

## **I. SUMMARY OF COMMISSION METHODOLOGY AND PRECEDENT**

### **A. Brief Historical Overview of Oil Pipeline Regulation and Market-Based Rates**

The Commission's oil pipeline market-based rate methodology has evolved significantly over time. When the Commission first obtained jurisdiction over oil pipeline rates in 1977, it used certain indexes to serve as the mechanism to regulate oil pipelines, which effectively allowed high price ceilings on rates. The Commission justified this methodology on the basis that competition in the overall oil pipeline sector was sufficient to serve as the primary check on rates.<sup>1</sup> The D.C. Circuit Court of Appeals in *Farmers II* reversed and established a bedrock principle in the market-based rate analysis—that competition can serve as the regulatory basis for rates, but only if it is reasoned and results from a particularized finding that the pipeline lacks market dominance in its discrete markets.<sup>2</sup>

On remand, the Commission determined that cost-based ratemaking must be the general methodology for setting oil pipeline rates.<sup>3</sup> Shortly thereafter, however, the Commission accepted the *Farmers II* court's invitation to allow market-based rates on a case-by-case basis. In the course of two proceedings involving Buckeye Pipe Line Company and Williams Pipe Line Company, the Commission defined the pipelines' product and geographic markets and analyzed a number of factors to assess their market dominance or market power in those defined markets.<sup>4</sup> In the markets where the pipelines lacked market power, the Commission allowed them to charge whatever rates they could negotiate in the markets (with some price cap limitations and monitoring requirements on Buckeye) on the basis that competition would ensure that the resulting rates were just and reasonable.<sup>5</sup> At this early stage, the Commission cited a host of factors regarding the pipeline's market power without giving any particular factor prominence over the others.<sup>6</sup> In later proceedings, some of these factors would be cited less and less and others would be elevated to the forefront of the Commission's analysis. Therefore, at the time, the Commission required that an oil pipeline's rates were to be generally set through cost-based ratemaking, but if justified by the particular circumstances, competition could serve as the regulating force on rates.

Congress perceived this regulatory framework as inefficient however. Therefore, it required the Commission to formulate a simplified approach to ratemaking to avoid any unnecessary costs or delays.<sup>7</sup> The Commission responded with a series of three rulemaking orders that changed the Commission's regulatory framework. First, in Order No. 561, the

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<sup>1</sup> *Williams Pipe Line Company*, Opinion No. 154, 21 FERC ¶ 61,260, at 61,608-09 (1982).

<sup>2</sup> *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502, 1509 n.50 (D.C. Cir. 1984) ("*Farmers II*").

<sup>3</sup> *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,833 (1985), *modified on reh'g*, Opinion No. 154-C, 33 FERC ¶ 61,327 (1985).

<sup>4</sup> *See Buckeye Pipe Line Co., L.P.*, Opinion No. 360, 53 FERC ¶ 61,473 (1990); *Buckeye Pipe Line Co., L.P.*, Opinion No. 360-A, 55 FERC ¶ 61,084 (1991); *Williams Pipe Line Co.*, Opinion No. 391, 68 FERC ¶ 61,136 (1994); *Williams Pipe Line Co.*, Opinion No. 391-A, 71 FERC ¶ 61,291 (1995).

<sup>5</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,675, 62,680-83; *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,695-96.

<sup>6</sup> *See Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,663, 62,667; *Buckeye*, Opinion No. 360-A, 55 FERC ¶ 61,084 at 61,260-61; *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,676.

<sup>7</sup> Pub. L. No. 102-486, 106 Stat. 2776, 3010 (1992), reprinted in 42 U.S.C. § 7172 note.

Commission established the use of a particular index to serve as a cap on rates as the simplified and generally applicable ratemaking methodology for oil pipelines.<sup>8</sup> Second, in Order No. 571, the Commission determined that cost-based ratemaking could be used as an alternative methodology (after setting the initial rate for new pipelines) only if indexing resulted in a substantial disconnect between rates and costs.<sup>9</sup> Third and finally, in Order No. 572, the Commission allowed market-based rates to also serve as an alternative option to indexing if it was justified by the pipeline's particular circumstances.<sup>10</sup> In Order No. 572, the Commission set forth the filing requirements and procedures for an oil pipeline requesting market-based rates.

Since Order No. 572, in analyzing an application for market-based rates, the Commission has adhered to the basic methodology of defining the applicant pipeline's product and geographic markets, and then analyzing certain factors to assess the pipeline's market power in those markets. The specifics of the Commission's methodology, however, have shifted over time. How the Commission defines a pipeline's geographic market and what competitive alternatives are to be included in the market power analysis has undergone significant change. In addition, the factors the Commission will primarily cite to when assessing the pipeline's market power in its defined markets has narrowed. The various steps in the evolution of the Commission's methodology since Order No. 572 are detailed in Section V of this Introduction. The current state of the Commission's market-based rate methodology is outlined below.

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<sup>8</sup> *Revisions to Oil Pipeline Regulation Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,985, at 30,952 (1993), *modified on reh'g*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 (1994), *aff'd*, *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

<sup>9</sup> *Cost-of-Service Filing and Reporting Requirements for Oil Pipelines*, Order No. 571, FERC Stats. & Regs. ¶ 31,006 (1994), *clarified in*, Order No. 571-A, FERC Stats. & Regs. ¶ 31,012 (1994), *aff'd*, *Association of Oil Pipe Lines*, 83 F.3d 1424.

<sup>10</sup> *Market-Based Ratemaking for Oil Pipelines*, Order No. 572, FERC Stats. & Regs. ¶ 31,007, at 31,179 (1994), *reh'g denied*, Order No. 572-A, 69 FERC ¶ 61,412 (1994), *aff'd*, *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424.

**B. Summary of Current Commission Market-Based Rate Methodology**

The Commission has allowed an oil pipeline to set its transportation rates at whatever rates it can negotiate in the market (market-based rates) if it demonstrates it lacks significant market power.<sup>11</sup> The basic premise is that in the absence of significant market power, competition and market forces will prevent a pipeline from charging a rate that is unjust and unreasonable, and rate regulation is, therefore, unnecessary.<sup>12</sup>

The Commission defines significant market power as actually controlling prices or excluding competition, or having the ability to control prices or exclude competition.<sup>13</sup> More specifically, the Commission has defined significant market power as the ability to profitably sustain prices above competitive levels for a significant period of time.<sup>14</sup> The Commission determines whether a pipeline has that ability by defining the products the pipeline transports and the geographic areas in which it provides transportation services. Then, the Commission assesses indicators of market dominance, primarily market share and market concentration, in those defined markets. Specifically, Order No. 572 requires a pipeline in its market-based rate application to (1) define the relevant geographic and product markets (including both destination and origin markets); (2) identify the competitive alternatives for shippers constraining the pipeline's ability to exercise market power; and (3) compute the market share and market concentration Herfindahl-Hirschman Index (HHI) based on the information provided about competitive alternatives.<sup>15</sup> The ultimate burden of justifying market-based rates is always on the applicant pipeline.<sup>16</sup>

Product Market. Applicant pipelines are required to define the product market for which they seek to establish a lack of significant market power.<sup>17</sup> Defining the product market is a key step in the market power analysis, as it identifies the products in which the market concentration and the pipeline's market share will be calculated. The inquiry is to identify the products for which the pipeline requests to establish a lack of significant market power and then determine all products that can serve as substitutes, such that an increase in the transportation rate or price of one product can cause a switch to the other.<sup>18</sup> All substitutes are properly within the same product market.<sup>19</sup>

At a minimum, the Commission requires applicant pipelines to differentiate their product market between the transportation of crude oil and the transportation of refined petroleum products.<sup>20</sup> The Commission does not foreclose contentions that the product market should be

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<sup>11</sup> See *id.* at 31,179-80, 31,187.

<sup>12</sup> *Id.* at 31,180.

<sup>13</sup> *Buckeye Pipe Line Co., L.P.*, 45 FERC ¶ 61,046, at 61,162-63 (1988).

<sup>14</sup> See, e.g., *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>15</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,187; 18 C.F.R. § 348.1(c).

<sup>16</sup> See, e.g., *Buckeye Pipe Line Co.*, 44 FERC ¶ 61,066, at 61,186 (1988).

<sup>17</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,189; 18 C.F.R. § 348.1(c)(2).

<sup>18</sup> See *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,663-64; *Enterprise Products Partners L.P.*, 146 FERC ¶ 61,115, at PP 43-44 (2014).

<sup>19</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,663-64; *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 43-44.

<sup>20</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,189.

further differentiated into, for example, sweet or heavy crude for a crude oil pipeline, or gasoline, diesel fuel, and jet fuel for a refined petroleum products pipeline.

In refined petroleum pipeline cases, however, the Commission has thus far found that the relevant product market should not be differentiated between the various refined petroleum products.<sup>21</sup> This is based on the Commission's finding that the substitution in the transportation of one petroleum product for the transportation of another petroleum product is nearly universal among refined petroleum pipelines.<sup>22</sup> The Commission has also found that the various refined petroleum products are substitutes because an increase in the price received or the transportation rate for one refined product can cause a switch to another in production or transportation, even if not in end use.<sup>23</sup> The Commission has not, however, foreclosed the possibility that refined petroleum products could be separated into different product markets if justified by the particular facts of a case.<sup>24</sup> Therefore, the Commission has thus far found that the product market for refined petroleum pipelines is the transportation of all refined petroleum products because individual petroleum products can be substituted for one another in transportation and production, even if not in end use, but has not foreclosed the possibility that this may not always be the case.

For crude oil pipelines, the Commission has directed a fact specific inquiry into the substitutes to the products for which the pipeline seeks to charge market-based rates.<sup>25</sup> It is unclear what guidance can be drawn from the one crude oil pipeline case where the product market was defined. In *Mobil*, the Commission determined that the product market was appropriately differentiated into the transportation of Western Canadian heavy sour crude oil (which accounted for 98 percent of volumes on the pipeline) as opposed to the transportation of all crude oil (which the pipeline could transport).<sup>26</sup> The Court of Appeals for the District of Columbia Circuit on review, however, based its market power decision on the pipeline's market share of Western Canadian crude regardless of type, but did not specifically adopt all crude oil as the product market.<sup>27</sup> Therefore, the Commission has not drawn any conclusions as to the guidance offered by this court opinion.<sup>28</sup> Instead, the Commission has directed a fact specific inquiry into the substitutes to the products for which the crude oil pipeline seeks to charge market-based rates in order to define the product market.<sup>29</sup> The Commission has specifically stated, however, that for a crude oil origin market, only products available from the production

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<sup>21</sup> See *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,664; *Enterprise TE Products Pipeline Company LLC*, Opinion No. 529, 146 FERC ¶ 61,157, at P 27 (2014); *Enterprise TE Products Pipeline Co. LLC*, 141 FERC ¶ 63,020, at PP 114-117 (2012) (Initial Decision).

<sup>22</sup> See *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,664.

<sup>23</sup> *Id.*

<sup>24</sup> *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 27.

<sup>25</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 44.

<sup>26</sup> *Mobil Pipe Line Co.*, 133 FERC ¶ 61,192, at PP 27-29 (2010) (finding that even though the pipeline was capable of transporting any type of crude oil, the practical reality was that there were no substitutes that could be economically transported on the pipeline except for Western Canadian heavy sour crude evidenced by the fact that nearly all shippers chose to ship this variety of crude oil on the pipeline).

<sup>27</sup> *Mobil Pipe Line Co. v. FERC*, 676 F.3d 1098, 1100-02 (2012).

<sup>28</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 42.

<sup>29</sup> *Id.* P 44.

field(s) from where the crude on the pipeline originates are to be included in the product market.<sup>30</sup>

Therefore, to define the product market the Commission has included: (1) the product for which the applicant pipeline seeks to charge market-based rates; and (2) any product that is a substitute to that product such that it could discipline the pipeline's exercise of market power in that product. To identify substitutes, the Commission has examined the cross-elasticity of demand between the products or whether an increase in the price of one product will cause a switch to the other. If so, the Commission has found those products are substitutes and included them in the same product market.

Geographic Markets and Alternative Sources of Transportation. The applicant pipeline is also required to define the geographic area in which it seeks to make a showing that it lacks significant market power and identify its viable competitors in that area.<sup>31</sup> The Commission has identified that these are separate processes.<sup>32</sup> The goal at the end of those processes is to identify the area around the pipeline's relevant terminal where viable competition exists to establish what alternative sources of transportation will be included in the market share and market concentration statistics. Generally, the object of defining the geographic area is to identify an area around the pipeline's terminal in which the price of the relevant product is largely determined by the buyers and sellers within the area.<sup>33</sup> That is, the goal is to identify the area around the applicant pipeline's terminal where viable competition exists. The applicant pipeline is required to define its origin markets (the locations where the products it transports originate) and its destination markets (the locations where the products it transports are destined on its pipeline), and establish that it does not have market power in those areas.<sup>34</sup>

The Commission has not required an oil pipeline to define its geographic markets in a particular way, but rather, it is to be determined from the particular facts of a case.<sup>35</sup> For crude oil pipelines, the Commission has found that the proper origin market is generally "the production field from where the crude oil being shipped on the pipeline derives."<sup>36</sup> This may be the production field(s) where the pipeline is physically located, or the production field(s) for inbound pipelines to the applicant pipeline that constitute the origin of the crude actually shipped on the applicant pipeline.<sup>37</sup> The Commission does not foreclose a different origin market for crude oil pipelines based on United States Department of Commerce, Bureau of Economic Analysis Economic Areas (BEAs)<sup>38</sup> or hubs, for example, if justified by the particular facts of a case.<sup>39</sup> For refined petroleum pipelines, the Commission has approved geographic markets

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<sup>30</sup> *Id.*

<sup>31</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,187-88, 31,191; 18 C.F.R. § 348.1(c)(1).

<sup>32</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 35 n.25.

<sup>33</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>34</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,187-89; 18 C.F.R. § 348.1(c)(1),(4).

<sup>35</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 35.

<sup>36</sup> *Id.* at P 39.

<sup>37</sup> *Id.*

<sup>38</sup> BEAs are geographic regions surrounding major cities that are intended to represent areas of actual economic activity. *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,661 n.13.

<sup>39</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 39.

based on BEAs,<sup>40</sup> enlarged BEAs or multiple BEAs,<sup>41</sup> and recently a 125-mile radius around the pipeline's terminal that excluded counties where the applicant pipeline's price was not competitive.<sup>42</sup>

Generally, to identify competitive alternatives to an applicant pipeline's terminal the Commission has held that the alternative must: (1) be able "to discipline, or prevent, a potential increase in price above the competitive level by the applicant pipeline;" (2) be "available to receive product diverted from the applicant pipeline in response to a price increase;" and (3) be "of the same quality as the applicant."<sup>43</sup>

Prior Commission precedent required detailed cost studies to establish a proposed alternative was cost competitive under the first requirement.<sup>44</sup> Recently, the Commission held that "[u]sage provides justification for determining that an alternative is a good alternative in terms of price."<sup>45</sup> Therefore, the Commission has found that actual used alternatives are necessarily competitive in terms of price.<sup>46</sup> This relies on shipper behavior "to implicitly demonstrate that the alternative is economic or profitable to that shipper."<sup>47</sup> Therefore, evidence that a proposed alternative is used satisfies the Commission's requirement that price data be provided to demonstrate an alternative is a good alternative in terms of price.<sup>48</sup>

For unused but "useable" alternatives (those that have available capacity and are of equal quality), the Commission directed as a first step a calculation of overall supply and demand for the disposal of the relevant product(s) in the relevant geographic market.<sup>49</sup> "It must be established whether the overall capacity to dispose of crude oil equals, is less than, or exceeds the crude oil contained in the origin market."<sup>50</sup> In the context of a crude oil origin market, the Commission explained that if the demand for disposition capacity out of the origin exceeds supply, no further analysis is required.<sup>51</sup> In that case, an alternative that is unused even when there is excess demand for capacity "is not an economic alternative, for otherwise shippers would avail themselves of the alternative to relieve the excess demand."<sup>52</sup> If disposition capacity

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<sup>40</sup> See *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>41</sup> See *Colonial Pipeline Co.*, 92 FERC ¶ 61,144, at 61,536-38 (2000).

<sup>42</sup> *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 40.

<sup>43</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 45.

<sup>44</sup> See, e.g., *Enterprise Products Partners L.P.*, 139 FERC ¶ 61,099, at P 32 (2012); *Mobil*, 133 FERC ¶ 61,192 at P 41; *Colonial*, 92 FERC ¶ 61,144 at 61,532 ; *TE Products Pipeline Co., L.P.*, 92 FERC ¶ 61,121, at 61,465-67 (2000).

<sup>45</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 70.

<sup>46</sup> *Id.* P 55; see also *id.* P 58 ("As the court held in *Mobil*, and the Commission confirms, the requirement that an alternative be determined a good alternative in terms of price does not require the actual calculation of a competitive price proxy when usage demonstrates an implied demonstration of competitiveness."); *Id.* P 61 ("The list of competitive alternatives therefore includes those alternatives in the geographic market being used to dispose of that which constitutes the product market.").

<sup>47</sup> *Id.* P 56.

<sup>48</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 56.

<sup>49</sup> *Id.* P 68.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* P 68.

exceeds demand or they are at equilibrium, the analysis go furthers into a detailed cost analysis because “alternatives may still be competitively priced though not currently being used.”<sup>53</sup>

Generally, if a detailed cost study is required to justify a proposed alternative, it will need to compare the costs between the proposed alternative and the competitive price. For destination markets, the study would compare the wholesale price at the proposed alternative plus trucking costs to the relevant geographic market to the delivered competitive price.<sup>54</sup> The purpose is to identify alternative sources of transportation that provide buyers with a delivered price within an acceptable range of the competitive price.<sup>55</sup> For origin markets, the purpose of the comparison is to identify alternative avenues of transportation out of the origin that provide a sale price to refineries and other sellers, minus transportation costs, that is within an acceptable range to the competitive price.<sup>56</sup>

The Commission has clarified that the competitive price to use as the benchmark to judge proposed alternatives in an origin market is the “netback of the alternative that provides the lowest netback among used alternatives.”<sup>57</sup> The Commission coined this competitive netback price among used alternatives in an origin market as the “marginal netback.”<sup>58</sup> As an illustration, the Commission explained that shippers “will seek to earn the highest netback among available alternatives, and will use the alternative with the highest netback until it no longer offers capacity.”<sup>59</sup> Shippers will “then seek to ship on the alternative offering the next highest net back, and so on until the marginal netback is reached. The marginal netback is the lowest netback generated among used alternatives.”<sup>60</sup> Once the marginal netback is determined from used alternatives, proposed unused alternatives are analyzed to determine whether they provide a netback that is within an acceptable range to still discipline a potential increase by the applicant pipeline above the competitive level.<sup>61</sup> Similarly, in a destination market the competitive price is set by the “marginal supplier” in the market.<sup>62</sup> In a destination market, the marginal supplier will be the used alternative in the market whose delivered commodity price in the relevant product(s) is highest.<sup>63</sup>

The Commission did not specify in the recent *Enterprise/Enbridge* proceeding or in Opinion No. 529 a threshold range to the marginal netback or marginal supplier by which proposed useable alternatives would be deemed acceptable.<sup>64</sup> In past cases, the Commission used a 15 percent threshold increase in the transportation component of the competitive price as the range to deem alternatives as price competitive.<sup>65</sup> In Opinion No. 529, the Commission

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<sup>53</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 68.

<sup>54</sup> See *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 43.

<sup>55</sup> *Id.*

<sup>56</sup> See *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 47-54, 69-70.

<sup>57</sup> *Id.* at P 55.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 69.

<sup>62</sup> *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 19.

<sup>63</sup> *Id.*

<sup>64</sup> See *Enterprise Products Partners*, 146 FERC ¶ 61,115; *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157.

<sup>65</sup> *Mobil*, 133 FERC ¶ 61,192 at P 24.

affirmed that the threshold range to determine competitive alternatives should be a range based on an increase in the transportation component of the competitive price, not an increase in the overall commodity price.<sup>66</sup>

In prior proceedings, the Commission established a rebuttable presumption for refined petroleum pipelines in both origin and destination markets that if the geographic market was defined as the relevant BEA all transportation alternatives within the BEA would be included in the market share and market concentration statistics unless participants raised a reasonable doubt that the BEA was not appropriate.<sup>67</sup> To raise a reasonable doubt, evidence that the BEA was abnormally large, sources of transportation were in discrete or remote areas of the BEA, or that alternative transportation sources within the BEA were either too costly or had insufficient capacity to serve as viable alternatives had to be produced.<sup>68</sup> If a reasonable doubt was raised, the applicant pipeline had the ultimate burden to define its geographic markets and the alternative sources of transportation to its pipeline.<sup>69</sup> The Commission's recent orders in the *Enterprise/Enbridge* and Opinion No. 529 proceedings did not directly overrule this precedent.<sup>70</sup>

In summary, the Commission has found that an applicant pipeline is free to define its geographic markets pursuant to its particular circumstances. To determine the alternatives to the pipeline's relevant terminal that will be included in the market power statistics, the Commission has required that the alternative be cost competitive, have available capacity, and be of the same quality. Recently, the Commission found that actual usage of a proposed alternative satisfies the requirement that the alternative be cost competitive. For unused alternatives, they are included in the market power statistics only if the relevant market is not capacity constrained and their costs are within an acceptable range to the competitive marginal supplier or marginal netback as evidenced through a detailed cost study.

Market Power Statistics. Applicant pipelines are also required to calculate their market share and the market concentration within their defined product and geographic markets.<sup>71</sup> These are the factors the Commission has principally cited when assessing a pipeline's market power in its defined markets in recent proceedings. Other factors have been discussed in making the market power determination, but only if the market share and market concentration statistics

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<sup>66</sup> *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 42. For example, that would provide in a destination market that alternative sources of transportation would be included in the market power statistics if they provide a delivered commodity price that is equal to or below the marginal supplier assuming a 15 percent increase (or some other acceptable range) in that supplier's transportation costs. Similarly, for an origin market, alternative sources of transportation would be included in the market power statistics if they provide a netback price equal to or greater than the marginal netback assuming a 15 percent threshold price increase (or some other acceptable range) in the marginal netback's transportation costs.

<sup>67</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,465-66.

<sup>68</sup> *Sunoco Pipeline, LP*, 114 FERC ¶ 61,036, at P 31 (2006); *Shell Pipeline Co., L.P.*, 103 FERC ¶ 61,236, at PP 19, 35-36 (2003); *Kaneb Pipe Line Operating Partnership, L.P.*, 83 FERC ¶ 61,183, at 61,761 (1998).

<sup>69</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,465-66.

<sup>70</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 35-39; *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at PP 39-45.

<sup>71</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192-93; 18 C.F.R. § 348.1(c)(7).

result in a close case.<sup>72</sup> These other factors, discussed in the sections below, include excess capacity in the market that could be used if a pipeline attempted to raise rates above competitive levels, potential competition that could enter the market upon a hypothetical price increase, and the presence of large buyers that can exert downward pressure on prices.

Market share and market concentration are often calculated from both actual delivery or receipt information and capacity based information.<sup>73</sup> For destination markets, market share delivery information means calculating the percentage of estimated actual deliveries into the relevant market by the applicant pipeline and viable alternative sources of transportation. For origin markets, this means calculating the percentage of estimated actual receipts for shipment in the relevant market by the various viable transportation participants. Parties also provide capacity based numbers to the Commission and often provide multiple such numbers, including: (1) total capacity to supply transportation services in the relevant markets, (2) “effective capacity” which is based on the lesser of total capacity to supply transportation services, or total consumption or shipments in the market, and (3) the DOJ Adjusted Capacity Method which assumes equal shares of capacity to all market participants.<sup>74</sup> In addition, in some cases, parties will adjust their capacity numbers to account for capacity that is committed to other areas, either upstream or downstream from the market being analyzed.<sup>75</sup>

Market concentration is a function of the number of firms in a market and their respective market shares.<sup>76</sup> In a highly concentrated market, the concern is that otherwise independent firms can easily collude on prices.<sup>77</sup> The Herfindahl-Hirschman Index (HHI) is used as the measure of market concentration and is calculated by summing the squares of the individual market shares of the applicant pipeline and all the appropriate alternative sources of transportation.<sup>78</sup>

The Commission has often looked at the ranges of numbers these metrics provide. The Commission has rejected requests to specifically set numerical thresholds of market concentration or market share as proof of market power. As a practical matter, however, the Commission has established through the adjudicatory process that it will generally find market power where HHI numbers are more than 2500 (which means there are four or less firms of equal size in the market), market share is greater than 50 percent, or there is a combination of HHI close to 2500 and market share numbers nearing 50 percent.<sup>79</sup> There are some limited exceptions noted in the sections that follow.

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<sup>72</sup> See *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 54 (affirming Judge’s conclusion that excess capacity and potential competition are cited only in close cases); *Enterprise TE Products*, 141 FERC ¶ 63,020 at PP 341, 359; *Colonial*, 92 FERC ¶ 61,144.

<sup>73</sup> See, e.g., *Sunoco*, 114 FERC ¶ 61,036 at P 39.

<sup>74</sup> See *Explorer Pipeline Co.*, 87 FERC ¶ 61,374, at 62,389-90, 62,390 n.28 (1999).

<sup>75</sup> See *id.* at 62,389.

<sup>76</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,667 n.45.

<sup>77</sup> *Id.* at 62,668-69.

<sup>78</sup> See, e.g., *id.* at 62,667; *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,661.

<sup>79</sup> See, e.g., *Kaneb*, 83 FERC ¶ 61,183 at 61,761; *SFPP, L.P.*, 84 FERC ¶ 61,338, at 62,494 & n.8 (1998); *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,677-78, 61,682-86.

Excess Capacity. Excess capacity is the available transportation capacity that exceeds total deliveries or receipts in the market.<sup>80</sup> It measures the ability to increase deliveries in a destination market or receipts in an origin market in response to a hypothetical increase in price by the applicant pipeline that is reflective of market power. While important, it will typically only be cited if the market share and market concentration statistics result in a close call.<sup>81</sup>

Potential Competition. The potential competition that exists in a market is relevant because it prevents or ameliorates the ability of an applicant pipeline to sustain a profitable increase in price. Potential competition that can economically enter the market upon an increase in price could come in the form of a new terminal in the market from a competitor pipeline, or new or increased barge or other water transportation alternatives. Similar to excess capacity, the Commission has cited it where the market share and market concentration statistics result in a close call.<sup>82</sup>

Large Buyers in a Destination Market or Large Suppliers in an Origin Market. The Commission has cited the presence of large buyers or large suppliers as a mitigating factor to an applicant pipeline's market power.<sup>83</sup> Theoretically, a large buyer or large supplier has its own market power that would prevent an applicant pipeline from raising its rates in a monopolistic fashion. The Commission cited this factor in its earlier market-based rate cases, but it has since been omitted in the Commission's determinations.

Form of Lighthanded Regulation. If the Commission finds an oil pipeline does not have market power in its relevant markets the pipeline will be free to charge whatever rate it can negotiate in the market.<sup>84</sup> Generally, there are no price caps, and no monitoring or filing requirements other than the tariff and form filings oil pipelines are otherwise required to make.<sup>85</sup> However, the Commission has left open the possibility that price caps or monitoring could be implemented if the particular facts of a case justify them.<sup>86</sup>

Given the established precedent on what market power statistics will cause the Commission concern, one of the principal areas of contention in these cases is now the size of the geographic market and what alternate sources of competition will be included in analyzing the pipeline's market power statistics. The issue will be whether the pipeline has proposed a large geographic market or included a significant number of alternative competitors outside the area, without evidentiary support, in an attempt to dilute the market share and market concentration numbers. The Commission has directed that alternatives sources of transportation be competitive in terms of price, available capacity, and quality. The proper methodology for analyzing whether an alternative source of transportation is cost competitive has evolved and will be discussed in detail below.

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<sup>80</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,670.

<sup>81</sup> See *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 54; *Enterprise TE Products*, 141 FERC ¶ 63,020 at P 359; *Colonial*, 92 FERC ¶ 61,144.

<sup>82</sup> *Mobil*, 133 FERC ¶ 61,192 at P 54; *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 54; *Enterprise TE Products*, 141 FERC ¶ 63,020 at P 341.

<sup>83</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,669-70.

<sup>84</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,186-87.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*