111 FERC ¶ 61,105
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Starks Gas Storage L.L.C. Docket Nos. CP05-8-000
CP05-9-000
CP05-10-000

PRELIMINARY DETERMINATION ON NON-ENVIRONMENTAL ISSUES

(Issued April 19, 2005)

1. On October 26, 2004, Starks Gas Storage L.L.C. (Starks) filed an application for a certificate of public convenience and necessity under section 7(c) of the Natural Gas Act (NGA) to construct and operate a salt dome natural gas storage facility in Calcasieu Parish, Louisiana, and an associated header system that interconnects Starks with the interstate pipeline grid in Calcasieu and Beauregard Parishes in Louisiana. Starks also requests a blanket certificate under subpart G of Part 284 of the Commission's regulations to provide open-access storage services and a blanket certificate under subpart F of Part 157 that will permit Starks to perform routine activities in connection with the construction, maintenance and operation of the storage facilities. In addition, Starks requests authority to charge market-based rates for its storage service and waiver of the Commission's Order No. 636 unbundling requirements so that Starks may store and sell its own gas when its system is undersubscribed.

2. The Commission makes a preliminary determination to approve the Starks storage project subject to the conditions discussed herein. We find, subject to the outcome of our environmental review, that this project will benefit customers by creating additional high deliverability storage in the Gulf Coast region, thereby enhancing competition and reliability. We will grant Starks the authority to charge market-based rates for storage service based on evidence that Starks lacks market power in the relevant market area. However, we will deny Starks' request for waiver of the unbundling requirements associated with its Part 284 blanket sales certificate.

3. This order does not consider or evaluate any of the environmental issues in this proceeding. Those issues are still pending and will be addressed in a subsequent order when the environmental review and analysis are complete. Thus, final approval and issuance of a certificate is dependent on a favorable environmental review and nothing in this order limits our actions regarding our environmental analysis.

I. BACKGROUND

4. Starks is a newly-created limited liability company organized under the laws of the State of Delaware. The sole member of Starks is Black Bayou Gas Storage Inc., which is a wholly-owned subsidiary of EnCana Gas Storage Inc. (EGSI), which in turn is an indirect, wholly-owned subsidiary of EnCana Corporation (EnCana), a Canadian corporation.

5. The corporate family to which Starks belongs owns and operates two natural gas facilities in the United States and three in Canada. Starks' parent, EGSI, operates Wild Goose Storage Inc. (Wild Goose), an intrastate storage facility that is authorized by the California Public Utilities Commission to provide storage at market-based rates. EGSI, through another subsidiary, Salt Plains Storage Inc. (Salt Plains), also owns and operates an intrastate storage facility in Oklahoma that is authorized to provide interstate storage services under section 311(a)(2) of the Natural Gas Policy Act at market-based rates.[1]

II. THE PROPOSAL

A. Facilities

1. Storage

6. Starks proposes to convert two salt dome caverns, located in Calcasieu Parish, into gas storage facilities. The caverns, Starks 1 and Starks 2, are approximately 400 feet in diameter and 1,000 feet high. The tops of Starks 1 and Starks 2 are located approximately 2,500 feet below the surface. The Starks dome has been in industrial development since the 1920s, first for the production of sulphur, then for the production of oil and gas, and more recently for the production of brine for the previous operator's commercial operations.

[1] *Manchester Pipeline Corporation*, 76 FERC ¶ 61,007 (1996). Salt Plains is the successor-in-interest to Manchester Pipeline Corporation with respect to this facility.

7. The storage project will be constructed in two stages. In Stage 1 of the project, Starks will convert and use the Starks 1 cavern to store approximately 13.3 Bcf of natural gas, consisting of approximately 8.8 Bcf of working gas with approximately 4.5 Bcf of cushion gas. The facilities will be designed to allow cycling of the entire working gas volume 5 to 6 times a year at the facility's peak withdrawal rates of 400 MMcf/d and peak injection rates of 375 MMcf/d. Starks intends to commence service using the Stage 1 facilities during the summer months of 2006.

8. In Stage 2 of the project, the Starks 2 cavern will be converted to gas storage. This conversion is expected to be completed approximately 11 months after Starks 1. Starks 2 will have a total storage capacity of 15.6 Bcf, with approximately 10.4 Bcf of working gas and approximately 5.3 Bcf of cushion gas. Overall, Starks' fully developed project will have nearly 29 Bcf of capacity of which more than 19 Bcf will be available working gas capacity. The peak withdrawal and injection rates for the project will double to 800 MMcf/d and 750 MMcf/d, respectively, with the completion of Stage 2.

2. <u>Header System and Compression</u>

9. The Starks project will be located approximately 25 miles west of Lake Charles, Louisiana, near the Texas border and close to the mainline facilities of five interstate pipelines: Tennessee Gas Pipeline Company (Tennessee), Texas Eastern Transmission, LP (Texas Eastern), Transcontinental Gas Pipe Line Corporation (Transco), Gulf South Pipeline Company, LP (Gulf South), and Trunkline Gas Company, LLC (Trunkline). The project will also be located near the intrastate pipeline system of Varibus Corporation (Varibus), a subsidiary of Entergy Louisiana, which provides service to an Entergy power plant and industries in the Lake Charles area.

10. In Stage 1, Starks proposes to construct a 35-mile long, 30-inch diameter header system to connect initially with three nearby pipelines. A connection with Tennessee will be made close to the storage caverns near Vinton, Louisiana. The connections with Texas Eastern and Transco will be made farther east near Gillis, Louisiana, in Beauregard Parish. The header will also cross or approach the proposed routes of several new pipelines being developed to connect new LNG terminal facilities to the marketplace. The majority of easements for the header system will parallel existing rights-of-way.

11. Starks proposes to construct a compressor station adjacent to the storage caverns on eight acres of managed forest land that is isolated from public roads and other structures. In Stage 1, four gas-fired compression units will be installed. In Stage 2, three more compressors will be added. This compression will be used to inject gas into storage and, as needed, to withdraw gas from storage for redelivery to the pipelines.

3. Brine Disposal

12. Starks intends to convert the existing salt caverns to gas storage as soon as the existing brining operations have been discontinued. Starks will displace the brine that remains in the wells with natural gas as it converts the caverns to natural gas storage. Once Starks begins injecting gas into the storage caverns, the gas will displace the remaining brine to the surface. The displaced brine will be transported to the current operator's Lake Charles facility via the existing brine pipeline for use as feedstock in its commercial operations. Starks will construct certain new facilities necessary to dispose of any surplus brine removed from the two caverns as they are converted to gas storage service. In Stage 1, these will consist of two new brine injection wells located approximately five miles from the main compressor site and a pipeline that will transport the surplus brine to that point.

B. Rates and Services

13. Starks requests a blanket certificate under subpart G of Part 284 in order to provide firm and interruptible storage services on an open-access basis. Starks also requests approval of its pro forma tariff at Exhibit P to its application. Starks proposes to provide a Firm Storage Service under Rate Schedule FSS and an Interruptible Storage Service under Rate Schedule ISS. The rate schedules are intended to allow Starks' customers to customize their respective injection rates, withdrawal rates and total inventory capacity based upon their needs.

14. Starks also requests authority to charge market-based rates for all storages services offered under Rate Schedules FSS and ISS. Starks supports its request with a Market Power Analysis at Exhibit I to its application that concludes that Starks will lack market power with respect to the services that it provides.

15. Because it proposes to charge market-based rates, Starks requests waiver of the Commission's cost-based regulations and the accounting and reporting requirements that the Commission has found to be inapplicable to storage providers that are granted market-based authority.

C. Waiver of Part 284 Requirement to Unbundle Services

16. In Order No. 636,[2] the Commission required pipelines to unbundle their sales services from their transportation services at the upstream point closest to the production area, and to provide all transportation services on a basis that is equal in quality for all gas supplies whether purchased from the pipeline or from any other gas supplier. The rule also issued blanket sales certificates to pipelines so that they can offer unbundled firm and interruptible sales services at market-based rates.

17. Starks requests that the Commission waive the unbundling requirement in subpart J of Part 284 in order to permit it to own and sell gas stored in otherwise unused capacity within its facility. Starks states that it would schedule injections and withdrawals of its own gas only after all storage customer nominations have been scheduled, and therefore no storage customer service would be disrupted by the waiver. Starks represents that, notwithstanding the waiver, it would operate the facility, as required by the NGA and section 284.7(b) of the regulations, in a manner that is neither unduly discriminatory nor preferential.

18. Specifically, Starks requests (1) a waiver of section 284.284(a) of the regulations, to modify the scope of the blanket sales authorization it would receive as a blanket storage provider under subparts B and G of Part 284, to permit such sales to be made on a bundled basis;[3] (2) a waiver of section 284.285, to permit its bundled sales to be

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[2] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* Order No. 636, FERC Stats. & Regs. ¶ 30,939 (1992), *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950 (1992), *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *reh'g denied*, 62 FERC ¶ 61,007 (1993) *remanded in part sub nom., United Distribution Co. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *cert. denied*, *Associated Gas Distributors v. FERC*, No. 95-1186 (1996), *order on reh'g*, Order No. 636-D, 83 FERC ¶ 61,210 (1998).

[3] Section 284.284(a) reads as follows: "*Authorization*. An interstate pipeline that offers transportation service under subpart B or G of this part is granted a blanket certificate of public convenience and necessity . . . to provide unbundled firm or interruptible sales in accordance with the provisions of this section."

abandoned on a self-implementing basis;[4] and (3) a waiver of section 284.286 to the extent necessary to permit the same Starks employees to both conduct its sales business and administer its storage operations.[5] Starks believes that waiver of section 284.286 is actually a technicality since, as an independent storage provider, it is already exempt under Order No. 2004-A[6] from rules that would bar it from working with an energy affiliate to achieve the operational efficiencies that it believes it needs.

19. Starks represents that on the basis of its initial open season, creditworthy potential customers are reluctant to make the longer-term contractual commitments required for Starks to secure project financing.[7] Starks argues that the waivers would enable it to more economically and efficiently operate the proposed facility, and thereby overcome a lack of readily available capital for the project. Starks maintains that if it is not allowed to generate revenue through sales of its own gas, "construction of incremental storage infrastructure and capacity will logically proceed only after the bulk of it has been contracted for on a traditional long-term basis (*i.e.* 10-15 years), with creditworthy customers."[8] Starks maintains that the waiver is consistent with recent Commission initiatives to encourage investment in natural gas infrastructure to meet current demands and avoid a future crisis of insufficient infrastructure.[9]

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[4] Section 284.285 reads as follows: "Abandonment of unbundled sales services is authorized . . . upon the expiration of the contractual term or upon termination of each individual sales arrangement authorized under § 284.284."

[5] Section 284.286 requires pipelines to organize their unbundled sales employees and transportation employees so that they function independently of one another, and to consider their unbundled sales employees as an operational unit that is the functional equivalent of a marketing affiliate.

[6] Standards of Conduct for Transmission Providers, Order No. 2004-A, III FERC Stats. & Regs. ¶ 61,161 at P 39 (2004), as codified at 18 C.F.R. § 358.3 (a)(3) (2005).

[7] Starks' 2004 open season yielded non-binding requests from six parties for a little over 6 Bcf of capacity for an average term of 3.3 years. Five years was the longest primary term offered by any bidder.

[8] Application at p. 52.

[9] *See* October 21, 2004, State of the Natural Gas Industry Conference in Docket No. PL04-17-000, and Staff Report on Natural Gas Storage dated September 30, 2004.

20. Starks states that the purpose of the Order No. 636 unbundling rule was to prevent abuses by large, regionally dominant transmission providers. Starks notes that prior to that order, pipelines traditionally provided storage on a bundled basis to support sales, and the costs associated with storage assets and their operations were included in the pipeline's cost-based transmission rates. In order to control the market power of these entities, the Commission, in Order No. 636, ordered major changes in the business practices of the natural gas industry, among which changes was a requirement that pipelines separate their sales of gas from their transportation service,[10] and a requirement to provide comparable firm and interruptible service to all shippers whether they purchase gas from the pipeline or another gas seller.

21. Starks maintains that under current circumstances, independent storage providers are economically and operationally incapable of engaging in the unduly discriminatory business practices that Order No. 636 addressed. Starks asserts that independent storage is fundamentally different from the storage that was owned and operated by large regionally dominant transmission providers, whose anti-competitive business practices led to Order No. 636. Starks argues that, unlike pipelines prior to restructuring, independent storage providers authorized to charge market-based rates have no market power, no exclusive franchise area, no captive ratepayers, no cost of service, no guaranteed rate of return, no ability to cross-subsidize at-risk business with ratepayer contributions and no affiliation with any transmission provider to which it connects.

22. Starks maintains, therefore, that for many of the same reasons that Order No. 2004-A exempted independent storage providers from the Standards of Conduct for Transmission Providers, finding that they are not capable of committing the unduly discriminatory business practices addressed by the standards, so too should the Commission recognize the same differences as justifying the exemption of independent storage providers from the unbundling requirement of Order No. 636.

D. <u>Need for the Project</u>

23. Starks notes that, in addition to the well-documented growing need for natural gas in the United States,[11] there is also increasing need for the type of high-deliverability gas storage that its salt caverns will provide. Among the factors contributing to this trend are: reduced demand from heavy industry with its strong baseload requirements; higher and

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[10] Section 284.1 defines transportation as including storage.

[11] *Annual Energy Outlook 2004 – With Projections to 2025*, Energy Information Administration, at p. 4 (Jan. 2004).

more volatile peak demands from the residential and consuming sectors; more gas-fired electric generation capacity that can be dispatched on an hour-to-hour basis, thereby producing even higher demand volatility; and the growth of LNG supply in the Gulf Coast region.

24. Starks states that its proposed facility will help to meet these new needs because deliverability from salt caverns is typically much higher than from storage facilities located in depleted reservoirs or aquifers. This allows multi-cycle service to be offered to those customers who wish to deplete and replenish their stored gas inventory frequently. The compression and control equipment at the Starks facility will be designed for rapid turn around from injection to withdrawal to offer customers the greatest flexibility possible.

25. In particular, Starks asserts that it will be in a position to facilitate the delivery of imported LNG to the North American market. Starks notes that there are at least five large-scale Gulf Coast LNG projects in various stages of operation, construction and planning in the vicinity of its project [12] with planned direct or indirect access to storage injection or withdrawal. Starks explains that these LNG marine terminal/regasification projects have limited storage capacity relative to the volumes of LNG projected to be off-loaded from the tanker deliveries. Thus, the LNG shippers must deliver their regasified LNG to the market within days of the initial off-loading, thereby limiting their operating flexibility. Starks states that the large capacity and multi-cycle high-deliverability characteristics of its project will give LNG shippers time and flexibility to meet changing market conditions. Starks adds that its project should be available to provide storage service before the currently projected in-service dates for four of these five LNG projects.

26. Notwithstanding this anticipated demand, Starks' first open season, held in early 2004, resulted in only six non-binding requests for service for a combined 6.15 Bcf of capacity. Since then Starks has expanded the scope of the project to offer access to more markets and to commit to a second storage cavern (Starks 2). However, as of the date that it filed its application, Starks had executed a precedent agreement with only one shipper. While Starks is confident in the viability of its project, it believes that the next open season it holds in early 2005 will confirm that the market it not yet ready to make

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[12] These recently approved or pending LNG applicants are: Trunkline LNG Company LLC; Cameron LNG, LLC; Sabine Pass LNG, L.P.; Pearl Crossing LLC; and Golden Pass LNG LP.

the long-term commitments usually deemed essential to the financing of large-scale natural gas projects. This phenomenon, asserts Starks, is one of the primary reasons Starks is requesting the Commission waive its open-access unbundling requirements to allow Starks to fill its unused storage with its own gas on a spot basis when the capacity is otherwise unsubscribed.

III. NOTICE, INTERVENTIONS, AND COMMENTS

27. Notice of Starks' application was published in the *Federal Register* on November 12, 2004, 69 Fed. Reg. 65,418. Interventions were due on or before November 24, 2004. Timely unopposed interventions were filed by the Keyspan Delivery Companies, Enstor Operating Company, LLC, Nicor Enerchange, Inc., Pine Prairie Energy Center, LLC and SG Resources Mississippi, L.L.C. Timely, unopposed motions to intervene are granted by operation of Rule 214 of the Commission's Rules of Practice and Procedure.[13] A number of parties filed comments supporting the project stating that it will benefit the local and national economy by providing a safe and readily available source of natural gas and will also provide full- and part-time employment for community residents.[14] No protests were filed.

IV. DISCUSSION

28. Since the proposed facilities will be used to transport natural gas in interstate commerce subject to the jurisdiction of the Commission, the construction, acquisition, and operation of the facilities are subject to the requirements of subsections (c) and (e) of section 7 of the NGA.

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[13] *See* 18 C.F.R. § 385.214(a)(3)(2004).

[14] Letters of support were filed by the Starks Business & Civic Association; Starks High School; Calcasieu Parish Police Jury; Louisiana Chemical Association; Parish of Calcasieu; Michael J. Oliver, Secretary, State of Louisiana – Louisiana Economic Development; Herman Ray Hill, State Representative, District 32; Brett Geymann, State Representative, District 35; Dan Flavin, State Representative, District 36; James David Cain, State Senator and David Vitter, Senator-Elect, United States Senate and Kathleen Babineaux Blanco, Governor, State of Louisiana.

A. **Public Convenience and Necessity**

29. On September 15, 1999, the Commission issued a Policy Statement[15] providing guidance as to how proposals for certificating new construction will be evaluated. Specifically, the Policy Statement explains that the Commission, in deciding whether to authorize the construction of new pipeline facilities, balances the public benefits against the potential adverse consequences. Our goal is to give appropriate consideration to the enhancement of competitive transportation alternatives, the possibility of overbuilding, subsidization by existing customers, the applicant's responsibility for unsubscribed capacity, the avoidance of unnecessary disruptions of the environment and the unneeded exercise of eminent domain in evaluating new pipeline construction.

30. Under this policy the threshold requirement for existing pipelines proposing new projects is that the pipeline must be prepared to financially support the project without relying on subsidization from the existing customers. The next step is to determine whether the applicant has made efforts to eliminate or minimize any adverse effects the project might have on the applicant's existing customers, existing pipelines in the market and their captive customers, or landowners and communities affected by the route of a new pipeline. If residual adverse effects on these interest groups are identified after efforts have been made to minimize them, the Commission will evaluate the project by balancing the evidence of public benefits to be achieved against the residual adverse effects. This is essentially an economic test. Only when the benefits outweigh the adverse effects on economic interests will the Commission then proceed to complete the environmental analysis where other interests are considered.

31. Starks meets the threshold requirement that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers because it is a new entrant to the natural gas storage market that has no existing customers.

32. Starks' proposal should not have any adverse impact on existing pipelines or their customers. Rather, it should enhance competition in the region by providing additional storage service at market-based rates. Starks' Market Power Study, at Exhibit I to its application, indicates that the proposed storage facility will be located in a highly competitive market area that has recently experienced a steady, rapid growth in gas use.

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[15] *Certification of New Interstate Natural Gas Pipeline Facilities (Policy Statement)*, 88 FERC & 61,227 (1999), *Order Clarifying Statement of Policy*, 90 FERC & 61,128 (2000), *Order Further Clarifying Statement of Policy*, 92 FERC & 61,094 (2000).

Starks will be one of a number of storage facilities in the region providing storage services at market-based rates. Further, Starks will be interconnecting with three different pipeline systems (and perhaps more) which should provide added flexibility to the customers holding capacity on these pipelines.

33. Because the two existing salt dome caverns have been in industrial development for decades, there will be no adverse impact on landowners associated with the conversion to storage. Starks has routed its header system along existing rights-of-way along the entire distance so as to minimize impact. All the proposed facilities are located in a rural area far from populated areas. Starks will construct the backup brine disposal facilities but states that these will be modest in scope and not a part of the storage facility itself. No landowner or community member has objected to the project. For these reasons we find that any adverse impacts on landowners and communities will be minimal.

34. We conclude that the Starks facility will enhance the development of an efficient interstate pipeline transportation system providing customers access to additional high-deliverability storage capacity. Gulf of Mexico producers, new LNG terminals in the area, customers transporting gas on interstate pipeline facilities connecting to the storage facility and local industries will all benefit. Based on the benefits Starks will provide to the market and the lack of any identified adverse effect on existing customers, other pipelines, landowners, or communities, we preliminarily find, consistent with the Policy Statement and section 7 of the NGA, that the public convenience and necessity requires approval of Starks' proposals.

B. Market-Based Rates

35. The Commission has approved market-based rates for storage services where applicants have demonstrated that, under the criteria in the Commission's Alternative Rate Policy Statement,[16] they lack significant market power or have adopted conditions that significantly mitigate market power. In prior orders, we have approved requests to charge market-based rates for storage services based on a finding that a proposed project would not be able to exercise market power due to its small size, its anticipated small

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[16] *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, *reh'g and clarification denied*, 75 FERC ¶ 61,024, *reh'g denied*, 75 FERC ¶ 61,066 (1966), *petition for review denied, Burlington Resources Oil & Gas Co. v. FERC*, Nos. 96-1160, *et al*., *U.S. App. Lexis* 20697 (D.C. Cir. 1998).

share of the market, and the existence of numerous competitors.[17] We have also distinguished between production area storage facilities, such as the area of southwest Louisiana where Starks is located, and market area storage.[18] In general, market power in a production area is less of a concern due to the numerous alternative storage facilities operating in competition with one another.

36. Starks' market power analysis for the storage market defines the relevant product and geographic markets, measures market share and concentration, and evaluates other factors.[19] For the purpose of its analysis, Starks identifies the relevant product market as underground natural gas storage. Starks identifies the relevant geographic market containing good alternatives to Starks' product as the Gulf Coast region from south Texas through Alabama, because that area is readily accessible by the interstate pipelines that will be connected to the Starks facilities and pipeline header.

37. We use the Herfindahl Hirschman Index (HHI) test to determine market concentration for gas pipeline and storage markets. The Alternative Rate Policy Statement states that a low HHI – generally less than 1,800 – indicates that sellers cannot exert market power because customers have sufficiently diverse sources of supply in the relevant market. While a low HHI suggests a lack of market power, a high HHI – generally greater than 1,800 – requires closer scrutiny in order to make a determination about a seller's ability to exert market power. Starks' market power analysis shows an HHI calculation for working gas capacity of 984 during Stage 1 and 962 during Stage 2. The HHI calculation for peak day deliverability is 838 for Stage 1 and 818 for Stage 2. These measures of market concentration are well below the Commission's threshold level of 1,800, indicating that Starks would be unable to exert market power in the relevant market area after the construction of its proposed storage facilities.

38. With respect to its aggregate share of the relevant market, Starks notes that it will be EnCana's only storage facility in the Gulf Coast market area and, therefore, consolidation with affiliated companies is not an issue. Starks provides separate analyses for Stages 1 and 2 of construction. For Stage 1, Starks identifies 47 alternative storage

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[17] *Egan Hub Partners, L.P.*, 99 FERC ¶ 61,269 (2002); *Egan Hub Partners, L.P.*, 95 FERC ¶ 61,395 (2001); *Moss Bluff Hub Partners, L.P.*, 80 FERC ¶ 61,181 (1997); *Egan Hub Partners, L.P.*, 77 FERC ¶ 61,016 (1996) .

[18] *Steuben Gas Storage Company*, 72 FERC ¶ 61,102 (1995), *order on compliance filing, issuing certificates, and denying reh'g*, 74 FERC ¶ 61,024 (1996).

[19] *See* Exhibit I to the Starks application.

providers, affiliated with 20 separate entities, in the relevant market area.[20] Nine of these providers have been authorized to use market-based rates. The current combined market working gas capacity of all facilities, including Starks, is 748.7 Bcf, with Starks controlling 8.8 Bcf, or 1.2 percent of the market. Starks' 0.4 Bcf of peak day deliverability during Stage 1 will be 1.7 percent of total market peak deliverability of 23.1 Bcf per day. Thus, we find that Starks' aggregate share of the relevant market will be relatively small during Stage 1.

39. The market analysis draws the same conclusions for Stage 2 regarding the relative size of Starks' market share.[21] For Stage 2, using the same alternative storage areas, the current combined market working gas capacity of all facilities, including Starks, is 759.2 Bcf, with Starks controlling 19.2 Bcf, or 2.5 percent of the market. Starks' 0.8 Bcf per day of deliverability after completion of Stage 2 will be 3.4 percent of total market peak deliverability of 23.5 Bcf per day. Thus, we find that Starks' aggregate share of the relevant market will be relatively small after the completion of Stage 2.

40. In addition, Starks points to numerous recently approved and proposed initial storage developments and expansions, including LNG facilities, as evidence of ease of entry in the relevant market area. Its market analysis identifies 30 new underground storage projects and/or expansions of existing storage facilities.[22] Starks notes that in the Gulf Coast region there are seven existing LNG facilities (including one import terminal) and over 20 proposed import terminals now being considered. In light of this information, we conclude that the barriers to entry to the storage market in the relevant market area are low.

41. Starks asserts that in addition to competing storage facilities, upon which its HHI analysis is based, there are alternatives to conventional storage in the Gulf Coast region that would further limit its ability to exercise market power. Starks' analysis of alternatives focuses on what it characterizes as a primary function of storage – to provide additional gas supplies in time of increased need, whether the duration of such need is

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[20] *See* Exhibit 1 to Starks' application at Attachment 1.

[21] *See* Exhibit I to Starks' application at Attachment 2.

[22] *See* Exhibit 1 to Starks' application at Attachment 3.

seasonal or short-term. Thus, Starks notes that in its relevant market, there are LNG storage facilities competing with conventional underground storage, gas marketers offering seasonal and swing contracts that would reduce a buyer's need for storage, and pipelines utilizing line pack to provide balancing and no-notice services that provide buyers with the flexibility similar to that offered by conventional underground storage.

42. In sum, we find that Starks' proposed storage facilities will be in a highly competitive production area where numerous storage service alternatives exist for potential customers. We also find that Starks' prospective market shares are low and that market area HHIs are below the threshold for further review. Thus, we conclude that Starks will lack market power. Further, Starks' proposal for market-based rates is unopposed. For these reasons, we will approve Starks' request to charge market-based rates for firm and interruptible storage services.

43. In addition to other reporting requirements directed herein, Starks must notify the Commission if future changes in circumstances significantly affect its present market power status. Thus, our approval of market based rates is subject to re-examination in the event that: (a) Starks adds storage capacity beyond the capacity authorized in this proceeding; (b) an affiliate increases storage capacity; (c) an affiliate links storage facilities to Starks; (d) Starks, or an affiliate, acquires an interest in, or is acquired by, an interstate pipeline connected to Starks. Since these circumstances could affect its market power status, Starks shall notify the Commission within 10 days of acquiring knowledge of any such changes. The notification shall include a detailed description of the new facilities and their relationship to Starks.[23]

44. Finally, the Commission convened a technical conference in Docket Nos. PL04-17-000 and AD04-11-000 on October 21, 2004, to initiate an industry dialogue focused on policy issues related to underground storage, including the appropriate reporting requirements for storage providers granted market-based rate authority. Therefore, the authorization granted to Starks here will be subject to the outcome of the proceeding in Docket Nos. PL04-17-000 and AD04-11-000.

C. Waivers Associated with Market-Based Rates

45. Starks requests waivers of certain regulations and requirements that the Commission has found to be inapplicable to storage providers that are granted market-based rate authority. Specifically, Starks requests waiver of the Commission's cost-based

[23] *See Copiah County Storage Company*, 99 FERC ¶ 61,316 (2002); *Egan Hub*, 99 FERC ¶ 61,269 (2002).

regulations, which include: (1) section 157.6(b)(8) (certificate applicants to submit cost and revenue data); (2) sections 157.14(a)(13), (14), (16), and (17) and 157.20(c)(3) (cost-based exhibits); (3) section 157.14(a)(10) (showing of accessible gas supplies); (4) the accounting and reporting requirements of Part 201 and section 260.2 relating to cost-of-service rate structure (Form 2A); (5) section 284.7(e) (reservation charge); and (6) section 284.10 (straight fixed-variable rate design methodology).

46. The cost-related information required by these regulations is not relevant in light of our approval of market-based rates for Starks' storage services. Thus, consistent with our findings in previous orders, [24] we will grant Starks' request for waivers with one exception. We will grant the requested waiver of Section 260.2 (Form No 2-A) of the regulations except for information necessary for the Commission's assessment of annual charges. Stark's is required to file pages 520 and 520a of Form 2A , reporting the gas volume information which is the basis for imposing an ACA charge.[25] We will also require Starks to maintain sufficient records consistent with the Uniform System of Accounts should the Commission require Starks to produce these reports in the future.

D. <u>Waiver of Part 284 Unbundling Requirements</u>

47. For the reasons discussed below, we will deny Starks' request to waive the Order No. 636 prohibition against making bundled sales.

48. In Order No. 636, the Commission required pipelines to unbundle the sales and transportation components of their bundled, firm sales services, in part, to remedy the pipelines' undue advantage as gas sellers over other non-pipeline gas sellers.[26] One reason for the pipelines' advantage was that the firm transportation embedded within their bundled firm sales service was superior in quality to both the firm and interruptible transportation used by non-pipeline merchants to move gas sold to LDCs and other

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[24] *See SG Resources Mississippi, L.L.C.*, 101 FERC ¶ 61,029 at P 26 (2004); *Egan Hub Partners, L.P.*, 95 FERC ¶ 61,395 at p. 62,473 (2001).

[25] *See Wyckoff Gas Storage Co., LLC*, 105 FERC ¶ 61,027 at P 65 (2003).

[26] The Commission amended section 284.1 to define transportation as including storage.

endusers. Order No. 636 prohibited bundled sales, requiring pipelines to offer the same high quality transportation and storage services to all, regardless of whether the gas was purchased from the pipeline or another merchant.[27] This ensured all gas sellers could compete on an equal basis.

49. In addition, the unbundling rule enabled gas purchasers to access storage that was formerly bundled into pipelines' sales, thereby allowing purchasers to efficiently serve peak season loads with less expensive off-season purchases. Further, the rule made significant amounts of high quality firm capacity available to purchasers, most of whom, just prior to Order No. 636, had no alternative, if they wished to buy gas from non-pipeline marketers, to shipping their purchases under inferior interruptible or firm transportation services.[28]

50. Now Starks is asking the Commission to permit bundled sales to allow Starks to store its own merchant gas at the storage field and make bundled sales. Starks asserts that permitting it to utilize unused capacity within the facility for generating revenue through sales will provide additional economic value to go forward with capital investment before the facility is fully subscribed.

51. Based on the circumstances presented here, we find that Starks has not justified a waiver from the unbundling requirements of Order No. 636. Given Starks' stated objective of optimizing use of uncontracted storage capacity, Starks has failed to provide sufficient reasons why it cannot achieve this goal through conventional means that do not require waiver of the regulations, such as through the use of a marketing affiliate. The unbundling rule, along with the remaining open-access requirements of Order No. 636, enable non-pipeline marketers to compete effectively with pipeline sales, and sales customers to experience the benefits of enhanced competition among competing suppliers. As we found in Order No. 636, the requirement that all pipelines unbundle transportation and sales is essential to ensure meaningful access to the pipeline grid. We conclude that the Commission's interest in preventing the unduly discriminatory behavior that caused the Commission to take action in Order No. 636 outweighs the alleged benefits of allowing Starks to optimize the value of uncontracted storage capacity by using it to store its own gas. For lack of an adequate showing of good cause, the Commission will deny Starks' request for waiver of the unbundling requirements of Order No. 636.

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[27] Order No. 636 at p. 30,411.

[28] Order No. 636-A, FERC Statutes and Regulations ¶ 30,939 (1992).

52. Because we are denying Starks' request to make bundled sales, Starks is directed to remove all references to its optimization gas in its tariff.

E. Tariff Issues

53. Starks proposes to offer firm and interruptible storage services on an open-access basis under the terms and conditions set forth in the pro forma tariff attached as Exhibit P to the application. We find that Starks' proposed tariff generally complies with Part 284 of the regulations with the exceptions discussed below.

1. Acquisition of Off-System Capacity and Waiver of the Shipper Must Have Title Rule

54. Section 28 of Starks' *Pro Forma* Tariff (OFF-SYSTEM CAPACITY) provides:

> From time to time, Starks may enter into transportation and/or storage agreements with other interstate or intrastate pipeline companies ("off-system pipeline"). In the event that Starks acquires capacity on an off-system pipeline, Starks will use such capacity for operational reasons and will only render service to Customers on the acquired capacity pursuant to this Starks' FERC Gas Tariff and subject to Starks' rates, as such tariff and rates may change from time to time. For purposes of transactions entered into subject to this section 28, the "shipper must have title" requirement is waived.

55. This language implements the Commission's policy with respect to pipelines' acquisition of off-system capacity. In a December 14, 2000 Order on Remand in *Texas Eastern Transmission Corporation (TETCO),*[29] the Commission found that pipelines no longer need to obtain prior approval to acquire capacity on another pipeline provided the acquiring pipeline filed tariff language specifying that it would only transport for others on off-system capacity pursuant to its existing tariff and rates. Starks' proposed tariff language is consistent with the requirements set forth in *TETCO* and authorizations granted other storage companies authorized to charge market-based rates,[30] and is accepted with the following clarification. Because Starks has only proposed to offer storage services, and has proposed no rates or tariff provisions relating to any other

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[29] 93 FERC ¶ 61,273 (2000), *reh'g denied*, 94 FERC ¶ 61,139 (2001).

[30] *See, e.g., SG Resources Mississippi, L.L.C.*, 101 FERC ¶ 61,029 at P 30-33 (2002).

transportation services other than storage, Starks may only use capacity obtained on other pipelines pursuant to *TETCO* in order to move gas into and out of storage. That is, Starks may not use its header facilities and capacity on other pipelines to transport gas which will not physically or contractually enter its storage facility unless and until it has received Commission authorization to provide such transportation services. Furthermore, Starks' authorized use of the *TETCO* waiver to provide storage service shall be limited to the geographic area covered by Starks' market study.

56. In order to ensure that Starks uses acquired off-system capacity in a manner consistent with its market-based rate authority and tariff provisions, and in order to satisfy our responsibility to monitor and prevent the exercise of market power, we will direct Starks, once it becomes operational, to make an annual informational filing on its provision of service using off-system capacity, as detailed below.

57. Within 30 days after its first full year of operation, and every year thereafter, Starks is directed to file, for each acquisition of off-system capacity:

a. the name of the off-system provider;
b. the type, level, term and rate of service contracted for by Starks;
c. a description of the geographic location - boundaries, receipt and delivery points, and segments comprising the capacity;
d. the operational purpose(s) for which the capacity is utilized;
e. a description of how the capacity is associated with specific transactions involving customers of Starks; and
f. an identification of total volumes, by Starks' rate schedule and customer, that Starks has nominated on each off-system provider during the reporting period.

2. Creditworthiness and Contract Termination

a. Determination of Creditworthiness/Deadline for Providing Financial Assurances

58. GT&C sections 3.1 and 3.2 require a shipper to establish and maintain an AAcceptable Credit Rating@ to Starks= "reasonable satisfaction." Under section 3.3, if a shipper is receiving service under its contract and experiences a reduction in its credit rating, it must provide additional financial assurances to Starks within five business days

section 3.3 does not state the consequence of a shipper failing to meet the five-day deadline. However, as discussed separately, such failure may be grounds for Starks to either suspend service under section 12.1, or invoke early termination of the contract under section 14.3(b)(ii).

<u>Discussion</u>

59. Consistent with our ruling in *Natural Gas Pipeline Company of America* (*Natural*), we will require Starks to include objective criteria in its tariff for determining whether a shipper is creditworthy.[31] We find that tariff language requiring shippers to establish and maintain an AAcceptable Credit Rating@ to Starks' Areasonable satisfaction@, allows Starks too much discretion, does not meet the Commission=s requirement that criteria for determining creditworthiness must be clear and objective, and allows for the possibility of undue discrimination. (The term AAcceptable Credit Rating@ is also used in section 3.4(b) with reference to a Guarantor company and must be revised in that section as well.) For example, the tariff does not specify what companies or sources Starks will rely upon to rate shippers, the minimally acceptable credit rating, whether a shipper that does not have a rating from a nationally recognized credit rating agency may establish a rating from a private source or through Starks, or whether Starks considers factors in addition to a shipper=s credit rating in making its creditworthiness determination.[32] In *Natural*,[33] we stated that it is important that the creditworthiness evaluation process be open and objective. Therefore, as we required in that order, Starks is directed to set forth in its tariff the objective financial analyses and criteria that it will use to determine a shipper=s creditworthiness.

60. In addition, although section 3.7 requires notifications under section 3 to be in writing, it is not clear how Starks intends to communicate its determinations on creditworthiness to shippers under sections 3.1 and 3.2, and whether it will specify the reasons for any denial of creditworthiness in such communication. In *Natural*, we held

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[31] 102 FERC & 61,355 at P 69 (2003); *see also*, *Tennessee Gas Pipeline Co*., 103 FERC & 61,275 at P 41 (2003).

[32] In recent orders, the Commission has approved a range of criteria for determining creditworthiness which it considers clear and objective, while allowing a service provider to exercise discretion in its determination. *See, e.g*., *Gulf South Pipeline Co., LP* (*Gulf South*), 107 FERC & 61,273 at P 20 (2004); *Natural*, 106 FERC ¶ 61,175 at P 84 (2004).

[33] 102 FERC & 61,355 at P 69 (2003).

that if a service provider finds a shipper to be uncreditworthy, it must communicate that finding in writing, and state the reasons for its finding. We also required that the written communication be made within 10 days of the determination, and that the shipper be provided recourse to challenge the finding.[34] Starks is directed to revise section 3 accordingly.

61. In addition, requiring a shipper to provide collateral assurances within five business days is an unreasonably short deadline. As we stated in *Gulf South*, A[f]ive days is not a reasonable time period to expect a shipper to obtain requisite collateral, and does not provide sufficient time for the Commission to respond to a complaint filed by a shipper who contends it was unfairly treated by the pipeline. In addition, the shipper may be faced with requests from other pipelines to provide collateral, and five days would not provide sufficient time.@[35]

62. Accordingly, we direct Starks to either (1) provide adequate justification for the five-day deadline; (2) justify a longer proposed notice period; or (3) consistent with prior orders, adopt the following approach, which the Commission has found to establish a reasonable balance between a service provider=s legitimate need to obtain security and the shipper=s need for adequate time to arrange for such security.[36] Under this approach, when a shipper loses its creditworthiness status, the shipper must, within five business days, pay for one month of service in advance in order to continue service. This will allow the shipper to have at least thirty days to provide the next three months of security for service.

63. If the shipper fails to provide the required security within these time periods, Starks may suspend service immediately, and also provide simultaneous written notice that it will terminate service in thirty days if the shipper fails to provide security. Starks should also provide written notification to the Commission at least thirty days prior to terminating a shipper=s service, as required by section 154.602 of the Commission=s regulations.

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[34] *Natural*, 106 FERC ¶ 61,175 at P 80 (2004); *Tennessee*, 103 FERC ¶ 61,275 at P 45 (2003).

[35] *Gulf South*, 103 FERC ¶ 61,129 at P 49 (2003), *reh=g denied*, 107 FERC & 61,273 at P 20 (2004).

[36] *See Tennessee*, 102 FERC & 61,075 at P 18 (2003).

b. Financial Assurances by Non-Creditworthy Shippers

64. Section 3.4 describes options available to a shipper that is required by section 3.3 to provide financial assurances. Such assurances may consist of either (1) a letter of credit equal to the total storage demand charge under an FSS contract, or the value of an ISS transaction as determined by Starks, (2) a guarantee from another company with an AAcceptable Credit Rating@, (3) prepayment of three months of demand charges, or (4) some other form of financial assurances to secure its obligations under the tariff, provided Starks has sole discretion to reject or accept such other form of assurances.

Discussion

65. The Commission finds that, except for the three-month prepayment of demand charges permitted by section 3.4(c), the financial assurances described in section 3.4 are potentially broader than allowed under Commission policy, and must therefore be clarified or revised in accordance with this discussion. We will, however, direct Starks to clarify in its tariff that such prepayments are considered collateral held for security and not advance payments for services.[37]

66. Since before Order Nos. 436 and 636, the Commission has approved a collateral requirement equal to three months of demand charges as the industry standard.[38] In *Natural*,[39] the Commission determined that requiring longer than three months of security is acceptable in precedent agreements for greenfield pipelines and major system expansions, but once the pipeline goes into service, tariff requirements for security must be limited to three months. This limitation applies equally to standby irrevocable letters of credit, collateral security, a guarantee by a creditworthy entity, or prepayment costs.

67. Therefore, it is possible that requiring a letter of credit to equal the total storage demand charge under an FSS contract or the value of an ISS transaction as determined by Starks would violate Commission policy if the term of the FSS contract or ISS transaction were longer than three months. Section 3.4(b) also applies the same requirements for financial assurances to a Guarantor company, rendering that section potentially inconsistent with the Commission=s collateral limitations. Moreover, the option in section 3.4(d) for a shipper to provide Asome other form of Financial

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[37] *See Tennessee*, 105 FERC ¶ 61,120 at P 17-24 (2003).

[38] *See Gulf South*, 107 FERC ¶ 61,273 at n. 38.

[39] *See Natural,* 102 FERC ¶ 61,355 at P 29-30 (2003).

Assurances to secure its obligations . . . that Starks may reject at any time . . . or accept . . . in its sole discretion@ is not indexed to the value of three months of charges under a shipper's contract, and therefore could either exceed the Commission's collateral limitations or allow for unduly discriminatory application. Starks is directed to revise its tariff proposal accordingly.

68. Finally, as we held in *Tennessee*,[40] Starks' shippers that opt to pay collateral equal to three months of demand charges as financial assurance under section 3.4(c) must have an opportunity to earn interest on such prepayments either by Starks paying the interest itself at the Commission's interest rate, or by the shipper designating an interest-bearing escrow account to which Starks may have access to payments for services provided if needed.

c. Suspension of Service

69. Under section 12, Starks may refuse to receive and deliver a shipper=s gas if the shipper fails to pay in full any amount owed to Starks that is not the subject of a good faith dispute, or fails to comply with a material provision of the tariff. This remedy is in addition to any other remedy Starks may have at law or in equity. In addition, Starks may set off any amount it owes to the shipper against amounts the shipper owes Starks. Before exercising these remedies, Starks must give the shipper two business days written prior notification, setting out the details of the alleged breach. If the shipper corrects the default in full before the end of the notice period, Starks will consider the notice as withdrawn.

Discussion

70. Section 12 does not address whether the shipper whose service is suspended will continue to be billed demand charges by Starks. In accordance with prior Commission orders,[41] we direct Starks to revise its tariff to clarify that shippers cannot incur demand charges when their service is suspended.

[40] 103 FERC ¶ 61,275 at P 21 (2003), *reh'g denied*, 105 FERC ¶ 61,120 at P 17-24.

[41] *See, e.g.*, *Natural*, 106 FERC ¶ 61,175 at P 53.

3. <u>Damages</u>

71. As set forth below, section 14.2 of the tariff requires Starks or a customer to pay one another monthly for delivery defaults at a service commencement or termination point. The payments, which the tariff describes as liquidated damages, are set at 10 percent above or below a defined price index, based on which party is at fault, as described in the tariff.

72. Also as set forth below, section 14.3 requires Starks or a customer, depending on which party is in default, to pay the other party damages for early contract termination. The level of damages for early contract termination is determined according to a formula based on the net present value of charges that would have been paid for the remaining term of the contract but for the early termination, including contract mitigation. The calculation is based on a defined replacement price index for the purchase or sale of gas.

73. Starks has not explained, or otherwise supported proposed section 14. As described more fully below, we will require Starks to fully support its proposals for damages in that section, and to justify how such proposals are consistent with Commission policy.

a. <u>Liquidated Damages</u>

74. Section 14.2 sets forth the following formula for determining liquidated damages:

> (a) If during any Gas Month, a Delivery Default shall occur, the Non-Defaulting Party shall have the option to require the Defaulting Party to pay Liquidated Damages pursuant to this section 14.2. That option may be exercised by notice in writing given to the Defaulting Party in accordance with the following provisions:
>
> > (i) In the case of an FSS Transaction, up to but not after the last day of the Gas Month next following the Gas Month in which the Delivery Default occurred.
> >
> > (ii) In the case of an ISS Transaction, up to but not after the 30th Gas Day following the end of the Term.

(b) Unless the Parties mutually agree to the contrary, Liquidated Damages shall be calculated and paid in accordance with the following provisions:

(i) If a Delivery Default arises from the failure of the Defaulting Party to deliver Gas at a Service Commencement Point, then Liquidated Damages shall be paid by the Non-Defaulting Party in an amount equal to the product of the Deficient Quantity and 110% of the price determined by reference to a Service Commencement Point Price Index for the Delivery Default Date.

(ii) If a Delivery Default arises from the failure of the Defaulting Party to accept Gas at a Service Commencement Point, then Liquidated Damages shall be paid by the Non-Defaulting Party in an amount equal to the product of the Deficient Quantity and 90% of the price determined by reference to a Service Commencement Point Price Index for the Delivery Default Date.

(iii) If a Delivery Default arises from the failure of the Defaulting Party to deliver Gas at a Service Termination Point, then Liquidated Damages shall be paid by the Defaulting Party in an amount equal to the product of the Deficient Quantity and 110% of the price determined by reference to a Service Termination Point Price Index for the Delivery Default Date.

(iv) If a Delivery Default arises from the failure of the Defaulting Party to accept Gas at a Service Termination Point, then the Liquidated Damages shall be paid by the Non-Defaulting Party in an amount equal to the product of the Deficient Quantity and 90% of the price determined by reference to a Service Termination Point Price Index for the Delivery Default Date.

(v) If during any Gas Month, a Delivery Default occurs on more than one Gas Day, then Liquidated Damages for each such Delivery Default shall be determined according to the above provisions and the obligation to pay Liquidated Damages owed by one Party to the other shall be netted against the amount, if any, otherwise payable to that Party by the other for that Gas Month.

(vi) The net amount of Liquidated Damages owing pursuant to the foregoing shall be determined and paid for each Gas Month in accordance with the provisions of section 10 of these General Terms and Conditions.

(c) Upon payment of Liquidated Damages, Customer's Inventory Account shall be adjusted as follows:

(i) If the Delivery Default arose from the failure of Customer to deliver Gas or from the failure of Starks to accept Gas, then Customer's Inventory Account shall be increased by an amount equal to the Deficient Quantity.

(ii) If the Delivery Default arose from the failure of Starks to deliver Gas or from the failure of Customer to accept Gas, then Customer's Inventory Account shall be decreased by an amount equal to the Deficient Quantity.

Discussion

75. The Commission is not able to determine whether section 14.2 is consistent with our policy without further information and review. Starks is directed to fully explain this proposal, and provide detailed numerical examples to support its narrative. Please include answers to the questions in Appendix A as part of your explanation.

b. Early Termination Damages

76. Section 14 provides for early termination of a service agreement by Starks or the shipper. According to section 14.3(a), the effective date of termination (Early Termination Date) is the date on which a Triggering Event occurs, as described in section 14.3(b). section 14.3(a) also provides that Ain the case of all other Triggering Events, the [early termination] date [is] determined by the Non-Defaulting Party by written notice to the Defaulting Party given no later than 10 days following discovery by the Non-Defaulting Party of a Triggering Event.@

77. Section 14.3(b) describes the following occurrences as triggering events: (1) the failure of a party to make any non-disputed payment due under the tariff, if not remedied within 2 business days of the other party giving notice of such non-payment; (2) the failure of a party to perform a material obligation under the tariff (except for non-payment or otherwise defined triggering events), if not remedied within 5 business days after notice is given; (3) the failure of a customer, within 2 business days of being

required to do so by written notice, to provide additional financial assurances or statements pursuant to section 3 (Creditworthiness), provided such notice may be given only if Starks believes that a material adverse change in the Customer=s financial condition has effected its ability to make payments due or to become due to Starks, or if the customer exceeds or is about to exceed its credit limit; or (4) the Defaulting party makes an assignment or general arrangement for the benefit of creditors, becomes involved in bankruptcy proceedings as described in the tariff, or is unable to pay its debts as they become due.

78. Section 14.3(c) states that when an Early Termination Date occurs, all transactions between the parties stop immediately, and the Non-Defaulting party will calculate Early Termination Damages based on the net present value of the remaining term of the contract, calculated from such date. Section 14.3(d) states that upon payment of Early Termination Damages by the Defaulting Party, the transactions terminated by the Non-Defaulting party are deemed to be fully performed, and both parties are released from further liability on the contract.

c. <u>Computation of Early Termination Damages</u>

79. Section 14.3(c) sets forth the following formula for determining liquidated damages if an early contract termination occurs:

> (i) The net present value of the amounts the Non-Defaulting Party would from time to time pay a third party on terms substantially the same as the Transaction in question and calculated for a period of time equal to the remaining period of the Transaction, commencing on the Early Termination Date, minus the net present value of the amounts the Non-Defaulting Party would from time to time have paid to the Defaulting Party pursuant to the terms of the Transaction had it not terminated, and calculated for the period of time equal to the remaining period of the Transaction, commencing on the Early Termination Date, and
>
> (ii) The net present value of the amounts the Non-Defaulting Party would from time to time have received from the Defaulting Party pursuant to the terms of the Transaction had it not terminated, and calculated for the period of time equal to the remaining period of the Transaction, commencing on the Early Termination Date, minus the net present value of the amounts the Non-Defaulting Party would from time to time receive from a third party on terms substantially

the same as the Transaction in question and calculated for a period of time equal to the remaining period of the Transaction, commencing on the Early Termination Date, will each be calculated and netted against each other.

(iii) The Non-Defaulting Party shall calculate a replacement transaction price for the purchase or sale of Gas for the purposes of section 14.3(c) (i) and 14.2 (c) (ii), based on the settlement prices of the New York Mercantile Exchange Gas futures contracts, adjusted for the basis differential between Henry Hub and a Service Commencement Point or Service Termination Point, as the case may be; or, the arithmetic average of bona fide prices quoted for a replacement transaction by at least 3 non-affiliated, independent, recognized dealers active in the energy swap markets.

(iv) The net present value for the Early Termination Damages will be calculated by using a discount rate equal to the Prime Rate in effect as of the Early Termination Date, plus 2%.

(v) Notwithstanding the preceding provisions of this section 14.3, or any other provision of this Starks FERC Gas Tariff or any Transaction entered into by the parties, if the Early Termination Damages, as calculated pursuant to this section 14.3, are less than zero, then they will be deemed to be zero.

(vi) For greater certainty, Starks may, at its option, apply the positive balance, if any, in Customer=s Inventory Account on the Early Termination Date, that is attributable to the Transactions terminated by it, as credit against any amount owed pursuant to this section 14.3 by Customer to Starks. The value of such credit shall be calculated based on 90% of the average price determined by reference to a Service Commencement Point Price Index for each day of the Gas Month next following the Early Termination Date.

Section 14.3(d) states that the Defaulting Party=s payment of Early Termination Damages constitutes full performance under the service agreement and releases the parties from any further liabilities to one another, except as otherwise provided in the tariff.

Discussion

80. The Commission is unable to determine whether section 14.3 is consistent with our policy without further information and review.

81. As previously stated, a service provider cannot terminate a shipper=s contract without giving both the shipper and the Commission at least 30 days prior notice. The notice provisions in section 14.3(b) are clearly not compliant with this requirement and must be revised accordingly.

82. Moreover, the Commission rejects paragraph (vi) of section 14.3(c), which permits Starks to offset amounts owed by the shipper against the positive balance in the shipper=s Inventory Account. This provision is, in effect, a confiscation of the shipper's gas in the system at the time of early contract termination. In *Tennessee*, the Commission rejected a proposal that would have permitted the pipeline to confiscate the gas of a shipper whose contract had been terminated, and sell the gas at market rates to offset the amount owed by the shipper.[42] There, the Commission expressed concern that this proposal would not adequately protect the rights of the shipper and other parties that may have an interest in the gas. Starks offset proposal in paragraph (vi) raises the same concern, as is therefore rejected. Nonetheless, as we noted in *Tennessee*, the pipeline may, in an appropriate state forum, assert against gas in the system at early termination, any carrier liens or interests that would be permitted under state law or the Uniform Commercial Code. Therefore, this rejection is without prejudice to Starks filing tariff language to assert a lien or interest that is consistent with applicable law.

83. The Commission is unable to determine whether the methodology in section 14.3(c) for calculating Early Termination Damages is reasonable. Starks did not include in its filing an explanation for this tariff proposal, in accordance with section 154.7 of the Commission's regulations. Further, it is unclear whether Starks intended such language to apply to contracts for stand-alone storage services, or to its proposal for bundled sales. Therefore, Starks is directed to explain the purpose and intended application of proposed section 14.3(c), supporting its narrative with quantitative examples that link each step in an Early Termination Damage calculation to language in paragraphs (i) through (vi). Starks' calculations should show various scenarios of terminations, including early and late in the contract term. The explanation and calculations should illustrate how Starks would determine amounts related to third-party contracts described in section 14.3(c),

[42] 102 FERC & 61,075 at P 26.

and how these amounts might compare with actual losses suffered by a non-defaulting party as a result of an early contract termination. Starks should also explain why it has included gas costs in the calculation of damages for early termination of a storage contract. Finally, Starks is directed to answer the questions in Appendix B of this order.

4. Negotiated Terms and Conditions

84. Section 4.5 of the tariff's Storage Services Agreement Form states that "[t]he commercial terms of any Transaction, including but not limited to service rates and Fuel Reimbursement Charge methodology selection, shall be subject to negotiation between Starks and Customer and reflected in an executed Appendix." Starks is directed to file tariff language to clarify that parties to a service agreement will not enter into negotiated terms and conditions in violation of the Commission's policy statement on Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines.[43]

5. Implementation of NAESB Standards

85. Starks has proposed to make its tariff compliant with Version 1.7 of the North American Energy Standards Board (NAESB) Standards, which the Commission has not adopted as of the date of this order. Therefore, when it files actual tariff sheets in this proceeding, Starks is directed to revise its tariff to be compliant with the latest version of the NAESB Standards adopted by the Commission at the time of filing.

6. Order No. 637 Compliance

a. Segmentation Related Issues

86. In *Clear Creek Gas Storage Company (Clear Creek*), we found that the requirements of section 284.7(d) did not apply to pipelines engaged solely in natural gas storage and which did not provide other transportation services.[44] Starks meets the requirements in *Clear Creek*. Thus, we hold that the requirements of section 284.7(d) do not apply to Starks. We also find that other tariff provisions related to segmentation, such as the allocation of primary point rights in segmented releases and within-the-path scheduling, do not apply to Starks.

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[43] 74 FERC ¶ 61,076 (1996).

[44] 96 FERC ¶ 61,071 (2001).

7. **Miscellaneous**

87. Section 29.3 provides that the tariff shall be governed and interpreted according to Louisiana law, and that the parties irrevocably submit to the jurisdiction of Louisiana courts. However, section 30.1 allows one party to a dispute between Starks and a shipper to require that the dispute be settled "according to the commercial rules of the American Arbitration Association, except as varied or excluded by . . . [the tariff] or the rules of the FERC." It is unclear whether section 30.1 is intended to limit the Commission's review of matters within its jurisdiction. Therefore, Starks is directed to file tariff revisions to clarify that section 30.1 does not limit the Commission's ability to address issues within its jurisdiction upon complaint or its own motion.

88. Section 24 provides that "Starks may waive any of its rights hereunder or any obligations of Customer on a basis which is not unduly discriminatory." The section goes on to state that such waiver does not constitute waiver of any future default in performance. Consistent with the Commission's order issued in *Northern Border Pipeline Company,* [45] we find the quoted tariff language to be overly broad, and having the potential for unreasonable and unjust application. As we stated in *Northern Border,* this language could be interpreted as giving the service provider almost unfettered discretion to include non-conforming material terms and conditions into a transportation agreement without seeking Commission approval. Therefore, Starks is directed to revise section 24 to clarify that this waiver only applies to specific defaults that have already happened.

89. The Commission will require Starks to file pro forma tariff sheets within 60 days of the date of issuance of this order consistent with the Commission's requirements in this order

F. **Blanket Certificates**

90. Starks requests issuance of a Part 284, subpart G, blanket certificate in order to provide open access storage services. Starks filed a *pro forma* Part 284 tariff to provide open access storage services. Since a Part 284 blanket certificate is required for Starks to offer these services, we make a preliminary determination to grant Starks a Part 284 blanket certificate, subject to the conditions imposed herein.

[45] 110 FERC ¶ 61,023 (2005).

91. We also make a preliminary determination to issue Starks a Part 157, subpart F blanket certificate. The subpart F blanket certificate gives a natural gas company section 7 authority to automatically, or after prior notice, perform certain eligible activities related to the construction, acquisition, replacement and operation of pipeline facilities. However, Starks' blanket certificate shall not include automatic authorization to increase storage capacity. This restriction on Starks' Part 157 blanket certificate is based on the fact the Starks' storage cavern is a salt cavern in the initial stages of development for which future expansion will require reevaluation of historical data and new engineering and geological data.

G. Design Capacity

92. The two salt caverns that Starks will convert to storage are each approximately 400 feet in diameter and 1,000 feet in height. The tops of the caverns are approximately 2,500 feet below the surface. The two salt caverns are separated vertically from the base of a fresh water aquifer used for drinking water by a minimum of 645 feet of salt, 665 feet of anhydrite and 220 feet of shale. Laterally a minimum 1,400 feet of salt exists between the caverns and the edge of the salt dome.

93. In section 7(c) cases we review and approve the design capacity of a project to ensure that the design is appropriate and efficient. Here we conclude that the design of Starks' storage facilities is appropriate subject to the conditions in Ordering Paragraph (K).

H. Conclusion

94. For the reasons discussed above, we find, subject to completion of our environmental review and Stark's acceptance of the conditions set forth below, that the benefits of its proposal will outweigh any potential adverse effects and therefore will be consistent with our Certificate Policy Statement and section 7 of the NGA. Accordingly, we are making a preliminary determination that the public convenience and necessity require the granting of the requested authorizations as conditioned herein and in any final order in this proceeding.

95. At a hearing held on April 13, 2005, the Commission on its own motion received and made a part of the record in this proceeding all evidence, including the application and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record.

The Commission orders:

(A) In Docket No. CP05-8-000, a preliminary determination is made to issue Starks a certificate of public convenience and necessity authorizing it to construct and operate the described storage facilities, subject to the environmental review of the proposal and issuance of a final order.

(B) The preliminary determination made in Paragraph (A) above contemplates issuance, after completion of pending review of all environmental matters raised by the application, of a final order of the Commission determining that the proposals are required by the public convenience and necessity, in accordance with NEPA and NGA section 7(c).

(C) In Docket No. CP05-10-000, a preliminary determination is made to issue Starks a blanket transportation certificate under subpart G of Part 284.

(D) In Docket No. CP05-9-000, a preliminary determination is made to issue Starks a blanket construction certificate under subpart F of Part 157.

(E) Any certificate and authority issued in a final order in this proceeding is conditioned upon Starks' compliance with all applicable Commission regulations under the Natural Gas Act, particularly the terms and conditions in Parts 154 and 284 and paragraphs (a), (c), (e) and (f) of section 157.20, except that the requirements of section 157.20(c)(3) are waived.

(F) Pursuant to section 157.20(b) of the Commission's regulations, the facilities authorized in paragraph (A), above, must be constructed and placed in service within three years of the date of the final order in this proceeding.

(G) Starks' request to charge market-based storage rates is approved as discussed in this order.

(H) Waiver is granted of the Commission's regulations that have been deemed inapplicable to storage providers with market-based rates, as discussed in this order.

(I) Waiver of the Commission's Part 284 unbundling requirements is denied.

(J) Starks shall submit revised pro forma tariff sheets that comply with the requirements contained in the body of this order within 60 days of the issuance of this order.

(K) Within 30 days after its first full year of operation, and every year thereafter, Starks is directed to file an annual informational filing on its provision of service using off-system capacity, as detailed in this order.

(L) Any certificates that will be issued by a final order in this proceeding will be conditioned upon Starks:

(1) establishing and maintaining a subsidence monitoring network over the proposed caverns storage area;

(2) assembling, testing and maintaining an emergency shutdown system;

(3) logging each Cavern's well periodically to check the integrity of the cavern roof and the casing;

(4) every five years, conducting sonar surveys of the caverns to monitor their dimensions and shape and to estimate pillar thickness between openings throughout the storage operations;

(5) conducting an annual inventory verification study on each cavern;

(6) ensuring that the maximum gas storage inventory stored not exceed 28,900 MMcf at 14.73 psia and 60•F, 13,300 MMcf in Starks 1and 15,600 MMcf in Starks 2;

(7) ensuring that the maximum gas storage shut-in stabilized pressure in each cavern does not exceed 0.9 psi per foot of cavern depth, and the minimum pressure in each cavern will be 0.34 psi per foot of the cavern depth;

(8) determining the final gas storage operating capacity of each cavern's working gas capacity, cushion gas capacity and the minimum pressure after each cavern's final operating parameters are determined (including data work papers to support the actual operating capacity determination);

(9) filing with the Secretary of the Commission before commencing gas storage operations in caverns one and two (a) results of a Mechanical Integrity Test for each cavern before conversion of that well/cavern to natural gas storage and (b) copies of the latest interference, tracer surveys, or other testing or analysis on the caverns which verify the lack of communication between the caverns; and

(10) filing semiannual reports for each cavern in accordance with section 157.214(c) of the Commission's regulations.

By the Commission. Commissioners Brownell and Kelliher concurring with separate statements attached.

(S E A L)

Linda Mitry,
Deputy Secretary.

APPENDIX A

The following questions refer to GT&C section 14.2 of Starks' pro forma tariff.

1. Section 14.2 appears intended to resolve imbalances at transaction points between volumes scheduled for delivery and actual delivered volumes, and to assess the defaulting party a penalty based on all volumes not delivered. Please state whether Starks considers a delivery default under section 14.2 to be a scheduling imbalance or a physical imbalance and, depending on your answer, how this provision is consistent with the Commission's policies on penalties as implemented in various orders on compliance with Order No. 637.

2. If Starks considers a delivery default in section 14.2 to be a physical imbalance, explain how section 14.2 is consistent with various Commission holdings on cash imbalance resolution mechanisms, and the necessity to provide imbalance management services in orders on compliance with Order No. 637.

3. Please explain why payments under section 14.2 are referred to as damages, what losses such damages are intended to compensate for, and how the value of such losses is determined.

4. Please justify the use of 10% as a premium above or below the commodity index price

5. Please state how the commodity index price referenced in section 14.2 is in compliance with the Commission's *Policy Statement on Natural Gas and Electric Price Indices* (*Price Indices Policy Statement*), issued in Docket No. PL03-3-000 on July 24, 2003,[46] and the subsequent *Order Regarding Future Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets* (*Order Regarding Future Price Formation*), issued on November 19, 2004.[47]

[46] 104 FERC ¶ 61,121 (2003).

[47] 109 FERC ¶ 61,184 (2004).

APPENDIX B

The following questions refer to GT&C section 14.3 of Starks' *pro forma* tariff:

1. What is the meaning of Aunder terms substantially the same as the Transaction in question@in section 14.3(c)(i). Identify all terms in your Storage Services Agreement Form to which this phrase could potentially apply.

2. Explain, for each type of contract to which section 14.3(c) applies, how Starks would determine the amounts it would pay to a hypothetical third party, and to the Defaulting Party in order to derive net present values. Provide quantitative examples with your explanation.

3. Explain why Starks uses the Prime Rate plus 2 percent to calculate net present values under paragraph (vi)? Justify the use of the 2 percent add-on.

4. Please provide an explanation and quantitative examples showing how paragraph (iii) would be used to calculate damages. Why is a commodity index price used to determine damages for storage services?

5. Explain each step in the method by which Starks would value the inventory in the Customer=s account referred to in paragraph (vi)? Provide quantitative examples as part of your answer.

6. Explain the meaning of the term AService Commencement/Termination Point Price Index@ with examples of such indices, showing how an average price would be calculated.

7. Please state how the AService Commencement/Termination Point Price Index@ referenced in section 14.3 is in compliance with the Commission's *Price Indices Policy Statement*[48] and the subsequent *Order Regarding Future Price Formation.*[49]

8. Explain why Starks chose to use 90 percent of the average price of inventory referred to in paragraph (vi) rather than 100 percent of the average price. Explain how this paragraph provides "greater certainty", as stated therein.

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[48] 104 FERC ¶ 61,121 (2003).

[49] 109 FERC ¶ 61,184 (2004).

9. Does the term APositive Balance@ in paragraph (vi) refer to volumetric balance or to the monetary value of such balance.

10. Is it possible for Customer=s account to have a negative balance at contract termination? If so, how would such balance be handled?

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Starks Gas Storage L.L.C. Docket Nos. CP05-8-000, CP05-9-000 and CP05-10-000

(Issued April 19, 2005)

BROWNELL, Commissioner, concurring:

In Order No. 636, the Commission required pipelines to separate or unbundled their sales of gas from their transportation services at the upstream point closest to the production area, and to provide comparable transportation service for all gas supplies whether purchased from the pipeline or any other gas supplier. Starks asks that the Commission waive the unbundling requirement to permit it to own and sell gas in otherwise unused or underutilized capacity within its storage facility. We deny the waiver request.

Starks states that its 2004 open season yielded non-binding requests from 6 parties for a little over 6 Bcf of capacity, or 45 percent of the Stage 1 capacity, for an average term of 3.3 years. Starks asserts that the lack of long-term contracts undermines its ability to secure project financing. Starks argues that the waiver of the unbundling requirement would enable it to more economically and efficiently operate the proposed facility, and overcome a lack of readily available capital. There are operational inefficiencies with any storage facility because deliverability and capacity commitments may be mismatched, the cycling needs (higher and/or lower) of customers may differ, and deliverability tends to decline over the winter season. If it is given the opportunity to generate additional revenue by using the unsold and underutilized capacity for its own gas, Starks believes it can be a viable business and is willing to commit the necessary development capital.

I have no intention of undoing the fundamental principles of Order No. 636, particularly the unbundling requirement. However, I am intrigued by a business model that offers potential efficiency gains and encourages the commitment of development capital before storage capacity is fully contracted on a long-term basis. As regulators, I think we need to be creative. I would consider granting a waiver of the unbundling requirement under the following conditions:

1. the applicant is an independent storage provider;
2. the applicant passes our market-based rate analysis;

3. the applicant is under an obligation to file to justify the continuation of the waiver and its market-based rate authorization;
4. the applicant may only move its own gas on third-party capacity to its storage facility, not to market; and
5. the applicant's tariff has operational safeguards such as Starks proposal to give third party shippers scheduling priority.

These conditions would permit the applicant to optimize the use of its storage facility by bundling its storage capacity and gas commodity, but only where the applicant has no market power over both the storage product and the sale of gas. Under these conditions, I believe the unbundling requirements purpose of preventing unduly discriminatory behavior is preserved.

For the first time, we attach conditions to the use of the *Tetco* waiver. We limit Starks' use of the *Tetco* waiver to the geographic area covered by Starks' market study and require Starks to make an annual informational filing detailing its use of the *Tetco* waiver. We attach these conditions without explanation. These conditions strike me as solution in search of a problem. In response to Staff Data Request 5b, Starks states that it "views the acquisition of capacity on other pipelines purely as an alternative to extending its header to other point of physical interconnection." Given how Starks plans to use the *Tetco* waiver, I have no objection to the geographic area limitation. However, the order fails to explain the nexus between the relevant geographic market for storage service and third-party transportation service. In the order, we do note that the annual information filing detailing Starks' use of the *Tetco* waiver is necessary to satisfy our responsibility to monitor and prevent the exercise of market power. I do not take issue with that statement. It strikes me, however, that the larger issue is approving market-based rates for storage service without some type of periodic update of the underlying market power analysis.

For these reasons, I concur with today's order.

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Nora Mead Brownell
Commissioner

UNTED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Starks Gas Storage L.L.C. Docket Nos. CP05-8-000, CP05-9-000 and CP05-10-000

(Issued April 19, 2005)

KELLIHER, Commissioner, *concurring*:

In its application to construct and operate a salt dome natural gas storage facility Starks sought, among other things, a waiver of the Commission's Order No. 636 unbundling requirements so that Starks may store and sell its own gas when its system is undersubscribed. Today's order grants the authorizations sought by Starks, but denies the request for a waiver of the Order No. 636 unbundling requirements.

I support this order, including the decision to deny the request for a waiver of the Order No. 636 unbundling requirements. In doing so, I wish to note, however, that I am not unsympathetic to the arguments in favor of granting a waiver of the Order No. 636 requirements in the context of an independent storage project.

Natural gas storage is vitally important to the meet the nation's energy needs and I believe that additional storage will assume ever greater importance in this era of higher natural gas prices and apparently declining production. While the Commission has an excellent record of approving such projects, I also believe that we need to consider what we might do to facilitate the addition of new storage in the future.

Currently, the Commission has a generic proceeding underway to examine policy options to encourage the development of new storage. In October 2004 the Commission convened a conference to examine these issues and thereafter it solicited and received comments which it currently has under consideration. The Commission has not yet concluded what actions it should take as a result of the information it received in that proceeding.

The principles embodied in Order No. 636 have been the bedrock of Commission policy in the natural gas arena for nearly 15 years; a decision to change those principles should not be undertaken lightly. Before deciding this significant issue, I believe the

Commission should first conclude its comprehensive deliberations in the generic storage proceeding and decide there what steps should be taken to facilitate the development of additional storage. I believe those deliberations will inform our decisions as to the need for actions such as that proposed by Starks here.

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Joseph T. Kelliher