hubs and market centers in Louisiana.¹⁶

14. KST also included an analysis showing the total meter capacity of the pipelines connected to the Katy Facilities. The capacity available to those pipelines connected to

¹² See Attachment 3 to the Market Power Analysis.

¹³ See Attachment 5 to the Market Power Analysis.

¹⁴ See Attachment 6 to the Market Power Analysis.

¹⁵ The incoming capacity and outgoing capacity of the Katy Facilities is 2,440 MMcf/d and 2,160 MMcf/d, respectively.

¹⁶ See Attachment 7 to the Market Power Analysis.

Katy is 24% of the incoming, and 18% of the outgoing capacity compared to the total of all hub capacities available to those pipelines.¹⁷ Further, the total HHIs of the combined Texas and Louisiana hubs and market centers (including Katy) for incoming capacity is 1,454 and 1,087 for outgoing capacity. KST notes these HHIs are well below the 1,800 threshold established by FERC as the level that, if exceeded, would require further analysis.¹⁸ KST states that in light of the vast number of alternate transportation paths and pipeline interconnections, KST's limited market share and its proximity to the numerous Texas and Louisiana hubs, KST will not be capable of exercising market power in a non-concentrated market for the interruptible hub services that it proposes to offer to its customers.

Discussion

15. 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.

16. For the Commission to grant KST the authority to charge market-based rates, it must first determine that KST lacks market power in offering its storage and hub services.¹⁹ 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.²⁰ Further, the Commission has approved market-based rates for wheeling services for other storage

¹⁷ See Attachment 9 to the Market Power Analysis.

¹⁸ Id.

¹⁹ See Koch Gateway Pipeline Company, 66 FERC ¶ 61,007 (1996).

²⁰ See, e.g., EPTG Texas Pipeline, LP, 103 FERC ¶ 61,181 (2003); Hill-Lake Gas Storage, L.P., 99 FERC ¶ 61,037 (2002); Transok, L.L.C., 93 FERC ¶ 61,031 (2000) (Transok II); ONEOK Gas Storage, L.L.C., 90 FERC ¶ 61,283 (2000) (ONEOK), LU Joint Venture, 88 FERC ¶ 61,035 (1999) (LBU); Honeoye Storage Corporation, 91 FERC ¶ 62,165 (2000); Central Oklahoma Oil and Gas Corporation, (COOG), 80 FERC ¶ 61,250 (1997); Manchester Pipeline Corporation, 76 FERC ¶ 61,007 (1996) (Manchester); Equitable Storage Company, 75 FERC ¶ 61,081 (1996) (Equitable); Enron Storage Company, 73 FERC ¶ 61,206 (1995) (Enron); Steuben Gas Storage Company, 72 FERC ¶ 61,102 (1995); Avoca Natural Gas Storage, 68 FERC 61,045 (1994); Transok, Inc., 64 FERC ¶ 61,095 (1993) (Transok I); and Petal Gas Storage Company, 64 FERC ¶ 61,190 (1993) (Petal).

facilities.²¹ Upon review of KST's filing, including the market power study, and Commission precedent, we conclude that KST is currently unable to exert market power.

17. KST defines its products as natural gas storage services and hub services. As to natural gas storage services, the market power study shows that the narrowly defined Texas market and Gulf Coast markets have working gas capacity and deliverability HHIs which are well below the 1800 threshold set by the Commission in its Policy Statement, indicating that the market is less concentrated. When the market definition is expanded to include storage from the combined Texas and Gulf Coast areas, concentration reflected in the HHI for KST dropped to 921 for working gas and to 854 for deliverability which further indicates that KST lacks market power.

18. We note that the Commission has approved market-based storage service rates predominately in cases involving production area storage services.²² 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, 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 area. KST has adequately shown that it does not have market power because the HHIs, indicating market concentration, are well below the 1800 level; its 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 production areas.²³

19. In addition to considering the HHI and market share figures, there are other factors to consider in determining whether the applicant can exercise market power. As detailed above, the market power study shows that KST'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 KST's small market share would make it difficult for it to hold its price above a competitive level. In addition, KST'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,

²¹ E.g., Moss Bluff Hub Partners, 80 FERC ¶ 61,181 (1997); Egan Hub Partners, L.P., 95 FERC ¶ 61,395 (2001).

²² See, e.g., Transok II; ONEOK; COOG; Moss Bluff Hub Partners, 80 FERC ¶ 61,181 (1997); Manchester; Equitable; Enron; Quachita River Gas Storage L.L.C., 68 FERC ¶ 61,402 (1994); Transok I; and Petal.

²³ See also Unocal Keystone Gas Storage, LLC, 106 FERC ¶ 61,033 (2004) (Keystone).

and Manchester) and pending projects.²⁴ As the Commission pointed out in LBU, much of the proposed increase in storage capacity is in the production area, which indicates ease of entry and a high 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.²⁵

20. As to KST's proposed parking, loaning, and wheeling services, we note that parking and loaning services are essentially variations of storage service. Thus, KST's market power analysis for its storage services also demonstrates that it lacks market power over its parking and loaning services. As to its proposed wheeling service, KST's market power study included a "bingo card" analysis. KST points out that this analysis shows that alternative paths exist for gas to move among the pipelines connected to KST with up to three direct alternatives for many of the interconnects. We find that the bingo card analysis is consistent with the Commission decisions approving market-based rates for wheeling service for other storage facilities. Using the incoming volume of 2,440 MMcf/d and outgoing volume of 2,160 MMcf/d at Katy Storage, KST has a market share of 24% and 18%, respectively of the total incoming and outgoing capacity in the combined Texas/Louisiana hub markets. Further, the total HHIs of the combined Texas and Louisiana hubs and market centers do not exceed the 1800 HHI threshold. This result also indicates that KST lacks market power regarding its proposed interruptible wheeling service.

21. Given these circumstances, we will approve KST's request to charge market based rates for its storage and hub services, subject to KST filing a revised Operating Statement consistent with the discussion below. Our approval of KST's request for market-based rates applies only to the storage services and hub services that are described above. Further, our approval of market-based rates for KST is subject to re-examination if a significant change occurs to KST's market power status. Examples of such a change would include affiliation with an interstate pipeline or local distribution, or more concentration of the geographic market.²⁶ Should KST desire to offer other stand-alone transportation service, the Commission will require KST to file a petition for rate approval under Section 284.123 of the regulations and KST must make a market-power analysis justifying market-based rates for such service.

²⁴ See Attachment 3 to the Market Power Analysis.

²⁵ Manchester at 61,022.

²⁶ See, e.g., Petal; Enron; and Equitable.

KST's Operating Statement

Nominations

22. OEMT states that KST's nominating process is cumbersome and unduly truncated. OEMT refers to two sections: 1) section 7.1 which provides that monthly nominations must be submitted no later than 9:00 a.m., Central Time on the second Business Day prior to the first day of each month or the Business Day prior to the date of initial deliveries; and 2) section 7.2 governing daily nominations which requires that gas be scheduled each Business Day prior to 9:00 a.m., Central Time, for gas flows on the next operating day. OEMT asserts these provisions are inexplicably burdensome, especially when compared to the North American Energy Standards (NAESB) standard which allows nominations up to 11:30 a.m. of the day prior to flow, seven days a week.

23. KST states that OEMT's request is patently unreasonable. KST asserts that OEMT wrongly assumes that KST is subject to the Natural Gas Act and requirements pertaining to interstate natural gas pipelines. KST asserts it is subject only to the Commission's limited jurisdiction under Section 311 of the NGPA.²⁷ Further, KST states, that in designing the terms and conditions for operation, KST has strived to be flexible within the physical requirements of its own system and the market conditions for the services that it seeks to provide. KST explains too, that as a Section 311 service provider, KST is not required to have on file a FERC tariff or to be in strict compliance with the NAESB rules, which are intended to facilitate uniform business procedures across all interstate pipelines. However, KST has agreed to change the time for both monthly and daily nominations to 10:00 a.m., Central Time, to accommodate OEMT's concerns. KST notes that the 10:00 a.m. deadline is consistent with the terms and conditions in effect when OEMT executed its contract with Aquila.

24. KST is correct that KST is not subject to strict compliance with the NAESB rules which allows for nominations up 11:30 a.m. of the day prior to gas flow, seven days a week. KST has agreed to change the time for both the monthly and daily nominations from 9:00 a.m. to 10:00 a.m. on a business day, to reflect the terms and conditions in effect when OEMT executed its contract with Aquila. We find that KST's proposal to reinstate the 10:00 a.m. timeline is reasonable and will provide the same flexibility for nominations that currently exist on KST's system. We also note that section 7.1 gives KST the discretion to accept late nominations and we would expect KST to schedule such requests on a best efforts basis and that all nominations will be scheduled on a non-discriminatory basis.

²⁷ EPGT Texas Pipeline, L.P., 99 FERC ¶ 61,295 (2002) (footnotes omitted), reh'g pending; see also Green Canyon Pipe Line Co., L.P., 98 FERC ¶ 61,041 at 61,123 (2002) ("Because intrastate pipelines are regulated primarily by the states, they are relieved of the more stringent regulatory obligations imposed on interstate pipelines when they engage in interstate transportation governed by Section 311").

Interruption of Service

25. OEMT takes issue with section 8.6 which allows KST to interrupt service in the event “conditions on the Transporter’s system vary substantially from this ‘normal’ design condition coincident with high levels of Customer receipt or delivery activity.” OEMT claims this provision was proposed so that the KST would not be required to use or install additional compression to effectuate deliveries. As an example, OEMT states that in the winter, the pressure into the interconnecting pipeline may be increased. OEMT claims that if KST has sold firm service at that particular delivery point, but did not want to install compression to make winter deliveries, section 8.6 would allow KST to interrupt firm service in the winter with out any repercussions, by asserting that the pressure required to make deliveries was outside of the ‘normal’ pressure.

26. OEMT also contends that section 15.5 should be eliminated. That provision states that “[n]othing herein shall obligate KST to add compression at the Katy Storage Facility in order to remedy a Force Majeure event.” OEMT asserts that this provision seems to indicate that KST recognizes that it may not be able to fulfill its firm obligations to make deliveries to certain pipelines due to pressure issues.

27. KST responds that both sections 8.6 and 15.5 are identical to the Operating Statement provisions of other Section 311 pipelines that have been approved by the Commission.²⁸ KST states there is nothing unusual about provisions that indicate the pressure at which gas will be received and OEMT’s assertions are mere speculation without support. Moreover, KST states that the 6-month rolling average of the gas pressure applicable to the four interstate pipelines that interconnect to the Katy Facilities, has consistently been within a narrow band – never exceeding 700 psi or falling below 575 psi.²⁹ KST adds that its Operating Statement provides all of the necessary assurances

²⁸ See, e.g., EPGT Texas Pipeline, L.P., Docket No. PR00-9-000, Order on Staff Panel, 99 FERC ¶ 61,295 (Section 7.2 of EPGT’s Operating Statement states that: “In the event that conditions on the Transporter’s system vary substantially from this ‘normal’ design condition coincident with high levels of Customer receipt or delivery activity, Company’s capability to receive or deliver the quantities set forth in its storage service agreements may be impaired, resulting in an interruption in service”). See also Unocal Keystone Gas Storage, LLC, Docket No. CP02-317-000, Order Issuing Certificate, 100 FERC ¶ 61,310 (2002) (Section 11.5 of Unocal’s Operating Statement reads: “Nothing herein shall obligate KGS to add compression at the Facilities in order to remedy a Force Majeure event”).

²⁹ See Exhibit B to KST’s Answer.

to firm customers that KST will fulfill its firm service obligations, subject only to reasonable interruptions.³⁰ KST claims OEMT's concerns are simply not justified.³¹

28. We agree with KST that pressure provisions normally exists in pipeline's operating statements. KST states that even though adjustments or suspension of service are rare, pressure at any of interconnecting pipelines can change significantly at any time due to the operational conditions on the pipeline.³² These conditions can make it difficult for KST to effectuate customer receipts and deliveries. As KST explains, if an interconnecting pipeline that normally operates at 600 psi drops to 400 psi, KST's ability to process receipts could be affected by the interconnecting pipeline's pressure drop and adjustments may also be required at a specific interconnect point(s), if nominations exceed the design capacity of the meter station of the pipeline.³³ KST states that any such re-allocation of capacity due to the occurrences of such events would be based on the priority of service set forth in section 8.0 of its Operating Statement. Moreover, KST states that it has not interrupted service to firm customers in the past twelve months.³⁴ KST's experience with its system and its statements here assure the Commission that its existing Operating Statement will maintain the firm service that exists on the KST system. However, the Commission expects that KST's customers will inform KST and the Commission if problems arise that would reduce KST's ability to maintain its firm service levels.

Curtailment of Service

29. OEMT raises concerns regarding the application of sections 8.7 and 8.8 of KST's Operating Statement. Section 8.7 provides that "KST shall schedule all volumes as nominated and tendered." Section 8.8 provides that "[w]hen circumstances arise after

³⁰ See Section 1.1 of KST's Operating Statement, which provides that KST reserves the right not to offer or commence any service, or to discontinue any interruptible service, if in KST's sole discretion, any impairment of intrastate firm service could result.

³¹ KST points out that OEMT's concern about adding compression should also be considered in light of the fact that OEMT's affiliate, ONEOK Texas Gas Storage, L.P., a Section 311 storage operator, file a Statement of Operating Conditions on June 5, 2000 in Docket No. SA94-4-000, that expressly provides that it "shall not be required to modify existing facilities or add new facilities in order to increase its capacity for service under the Agreement." Section XI.C.

³² See Response to Staff Data Request No. 1.

³³ Id.

³⁴ Id.

scheduling has occurred which restrict KST's ability to provide transportation or storage service for all gas tendered under executed Service Agreements with Customers on KST's system and require service to be curtailed, service shall be curtailed in the reverse order of scheduling." OEMT states these two sections are inconsistent with the explicit priorities of service set forth in section 8.1 of the tariff. OEMT asserts that interruptible service should be curtailed before firm service and contends that the vague reference to "order of scheduling" should not provide KST discretion to trump that fundamental premise. KST states that it agrees fully with the premise that interruptible service should be curtailed prior to firm service. To the extent any provisions of KST's Operating Statement appear inconsistent with this principle, KST states it will make the necessary modification.

30. To eliminate any confusion, KST is directed to revise section 8.8 to state that "service shall be curtailed in the reverse order of priority as set forth section 8.1. The reverse order of priority in section 8.1 would require curtailments first be made of make-up volumes, then authorized overruns, then interruptible service, and finally firm service. This is also consistent with the language that KST currently has in section 8.2 of its Operating Statement which provides that if KST is unable to meet its scheduled obligations, KST will interrupt storage service to its customers in the reverse order of priority set forth in section 8.1.

Imbalances

31. OEMT says that section 9.1 unreasonably requires shippers to "manage receipts and deliveries so that imbalances shall be kept as near to zero as practicable" and disputes KST's right to "take actions of whatever nature as may be required to correct imbalances including termination of service." OEMT claims section 9.1 is unduly vague and provides KST unfettered discretion. OEMT claims there should be concrete parameters defining shippers' obligations to manage imbalances, and it should not be left to the unfettered discretion of the storage operator.

32. KST states that section 9.1 has no tangible impact on OEMT, and its claims to the contrary should be ignored. KST states that the identical provision, requiring shippers to minimize imbalances, was in the Aquila Operating Statement in effect at the time OEMT contracted with Aquila for firm service. Moreover, KST explains that, as a firm shipper, OEMT should be aware by now that from a practical standpoint, imbalances on the KST system have no impact on storage customers. KST states it has entered into Operating Balancing Agreements (OBAs) with its interconnecting pipelines such that any imbalances are resolved between pipeline and KST. KST points out that none of KST's customers are either penalized or benefited due to any imbalances. KST states that as there are no imbalances on KST's system from the customer perspective, OEMT's challenge to section 9.1 of KST's Operating Statement should be rejected.

33. We agree with OEMT that section 9.1 is vague. Moreover, section 9.1 is unnecessary given KST's explanation that KST and its interconnecting pipelines resolve any physical imbalances through their respective OBAs. As KST explains, if operational or physical conditions exist such that actual physical flow differs from the confirmed nominated volumes, either KST or the interconnecting pipelines will keep the other "whole" so that nominated quantities by customers are maintained as-is.³⁵ KST states that because it has OBAs in place, a shipper will always receive, or have delivered, its gas volumes as nominated. Accordingly, KST is directed to remove section 9.1 from its operating statement.

Upstream Pipelines

34. OEMT asserts that section 12.1 of KST's Operating Statement requiring a shipper to provide information in the control of an upstream pipeline to KST on or before the fifth day of the month is both unreasonable and unrealistic.

35. KST states that this section is similar to a provision that was in place when OEMT executed its firm service agreements with Aquila eighteen months ago. While KST believes that there is no merit to OEMT's position, KST states it is willing to remove this provision from section 12.1 as an accommodation measure. KST is directed to make this change accordingly.

Good Faith Disputes

36. OEMT asserts that the good faith dispute provisions in section 12.4.2 should be explicitly recognized as an exception to the mandatory payment of interest set forth in section 12.4.1.

37. KST states the payment of interest set forth in section 12.4.1 is a standard billing provision, approved the Commission in previous orders.³⁶ KST points out that such provisions simply require that a customer pay a late charge, that shall accrue daily, on any unpaid balance if that customer fails to pay the entire bill when the amount is due. KST further notes this provision (section 12.4.1 of KST's Operating Statement) is separate from section 12.4.2(b) that provides that if a customer has a good faith dispute with respect to any bill, the customer shall pay to KST the amount, if any, that the customer concedes to be correct. KST explains that the second provision does not constitute an exception to the accrual of interest on a portion of an unpaid bill. KST

³⁵ See Response to Staff Data Request No. 2.

³⁶ See, e.g., Unocal Keystone Gas Storage, LLC, Docket No. CP02-317-000, Order Issuing Certificate, 100 FERC ¶ 61,310 (Section 20.4(b)(iii) of Unocal's Operating Statement contains an identical provision).

states that given the widespread industry and Commission acceptance of such billing provisions, OEMT's challenge to this provision should be dismissed.

38. KST is correct that its billing and good faith disputes provisions are standard in pipeline operating statements. OEMT's concern relates to whether interest is due on that portion of an unpaid bill for which there is a good faith dispute. KST states that it does not charge interest on any good faith dispute and says it works diligently and works in good faith to resolve any type of issues involving discrepancies in volumes or rates associated with its services.³⁷ However, KST's practice of suspending interest on that portion of a disputed bill for which there is a good faith dispute is not explicit in KST's Operating Statement. Therefore, we direct KST to revise its operating statement accordingly.³⁸

Termination of Contract - Title to Inventory

39. OEMT contends that section 13.2.3 provides KST the right to automatically acquire title to all Customer Inventory at the date of termination of a contract, and that such provision is thus unduly onerous and punitive.

40. KST responds that OEMT has misread section 13.2.3 of its Operating Statement. section 13.2.3 reads, in part, as follows: "To the extent that any Customer Inventory exists at the termination, KST shall have the right to sell all or a portion of the Customer Inventory to offset amounts due and payable to KST outstanding from the terminated transactions." Contrary to OEMT's assertions, KST states section 13.2.3 merely gives KST the right to sell customer inventory as an offset to amounts due and payable to KST at the date of contract termination. KST states it does not, in any way, give KST an unfettered right to automatically acquire title to all customer inventory when the contract terminates. KST explains the Commission has previously acknowledged that parties may avail themselves of state law remedies when they are still seeking payment for service after the termination of the service agreement.³⁹ In addition, KST asserts that Texas law, which governs KST's Operating Statement, provides gas storage companies a warehouseman's lien on gas in storage.⁴⁰ Further, KST notes that provisions

³⁷ See Response to Staff Data Request No. 3.

³⁸ See, e.g., PanEnergy Louisiana Intrastate, LLC's Statement of Operating Conditions. Section XIII – B. Late Payments provides that "Shipper shall not be required to pay interest on any amount billed which is in good faith disputed in writing by Shipper and is ultimately determined to be in error; provided, however, interest shall be due if such amount billed is found not to be in error."

³⁹ See Tennessee Gas Pipeline Co., 103 FERC ¶ 61,275 at P 76 (2003).

⁴⁰ Texas Bus. & Com. Code Ann. § 7.209 (Vernon 2000).

memorializing warehouseman's liens for Texas-based Section 311 storage operators have also been contained in several other Operating Statements that have been approved by the Commission.⁴¹

41. The Commission has previously addressed the issue of the pipeline's right of set-off in situations where monies are owed the pipeline at the termination of a shipper's contract. In Tennessee, the Commission addressed this issue where Tennessee proposed to confiscate gas left on its system (i.e., take title to gas left on its system) by a non-creditworthy shipper whose contract has been terminated. The Commission rejected Tennessee's proposal, reasoning that the pipeline had not provided any legal justification of its right to confiscate a shipper's gas, and the Commission is concerned that such a provision does not adequately protect the rights of the shipper and other parties that may have an interest in the gas. However, the Commission stated that although it was not providing Tennessee with a priority to gas on its system, the Commission saw no reason why Tennessee should be prevented from obtaining a carrier or other lien as permitted under state law.⁴² Similarly, we find that KST has not provided sufficient justification of its right to confiscate a shipper's gas. For the same reasons enunciated in Tennessee, we will reject KST's proposed section 13.2.3, without prejudice to KST revising its operating statement to provide that carrier liens imposed must be consistent with applicable law.⁴³

Demand Charge Credits

42. OEMT asserts that demand charge credits should be available to firm shippers who are curtailed. OEMT states that sections 15.6 and 20.2 of KST's Operating Statement completely ignore this fundamental principle and thus fail to provide any incentive for KST to keep outages to a minimum.

43. KST responds that section 15.6 simply states that the occurrence of a force majeure event, whether claimed by the Customer or KST, will not relieve the customer of its obligation to pay any rates or charges due to KST. KST states that section 20.2 references interruptions for alterations and repair of facilities, and is identical to section 16.2 that was contained in the Aquila Operating Statement. KST asserts that

⁴¹ See, e.g., Hill-Lake Gas Storage, L.P., Docket No. PR02-8-000, Order Approving Rate Filing Subject to Condition, 99 FERC ¶ 61,037 (2002). (Section 12.7 of Hill-Lake's Operating Statement).

⁴² See Tennessee, 103 FERC ¶ 61,275 at P 76; see also Northern Natural Gas Company, 103 FERC ¶ 61,276 (2003).

⁴³ See Honeoye Storage Corporation, 102 FERC ¶ 61,340 at P 4 (2003). See also Northern Natural Gas Company, 102 FERC ¶ 61,276 (2003).

these provisions, like others discussed above, are quite commonplace, and are contained in the Operating Statements of other Section 311 storage providers.⁴⁴

44. We have required pipelines with cost-based rates to provide demand charge credits. Here, however, we are approving market-based rates based on a finding that KST lacks market power and that its small market share would make it difficult for KST to hold its prices above a competitive level. In this circumstance, we believe it appropriate to leave the issue of demand charge credits for negotiation between the pipeline and individual shipper.

The Commission orders:

(A) KST's request to charge market-based rates on a non-discriminatory basis for its Section 311 storage and hub services is approved, subject to the conditions and discussion above. KST must notify the Commission if future circumstances, including acquisitions, affect its present market power status.

(B) KST shall file a revised Statement of Operating Conditions within 15 days of the date of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

⁴⁴ See, e.g., Unocal Keystone Gas Storage, LLC, Docket No. CP02-317-000, Order Issuing Certificate (Section 16 (Maintenance Work Curtailments) of Operating Statement); ONEOK Texas Gas Storage, L.P., Docket No. SA94-4-000 (Section XIV of Operating Statement, which gives ONEOK the right to interrupt service to make necessary alterations and repairs).