103 FERC ¶ 61,277

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Red Lake Gas Storage, L.P. — Docket Nos. CP02-420-000, -001
CP02-421-000, -001
CP02-422-000, -001

ORDER DENYING REHEARING AND TERMINATING PROCEEDING

(Issued June 4, 2003)

1. On August 30, 2002, Red Lake Gas Storage, L. P. (Red Lake) filed applications in Docket Nos. CP02-420-000, CP02-421-000, and CP02-422-000 for certificates of public convenience and necessity pursuant to Section 7(c) of the Natural Gas Act (NGA). The application requested necessary certificate authorization for Red Lake to construct and operate a natural gas storage facility in Mohave County, Arizona, to provide storage services under market-based rates, to construct, acquire and operate certain other facilities, and to provide limited unbundled sales service. The Commission's January 30 2003 order found on a preliminary basis that the gas storage facility would provide valuable infrastructure assisting the development of relevant natural gas markets.[1] Red Lake's request to charge market-based rates was denied because Red Lake would have power in the relevant market. Red Lake has sought rehearing of that denial, stating again that the project can not proceed without market-based rate authority.

2. This order denies rehearing and terminates this proceeding. Red Lake provides no sound reason supporting market-based rates here, and has reiterated that the project will not go forward without market-based rate authority approval. The Commission is interested, however, in assuring the appropriate development of natural gas storage facilities to meet growing demand within southwestern markets. Notice will be provided of a technical conference to be convened by Commission staff to allow analysis of

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[1]See Red Lake Gas Storage, L.P.,102 FERC ¶ 61,077 (2003) (the "January 30 Order").

relevant market needs and regulatory options available to the Commission to assure that such needs are appropriately met.

Background

3. Red Lake is a start-up, natural gas storage corporation and proposes to develop and operate a natural gas storage facility in the Hualapai Valley of Mohave County, Arizona, approximately 30 miles north of Kingman, Arizona. On August 30, 2002, Red Lake filed its applications including the request for authority to charge market-based rates for storage and hub services pursuant to the Commission's 1996 Alternative Rate Policy Statement.[2] Specifically, Red Lake proposed to charge market-based rates for primary and secondary storage service, as well as interruptible parking, wheeling, loan, balancing, and imbalance trading services.

4. On January 30, 2003 (the January 30 Order), the Commission made preliminary determinations on the non-environmental issues in these filings. We found that Red Lake's proposal, as conditioned, would serve the public interest by developing natural gas infrastructure, by providing high deliverability storage service to meet growing demand and providing customers with increased flexibility. The Commission also found that insufficient good alternatives to the proposed Red Lake services exist outside the Arizona and southern California region, which was thus defined as the appropriate geographic market. To preclude the exercise of market power, we denied Red Lake's request for authority to provide service under market-based rates and required Red Lake to file appropriate cost-based rate proposals. The Commission noted that Red Lake has had the option of proposing a Negotiated Rate program, under which it would enjoy flexibility to establish individual rate agreements with customers, who would retain the right to be charged recourse rates on file with the Commission.[3]

5. On March 3, 2003, Red Lake filed a request for rehearing. Red Lake asserts that the January 30 Order erred by (1) redefining Red Lake's proposed geographic market and concluding that Red Lake's customers lack sufficient alternatives in that geographic market and by (2) finding that, under market-based rates, Red Lake would be able to

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[2]Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, 74 FERC ¶ 61,076 (1996), reh'g and clarification denied, 75 FERC ¶ 61,024 (1996)("Policy Statement").

[3]See Policy Statement, 74 FERC at 61,241-242 (1996).

exercise market power and unduly discriminate in the provision of services.[4] Red Lake reiterates that, unless market-based rates are approved, development of the proposed storage facility cannot go forward. Red Lake states that cost of service rates do not provide adequate incentive to attract the investment necessary to develop a risky project like Red Lake.[5] In soft market conditions, such as those Red Lake asserts exist currently, service discounts "below a rate that recovers capital investment" would be required "with no possibility of making up this loss during more favorable market conditions."[6] Red Lake does not discuss any aspect of the January 30 Order's reference to the Commission's Negotiated Rate policy, which would allow the negotiation of contracts with customers based on those customers' needs as agreed to by Red Lake.[7]

Discussion

Policy Statement

6. The Policy Statement provides guidelines for the identification and analysis of issues necessary to support a principled resolution of Red Lake's rehearing request.[8] As discussed more fully below, Red Lake argues that it has assumed the risk of revenue loss resulting from a lack of sufficient business, that this justifies the Commission in granting Red Lake authority to charge market-based rates, and that the Commission's failure to do so sends the wrong message to other companies interested in providing further infrastructure to the gas storage markets. We believe rather that our orders in this

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[4]Request for Rehearing at 1-2. Red Lake states that it is willing to consider, as mitigation measures, a requirement to report additional information to the Commission and/or requirements regarding offering capacity through open seasons.

[5]By letter filed April 30, 2003, Red Lake stated again that it could not, absent market-based rate authority, attract sufficient investment to develop the facility.

[6] Request for Rehearing at 7.

[7]See January 30 Order, 102 FERC ¶ 61,077 at P 41 (2003). Red Lake does, however, argue that one of its purposes in seeking market based rate authority is to allow for negotiation of rates to meet specific customers' needs. Request for Rehearing at 7.

[8]As applied here, the Policy Statement's principal purposes are to determine: 1) whether [Red Lake] can "withhold or restrict services" and thereafter increase price by a significant amount for a significant period of time, and 2) whether [Red Lake] can "discriminate unduly in price or terms and conditions." Policy Statement at 61,230 (1996).

proceeding send the appropriate message, i.e., that customers must be protected from the exercise of market power, even in an incipient market like this, and that the price of market development demanded by Red Lake (market-based rates) is too high.

7. The basic inquiry established by our Policy Statement is whether Red Lake will have market power, and the Commission requires every applicant seeking the right to charge market-based rates to demonstrate that it lacks significant market power in the relevant markets. The analysis of whether the applicant has the ability to exercise market power includes three major steps: define the relevant markets; measure the market share and market concentration; and evaluate other relevant factors.[9]

8. The first step is to define the relevant market, which process begins by identifying "the specific products or services and the suppliers of those products and services that provide good alternatives to the applicant's ability to exercise market power."[10] 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 service.[11] 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."[12]

9. After identifying available alternative products or services, the Commission will identify all the sellers of such products or services. "The collection of alternative sellers and the applicant constitutes the geographic market."[13] The January 30 Order found, in accordance with the Policy Statement, that good alternatives to Red Lake's services are not available throughout the broad geographic territory asserted by Red Lake in its application (Texas, California, Arizona, New Mexico, and Nevada). The Commission

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[9]Policy Statement, 74 FERC ¶ 61,076 at 61,230-231 (1996)

[10]Id.

[11]See Koch Gateway Pipeline Co., 66 FERC ¶ 61,385 at 62,299 (1994) (interstate pipeline permitted to charge market-based storage rates for production area storage facility). In addition, to constrain the exercise of market power, the alternative must be available in sufficient quantity to make a price increase unprofitable. Id.

[12]The "product market" includes "the applicant's service together with other services that are good alternatives." Policy Statement at 61,231 (1996).

[13]Id. at 61,232 - 61,233 (1996).

limited and thus redefined that market as including only Arizona and southern California, because good alternatives are found only in those places.[14]

10. On rehearing, Red Lake argues that the critical error in the January 30 Order is that the Commission misconstrued Red Lake's application as limiting Red Lake's geographic market to Arizona and southern, but not northern, California. Red Lake claims that the good alternatives are found in California (north and south), Arizona, Nevada, and New Mexico (the "CANN" market).[15] Red Lake states these services are available, reasonably priced, and comparable to the services Red Lake will offer.

11. Review of Red Lake's claims, however, shows again that 1) no good alternatives exist beyond the southern California/Arizona market, and thus that 2) the January 30 Order's determination of the geographic market as including only southern California and Arizona was supported by the evidence available and should be affirmed in this order.

Northern California Storage

12. Red Lake claims that several northern California storage facilities, PG&E, Lodi Gas Storage and Wild Goose Gas Storage, operate as good alternatives in direct storage-on-storage competition.[16] Red Lake claims that Lodi and Wild Goose were designed to respond to rapid customer demand requirements, offer traditional and peaking services, and thus would be competitive.[17] Red Lake claims that transportation service is available from northern California storage to Arizona or southern California under PG&E's Off-

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[14]January 30 Order, 102 FERC ¶ 61,077 at P 28-29 (2003).

[15]Request for rehearing at 3. However, Red Lake states also on rehearing that storage facilities in eastern New Mexico are not included in the HHI calculations submitted with the rehearing request. Red Lake does not assert on rehearing that Texas should be included in its geographic market.

[16]In total, Red Lake asserts that there is currently "available" 32.5 Bcf of firm, un-subscribed storage capacity at California storage facilities, which total will grow to at least 43.1 Bcf in 2004, including 23 Bcf of SoCalGas capacity, and also "the Wild Goose expansion and from PG&E's noncore storage." Request for Rehearing at 14. But Red Lake's Affidavit of McConihe states (at ¶ 18) that the SoCalGas capacity has not been marketed because of delay in the restructuring of southern California markets. Such capacity is thus not "available," and total California storage should not include such capacity.

[17]Request for rehearing at 10.

System Service (through Kern River's Wheeler Ridge Station) at a cost of $0.3272/Dth,[18] but admits that this path may offer "constraints and resulting high transportation costs."[19] Red Lake also argues that northern California storage can serve the East of California market (i.e., Arizona) by delivery through PG&E's Off-System Service to El Paso at Topock at a cost of $0.4034/Dth, under El Paso's new California Receipt Service.

Commission Response

13. Review of the evidence concerning the availability, price, and quality of northern California storage fails to support Red Lake's claim that it is a good alternative. In support of the availability of competitive storage service, Red Lake offers unsubstantiated assertions.[20] Further, a key element of a good alternative storage service, i.e., the availability of transportation service to move the gas from northern California storage to demand markets located elsewhere, has not been shown. Such service would normally involve movement of gas through Wheeler Ridge, and transportation of gas through Wheeler Ridge has been subject to substantial constraints for some time.[21] The continuing efforts of the CPUC to assist in relieving such constraints by restructuring the contractual rights customers enjoy on the SoCalGas system are constructive and offer hope for a more efficient southern California transportation system. Currently, however, no evidence shows that the CPUC's purposes have yet been fulfilled. Therefore, good alternative transportation services from northern California are not available to compete for customers' business with market-based rates offered by Red Lake.

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[18]Wilson Affidavit at ¶ 85. PG&E Gas Tariff Schedule G-AFTOFF, Annual Firm Transportation Off-System, provides an intrastate service in California subject to the jurisdiction of the California Public Utilities Commission (CPUC). The degree to which such service is firm is not established by the record.

[19]See Affidavit of Wilson at ¶ 86.

[20]See Attachment A to the rehearing request, affidavit of Bruce McConihe at ¶ 20, note 15 (reference to a "conversation with Wild Goose on 2/17/03"). Similar unsubstantiated references ("conversations" with un-named sources) attempt to establish that customers of Wild Goose and PG&E are able to "serve load" in southern California. Id. at ¶ 7, notes 3 and 4.

[21]See, e.g., Kern River Gas Transmission Co., 98 FERC ¶ 61,205 at 61,712 (2002). Red Lake offers no evidence that such constraints no longer exist, relying merely on the broad claim that such service would be reliable. See Wilson affidavit at ¶ 84-85.

14. Indeed, as to PG&E's storage services themselves, Red Lake admits that such services are not yet available to "non-core" customers, will become available only in 2004, and even then only on a short-term basis.[22] Further, any long-term storage agreements are subject to CPUC approval, and thus substantial uncertainty exists regarding the availability of such services.[23] To describe the rates under which northern California storage services are provided, Red Lake offers only the statement that PG&E is capable of discounting from tariff rates to fill up un-subscribed storage space.[24] No evidence of such discounting ever having occurred is submitted. As to the East of California market, El Paso's service is only available on an interruptible basis. Red Lake fails to show how or at what cost firm transportation to East of California customers might be available, and no good alternative has been shown here.

15. The January 30 Order found that the issues of high-cost and reliability associated with transporting gas between what have recently been two separate geographic markets (northern California and southern California-Arizona) preclude finding northern California storage/transportation to be a good substitute for Red Lake's storage service.[25] Red Lake has submitted no evidence reasonably construed as requiring a reversal of that conclusion. The relevant geographic market in which Red Lake would operate cannot include northern California. Red Lake makes no attempt to show the availability of current storage services elsewhere in the CANN market, and the January 30 Order's conclusion that the relevant geographic market includes only southern California and Arizona must be affirmed.

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[22] Id. at ¶ 17.

[23] Id.

[24] Id. at ¶ 19.

[25] See January 30 Order, 102 FERC ¶ 61,077 at P 28-29 (2003); see also Affidavit of McConihe at ¶ 6 (northern and southern California "no longer" operate as separate markets as they have in the past).

Pipeline Transportation Capacity

16. Red Lake argues also that pipeline capacity, standing alone, is a substitute for and competes directly with storage capacity, because use of pipeline capacity permits customers to use relatively more flowing gas supply, and relatively less storage, to meet their variable load patterns. Red Lake states that El Paso, for example, has been providing such service to East of California customers in Arizona, Nevada and New Mexico with growing, and very uneven, gas demands.[26] Further, Red Lake claims that significant constraints into California are not expected, and that El Paso's capacity is currently not valued highly.[27] Red Lake cites limited interest in available turn-back capacity on El Paso to prove this true.[28]

17. In support, Red Lake also argues broadly that other competitive non-storage alternatives have become increasingly available after the filing of its certificate application and limit the value of storage services. [29] Looking forward, argues Red Lake, the markets will be significantly more price sensitive than in the past. Red Lake states that the conditions that caused high prices in 2000-2001 are being corrected by the Commission's review of allocation problems on El Paso, by the Commission's commitment to vigilant market oversight, and by the CPUC's implementation of firm, tradable receipt point rights on the SoCalGas system. The "markets" are no longer constrained, states Red Lake, or vulnerable to any attempted exercise of market power.[30]

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[26]Red Lake states El Paso's total firm East of California load averaged 1,000,000 Dth/day while serving all of these customers with no market area storage at all. However, as Red Lake recognizes, this is the result of such East of California customers being full-requirements customers. See Wilson affidavit at ¶ 60.

[27]Wilson Affidavit at ¶ 27-28, citing unidentified broker.

[28]Citing Compliance Report of El Paso filed September 3, 2003, in Docket No. RP00-336.

[29]I.e., purported increases in new natural gas pipeline and storage capacity, coupled with lower demand for interstate capacity, citing California Energy Commission's Natural Gas Supply and Infrastructure Assessment (December, 2002). See Wilson Affidavit at ¶ 16-21 and 41.

[30]Request for rehearing at 17.

Commission Response

18. In order for gas transportation capacity to compete effectively with Red Lake's firm storage service, such capacity must be firm and it must be available, at competitive price levels. Red Lake establishes neither of these conditions. A customer holding firm storage capacity on Red Lake is assured that gas will be available when needed, and such demand will likely vary from season to season. Use of El Paso interstate capacity as a direct alternative will assure the receipt of such gas only if the customer holds firm capacity from the production area. Currently, firm transportation capacity on El Paso Pipeline, Questar Southern Trails Pipeline Company, and Transwestern Pipeline Company is fully subscribed. Indeed, El Paso will remain fully subscribed upon the conversion of full requirements customers to contract demand customers.[31] The only alternative available would be Red Lake's storage service.

19. Further, Red Lake's reliance on wide projections of lower future gas demand and slack future pipeline capacity is undercut by the complexity of the issues yet remaining to be resolved in the western markets. The current El Paso proceeding to which Red Lake alludes, Docket No. RP00-336, involves resolution of long-standing constrained capacity issues on that system. Comments filed therein by certain parties indicate that any diminished value currently accorded El Paso's capacity is caused by concerns over the degree of firmness in service yet to be established and made available in that case.[32] Thus Red Lake offers nothing to support a reasonable expectation that available excess pipeline capacity would provide a directly competitive and good alternative to Red Lake's service, when analyzed under the Policy Statement's three standards of availability, price, and quality.[33]

Exchanges

20. Red Lake, relying on the affidavit of its witness, Mr. James Wilson, argues that certain exchange arrangements could operate as good alternatives. Under such arrangements, typically involving a marketer with customers in both northern California and East of California and holding firm transportation capacity on both El Paso and

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[31] See El Paso Natural Gas Company, 100 FERC ¶ 61,285 (2002).

[32] See Full Requirements Shippers' Response to September 3, 2003 Report of El Paso, filed September 12, 2003, at 5.

[33] Nor does Red Lake offer any HHI representations of how pipeline capacity can function as a good alternative. Its conclusions regarding pipeline capacity as a good alternative thus remain speculative.

PG&E, the marketer would simply nominate gas flowing westward on El Paso to the East of California customer and withdraw from the northern California storage to serve the California load.[34] Thus, states Red Lake, customers could use all California storage, northern and southern, as good alternatives to the service Red Lake will provide.[35]

Commission Response

21. Exchange arrangements such as Wilson hypothesizes could theoretically occur under the precise set of circumstances posited, but Wilson admits that evidence "that such arrangements are used would be hard to produce."[36] Under current market conditions, he states, exchange arrangements are unnecessary since most East of California customers are still full-requirements customers and "do not yet need storage services."[37] It appears equally true that few customers are in a position to use such arrangements, other than the hypothesized marketer with both supply and transportation readily available. Certainly the record here is devoid of evidence of marketplace use. A theory of speculative potential exchange availability, unsupported by any evidence of the customer's costs imposed for use of such services or of the quality of such arrangements, offers nothing upon which we can reasonably rely as good alternatives and put at risk the needs of Red Lake's storage customers.

HHI and Market Share Calculations

22. Red Lake states that, assuming the availability of both the expanded northern California Wild Goose facility, scheduled for completion in Spring 2004, and the Red Lake facility, the HHI for working gas in the CANN geographic market it proposes would be 3,423, and the HHI for peak day deliverability would be 3,225.[38] Red Lake's market share will be 4.4 percent for working gas capacity and 12.3 percent for peak day deliverability. Red Lake argues that such sets of HHI values are within the range

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[34]Wilson at ¶ 89.

[35]Request for rehearing at 12.

[36]Wilson at ¶ 91.

[37]Id.

[38]Request for rehearing at 13-14.

previously approved by the Commission for market-based rates for storage facilities.[39] However, as noted in the January 30 Order, the Commission uses the HHI measure of concentration to indicate the level of scrutiny to be given the applicant in evaluating whether a market-based rate should be granted.[40] If the HHI is above 1,800, as here, the Commission will give the applicant closer scrutiny because the index indicates that the market is more concentrated and the applicant may have significant market power.[41] Red Lake has submitted nothing on rehearing requiring the Commission to change its HHI analysis of markets or alternative services within markets.

23. The HHI calculations proposed by Red Lake on rehearing include both southern California storage (four SoCalGas facilities) and northern California storage (three PG&E facilities, Western Hub's Lodi, and Wild Goose Storage).[42] Even assuming that the northern California storage services should be included in the geographic market for purposes of HHI analysis, the results show high levels of concentration. The lowest HHIs proposed by Red Lake (which includes the anticipated expansion of Wild Goose Storage by April, 2004) include a working gas capacity HHI of 3,423 and a peak day deliverability of 3,225, both of which are substantially in excess of the 1,800 threshhold. Such markets are highly concentrated, and closer scrutiny of Red Lake is required.[43]

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[39] Id., citing Avoca Natural Gas Storage, 68 FERC ¶ 61,045 (1994); New York State Electric & Gas Corp., 81 FERC ¶ 61,020 (1997); Steuben Gas Storage Co., 72 FERC ¶ 61,102 (1995); NE Hub Partners, L.P., 83 FERC ¶ 61,043 (1998).

[40] The Commission examines concentration in the relevant market using the Herfindahl-Hirschman Index (HHI). The Commission did not adopt a rigid brightline threshold for the HHI to be used in granting or denying the ability to charge market-based rates. Instead, if the HHI is above 1,800, the Commission will give the applicant more scrutiny because the index indicates the applicant may have significant market power since the market is concentrated. Conversely, an HHI below 1,800 would result in less scrutiny of the applicant's potential to exercise significant market power because the market is less concentrated. Policy Statement, 74 FERC ¶ 61,076, at 61,235 (1996).

[41] See Policy Statement, 74 FERC ¶ 61,076 at 61,235 (1996).

[42] Red Lake Rehearing Request at 13-14, Ex. KAR 2-2b, Ex. KAR 3-3b.

[43] Indeed, appropriate geographic market analysis (southern California-Arizona) continues to yield an HHI of 8,167 for working gas capacity and 6,816 for peak day delivery.

Further Scrutiny

24. Red Lake asserts that the market share and HHIs are within the range of values for which the Commission has permitted market-based rates in Avoca, Steuben, NYSEG, and NE Hub.[44] The Commission notes that market-based rates were found appropriate in those proceedings, despite the storage markets being highly concentrated, because of specific factors not present in the current analysis: ease of entry, and small market shares of the applicants.

Ease of Entry

25. Red Lake contends that evidence shows relative ease of entry into the relevant gas storage market.[45] Red Lake's expert witness Bruce McConihe argues that there is well-documented potential to develop salt cavern storage facilities within Arizona.[46] Specifically, Red Lake cites the Commission's order granting Desert Crossing authority to determine the operational feasibility of developing certain Arizona storage caverns for use as a natural gas storage facility.[47] Red Lake also relies on the northern California storage facilities, Wild Goose and Western Hub Properties' Lodi facility, to show ease of entry.[48] However, both of these storage facilities are in northern California. As discussed above, these alternatives may exist in northern California, but analysis of their quality and price shows them not to be good alternatives.

26. The January 30 Order found it premature to conclude that entry would be relatively easy in the Red Lake market area, absent evidence regarding the geologic complexity of potential expansions, the depth of the injection/withdrawal wells, and the

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[44]Avoca Natural Gas Storage, 68 FERC ¶ 61,045 (1994); Steuben Gas Storage Co., 72 FERC ¶ 61,102 (1995); New York State Electric& Gas Corp., 81 FERC ¶ 61,020 (1997); and NE Hub Partners, 83 FERC ¶ 61,043 (1998).

[45]Citing Steuben Gas Storage, 72 FERC ¶ 61,102 (1995).

[46]See Affidavit of Bruce McConihe at ¶ 33.

[47]See 98 FERC ¶ 61,277 (2002). Another applicant, Copper Eagle, has also been granted similar authority in Docket No. CP02-188. See 99 FERC ¶ 61,270 (2002).

[48]See Ex. KAR-2a and 2-b; Ex. KAR-1, filed with Red Lake's certificate application at 16-17, filed 8/9/02.

permitting process for construction.[49] Such evidence has yet to be presented, and Red Lake's contention that the potential for new natural gas storage facilities in salt caverns eases entry into the gas storage market remains speculative.

Size of Applicant

27. Red Lake's market share is not small relative to the various applicants' shares in the four orders cited above, either under the southern California-Arizona geographic market definition we conclude is appropriate, or even under the CANN definition proposed by Red Lake on rehearing. Under the January 30 Order's market definition, Red Lake's market share is significantly higher than the market shares in Red Lake's cited orders. In the working gas capacity market, Red Lake's market share ranges from 2.9 to 34.0 times higher than the market shares in the cited orders. Similarly, in the peak day deliverability market, Red Lake's market share ranges from 2.1 to 14.1 times higher than such cited market shares.

Source	Working Gas Capacity Market Share	Peak Day Deliverability Market Share
January 30 Order	10.2%	19.8%
Red Lake Rehearing Request	4.4%	12.3%
Avoca Order	3.0%	9.6%
Steuben Order	3.5%	1.7%
NYSEG Order	0.3%	1.4%
NE Hub Order	1.2%	5.0%

28. Even assuming the propriety of the CANN geographic market definition proposed on rehearing by Red Lake, Red Lake's market share is significantly higher than the market shares determined in the cited orders. In the working gas capacity market, Red Lake's market share would be from 1.3 to 14.6 times higher; in the peak day deliverability market, Red Lake's market share would be 1.3 to 8.8 times higher.

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[49]See January 30 Order, 102 FERC ¶ 61,077 at ¶ 37 (2003).

Conclusion

29. Red Lake's request for market-based rates was denied because the market it will operate in will be extremely concentrated and Red Lake will have substantial market power. Red Lake's rehearing request provides no reasonable support for granting rehearing.

30. Red Lake states that it requires market rate authority because: 1) it has no existing customers, no affiliates to use its services, and thus will incur the entire risk of facility cost recovery through facility use, 2) Red Lake will have to compete with existing alternatives to its services, 3) Red Lake's open season resulted in highly contingent precedent agreements covering only about 61 percent of its proposed capacity,[50] 4) the creditworthiness of potential customers throughout the natural gas industry has increased the risk of developing the facility, and 5) use of cost-based rates will require discounting below capital recovery levels in soft market conditions without the "possibility of making up this loss during tight markets."[51]

31. Red Lake argues that it is "only the prospect of occasionally being able to recover more than cost-based rates that can offset" the risks Red Lake faces.[52] Absent the availability of such an upside, Red Lake states that its proposal will result in "unacceptable business risk," since cost-of-service rates "do not provide the flexibility to tailor services to customers' needs and maximize the value of the project in the marketplace." [53] Denial of this request, states Red Lake, will "send a negative signal to other market participants and discourage them from developing other needed gas infrastructure."[54]

32. As to Red Lake's stated need for market-based rates, a certain degree of risk of underutilization of jurisdictional facilities is common to most natural gas companies currently providing services. Red Lake has apparently not considered seriously the

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[50]Red Lake requested that the precedent agreements submitted as part of its application be accorded confidential treatment. Application at 50.

[51]Request for rehearing at 18.

[52]Id. at 19.

[53]Id.

[54]Request for rehearing at 19, n. 52.

Commission's various efforts to provide rate-making options responsive to the market pressures faced by jurisdictional companies. Red Lake makes no attempt to explain why a Negotiated Rate program would be unresponsive to its asserted need for custom-tailored service agreements.[55] Nor is any reference made to Order No. 637, in which the Commission revised its regulatory policies specifically to enable the provision of transportation services under peak/off-peak and term differentiated rates.[56] The Commission will make such options available to a jurisdictional applicant where it finds "that such rates better reflect the demands and risks it faces."[57] Here, Red Lake asserts without explanation a need to obtain higher returns from its customers in tight markets in order to make up for lower rates during softer markets.

33. Market-based rate authority is not an alternative to which certificate applicants become entitled merely on the basis of risk assumption. That factor is clearly one of the circumstances underlying the analysis we conduct under the Policy Statement, but it is the need to avoid subjecting customers to the exercise of market power that drives the analysis. Consistent with our responsibility under the Natural Gas Act to assure just and reasonable rates, the Commission must assure that sufficient good alternatives can reasonably be expected to preclude forcing customers' choices of specific services and rates.[58] Under the facts presented here, the risk of such forcing is too high.

34. The Commission reaffirms that the relevant geographic market for Red Lake storage service does not include northern California. The services available at and through the northern California storage facilities have not been shown to match Red Lake's services in availability, price, or quality, as required by the Policy Statement. PG&E's storage facilities are available only on a short-term basis to non-core customers and are subject to CPUC approval. The added costs and constraints of transporting gas from northern California storage to the southern California or East of California markets

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[55] See January 30 Order, 102 FERC ¶ 61,077 at P 41 (2003).

[56] See Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, Order No. 637, FERC Statutes and Regulations, Regulations Preambles July 1996 - December 2000 ¶ 31,091 (February 9, 2000).

[57] Id. at 31,263 (2000).

[58] See Northwest Natural Gas Company, 95 FERC ¶ 61,242 (2001). To the degree there is market support prompting the development of other, new storage projects competitive with that of Red Lake, the Commission would be thereby enabled to find good alternatives available and to justify granting market-based rate authority.

preclude us from finding good alternatives to Red Lake's services in the northern California market. Nor does Red Lake provide evidence of good alternatives in the rest of the CANN market it claims. Based on all of the above, the Commission will deny rehearing.[59] Given Red Lake's firm position that the project will not go forward without market-based rates, the Commission will terminate this proceeding in order to assure appropriate use of limited Commission resources.

35. The record here does suggest, however, the propriety of further Commission review of the development of gas storage infrastructure necessary to the optimal operational efficiency of the southwestern natural gas markets. As noted above, the viability of several such projects, unrelated to Red Lake's, is currently being reviewed by the sponsors thereof. The Commission will convene a technical conference in the near future to gather relevant information and review relevant policies in order to measure market needs against current regulatory programs.

The Commission orders:

The rehearing request filed by Red Lake in this proceeding is denied, and this proceeding is terminated.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[59]On May 3, 2003, The Hualapai Tribe, an intervener in Docket No. CP02-420-000, filed a motion to intervene in Docket Nos. CP02-421-000 and CP02-422-000. The Hualapai Tribe states that, due to a clerical error, its original motion to intervene failed to specify all three of the involved dockets. For good cause shown, the May 3 motion is granted.