

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

State of the Natural Gas Industry Conference) Docket No. PL04-17-000
Staff Report on Natural Gas Storage) Docket No. AD04-11-000

**INITIAL POST-CONFERENCE COMMENTS
OF THE
NATURAL GAS SUPPLY ASSOCIATION**

The Natural Gas Supply Association (“NGSA”) submits these initial post-conference comments pursuant to the procedures established by the Federal Energy Regulatory Commission (“FERC” or “Commission”) in the Notice of Public Conference and Agenda issued in the above-captioned proceeding on October 13, 2004. NGSA represents integrated and independent companies that produce and market natural gas in the United States. Established in 1965, NGSA encourages expanded use of natural gas and supports regulatory and legislative actions that foster competitive markets.

I. Executive Summary.

NGSA commends the Commission for holding its annual State of the Natural Gas Industry Conference (“October 21 Conference”) to examine ways in which it can encourage the development of needed storage facilities. We believe there are ways the Commission can promote new storage development as well as remove unnecessary barriers to entry. While the NGSA member companies have various ideas about the policy changes needed to encourage storage development, all agree that there are measured steps, which can be taken to promote storage development without forsaking

the regulatory accomplishments of the past decade and the fundamental principles and protections afforded to the industry today.

As the Commission contemplates its path forward, there are several considerations that we hope the Commission will take into account:

- ***Allowed Returns for Greenfield Storage Development and Operations Should Recognize the Inherent Risk Relative to Pipeline Infrastructure Development and Operations.***
- ***The Commission Must Find a Legally Defensible Way to Ensure Any New Market Power Test Is Only Applied to New Independent Storage Entrants.***
- ***Additional Mitigation Measures Should Be Imposed on Storage Providers Who Are Permitted to Charge Market-based Rates Without Undergoing the Traditional Market Power Test.***
- ***The Commission Should Maintain the Shipper Must Have Title Rule.***

II. Communications and Correspondence.

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III. Allowed Returns for Greenfield Storage Development and Operations Should Recognize the Inherent Risk Relative to Pipeline Infrastructure Development and Operations.

As independent storage developers reiterated on numerous occasions at the October 21 Conference, for a variety of reasons, certain types of underground storage fields are inherently more risky to develop than pipeline infrastructure. Geophysical

factors are major risks in the development of storage and require significant upfront investments for pre-testing, particularly with greenfield projects. Also, there is considerable risk associated with the recovery of investment when significant levels of storage capacity are unsubscribed or subscribed only for a short duration. As noted in the September 30, 2001 FERC Staff Report on the “Current State of and Issues Concerning Underground Natural Gas Storage” (“September 30 Report”) and at the October 21 Conference, these economic risks are present for a large number of new storage projects under consideration by developers today.

Given the level of risk undertaken for new storage development, NGSA encourages the Commission to recognize these increased risks and to compensate those developers accordingly when setting their approved returns under a cost-based rate structure. Especially during the early years of a project, the Commission should make sure that the increased risks are matched with the appropriate reward. Of course, over time, the level of risk may diminish and a re-examination of the allowed return may be warranted.

IV. The Commission Must Find a Legally Defensible Way to Ensure Any New Market Power Test Is Only Applied to New Independent Storage Entrants.

On page 30 of the September 30 Report, the FERC Staff contemplates a Commission determination of market-based rates for new independent storage projects. If the Commission chooses to alter its current market power analysis for new independent storage projects, it must be clear about what constitutes a truly *independent* storage provider. NGSA agrees with the September 30 report, that to qualify for as a new

independent storage provider, the project owner must assume all market risk and have no captive customers. But there are several other qualifications which are just as critical.

By no means should the Commission allow any new policy relaxing the current market power test for storage to creep into traditionally regulated pipeline transportation services and integrated storage.¹ Storage that is owned by a currently regulated pipeline company should not be considered independent. Similarly, we would argue against characterizing a pipeline energy affiliate as an independent provider of storage, particularly when those facilities are connected to its affiliated pipeline. Nor should a new market power policy be applied to existing storage that has been simply spun down or spun off from a currently regulated facility, given that the spun off facilities serve an existing customer base and would not offer new incremental capacity to the market.

The nature of most pipeline transportation, as well as the physically-related no-notice and pipeline-owned storage services, is very different from the services provided by independent storage. Because of the monopoly characteristics of interstate pipeline transportation services, pipelines have found it difficult to pass the current test for market-based rates; yet storage has often successfully met the standards of the current market power test. Pipeline storage is also distinct from independent storage because it is integrated with effective operation of pipeline transportation system functions, particularly no-notice service. In fact, it is common to allocate storage costs when designing rates for pipeline transportation services. Because of these distinctions, there

¹ Moreover, the Commission should not consider removing the rate cap on capacity release transactions and other short-term and interruptible services, which was mentioned as a possible option in the September 30 Report. See page 31.

remains a critical need to maintain the traditional market power test for pipeline transportation services.

V. Additional Mitigation Measures Should Be Imposed on Storage Providers Who Are Permitted to Charge Market-based Rates Without Undergoing the Traditional Market Power Test.

Under a new, less-restrictive market power test for independent storage providers, certain mitigation procedures should be required to provide adequate protection to storage customers. These mitigation measures go beyond what the Commission has traditionally required when a storage provider has been able to successfully show that it lacks market power under the current market power test.

First, NGSAs support the use of capacity auctions that can ensure that capacity is allocated to those valuing the storage capacity the most. Auctions can also provide additional assurance that parties are not withholding capacity from the market.

Additionally, a storage provider should be required to alert the Commission when a significant change in circumstances has occurred so that there is an opportunity to re-examine the operator's potential to exert undue market power. Similar requirements have been imposed in previous cases where the Commission approved market-based rates for storage.² In fact, to be certain that no market power issues arise and go undetected, the Commission should consider its own periodic assessment (e.g. every five years) of whether significant changes have occurred. A "significant change in circumstances" review may be warranted if the levels of firm contracts significantly change, if the contract duration periods significantly change, if an affiliate acquires an interest in

² See *K N Interstate Gas Transmission Company*, 76 FERC ¶61,134 (1996) and 82 FERC ¶ 61,009 (1998).

facilities in the same market area, or if other events occur such as a merger and acquisition of the storage facilities.

Expedited complaint procedures for shippers can be another valuable mitigation tool. For this process to be truly useful to storage customers, however, the Commission should specify what standards or market power test it will use when reviewing whether an action was the consequence of undue exertion of market power. Consideration should be given to the establishment of recourse rates when a complaint is filed and the storage facilities fail the market power test. Moreover, storage developers should have the ability to seek immediate recourse from the Commission when a pipeline has not provided an interconnection within a reasonable period of time.

VI. The Commission Must Maintain the Shipper Must Have Title Rule.

Unbundling of transportation and the commodity under Order No. 636 has been the trademark success of our industry and the shipper must have title rule provides the very foundation for that success. Without this rule, the capacity release program would cease to exist, and there would be few, if any, options in the market other than a bundled product, which would lead to a reduction in the Commission's oversight as well as a giant step back for our industry.

We understand that independent storage providers desire to more readily compete with services offered by the pipeline. However, there are other ways that independent storage operators can provide enhanced services to their customers, such as hub-to-hub transfers without eliminating the shipper must have title rule. For instance, an affiliate of the storage operator could act as an agent for the storage operator's customers to get their

gas to another location. Storage providers could provide imbalance protection services. Also, there may be pipeline rate design solutions that could effectively address problems of preferential treatment for pipeline customers over those selecting services from an independent provider. Because there are other options available, we urge the Commission not to give up on fundamental aspects of restructuring solely to enhance the operations of a few.

VII. Conclusion.

NGSA urges the Commission to consider the comments carefully in this proceeding and to balance its interests of providing incentives for storage development with its goals of providing adequate customer protections.

Respectfully submitted,

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