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Court Faults FERC in its Handling of ANR Storage Company's Six-Year Quest for Authorization to Charge Market-Based Rates for Natural Gas Storage Services

On September 21, 2018, the U.S. Court of Appeals for the District of Columbia Circuit issued a decision setting aside Federal Energy Regulatory Commission (FERC) orders denying TransCanada Corporation subsidiary ANR Storage Company's (ANRS) request for authorization to charge market-based rates and remanding the matter to FERC for further proceedings. *ANR Storage Co. v. FERC*, ___ F.3d ___, 2018 WL 4515905 (D.C. Cir. 2018). The court's decision addressed a series of FERC orders, the latest of which was issued in 2016, in which FERC found that ANRS had failed to demonstrate that it lacked significant market power as to natural gas storage services in the relevant geographic market and accordingly denied ANRS's request.

The court's decision may have significant implications for interstate natural gas pipelines and other storage operators that wish to move away from cost-based rate regulation.

BACKGROUND

Over the past two decades, FERC has authorized many natural gas storage providers to charge market-based rates. Most of these authorizations have been granted to developers of new underground natural gas storage projects. As start-up companies, these storage providers enter the market without established customer bases and generally with small market shares. FERC, however, applies the same market power criteria in considering requests for authorization to charge market-based rates by incumbent storage providers, such as ANRS (the longtime operator of four natural gas storage facilities located in Michigan).

FERC requires an applicant for market-based rate authorization to demonstrate that it lacks significant market power. The agency defines market power as the ability profitably to maintain prices above competitive



levels for a significant period of time. It assesses market power in three steps: first, it defines the relevant product and geographic markets; second, it calculates market share and concentration within those markets; and third, it considers other relevant factors. Market share measures a company's ability to exercise market power unilaterally, whereas market concentration, as measured by the Herfindahl-Hirschman Index (HHI), measures the ability of sellers to exercise market power jointly.

ANRS submitted a petition for declaratory order seeking market-based rate authority in March, 2012 (FERC Docket No. RP12-479). Numerous interested persons filed in opposition to ANRS's petition. FERC set the matter for hearing before an administrative law judge (ALJ). In his Initial Decision, the ALJ found that ANRS had failed to show that it lacked market power. *ANR Storage Co.*, 146 FERC ¶ 63,007 (2014). On review, the Commission rejected various aspects of the ALJ's reasoning, but ultimately affirmed his decision. *ANR Storage Co.*, Opinion No. 538, 153 FERC ¶ 61,052 (2015). FERC recalculated ANRS's market shares to be 16.12% for working gas capacity and 15.16% for daily deliverability. It calculated the HHIs for these markets to be 951 and 1,010. FERC acknowledged that it had granted market-based rate authority to other natural-gas companies with similar market shares, and it characterized the relevant HHIs as "low." But it denied ANRS's petition because it was concerned that ANRS was the largest competitor in the market for working gas storage capacity, and that a significant part of that market consisted of intrastate or subscribed storage capacity. After FERC issued a rehearing order that left its analysis unchanged, *ANR Storage Co.*, 155 FERC ¶ 61,279 (2016), ANRS sought judicial review.

ANRS raised a variety of challenges. The court rejected most of them, either accepting FERC's reasoning or noting that FERC could correct minor, non-determinative errors during the remand proceeding. It accepted two of ANRS's arguments, concluding that FERC's decision is inconsistent with its own precedent and is internally inconsistent.

FERC'S DECISION IS INCONSISTENT WITH ITS OWN PRECEDENT

ANRS argued that under FERC precedent market shares of around 16% are too low to establish the existence of market power. The Court ultimately agreed with ANRS that FERC did not adequately distinguish its past decisions involving ANRS's principal competitor in the relevant market, DTE Energy Company, which had market shares comparable to those FERC calculated for ANRS.

In 2008, FERC authorized two DTE subsidiaries, Washington 10 Storage Corporation (Washington 10) and Michigan Consolidated Gas Company (MichCon), to charge market-based rates for their storage services. DTE's market share (combined for its affiliates) was over 18% for working gas and 17% for daily deliverability, slightly higher than the ANRS market shares FERC calculated in the challenged orders. The court observed that, despite the obvious similarities between the two leading suppliers in the relevant market, the orders at issue barely even mentioned FERC's disparate treatment of the two companies.

FERC attempted to justify its earlier decisions by noting that the Washington 10 application was unopposed and the MichCon application, while opposed, was the subject of a settlement. The court rejected this justification, concluding that the lack of opposition or the presence of a settlement does not justify treating ANRS and DTE differently.

FERC argued that, when the DTE affiliates sought to charge market-based rates, their market power was checked because DTE's largest competitor, ANRS, charged cost-based rates, but when ANRS sought to charge market-based rates, its market power posed a greater concern because ANRS's largest competitor, DTE, already was charging market-based rates. The court responded "[w]e frankly doubt that FERC may pick winners and losers in this way, based on which of two otherwise indistinguishable competitors happens to win a race to the FERC equivalent of a courthouse." The court declined to rule on this proffered justification because FERC did not mention it in the orders under review.



The court concluded that ANRS and DTE appear indistinguishable as leading competitors with virtually identical shares in the same relevant market and, because FERC did not provide any reasonable justification for allowing DTE affiliates but not ANRS to charge market-based rates, FERC’s decision is arbitrary and capricious.

FERC’S DECISION IS INTERNALLY INCONSISTENT

ANRS further challenged FERC’s consideration of intrastate storage services and previously subscribed interstate storage services as competitive alternatives to ANRS’s services. The court found it perplexing that FERC included these services in the relevant product market, then deemed them good alternatives, but finally found that they were not sufficiently good alternatives to constrain ANRS’s exercise of market power. FERC stated that it found “concerning” the number of intrastate and fully subscribed facilities that would need to enter the interstate market in order to constrain ANRS’s exercise of market power. Driven by this concern, and mindful of ANRS’s status as a market leader, FERC concluded that ANRS had not proven that it lacked market power.

The court concluded that “[t]here may be good reasons why intrastate or fully subscribed facilities would not check ANRS’s exercise of market power, but FERC’s conclusion to that effect is inconsistent with most of its analysis on this point. Because FERC’s decision is internally inconsistent, it is arbitrary and capricious.”

CONCLUSION

The D.C. Circuit’s ANRS decision takes FERC to task for treating similar market participants inconsistently. The court goes on to chide FERC for reaching a conclusion regarding the ability of intrastate and fully subscribed storage facilities to check ANRS’s market power that is at odds with FERC’s own analysis. Neither conclusion breaks new ground, since inconsistency in an agency’s treatment of similarly situated entities and in the agency’s analysis would seem to be quintessentially arbitrary and capricious. But the court does offer one notable further observation, when it rejects FERC’s suggestion that whether an application for market-based rate authorization should be granted may turn on whether the application is opposed. In so doing, the D.C. Circuit challenges a premise FERC has often articulated in its orders as a justification for its actions.

Whether to grant ANRS’s application for authorization to charge market-based rates remains FERC’s responsibility on remand. But the D.C. Circuit has left FERC little room, it would appear, to reaffirm its denial.

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