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OFFICE OF ADMINISTRATIVE LITIGATION



INTRODUCTION TO STAFF LEGAL HANDBOOK ON  
MARKET-BASED RATES FOR OIL PIPELINES  
FIRST EDITION

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## TABLE OF CONTENTS

TABLE OF AUTHORITIES .....	i
I. SUMMARY OF COMMISSION METHODOLOGY AND PRECEDENT .....	1
A. Brief Historical Overview of Oil Pipeline Regulation and Market-Based Rates .....	1
B. Summary of Current Commission Market-Based Rate Methodology .....	3
II. HISTORICAL OVERVIEW OF OIL PIPELINE RATE REGULATION .....	11
A. Opinion No. 154, Farmers II, and FERC’s Initial Reliance on Competition .....	12
1. Opinion No. 154 Relies on Implied Market Competition .....	12
2. Farmers II Court Requires Pipeline Specific Analysis of Market Power .....	13
B. Opinion No. 154-B’s Cost Based Methodology .....	15
III. THE DEPARTMENT OF JUSTICE’S PROPOSED PARTIAL DEREGULATION OF OIL PIPELINES AND GUIDELINES ON MARKET POWER .....	15
IV. THE MOVE TO OIL PIPELINE MARKET-BASED RATES .....	16
A. Opinion Nos. 360 and 360-A in the Buckeye Pipe Line Company Proceeding Adopt Market-Based Rates on a Case-by-Case Basis .....	17
1. Interlocutory Order Recognizes Market-Based Rates on a Case-by-Case Basis .....	17
2. Interlocutory Order Clarifies and Elaborates on Market-Based Rate Inquiry .....	18
3. Opinion No. 360 Establishes the Market Based Rate Inquiry .....	19
4. Opinion No. 360-A Adheres to Case-by-Case, Multi-Factored Analysis .....	26
B. Opinion Nos. 391 and 391-A in Williams Pipe Line Company Proceeding Utilizes Buckeye Market Power Analysis .....	27
1. Opinion No. 391 Builds on the Buckeye Market Power Analysis .....	28
2. Opinion No. 391-A Further Clarifies and Modifies the Market Power Analysis .....	35
C. Energy Policy Act of 1992 and Rulemaking Order No. 572 on Oil Pipeline Market- Based Rates .....	38
1. Order No. 561 Establishes Indexing as the Generally Applicable Ratemaking Tool and Order No. 571 Permits Cost-of-Service Rates in Defined Circumstances .....	39
2. Order No. 572 Establishes Filing Requirements and Procedures for Market-Based Rates .....	40

V. POST ORDER NO. 572 MARKET-BASED RATE CASES .....	45
A. Kaneb Pipe Line Proceeding Outlines When to Deviate from BEA Geographic Areas for Refined Petroleum Pipelines .....	46
B. SFPP, L.P. Proceeding Examines Geographic Origin Markets .....	47
1. Order on Application for Market-Based Rates Outlines Geographic Origin Market Inquiry .....	48
2. SFPP Failed to Justify Proposed Alternative Sources of Transportation in Origin Market .....	49
C. Explorer Pipeline Company Proceeding Addresses Corridor Geographic Markets .....	50
D. TE Products Pipeline Matter Establishes a Rebuttable Presumption in Favor of BEAs for Refined Petroleum Pipelines and Requires Detailed Cost Comparisons to Justify a Rebutted BEA, an Expanded BEA, or Alternative Sources Outside a BEA .....	53
E. Colonial Pipeline Company Proceeding Establishes Netback Cost Study for Determining Good Alternatives in a Geographic Origin Market .....	56
F. Sunoco Pipeline L.P. Proceeding Outlines Reasonable Grounds to Challenge a BEA Geographic Market .....	59
G. Court of Appeals in Mobil Pipe Line Company Proceeding Overturns Results of Netback Cost Study .....	61
1. Commission Finds Mobil Lacks Market Power in Gulf Coast Destination Market but Sets Upper Midwest Origin Market for Hearing .....	61
2. Netback Analysis Reveals Mobil Has No Competition .....	62
3. D.C. Circuit Court of Appeals Finds Broad Market Indicators Clearly Evidence Mobil Lacked Significant Market Power .....	65
4. Market-Based Rates Granted on Remand .....	67
H. Enterprise/Enbridge Proceeding Reaffirms Existing Market-Based Rate Methodology but Modifies Requirement To Show Good Alternatives in Terms of Cost .....	68
1. Initially Commission Denied Application To Charge Market-Based Rates Because of the Lack of Detailed Cost Analysis To Justify Good Alternatives .....	69
2. On Rehearing the Commission Reaffirmed its Market-Based Rate Methodology but Modified How to Determine Good Alternatives in Terms of Cost .....	69
VI. CONCLUSION.....	75

## TABLE OF AUTHORITIES

### COURT CASES

<i>Farmers Union Central Exchange v. FERC</i> , 584 F.2d 408 (D.C. Cir. 1978), <i>cert. denied</i> , 439 U.S. 995 (1978) (“ <i>Farmers I</i> ”).	11, 12
<i>Farmers Union Central Exchange, Inc. v. FERC</i> , 734 F.2d 1486 (D.C. Cir. 1984) (“ <i>Farmers II</i> ”).	1, 11, 12, 13, 14, 18, 27
<i>Mobil Pipe Line Co. v. FERC</i> , 676 F.3d 1098 (2012).	4, 65, 66, 67, 73, 74, 75
<i>Rebel Oil Co., Inc. v. Atl. Richfield Co.</i> , 51 F.3d 1421 (9th Cir. 1995).	16
<i>Spectrum Sports, Inc. v. McQuillan</i> , 506 U.S. 447 (1993).	16
<i>Standard Oil Co. of New Jersey v. United States</i> , 221 U.S. 1 (1911).	11

### STATUTES

15 U.S.C. § 18.	16
42 U.S.C. §§ 7101-75.	12
49 U.S.C. app. § 1 (1988).	11
49 U.S.C. app. § 6 (1988).	11
49 U.S.C. app. §§ 2, 3 (1988).	11
Pub. L. No. 102-486, 106 Stat. 2776, 3010 (1992), reprinted in 42 U.S.C. § 7172 note.	2, 38
Pub. L. No. 59-337, 34 Stat. 584	11
Pub. L. No. 95-473 § 4 (1978).	11

### COMMISSION REGULATIONS

18 C.F.R. § 342.2.	39
18 C.F.R. § 342.3.	39
18 C.F.R. § 342.4.	39
18 C.F.R. § 343.2.	40
18 C.F.R. § 348.1.	3, 5, 8, 32, 41, 42, 43, 44, 45
18 C.F.R. § 348.2.	45
18 C.F.R. §§ 342.0-342.4, 343.0-343.5.	39

### COMMISSION RULES

<i>Analysis of Horizontal Market Power under the Federal Power Act</i> , 138 FERC ¶ 61,109 (2012).	16
<i>Cost-of-Service Filing and Reporting Requirements for Oil Pipelines</i> , Order No. 571, FERC Stats. & Regs. ¶ 31,006 (1994), <i>clarified in</i> , Order No. 571-A, FERC Stats. & Regs. ¶ 31,012 (1994), <i>aff’d</i> , <i>Association of Oil Pipe Lines</i> , 83 F.3d 1424.	2, 39
<i>Five-Year Review of Oil Pricing Index</i> , 133 FERC ¶ 61,228 (2010).	39

<i>Market-Based Ratemaking for Oil Pipelines</i> , Order No. 572, FERC Stats. & Regs. ¶ 31,007 (1994), <i>reh'g denied</i> , Order No. 572-A, 69 FERC ¶ 61,412 (1994), <i>aff'd</i> , <i>Association of Oil Pipe Lines v. FERC</i> , 83 F.3d 1424.....	2, 3, 5, 8, 10, 27, 32, 40, 41, 42, 43, 44, 45, 75
<i>Revisions to Oil Pipeline Regulation Pursuant to the Energy Policy Act of 1992</i> , Order No. 561, FERC Stats. & Regs. ¶ 30,985 (1993), <i>modified on reh'g</i> , Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 (1994), <i>aff'd</i> , <i>Association of Oil Pipe Lines v. FERC</i> , 83 F.3d 1424 (D.C. Cir. 1996). .....	2, 38, 39

COMMISSION CASES

<i>Buckeye Pipe Line Co., L.P.</i> , 142 FERC ¶ 61,140, at P 13 (2013).....	26
<i>Buckeye Pipe Line Co., L.P.</i> , 44 FERC ¶ 61,066 (1988).....	3, 17, 18
<i>Buckeye Pipe Line Co., L.P.</i> , 45 FERC ¶ 61,046 (1988).....	3, 19
<i>Buckeye Pipe Line Co., L.P.</i> , 50 FERC ¶ 63,011 (1990).....	22, 64
<i>Buckeye Pipe Line Co., L.P.</i> , Opinion No. 360, 53 FERC ¶ 61,473 (1990). ...	1, 2, 3, 4, 5, 6, 9, 10, 16, 17, 20, 21, 22, 23, 24, 25, 26, 51
<i>Buckeye Pipe Line Co., L.P.</i> , Opinion No. 360-A, 55 FERC ¶ 61,084 (1991).....	1, 2, 26
<i>Buckeye Pipeline Co., L.P.</i> , 142 FERC ¶ 61,162 (2013).....	26
<i>Colonial Pipeline Co.</i> , 92 FERC ¶ 61,144 (2000).....	6, 9, 10, 16, 56, 57, 58, 75
<i>Colonial Pipeline Co.</i> , 95 FERC ¶ 61,210 (2001).....	59
<i>Colonial Pipeline Co.</i> , 95 FERC ¶ 61,377 (2001).....	59
<i>Enterprise Products Partners L.P.</i> , 139 FERC ¶ 61,099 (2012).....	6, 68, 69
<i>Enterprise Products Partners L.P.</i> , 139 FERC ¶ 61,255 (2012).....	69
<i>Enterprise Products Partners L.P.</i> , 146 FERC ¶ 61,115 (2014). 3, 4, 5, 6, 7, 8, 27, 37, 60, 70, 71, 72, 73, 74, 75	
<i>Enterprise TE Products Pipeline Co. LLC</i> , 137 FERC ¶ 61,027 (2011).....	56
<i>Enterprise TE Products Pipeline Co. LLC</i> , 141 FERC ¶ 63,020 (2012) (Initial Decision). 4, 9, 10, 22	
<i>Enterprise TE Products Pipeline Company LLC</i> , Opinion No. 529, 146 FERC ¶ 61,157 (2014) 4, 6, 7, 8, 9, 10, 56, 70, 72, 75	
<i>Explorer Pipeline Co.</i> , 87 FERC ¶ 61,374 (1999).....	9, 50, 51, 52, 53, 67
<i>Kaneb Pipe Line Operating Partnership, L.P.</i> , 83 FERC ¶ 61,183 (1998).....	8, 9, 38, 46, 47, 75
<i>Longhorn Partners Pipeline, L.P.</i> , 83 FERC ¶ 61,345 (1998). .....	16, 67
<i>Mobil Pipe Line Co.</i> , 121 FERC ¶ 61,268 (2007). .....	61, 62
<i>Mobil Pipe Line Co.</i> , 133 FERC ¶ 61,192 (2010). .....	4, 6, 7, 10, 23, 29, 62, 63, 64, 65, 73, 75
<i>Mobil Pipe Line Co.</i> , 140 FERC ¶ 61,104 (2012). .....	67
<i>Mobil Pipe Line Co.</i> , 142 FERC ¶ 61,175 (2013). .....	67
<i>SFPP, L.P.</i> , 102 FERC ¶ 61,240 (2003), <i>reh'g denied</i> , 104 FERC ¶ 61,136 (2003). .....	49, 50
<i>SFPP, L.P.</i> , 84 FERC ¶ 61,338 (1998). .....	9, 38, 48, 49, 71, 75
<i>Shell Pipeline Co., L.P.</i> , 103 FERC ¶ 61,236 (2003). .....	8, 60
<i>Sunoco Pipeline, L.P.</i> , 118 FERC ¶ 61,266 (2007). .....	60

<i>Sunoco Pipeline, LP</i> , 114 FERC ¶ 61,036 (2006) .....	8, 9, 16, 59, 60
<i>TE Products Pipeline Co., L.P.</i> , 92 FERC ¶ 61,121 (2000). .....	6, 8, 37, 54, 55
<i>TE Products Pipeline Co., L.P.</i> , 95 FERC ¶ 61,108 (2001). .....	56
<i>Trans Alaska Pipeline System</i> , 21 FERC ¶ 61,092 (1982). .....	13
<i>Transwestern Pipeline Company</i> , Order No. 500, 43 FERC ¶ 61,240 (1988). .....	18
<i>Williams Pipe Line Co.</i> , Opinion No. 154-B, 31 FERC ¶ 61,377 (1985), <i>modified on reh'g</i> , Opinion No. 154-C, 33 FERC ¶ 61,327 (1985). .....	1, 15
<i>Williams Pipe Line Co.</i> , Opinion No. 391, 68 FERC ¶ 61,136 (1994)....	1, 2, 9, 16, 23, 28, 29, 30, 31, 32, 33, 34, 52, 60, 75
<i>Williams Pipe Line Co.</i> , Opinion No. 391-A, 71 FERC ¶ 61,291 (1995)...	1, 16, 35, 36, 37, 38, 62
<i>Williams Pipe Line Company</i> , Opinion No. 154, 21 FERC ¶ 61,260 (1982). .....	1, 12, 13, 14

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Barak Orbach & Grace Campbell Rebling, <i>The Antitrust Curse of Bigness</i> , 85 S. CAL. L. REV. 605 (2012). .....	11
<i>Report of the Oil Pipeline Regulation Committee</i> , 25 ENERGY L.J. 259 (2004). .....	51
Steven Reed & Pantelis Michalopoulos, <i>Oil Pipeline Regulatory Reform; Still in the Labyrinth?</i> , 16 ENERGY L.J. 65 (1995). .....	11, 38, 40

#### ICC CASES

<i>Minnelusa Oil Corp. v. Continental Pipe Line Co.</i> , 258 I.C.C. 41 (1944) .....	12
<i>Petroleum Rate Shippers' Ass'n v. Alton &amp; So. R.R.</i> , 243 I.C.C. 589 (1941).....	11, 12
<i>Reduced Pipe Line Rates and Gathering Charges</i> , 243 I.C.C. 115 (1940). .....	11
<i>Reduced Pipe Line Rates and Gathering Charges</i> , 272 I.C.C. 375 (1948) .....	11, 12

#### DEPARTMENT OF JUSTICE REPORTS

ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, OIL PIPELINE DEREGULATION (1986).....	15
U.S. DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (1992) (revised 1997 and 2010).....	15

This is the first edition of Staff’s Legal Handbook on Market-Based Rates for Oil Pipelines. It is a special edition of Staff’s Oil Pipeline Handbook series and focuses on market-based rate proceedings. It follows in the footsteps of Staff’s Oil Pipeline Handbook, Volumes I-V, published in 1987, 1992, 1998, 2005, and 2014 which compiled major statutes, regulations, and cases on oil pipeline regulation. While this Handbook and Volumes I-V overlap temporally, the varying subjects discussed means that few cases are discussed or provided twice.

This introduction begins with a brief historical overview of oil pipeline regulation and market-based rates, and a summary of the current Federal Energy Regulatory Commission (“FERC” or “Commission”) methodology and precedent for determining whether an oil pipeline is permitted to charge market-based rates. A detailed analysis of the history of oil pipeline rate methodology in the context of market-based rates follows, along with a discussion of relevant precedent and methodology established at the Commission and in the courts applicable to oil pipeline market-based rates. The Handbook compiles the most notable orders, regulations, Department of Justice reports, and cases on this subject. Additionally, the Handbook contains a table of the outcomes of the notable oil pipeline market-based rate cases filed at the Commission and a map of the markets the Commission has considered in market-based rate applications with indications regarding whether those markets were found to be competitive.

## **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

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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).

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 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>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.

<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.*

## II. HISTORICAL OVERVIEW OF OIL PIPELINE RATE REGULATION

The antitrust laws that seek to prevent monopolistic and anti-competitive behavior were enacted in the late nineteenth century in response to the perceived monopoly power of large industrial trusts that existed at the time, including the Standard Oil Trust.<sup>87</sup> Regulation of oil pipeline rates began with the enactment of the Hepburn Act of 1906,<sup>88</sup> which amended the Interstate Commerce Act to bring within its purview “common carriers engaged in...the transportation of oil...by pipe line.”<sup>89</sup> Like railroads and other common carriers subject to regulation under the Interstate Commerce Act, oil pipelines were required to post tariffs with the Interstate Commerce Commission,<sup>90</sup> to charge only just and reasonable rates,<sup>91</sup> and to avoid unjust discrimination and undue preferences.<sup>92</sup>

From 1906 until the late 1930s, there were few, if any, litigated proceedings before the Interstate Commerce Commission addressing oil pipeline rates.<sup>93</sup> In 1940, for the first time, the Interstate Commerce Commission enunciated a standard for assessing the reasonableness of oil pipeline rates.<sup>94</sup> That standard used a weighted average of both the original cost of the pipeline infrastructure and the cost of reproducing that infrastructure under the conditions at the time of the rate case to determine a “valuation” or “fair value” rate base.<sup>95</sup> The pipeline’s allowable revenues were determined by applying a fixed rate of return (ultimately set by the Interstate Commerce Commission at 8% for crude oil pipelines and 10% for petroleum products pipelines) to the valuation rate base.<sup>96</sup>

This “fair value” methodology used by the Interstate Commerce Commission for oil pipelines was based on its ratemaking treatment of railroads and the United States’ Supreme Court’s approval of such methodologies in *Smyth v. Ames*, 169 U.S. 466, 546-47 (1898).<sup>97</sup> The Interstate Commerce Commission issued only three other published opinions on its oil pipeline

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<sup>87</sup> See *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911); Barak Orbach & Grace Campbell Rebling, *The Antitrust Curse of Bigness*, 85 S. CAL. L. REV. 605, 606 (2012).

<sup>88</sup> Pub. L. No. 59-337, 34 Stat. 584 (codified as amended in scattered sections of 49 U.S.C.).

<sup>89</sup> 49 U.S.C. app. § 1(1)(b) (1988). The Interstate Commerce Act as it applies to oil pipelines is the Act as it stood on the date of the enactment of the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977), which provided among other things for the transfer of jurisdiction over oil pipelines to the newly created FERC. Revised Interstate Commerce Act, Pub. L. No. 95-473 § 4(c), 92 Stat. 1337, 1470 (1978). For this reason, the 1978 recodification of the Interstate Commerce Act beginning at 49 U.S.C. § 10101 and all subsequent amendments to that Act are inapplicable to oil pipelines. The version of the ICA that does apply to oil pipelines is found in the appendix to the 1988 edition of Title 49 of the United States Code.

<sup>90</sup> 49 U.S.C. app. § 6 (1988).

<sup>91</sup> 49 U.S.C. app. § 1(5) (1988).

<sup>92</sup> 49 U.S.C. app. §§ 2, 3(1) (1988).

<sup>93</sup> See Steven Reed & Pantelis Michalopoulos, *Oil Pipeline Regulatory Reform; Still in the Labyrinth?*, 16 ENERGY L.J. 65, 68 (1995).

<sup>94</sup> See *Reduced Pipe Line Rates and Gathering Charges*, 243 I.C.C. 115 (1940).

<sup>95</sup> See *Farmers II*, 734 F.2d at 1495.

<sup>96</sup> *Reduced Pipe Line Rates and Gathering Charges*, 272 I.C.C. 375 (1948); *Petroleum Rate Shippers’ Ass’n v. Alton & So. R.R.*, 243 I.C.C. 589 (1941).

<sup>97</sup> See *Farmers II*, 734 F.2d at 1495 n.29; see also *Farmers Union Central Exchange v. FERC*, 584 F.2d 408, 414 (D.C. Cir. 1978), cert. denied, 439 U.S. 995 (1978) (“*Farmers I*”).

valuation methodology after its establishment,<sup>98</sup> and it did so principally before the landmark decision in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In that case, the U.S. Supreme Court established the fair and reasonable deference test toward rate determinations and approved prudently invested original cost less depreciation to determine rate base.<sup>99</sup>

A. **Opinion No. 154, Farmers II, and FERC's Initial Reliance on Competition**

The change from the methodology of the Interstate Commerce Commission to the Federal Energy Regulatory Commission's ratemaking methodologies highlights several key aspects of what "just and reasonable" has been interpreted to mean under the Interstate Commerce Act in relation to market-based rates. The D.C. Circuit Court of Appeals' rejection of any reliance on assumed market competition as the basis for "just and reasonable" rates has served as the touchstone for the Commission's market-based rate methodology. Among other findings, it has led to the Commission's continued adherence to a determination of market-based rates on a particularized case-by-case basis, and the Commission's requirement for detailed studies showing that alternative transportation sources included in the market power statistics are viable in terms of cost.

1. **Opinion No. 154 Relies on Implied Market Competition**

In the late 1970s, a group of shippers challenged the reasonableness of a rate increase by the Williams Brothers Pipe Line Company.<sup>100</sup> The Interstate Commerce Commission upheld the rate increase and the shippers challenged that order in the D.C. Circuit Court of Appeals.<sup>101</sup> While that appeal was pending, however, Congress transferred jurisdiction over oil pipeline rates from the Interstate Commerce Commission to FERC.<sup>102</sup> FERC was granted a remand by the appeals court to consider the regulatory system it would apply to oil pipeline rates.<sup>103</sup>

In response to the remand, the Commission issued Opinion No. 154. The opinion retained the "fair valuation" methodology of the Interstate Commerce Commission for determining rate base.<sup>104</sup> The Commission revised the rate of return methodology, however, from a fixed percentage to offering the pipeline a selection of eight different index measures of the growth in the economy as a cap on the rate of return.<sup>105</sup> The Commission reasoned that oil pipeline rate regulation should serve only as a limit on egregious price exploitation by the regulated pipelines, and that competitive market forces could be principally relied upon to assure

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<sup>98</sup> See *Petroleum Rate Shippers' Ass'n*, 243 I.C.C. 589 (1941); *Minnelusa Oil Corp. v. Continental Pipe Line Co.*, 258 I.C.C. 41 (1944); and *Reduced Pipe Line Rates and Gathering Charges*, 272 I.C.C. 375 (1948).

<sup>99</sup> See also *Farmers I*, 584 F.2d at 413-14.

<sup>100</sup> *Farmers I*, 584 F.2d at 410.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 416; Department of Energy Organization Act, 42 U.S.C. §§ 7101-75.

<sup>103</sup> *Farmers I*, 584 F.2d 408.

<sup>104</sup> *Williams*, Opinion No. 154, 21 FERC ¶ 61,260 at 61,632.

<sup>105</sup> *Id.* at 61,645-46. This rate of return was not applied to the book equity or actual equity in the capital structure, or to the percentage of the valuation rate base represented by the proportion of equity relative to debt in the oil pipeline's overall capital structure. Rather, this rate was the allowed return on the entire valuation rate base, less the face amount of debt. *Id.* at 61,647-48. A good example of this methodology is provided in *Farmers II*, 734 F.2d at 1525.

proper rate levels.<sup>106</sup> The Commission noted that competition in the oil pipeline sector was more potent than in the other sectors it regulated, and therefore, rate regulation should serve as a supplement to that competition or serve “in the nature of a check on gross abuse.”<sup>107</sup>

The Commission based the opinion in significant part on its finding that the economic market for oil pipelines had become competitive since 1906, and that “[p]rohibitive pricing has become uneconomic”<sup>108</sup> and “[n]o oil company (not even the largest) is wholly self-sufficient.”<sup>109</sup> The Commission also noted the significant decline in the price of pipeline transportation from 1931–1969.<sup>110</sup> Therefore, the Commission held that oil pipeline regulation “can and should continue to rely far more heavily on the market” and “should continue to be peripheral to the pricing process. That peripheral function relates to situations in which monopolistic pockets, short-run disequilibria, or other factors produce market prices that are grossly abusive and socially unacceptable.”<sup>111</sup>

## 2. Farmers II Court Requires Pipeline Specific Analysis of Market Power

The D.C. Circuit Court of Appeals in *Farmers II* struck down Opinion No. 154 in most material respects. Ultimately, the court was not persuaded by the Commission’s determination that the oil pipeline industry was competitive or that the level of evaluation conducted to make that determination was sufficient. The court’s holding on the analysis required to deviate from cost-based ratemaking would serve as the guiding precedent for the Commission in its subsequent market-based rate methodology.

The court held that the Commission’s reliance on competitive market forces and other non-cost factors (for example, the need to incentivize infrastructure development), was appropriate in certain circumstances. But, how those factors justified a particular rate must be specified and reasoned:

Because the relevant costs, including the cost of capital, often offer the principal points of reference for whether the resulting rate is “less than compensatory” or “excessive,” the most useful and reliable starting point for rate regulation is an inquiry into costs. At the same time, non-cost factors may legitimate a departure from a rigid cost-based approach. The mere invocation of a non-cost factor, however, does not alleviate a reviewing court of its duty to assure itself that the Commission has given reasoned consideration to each of the pertinent factors. On the contrary, each deviation from cost-based pricing must be found not to be unreasonable and to be consistent with the Commission’s statutory responsibility. Thus, when FERC chooses to refer to non-cost factors in ratesetting, it must

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<sup>106</sup> *Trans Alaska Pipeline System*, 21 FERC ¶ 61,092, at 61,285 (1982) (related order issued the same day as *Williams*, Opinion No. 154, 21 FERC ¶ 61,260).

<sup>107</sup> *Id.*

<sup>108</sup> *Williams*, Opinion No. 154, 21 FERC ¶ 61,260 at 61,608.

<sup>109</sup> *Id.* at 61,609. The Commission also considered the legislative history of the Interstate Commerce Act, and the non-cost factor of increased infrastructure development in support of its light-handed regulation. *Farmers II*, 734 F.2d at 1503-07.

<sup>110</sup> *Williams*, Opinion No. 154, 21 FERC ¶ 61,260 at 61,608.

<sup>111</sup> *Id.* at 61,649.

specify the nature of the relevant non-cost factor and offer a reasoned explanation of how the factor justifies the resulting rates.<sup>112</sup>

The Commission's methodology, however, did not provide a check to ensure that market forces would actually hold prices at a just and reasonable rate. Instead, the Commission instituted price ceilings that would seldom be reached in practice, and by the Commission's own admission allowed "creamy returns."<sup>113</sup> Importantly, the Commission failed to provide a mechanism to determine or monitor whether competition in the oil pipeline industry would actually keep prices at a just and reasonable level.<sup>114</sup>

The court was particularly concerned with what it characterized as a lack of meaningful analysis by the Commission on the level of competition in the oil pipeline industry.<sup>115</sup> The court held "that to have any relevance at all, competition must be evaluated in terms of discrete regional markets."<sup>116</sup> Akin to the requirements for deregulating rail carriers under the Interstate Commerce Act, a specific particularized finding that a pipeline does not have "market dominance" is required before competition might be properly taken into account.<sup>117</sup>

Without reasoned analysis into the market competition of the oil pipeline industry, the court was not persuaded that the reliance on competitive market forces was justified or amounted to anything other than an assumed check on rates.<sup>118</sup> "We believe that this apologia for virtual deregulation of oil pipeline rates oversteps the proper bounds of agency discretion under the 'just and reasonable' standard...Whether the purpose of oil pipeline rate regulation is 'consumer protection' or 'producer protection,' the statute requires meaningful rate regulation."<sup>119</sup> The court concluded that "presumed market forces may not comprise the principal regulatory constraint."<sup>120</sup> Instead, "[d]epartures from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justified by those factors."<sup>121</sup>

Therefore, if competition was relied upon to ensure just and reasonable rates, the court in *Farmers II* directed FERC to conduct further analysis into the level of competition in the

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<sup>112</sup> *Farmers II*, 734 F.2d at 1502 (citations omitted).

<sup>113</sup> *Id.* at 1509.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at 1509 n.50. The Commission's finding on competition was the following:

It is obvious that something has been holding these rates down. That something must be a marketplace force. The industry labels that force "competition." The parties have spent much time and great energy debating this matter of competition. Each set of protagonists makes valid points. This is a rather "soft" kind of competition. It appears to be of a live and let-live kind. But this does not mean that it is not there. Nor does it necessarily negate a finding of considerable potency.

*Williams*, Opinion No. 154, 21 FERC ¶ 61,260 at 61,608.

<sup>116</sup> *Farmers II*, 734 F.2d at 1509 n.50.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1508.

<sup>119</sup> *Id.* at 1507.

<sup>120</sup> *Id.* at 1530.

<sup>121</sup> *Farmers II*, 734 F.2d at 1530.

applicant pipeline's relevant markets. The court held that for competition to serve as the non-cost factor justifying rates it must be evaluated pursuant to a reasoned method that analyzes the pipeline's discrete regional markets. In addition, that analysis must result in a finding that the particular pipeline in question does not have market dominance.

**B. Opinion No. 154-B's Cost Based Methodology**

After remand from *Farmers II*, the Commission reevaluated both the reliance on competitive market forces as the principal check on oil pipeline rates and the Interstate Commerce Commission's valuation methodology to determine rate base. In Opinion No. 154-B, the Commission held that "[i]t is evident that oil pipeline rates as a general rule must be cost-based."<sup>122</sup> The Commission concluded that the rate base methodology should be derived from the original cost of the investment as opposed to the cost to reproduce the investment at the time, and adopted a unique approach for oil pipelines.<sup>123</sup> A detailed description of the Commission's cost-based approach to oil pipeline ratemaking is provided in Opinion No. 154-B.<sup>124</sup>

**III. THE DEPARTMENT OF JUSTICE'S PROPOSED PARTIAL DEREGULATION OF OIL PIPELINES AND GUIDELINES ON MARKET POWER**

In 1986, shortly after Opinion No. 154-B was issued, the Department of Justice (DOJ) issued a report on the state of competition in the oil pipeline sector.<sup>125</sup> The report concluded that most existing crude oil and refined petroleum products pipelines could be safely deregulated, and all new crude oil pipelines could be deregulated. This report by the DOJ is often cited in oil pipeline market-based rate cases, and a copy of the report is provided in the Handbook.

During this same timeframe, the DOJ and the Federal Trade Commission also issued guidelines on assessing market power for horizontal mergers.<sup>126</sup> As provided in detail below, FERC is concerned with the existence of market power. In contrast to a violation of the antitrust provisions for monopolization or attempted monopolization, the Commission is generally not concerned with intent or the unlawful nature of the conduct undertaken to achieve the

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<sup>122</sup> *Williams*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* Briefly, the opinion provided for a transition mechanism from the "fair valuation" methodology to determine rate base to the original cost less depreciation method. This transition mechanism (the "starting rate base") was made up in part from the pipeline's last Interstate Commerce Commission rate base valuation, and in part based on the pipeline's original cost of their capital investments less depreciation. *Id.* at 61,833-36. On a forward-looking basis, the pipeline's rate base is determined based on the original cost of the capital investment. *Id.* at 61,833. The original cost is determined by including inflation in the equity portion of the cost of the capital, but not in the debt portion, which is determined on a depreciated original cost basis. *Williams*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833. With respect to rate of return, the equity portion of the rate base receives only a "real" equity rate of return, meaning one from which the inflation component has been extracted. *Id.* at 61,834. The debt portion of the rate base, on the other hand, is subject to a nominal debt return, reflecting the fact that the debt rate base does not include inflation. *Id.* at 61,835.

<sup>125</sup> ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, OIL PIPELINE DEREGULATION (1986).

<sup>126</sup> U.S. DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (1992) (revised 1997 and 2010).

monopoly.<sup>127</sup> Therefore, the Commission’s inquiry more closely resembles the antitrust statute’s prohibition on mergers and acquisitions “where ... the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly....”<sup>128</sup> The DOJ and Federal Trade Commission guidelines are designed for this type of market power determination, and therefore, they have been cited by the Commission and the participants in market-based proceedings before the Commission. The 1997 version is provided in the Handbook. The guidelines were recently updated in 2010. The Commission has declined to take into account changes in the updated guidelines in the context of merger requests of electric utilities and applications for market-based rates by wholesale electric providers under the Federal Power Act.<sup>129</sup>

It should be noted that while persuasive, the Commission has not strictly adhered to the 1997 guidelines. For example, the guidelines provide a particular methodology for calculating HHI and market share (DOJ Adjusted Capacity Method), which is discussed in Section V below. While parties sometimes provide the numbers derived from the DOJ methodology and the Commission will cite them, the Commission has not required use of this DOJ methodology for calculating HHI or market share.<sup>130</sup> In addition, the guidelines find an HHI of 1800 reflects a highly concentrated market, but the Commission has approved markets with HHIs above 1800 on numerous occasions.<sup>131</sup> Likewise, the Commission has varied from the guidelines in other respects, such as the level of waterborne alternatives in a market that will raise a presumption an applicant pipeline lacks market power.<sup>132</sup>

#### **IV. THE MOVE TO OIL PIPELINE MARKET-BASED RATES**

Soon after the DOJ’s deregulation study finding significant competition in the oil pipeline sector, the Commission approved (largely without prompting from the particular applicant pipeline in question) the use of market-based rates under certain circumstances. The Commission adopted the approach articulated by the *Farmers II* court as a reasoned approach to market-based ratemaking, i.e., one that analyzes the particular pipeline’s market dominance in its discrete regional markets. The methodology adopted by the Commission to make this

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<sup>127</sup> To establish a Sherman Act § 2 violation for attempted monopolization, a private plaintiff seeking damages must demonstrate four elements: (1) specific intent to control prices or destroy competition; (2) predatory or anticompetitive conduct directed at accomplishing that purpose; (3) a dangerous probability of achieving “monopoly power”; and (4) causal antitrust injury. See *Rebel Oil Co., Inc. v. Atl. Richfield Co.*, 51 F.3d 1421, 1432-33 (9th Cir. 1995); see also *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993).

<sup>128</sup> 15 U.S.C. § 18.

<sup>129</sup> See *Analysis of Horizontal Market Power under the Federal Power Act*, 138 FERC ¶ 61,109 (2012).

<sup>130</sup> See, e.g., *Longhorn Partners Pipeline, L.P.*, 83 FERC ¶ 61,345, at 62,379, 62,381 (1998) (citing HHI and market share numbers calculated from various methodologies including the DOJ method as all in line with a finding of no market power based on Commission precedent); *Colonial*, 92 FERC ¶ 61,144 at 61,534-39 (Commission cited HHI statistics based on DOJ and other methods to find the applicant pipeline did not have market power in its contested destination markets); *Sunoco*, 114 FERC ¶ 61,036 at 61,105 (citing HHI and market share numbers derived from DOJ and other methodologies in finding a lack of market power in a contested destination market).

<sup>131</sup> See, e.g., *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 61,670-71 (finding in a litigated proceeding that pipeline lacked market power in a region where HHI was calculated at 2102); *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,682 (finding in a litigated proceeding that applicant pipeline lacked market power in regions where HHI was 2381 and 2048 respectively).

<sup>132</sup> See *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,137-38.

particularized assessment was to first define the pipeline's relevant product and geographic markets. Then, a number of factors designed to assess the pipeline's market power in those defined markets were to be analyzed. This basic methodological framework remains in place today. In addition, the first two proceedings that recognized market-based rates on a case-by-case basis are still controlling Commission precedent on a number of issues. Those include how to properly define the product market, the underlying purpose and method to defining the geographic market, and the market power statistics the Commission will find indicative, or not, of market power.

How the Commission will discuss or analyze certain factors in the market power analysis has shifted over time however. When the Commission first articulated its methodology in the two proceedings detailed below, it cited a number of factors without giving any one factor prominence over the others. For example, the Commission took a balanced approach in weighing the excess capacity in the relevant markets, the market power of large buyers in the pipeline's destination markets, and the market share and market concentration statistics. In later cases, however, the Commission shifted to citing most prominently the market share and market concentration statistics over other factors.

A. **Opinion Nos. 360 and 360-A in the Buckeye Pipe Line Company Proceeding Adopt Market-Based Rates on a Case-by-Case Basis**

The Commission's allowance of market-based rates on a case-by-case basis originated in a series of orders related to Buckeye Pipe Line Company's request for a general rate increase. The Commission detailed in this proceeding the methodology it would use to assess a pipeline's market power, how it would define the pipeline's product and geographic markets, and the factors it would assess in analyzing a pipeline's market power. The Commission continues to rely on Opinion Nos. 360 and 360-A for the proper overall methodology to employ, the analysis to define the product market, and the basic underpinnings for defining the geographic market. In addition, while some of the factors the Commission used to analyze Buckeye's market power have been cited less and less, how the Commission calculated and analyzed the factors that have risen to the forefront of the analysis is highly relevant today.

1. **Interlocutory Order Recognizes Market-Based Rates on a Case-by-Case Basis**

In 1987, in accordance with Opinion No. 154-B methodology, Buckeye filed a proposed six percent general rate increase.<sup>133</sup> As part of its presentation, Buckeye filed certain cost allocation data relating to individual rates on its system pursuant to a protective order that prevented public disclosure of the information.<sup>134</sup> The judge ordered Buckeye to disclose its cost allocation data by the date of the evidentiary hearing on the basis that such cost of service data was of the type usually released to the public.<sup>135</sup> Buckeye filed an interlocutory appeal to the Commission, arguing in part that "it should not be forced to suffer the serious competitive injury

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<sup>133</sup> See *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,659.

<sup>134</sup> *Buckeye*, 44 FERC ¶ 61,066 at 61,883.

<sup>135</sup> *Id.* at 61,882-83.

the ALJ found likely to occur from disclosure of the involved cost data when it is unclear whether cost-based...ratemaking is required under *Farmers...II*.”<sup>136</sup>

Buckeye’s interlocutory appeal was “primarily directed to the narrow issue of whether certain cost-of-service data should continue to be protected.”<sup>137</sup> The Commission used the opportunity, however, to establish that if a pipeline lacked significant market power a form of “lightheaded” regulation less stringent than the Opinion No. 154-B cost-based methodology would be permitted. Citing *Farmers II*, the Commission held that it could deviate from strict cost-of-service rate review if non-cost circumstances, such as competition, demonstrated that the resulting rates from such an approach would satisfy the just and reasonable standard.<sup>138</sup>

Analytical Framework and Factors of Analysis. Relying on *Farmers II*, the Commission noted that the competitive forces warranting lightheaded regulation “would have to be clearly identified and must be shown to keep prices at a just and reasonable level to ensure that the Commission can protect shippers from unreasonable rates under the [Interstate Commerce Act].”<sup>139</sup> The Commission held that the oil pipeline would have the burden of demonstrating that it was entitled to regulation less stringent than cost-based ratemaking.<sup>140</sup> To satisfy that burden the pipeline would have to demonstrate it lacked significant market power in its relevant markets.<sup>141</sup> The Commission noted that an oil pipeline could demonstrate a lack of market power by showing, for instance, that shippers and buyers have sufficient alternatives to the applicant pipeline.<sup>142</sup>

The Commission concluded by remanding the proceeding to the judge to evaluate the competitive conditions within the relevant markets and determine whether Buckeye had market power in those markets.<sup>143</sup> Once a determination was made with respect to market power, the findings were to be submitted to the Commission to determine whether the proposed rates should be evaluated under the Opinion No. 154-B cost-based methodology or under a less strict standard.<sup>144</sup>

## 2. Interlocutory Order Clarifies and Elaborates on Market-Based Rate Inquiry

Upon rehearing of the interlocutory order, the Commission clarified and elaborated on several aspects of the required market power analysis. The Commission outlined the particular methodology it would employ and the factors of analysis it would use to assess the pipeline’s market power. The Commission’s methodology and factors of analysis were largely adopted from those used to assess monopoly power under the antitrust statutes. The basic framework of the analysis articulated remains in place today.

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<sup>136</sup> *Id.* at 61,883.

<sup>137</sup> *Id.* at 61,884.

<sup>138</sup> *Id.* at 61,885 (citing *Farmers II*, 734 F.2d at 1510; *Transwestern Pipeline Company*, Order No. 500, 43 FERC ¶ 61,240, at 61,650 (1988)).

<sup>139</sup> *Buckeye*, 44 FERC ¶ 61,066 at 61,885.

<sup>140</sup> *Id.* at 61,886.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Buckeye*, 44 FERC ¶ 61,066 at 61,886.

Analytical Framework and Factors of Analysis. The Commission elaborated that its envisioned analysis into an oil pipeline’s market power would “to a large extent...mirror the type of inquiry used by courts in evaluating monopoly power.”<sup>145</sup>

In determining whether such power exists, it is necessary to define the relevant market, which is normally identified in terms of the products affected and geographic market dimensions. Once the relevant market has been determined, monopoly power can be proven by actual exercise of control over prices or exclusion of competition (limitations on this power by regulatory agencies is also relevant), or in the absence of actual exercise of control or exclusion of competition, by evidence of an ability to control prices or exclude competition. Factors considered here include market share...economies of scale, competitor size and performance, entry barriers, pricing practices, market stability, and other considerations. From this it can be seen that, absent a clear case of actual control of prices or exclusion of competition, the determination as to whether monopoly power exists in any given case can involve weighing a myriad of factors.<sup>146</sup>

The Commission posited that its list of factors to determine market power “is illustrative of the types of evidence that the parties may submit in attempting to address the issue of market power.”<sup>147</sup> The Commission also noted the factors considered by the DOJ in its report on Oil Pipeline Deregulation may be relevant to the analysis. These included “the number and size of pipeline carriers or alternate suppliers in the relevant market (such data was used to calculate a Herfindahl-Hirschman index), the cost of truck transportation between geographic markets, the presence of excess capacity on a regulated pipeline in question, and the potential for certain competitors to increase sales.”<sup>148</sup>

On rehearing, the Commission clarified that it envisioned a monopoly power type inquiry would be conducted. The basic framework, which remains in place today, called for the pipeline’s product and geographic markets to be defined and then the market power in those defined markets to be analyzed through the assessment of certain factors. The Commission also listed numerous factors it would find persuasive in making that assessment. Ultimately, the inquiry the Commission required was a determination on whether the pipeline actually controls prices or excludes competition in a market area, or has the ability to control prices or exclude competition in a market area.

### 3. Opinion No. 360 Establishes the Market Based Rate Inquiry

In Opinion No. 360, the Commission put its case-by-case approach to practical use. This resulted in the Commission’s first rulings on how to determine the proper product and geographic markets, and how the factors to assess market power in those defined markets would be calculated and weighed.

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<sup>145</sup> *Buckeye*, 45 FERC ¶ 61,046 at 61,162.

<sup>146</sup> *Id.* at 61,162-63.

<sup>147</sup> *Id.* at 61,163 n.20.

<sup>148</sup> *Id.* at 61,163 n.21.

On February 12, 1990, the judge issued the initial decision finding that Buckeye lacked significant market power in all twenty-two of the markets in which it provided transportation services.<sup>149</sup> On exceptions, the Commission affirmed the conclusion that Buckeye lacked significant market power in fifteen markets. But, the Commission found four markets in which Buckeye had significant market power, reversed because of inadequate evidence as to the New York market, and held two others were inappropriate for consideration because Buckeye had no tariff on file to serve those markets.<sup>150</sup>

Analytical Framework and Factors of Analysis. In evaluating the evidence presented at the hearing and the judge's findings on Buckeye's market power, the Commission first defined the applicant pipeline's product and geographic markets.<sup>151</sup> The Commission held that "before market power may be assessed, the relevant product and geographic markets must be defined."<sup>152</sup>

The Commission then used as an initial screen the HHI calculations of market concentration in the pipeline's relevant markets calculated by Trial Staff.<sup>153</sup> Markets with extremely low HHI numbers were subjected to less scrutiny.<sup>154</sup> For all other markets, the Commission weighed a myriad of factors, including "the potential entry of competitors into the market, available transportation alternatives, market share, availability of excess capacity," and the presence of large buyers able to use their own market power to exert downward pressure on transportation rates.<sup>155</sup> The Commission then concluded whether, on balance, those factors established that Buckeye had significant market power in any particular market that required continued close regulatory oversight of its rates.<sup>156</sup>

The Commission has retained this overall methodological framework, which defines the product and geographic markets and then assesses certain factors of market power in those defined markets. The use of market concentration numbers alone as an initial screen, however, is not used in the current Commission analysis. Instead, the Commission analyzes every market, but uses both the market share and market concentration statistics as the primary factors it will cite to in its analysis.

Product Market. The judge found that the relevant product market was the transportation of all refined pipeline petroleum products.<sup>157</sup> An intervenor, the Air Transport Association, contended that the relevant product market should be differentiated into jet fuel, gasoline, and

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<sup>149</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,658-59.

<sup>150</sup> *Id.* at 62,659, 62,674.

<sup>151</sup> *Id.* at 62,663.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,663.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

fuel oil markets because they are separate products that cannot be substituted for one another as to end use.<sup>158</sup>

The Commission held that the appropriate inquiry to determine the product market is whether products are substitutes for one another and whether their prices move together.<sup>159</sup> If they are substitutes, those products are properly within the same product market.<sup>160</sup> The Commission found that the ease of substitution between petroleum products both in their transportation and production, even if not in end use, showed that the relevant product market was the transportation of all refined petroleum products, not the transportation of specific differentiated products.<sup>161</sup>

The Commission noted that the “substitution of the transportation of one petroleum product for the transportation of another petroleum product is nearly universal among pipelines.”<sup>162</sup> Further, as to production, refiners of petroleum products can switch their production mix in response to an increase in the price of one as compared to the other, which causes their prices to move together.<sup>163</sup> For example, an increase in the price of jet fuel as compared to gasoline will cause a switch to produce more jet fuel, decreasing the supply of gasoline, causing the price of gasoline to also increase.<sup>164</sup> Therefore, the Commission concluded that all petroleum products were substitutes for each other in transportation and production, even if not in use, and defined the product market as the transportation of all refined pipelineable petroleum products. The Commission’s analysis in this case for determining the product market and proper substitutes applies today.

Geographic Market and Alternative Sources of Transportation. In addition to defining the products the pipeline transports, it is also necessary to define the geographic area in which the pipeline transports those products in order to measure market power. The judge in *Buckeye* determined that the relevant BEAs, including all supplies of transportation from all origins to those areas, would serve as the geographic market.<sup>165</sup> “BEAs are geographic regions surrounding major cities that are intended to represent areas of actual economic activity.”<sup>166</sup>

The Air Transport Association contended that the relevant geographic markets should be the individual airports to which *Buckeye* transported jet fuel.<sup>167</sup> The Commission outlined the purpose of defining the geographic market, and adopted the process for making that determination that was utilized by Trial Staff. The Commission held that the primary purpose in defining the geographic market “is to identify an area in which the price of the relevant product is largely determined by the buyers and sellers within the area.”<sup>168</sup> That is, the goal is to identify the area around the pipeline’s terminal where viable competition exists and include alternative

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<sup>158</sup> *Id.* at 62,663-64.

<sup>159</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,664.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,664.

<sup>165</sup> *Id.* at 62,661.

<sup>166</sup> *Id.* at 62,661 n.13.

<sup>167</sup> *Id.* at 62,665.

<sup>168</sup> *Id.*

suppliers within that area in the market power analysis. The Commission found that a hypothetical price increase in the relevant product (the threshold price increase) “is used to estimate the ability of buyers to avoid the price increase by purchasing the same product from sellers in other areas.”<sup>169</sup> The process for defining the geographic area, as testified by Trial Staff witness Dr. Ogur and approved by the Commission, was as follows:

In his analysis Dr. Ogur assumed a threshold price increase in [a proposed] geographic area. He then looked for evidence that buyers could travel to sellers in other areas and for evidence that sellers in other areas could ship into the area in question. If buyers can avoid a price increase in either manner, then the geographic market must be expanded to include the other area of competing sellers. The process is repeated until a geographic market is defined within which the price increase can be profitably imposed on buyers.<sup>170</sup>

The threshold price increase Dr. Ogur used was an increase of 0.5 cents/gallon (which amounted to a 40 percent price increase over Buckeye’s average transportation rate).<sup>171</sup> Dr. Ogur concluded, and the Commission agreed, that a BEA was a reasonable approximation of the relevant geographic market for the delivered product and was the smallest geographic area that seemed reasonable.<sup>172</sup> The Commission found that it was not reasonable to have an area smaller than a BEA because viable competition to the pipeline existed within the BEAs. Specifically, buyers could avoid a hypothetical threshold price increase of 0.5 cents/gallon through the presence of competitive trucking shipments that existed within the BEAs.<sup>173</sup>

Therefore, the Commission in *Buckeye* provided that the underlying goal in defining the geographic market is to identify viable competitive alternatives to a pipeline. The process of identifying those viable alternatives through a cost comparison utilizing a hypothetical price increase has undergone some change. The amount of the threshold price increase has been a matter of significant contention. Further, as detailed throughout this introduction, the Commission has limited the circumstances when a detailed price test is required.

Ability to Increase Price as Threshold for Market Power. After addressing the relevant geographic market, the Commission in *Buckeye* turned to the appropriate methodology for measuring market power within the defined product and geographic market. The judge held, and the parties agreed, that “market power is the ability to raise price above the competitive level for a significant time period.”<sup>174</sup> The judge further defined significant market power “as the ability to control market price by sustaining at least a 15-percent real price increase, without losing sales, for a period of at least two years.”<sup>175</sup> The parties generally agreed that this standard was

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<sup>169</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>170</sup> *Id.*

<sup>171</sup> *Buckeye Pipe Line Co., L.P.*, 50 FERC ¶ 63,011, at 65,049 (1990) (Initial Decision); *see also Enterprise TE Products*, 141 FERC ¶ 63,020 at P 195.

<sup>172</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 62,666.

<sup>175</sup> *Id.* A “real” price increase is one adjusted for inflation.

acceptable as a minimum requirement for finding significant market power.<sup>176</sup> The Commission held this definition of market power was “adequate in this proceeding.”<sup>177</sup>

The Commission further held that the relevant price to be considered in determining whether Buckeye could profitably increase its transportation prices above the competitive level was the “delivered product price,” which includes “all transportation costs and the product price from the source.”<sup>178</sup>

Because shippers or customers in the destination market often have the option of switching away from purchasing transportation into the market, and, instead, purchasing the delivered product itself, suppliers of transportation must compete with suppliers of the delivered product... Therefore, any market power that might be exercised by transportation suppliers can be limited by delivered product suppliers who provide both product and transportation.<sup>179</sup>

Buckeye had never increased its rates by more than 15 percent over a two year period however.<sup>180</sup> And no party attempted to show that Buckeye had (or did not have) the ability to do so in its defined product and geographic markets. The 15 percent increase in price used in *Buckeye* as the definition of a price increase that equates to market power has been used by the Commission as a permissible range to use when comparing a hypothetical threshold increase in the competitive price to possible alternative sources of transportation.<sup>181</sup>

Market Power Statistics (Market Concentration and HHI). In *Buckeye*, the Commission addressed the factors it would use in its analysis and their parameters. In analyzing market power, the judge identified market concentration as one of the factors to be considered.<sup>182</sup> The judge acknowledged the HHI<sup>183</sup> as a preliminary threshold measure of market concentration, but stated that the number and type of true economic alternatives were his paramount consideration.<sup>184</sup> Trial Staff and the Air Transport Association urged the Commission to more strongly consider market concentration and the HHI in determining Buckeye’s market power.<sup>185</sup>

The Commission first explained that “[m]arket concentration is a function of the number of firms in a market and their respective market shares, and HHIs are an appropriate and widely used measure of market concentration.”<sup>186</sup> The Commission determined that the proper method to calculate HHIs in this case was the method used by Trial Staff, which was based on delivery data, “e.g., deliveries into each BEA....”<sup>187</sup> At this time, the Commission declined the invitation

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<sup>176</sup> *Id.*

<sup>177</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* at 62,666.

<sup>181</sup> *See Mobil*, 133 FERC ¶ 61,192 at P 24.

<sup>182</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665.

<sup>183</sup> The HHI is calculated by summing the squares of the individual market shares of all the market participants. *See, e.g., Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,661.

<sup>184</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,666-67.

<sup>185</sup> *Id.* at 62,667.

<sup>186</sup> *Id.* at 62,667 n.45.

<sup>187</sup> *Id.* at 62,667.

to give the factor more weight or base the market power analysis primarily on market concentration however.<sup>188</sup> The Commission reiterated that the HHI is a useful factor in determining market power, however, because it provides useful information about the degree of concentration in a market and where on the competitive spectrum that market likely lies.<sup>189</sup>

The Commission also noted that a high HHI raised concerns of cooperative, non-competitive behavior. In highly concentrated markets, the Commission observed that the pricing behavior of firms would directly impact the positions of their competitors, and firms would weigh the likely responses of their rivals before changing prices.<sup>190</sup>

Therefore, the Commission determined that the analysis it would employ in evaluating Buckeye's market power would examine relevant BEAs as the geographic market, the transportation of refined pipeline petroleum products as the product market, and it would not elevate one particular factor over the others in the analysis, but instead analyze all factors under a balanced approach.

Analysis of Particular Markets. Most of the markets in *Buckeye* were uncontested and not discussed.<sup>191</sup> In applying its analysis to the contested markets, the factors the Commission relied on included market concentration, market share, competition from alternative transportation like barges or trucks, large buyers that might have leverage to exert downward pressure on prices, and excess transportation capacity within the market.<sup>192</sup>

For example, in the Pittsburgh BEA, Buckeye faced competition from barges, a large buyer in USAir that purchased sixty-five percent of the product transported to the Pittsburgh airport, a significant amount of excess capacity above total deliveries, and potential competitive entry from trucking firms.<sup>193</sup> The Commission concluded:

[Trial Staff]...calculated an HHI of 2102 for Pittsburgh. This HHI suggests a degree of market concentration that, when considered with Buckeye's 43.7 percent market share, makes the decision with respect to this market a close call. However, after considering the nature and quality of the transportation alternatives relied on by the ALJ and the amount of excess capacity in the market, we conclude that Buckeye does not have significant market power in the Pittsburgh BEA.<sup>194</sup>

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<sup>188</sup> *Id.* at 62,667 n.45.

<sup>189</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,667.

<sup>190</sup> *Id.* at 62,668-69.

<sup>191</sup> *Id.* at 62,669.

<sup>192</sup> *Id.* at 62,669-70. The Commission measured "excess capacity" by comparing total transportation capacity to total deliveries into the market. *Id.* at 62,670.

<sup>193</sup> *Id.* at 62,669.

<sup>194</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,669. For context regarding the HHI, under the DOJ Merger Guidelines, if an HHI is less than 1000, the market is viewed as competitive. *Id.* at 62,667 n.46. If the HHI exceeds 1800, the guidelines find that significant market power may be exercised, and the DOJ will examine entry conditions and other factors to determine whether a proposed merger is likely to increase market power. *Id.* Trial Staff in the *Buckeye* case recommended the use of an 1800 threshold, consistent with the approach suggested in the DOJ Merger Guidelines and the approach taken by the Commission in natural gas pipeline cases. *Id.*

Of note in the Columbus BEA, the Commission held that the competition Buckeye faced from a privately owned pipeline that served only its owners was relevant to the market power analysis.<sup>195</sup> In that market, even though the HHI was calculated to be 3051, the Commission found a lack of market power from Buckeye's market share of 28.5 percent; the existence of excess capacity; competition from trucking, barging, and the proprietary pipeline; and the presence of a large buyer.<sup>196</sup>

The Commission found that Buckeye had market power in four of its markets. In those markets, generally the market share and HHI numbers were extremely high, and there was a lack of competition in fact or through potential entrants.<sup>197</sup> For instance, in the Cleveland BEA, the HHI was calculated to be in the range of 2400 to 5976, with a market share by Buckeye of 75.7 percent.<sup>198</sup> In the Rochester BEA, the HHI was calculated at 5378 with a 71.3 percent market share by Buckeye, and there were no potential entrants that could enter the market at a reasonable cost.<sup>199</sup>

Viewed from a purely market share and market concentration perspective, the Commission found Buckeye had market power in a market when the HHI was above 2500 and market share was in excess of 50 percent.<sup>200</sup> Likewise, from only a market share and market concentration perspective, the Commission generally found Buckeye did not have market power in markets where the HHI was below 2500 and market share was less than 45 percent.<sup>201</sup> However, as noted, the Commission found a lack of market power in the Columbus BEA where the HHI was 3051 because other mitigating factors were present.<sup>202</sup> Therefore, from a market power statistic perspective, HHIs above 2500 accompanied by market shares close to 50 percent were found to be indicative of market power. Those numbers along with the absence of other mitigating factors, such as a lack of excess capacity or lack of large buyers, led the Commission to a finding of market power.

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<sup>195</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,670-71.

<sup>196</sup> *Id.* at 62,671.

<sup>197</sup> *Id.* at 62,671-73.

<sup>198</sup> *Id.* at 62,671.

<sup>199</sup> *Id.* at 62,672.

<sup>200</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,671-73. The particular statistics the Commission relied on to find significant market power in the BEA markets were:

- Cleveland (HHI unclear, but calculated from 2400 to 5976; market share 75.7 percent);
- Rochester (HHI 5378; market share 71.3 percent);
- Syracuse-Utica (HHI 4783; market share 68.4 percent);
- Binghamton-Elmira (HHI 3401; market share 50.2 percent).

<sup>201</sup> *Id.* at 62,669-71. The particular statistics the Commission relied on to find a lack of significant market power in the BEA markets were:

- Pittsburgh (HHI 2102; market share 43.7 percent);
- Indianapolis (HHI unclear, but calculated from 1400 to 4678; market share 2 percent);
- Detroit (HHI unclear, but calculated from 1600 to 2252; market share 38.5 percent);
- Columbus (HHI 3051; market share 28.5 percent).

<sup>202</sup> *Id.* at 62,670-71.

Form of Lighthanded Regulation. After making its determination on Buckeye's market power in its various markets, the Commission adopted Buckeye's proposal for lighthanded regulation. In markets where Buckeye lacked market power, the Commission allowed Buckeye to charge rates it could negotiate in the market, but provided price caps and monitoring requirements.<sup>203</sup> This is the only proceeding to date where the Commission has conditioned its allowance of market-based rates with price caps or monitoring requirements. The Commission remanded the proceeding to the judge to determine the just and reasonable baseline rate in markets where Buckeye had significant market power.<sup>204</sup>

#### 4. Opinion No. 360-A Adheres to Case-by-Case, Multi-Factored Analysis

In requesting rehearing of Opinion No. 360, the Association of Oil Pipe Lines urged the Commission to determine that some of its findings in *Buckeye* would apply in a broad fashion to future requests by oil pipelines for market-based rate treatment.<sup>205</sup> For instance, the Association of Oil Pipe Lines requested that the Commission establish a rebuttable presumption that the product and geographic market definitions adopted in *Buckeye* would be utilized in future market power determinations.<sup>206</sup> The Commission held that it would continue the case-by-case approach, at least until it gained more experience with oil pipeline market-based rate determinations.<sup>207</sup> The Commission has continued to adhere to its methodology for defining the product market in any event, however, and has adopted a rebuttable presumption in favor of the use of BEAs as the geographic market.

The Association of Oil Pipe Lines also requested that the Commission make a broad recognition that competition could serve as the principal restraint on prices in the oil pipeline industry.<sup>208</sup> It contended there was overwhelming evidence of competition in the oil pipeline industry as a whole which would support a rebuttable presumption that competition could serve as the principal regulation of oil pipeline rates.<sup>209</sup> The Commission noted that this would require

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<sup>203</sup> In markets where Buckeye did not have market power, it was subject to a 15 percent real price increase cap over every two year period (which was the same threshold adopted as the definition of market power). *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,675, 62,680-81. It was also required to provide justification for certain increases below the cap in those markets. *Id.* In markets where Buckeye did have significant market power it was required to decrease its rates when there was "any average decrease in rates" in markets where it did not have significant market power. *Id.* at 62,682-83. And if Buckeye's rates in markets where it did not have significant market power increased on average by some percentage, it would be permitted to increase rates in markets where it did have significant market power by that average percentage increase. *Id.* The Commission also required Buckeye to submit annual reports detailing price and revenue changes to monitor Buckeye's market power, and the lighthanded regulation was accepted for a limited three-year time frame. *Id.* at 62,684-85. Subsequently, the Commission discontinued Buckeye's experimental market-based rate program, but for those markets that were found competitive in Opinion No. 360, Buckeye was permitted to maintain market-based rates in those markets without requalifying. *Buckeye Pipe Line Co., L.P.*, 142 FERC ¶ 61,140, at P 13 (2013). Buckeye has since applied for market-based rates in the New York City market, which the Commission set for hearing. *Buckeye Pipeline Co., L.P.*, 142 FERC ¶ 61,162 (2013).

<sup>204</sup> *Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,685.

<sup>205</sup> *Buckeye*, Opinion No. 360-A, 55 FERC ¶ 61,084 at 61,260.

<sup>206</sup> *Id.*

<sup>207</sup> *Id.* The Commission also declined a similar request to adopt threshold HHI numbers which would serve as an irrebuttable presumption of a lack of market power. *Id.* at 61,261.

<sup>208</sup> *Id.*

<sup>209</sup> *Buckeye*, Opinion No. 360-A, 55 FERC ¶ 61,084 at 61,261.

a party requesting a traditional cost based approach to bear the burden of proof, rather than the pipeline bearing the burden of demonstrating that some lighthanded regulatory approach should be used.<sup>210</sup> The Commission declined the request, recognizing that *Farmers II* rejected the reliance on presumed market forces to serve as the principal regulatory constraint on oil pipeline rates.<sup>211</sup>

Market Concentration and HHI. The Commission clarified in Opinion No. 360-A at the Association of Oil Pipe Lines' request that in future oil pipeline market analyses, "data other than delivery data (such as pipeline capacity) may be used as a basis for calculating HHIs," and that pipelines "are free to propose using delivery data or any other appropriate data for the purposes of calculating HHIs."<sup>212</sup> In subsequent proceedings, the Commission would allow capacity based data and would require its use to calculate market concentration if delivery based data was used to calculate market share.<sup>213</sup> In addition, the practice would develop among the participants in these proceedings to provide multiple capacity and delivery based calculations for market share and market concentration.

**B. *Opinion Nos. 391 and 391-A in Williams Pipe Line Company Proceeding Utilizes Buckeye Market Power Analysis***

The market power analysis pioneered in *Buckeye* was followed by the Commission, with some variations, in the second market power case decided on the merits. The Commission again utilized the basic methodology outlined in *Buckeye* of defining the product and geographic markets, and then analyzing particular factors to assess market power in those defined markets. In this matter, the participants contested what alternative sources of transportation should be included in the pipeline's geographic market in an attempt to either increase or dilute the market power statistics. This would be a recurring theme in subsequent cases. The Commission held cost data that compared the pipeline with proposed alternative sources of transportation was highly relevant to assessing the cost viability of potential competitors and whether those competitors should be included in the market power statistics. In subsequent proceedings, the Commission would make this cost comparison data mandatory in certain circumstances, but ultimately limit when those circumstances would arise to the analysis of a proposed alternative that was unused in a market not facing capacity constraints.<sup>214</sup>

The Commission also evaluated again in this proceeding what factors it would consider in assessing market power in the pipeline's markets, how it would define those factors, and how those factors would be calculated. The participants attempted to test the boundaries of what factors could be considered in determining market power. For example, the participants requested that the Commission consider certain new factors that were contended to be indicative, or not, of market power. These included exchanges, the presence of vertically integrated conglomerate competitors, and low profitability. Generally, the Commission accorded little, if any, weight to these factors. Instead, the Commission relied on the factors it had identified in

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<sup>210</sup> *Id.*

<sup>211</sup> *Id.* at 61,260-61 (citing *Farmers II*, 734 F.2d at 1530).

<sup>212</sup> *Id.*

<sup>213</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192.

<sup>214</sup> See *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 53-56, 68-70.

*Buckeye* to analyze the pipeline's market power in its defined markets. The Commission's determinations regarding what HHI and market share statistics would cause it to find market power would serve as a benchmark for later proceedings.

1. *Opinion No. 391 Builds on the Buckeye Market Power Analysis*

The Williams Pipe Line Company filed an application for market-based rates in conformance with the procedure adopted in *Buckeye*.<sup>215</sup> The judge determined that Williams had made the required showing that it lacked market power in twenty-two of its markets, but failed to satisfy its burden in its remaining ten markets.<sup>216</sup>

Ability to Sustain Price Increase as Threshold for Market Power. Upon exceptions, the Commission first addressed whether its definition of market power, i.e., the ability to profitably sustain a price increase over a significant period of time, should be reduced to a specific number and used as a threshold for determining market power.<sup>217</sup> Williams and several intervenors asserted that a 15 percent price increase above the pipeline's transportation rate, similar to the percentage used in *Buckeye*, should be used as a threshold benchmark of a pipeline's market power.<sup>218</sup> Trial Staff asserted that Williams had failed in its burden of proof to justify a particular benchmark because it only presented evidence on the inability to raise rates by this threshold in a few of its markets.<sup>219</sup> The judge agreed, holding that a 15 percent price increase threshold had been studied for only three of Williams' relevant markets, and therefore, had not been sufficiently tested in the record.<sup>220</sup> Further, neither the DOJ Merger Guidelines nor the Oil Pipeline Deregulation Study had applied a particular numerical test.<sup>221</sup> And, the 15 percent definition of market power used in *Buckeye* cited by the Commission as "adequate" did not mandate that specific percentage in subsequent cases.<sup>222</sup>

The Commission upheld the reasoning of the judge.<sup>223</sup> In addition, the Commission determined that the use of a specific rate increase as a threshold benchmark of market power was inappropriate. The Commission determined that the ability to sustain a rate increase does not *per se* indicate market power, "any more than the existence of competition prevents a rate increase."<sup>224</sup> The Commission also noted that the DOJ Merger Guidelines do not require a specifically quantified price increase threshold in a market power analysis.<sup>225</sup> The guidelines note that a test to measure whether a pipeline can profitably maintain prices above competitive levels for a significant period of time (often referred to as a SSNIP test) is only a "methodological tool" and that "mechanical application...may provide misleading answers to the

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<sup>215</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,655.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.* at 61,657-59.

<sup>218</sup> *Id.* at 61,657.

<sup>219</sup> *Id.* at 61,658.

<sup>220</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,657.

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *Id.* at 61,658-59.

<sup>224</sup> *Id.* at 61,658.

<sup>225</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,659.

economic questions.”<sup>226</sup> Instead of a mechanical application of a threshold price increase, “a great deal of judgment is involved in order to examine and weigh all factors....”<sup>227</sup> Therefore, the Commission concluded that the judge “properly relied more on the presence or absence of competition in a given market as an indicator of the ability to sustain a rate increase in that market.”<sup>228</sup>

In later proceedings as noted above in the discussion of *Buckeye*, the Commission has used a 15 percent threshold price increase in the transportation component of the competitive rate as the range to determine if proposed alternative sources of transportation are cost competitive.<sup>229</sup>

Geographic Market. The Commission considered in Opinion No. 391 whether the appropriate geographic markets should be origin and destination pairs that the pipeline served, often described as corridors, or, as in the *Buckeye* case, destination markets.<sup>230</sup> The Commission would have to address this issue in later proceedings as well. Intervenor Texaco contended that corridors should be the relevant geographic markets because the rates for oil pipeline transportation are stated in terms of receipt points and delivery points.<sup>231</sup> Further, even if a destination market has unused capacity, that is irrelevant to a shipper who has only one option to ship from its origin to a particular destination.<sup>232</sup> Williams, the Association of Oil Pipelines, and Trial Staff supported the use of BEA destination markets.<sup>233</sup> Staff contended that the use of corridors would result in the analysis of “literally...thousands of corridors.”<sup>234</sup>

The Commission rejected the request to adopt origin and destination corridors as the relevant geographic markets. The Commission reasoned that the real economic concern of shippers was not whether its petroleum products traveled between specific locations via pipeline, but the delivered price of the product in the destination market.<sup>235</sup> Further, focusing on pipeline corridors would eliminate competitive suppliers that did not provide services over the particular corridor, but still supplied product to destination markets.<sup>236</sup> The Commission ultimately held, consistent with *Buckeye*, that the geographic markets were the pipeline’s destination BEAs, although the Commission qualified this determination as “limited to this case.”<sup>237</sup>

Alternative Sources of Transportation. The Commission was also confronted with an issue it would have to address numerous times in later proceedings, i.e., what alternative supply sources should be considered in calculating the market power statistics. In this proceeding, the Commission addressed the extent to which barges, refineries, trucking capacity, private

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<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> *Id.* at 61,658.

<sup>229</sup> *See Mobil*, 133 FERC ¶ 61,192 at P 24.

<sup>230</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,660-61.

<sup>231</sup> *Id.* at 61,660.

<sup>232</sup> *Id.*

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

<sup>235</sup> *Id.* at 61,660-61.

<sup>236</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,661.

<sup>237</sup> *Id.*

pipelines, and pipelines running through the market but without terminals could be considered. The Commission agreed that private pipelines should be considered because “the ultimate customers in destination markets have the option of purchasing product that is delivered from these pipelines.”<sup>238</sup> Pipelines without terminals in the market should be considered where construction of a terminal could likely “occur with economic success.”<sup>239</sup> The Commission recognized that the requirement to show “economic success” was “somewhat inexact.”<sup>240</sup> But, it found it was appropriate, and cited the DOJ’s Merger Guidelines for factors to consider in making the assessment (e.g., timeliness, likelihood, magnitude of the entry, and character and scope of the entry).<sup>241</sup>

The Commission accepted the judge’s determinations to include barges and refineries in the calculation of market share and HHI to the extent those sources could serve a particular market.<sup>242</sup> For truck-delivered capacity, the judge determined it should be included to the extent trucks can effectively carry products into the BEA, and found trucks were only cost-competitive at a range of 65 to 70 miles.<sup>243</sup> The Commission rejected a specific mechanical mileage limit.<sup>244</sup> Like barges and refineries the Commission found that truck-delivered capacity should be included to the extent the evidence established they could actually serve the particular market in question.<sup>245</sup> The Commission found that including or excluding external sources from a BEA based on a mechanical mileage limit failed to take into consideration the actual economic ability to compete in a particular BEA or serve the major population centers in a BEA.<sup>246</sup> The Commission found that in the case of some of the larger BEAs, “truck hauls of approximately 100 miles from the BEAs may constitute viable competition in certain instances.”<sup>247</sup>

Market Concentration and HHI. The Commission in Opinion No. 391 presented a detailed analysis of the components of HHI and its application as a threshold screening device. The judge adopted an initial HHI screen of 2500, finding that markets above 2500 were likely uncompetitive and subjecting more careful scrutiny to markets with HHIs less than 2500.<sup>248</sup> The Commission found that “the ALJ’s decision to use an HHI value of 2500 as an initial screen to be adequate in this case in light of his examination of other factors.”<sup>249</sup> The Commission emphasized, however, that it had carefully scrutinized all contested markets regardless of the initial HHI. “[C]hoosing any single HHI value as a threshold for screening markets is much less important than carefully weighing...all relevant factors that might contribute to or detract from market power.”<sup>250</sup> Therefore, the Commission accepted the 2500 HHI screen as a concept to organize the inquiry into different markets, but subjected all the contested markets to a thorough evaluation of all relevant factors, including HHI. This would be important for the ultimate

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<sup>238</sup> *Id.* at 61,667.

<sup>239</sup> *Id.*

<sup>240</sup> *Id.* at 61,667.

<sup>241</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,667.

<sup>242</sup> *Id.* at 61,667-68.

<sup>243</sup> *Id.* at 61,668-69.

<sup>244</sup> *Id.* at 61,669-70.

<sup>245</sup> *Id.*

<sup>246</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,669-70.

<sup>247</sup> *Id.* at 61,676.

<sup>248</sup> *Id.* at 61,661-63, 61,675-76.

<sup>249</sup> *Id.* at 61,663.

<sup>250</sup> *Id.* at 61,676.

determination and reflective of the process in later cases, as the Commission recalculated the HHI in numerous markets after concluding that certain alternative sources of transportation should, or should not, be included in the calculation.

The Commission then analyzed the proper calculation of HHIs, including whether the market share used in calculating HHIs should be based on delivery or capacity data. The judge determined that transportation capacity would serve as the basis for calculating market shares, as opposed to the actual deliveries by the relevant participants into the market as was done in *Buckeye*.<sup>251</sup> The judge based his decision on the availability of capacity data and the absence of complete delivery data.<sup>252</sup> Further, the judge cited the lack of an absolute policy of requiring delivery based market shares in *Buckeye*.<sup>253</sup> Acknowledging the “inherent imprecision” in using capacity data because it may be significantly higher than actual demand within a market, the judge “stated that such data could be modified to conform to known consumption....”<sup>254</sup>

The Commission agreed, finding that even though the use of capacity data could result in imprecision “a market power analysis in general is not an exact calculation....”<sup>255</sup> The Commission also found support from the DOJ Merger Guidelines’ reliance on capacity shares when the product is homogenous. The rationale articulated was that market shares based on actual deliveries is more appropriate when firms’ products are chosen based on their differentiated characteristics, but when products are similar, the ability to supply capacity most effectively distinguishes between firms.<sup>256</sup>

The Commission also affirmed the judge regarding the proper method to calculate capacity in determining market share in HHIs. The shippers requested the use of total physical capacity of all internal sources, while the pipeline requested the inclusion of certain external sources to the BEAs and trimmed down certain market participants’ capacity to reflect their shares of actual consumption.<sup>257</sup> The Commission and the judge accepted the testimony of the Trial Staff witness that proposed a middle ground of “effective” capacity, which used the capacity of the participant source or total consumption, whichever was smaller, as that participant’s capacity number to be used to determine the market power statistics.<sup>258</sup> This finding would serve as the basis for the Commission’s effective capacity method for calculating capacity based market share and HHI statistics in later proceedings.

Interestingly, the judge decided, and no one contested, that actual deliveries by the applicant pipeline and alternative sources was the appropriate way to determine market share when considered as a standalone factor, even though capacity was used to calculate market share when determining the HHI.<sup>259</sup> The judge found that this variation was a good check and balance

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<sup>251</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,663.

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> *Id.* at 61,664.

<sup>256</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,665.

<sup>257</sup> *Id.* at 61,671.

<sup>258</sup> *Id.* at 61,665-66, 61,665 n.57.

<sup>259</sup> *Id.* at 61,671.

on the use of capacity data in the calculation of market share in determining HHI.<sup>260</sup> In effect, this ensures that capacity data, which may not account for actual demand in a market, and delivery data, which may not account for the ability to increase supply in response to an increase in price, will both be included in the market power statistics in some form. This check and balance between capacity and delivery data in calculating market share for HHI and as a stand-alone metric would later be adopted by the Commission.<sup>261</sup>

Exchanges. Moving from HHIs, the Commission also accepted the judge's refusal to accord much weight to exchanges. Exchanges are not new barrels of petroleum product, but merely the transfer of ownership of the product at a specific location.<sup>262</sup> Noting that the capacity for exchanges was included in the capacity based market share calculation of HHIs, the Commission found "[t]he potential for double counting exists where the capacity is included in the HHI and then the exchange which utilizes that capacity is again...considered a mitigating factor."<sup>263</sup>

Presence of Vertically Integrated Conglomerates as Competition. Williams also contended that the presence of large vertically integrated companies with pipeline affiliates within its markets justified a finding of a lack of market power.<sup>264</sup> Williams contended these companies enjoyed an inherent competitive advantage by being able to transport refined products at cost. The Commission rejected the contention that this factor alone justified a finding of a lack of market power because it was unsupported in the record.<sup>265</sup>

Low Profitability. Likewise, the Commission was not convinced that Williams' "low profitability" was indicative of a lack of market power.<sup>266</sup> The Commission did not discuss this contention in detail, except to provide that "[t]he mere fact that evidence of supra normal or unreasonably high profits is relevant to determining the existence of market power does not mean that a firm's failure to earn its allowed rate of return proves it lacks market power."<sup>267</sup>

Excess Capacity. Finally, the Commission found that the importance of excess capacity lies not in a particular mathematical number, but in its relative magnitude in comparison to other BEAs. Williams contended that excess capacity should be measured by some absolute numerical threshold, not in terms of the excess capacity number in relation or comparison to other markets.<sup>268</sup> Williams also contended excess capacity should have been given more weight in the analysis.<sup>269</sup> Intervenor Total and Trial Staff asserted that the judge gave more than adequate weight to excess capacity.<sup>270</sup> In addition, Total contended that Williams' excess capacity calculation was flawed because it had failed to subtract capacity that was committed to other

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<sup>260</sup> *Id.*

<sup>261</sup> *See* Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192; 18 C.F.R. § 348.1(c)(7).

<sup>262</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,673.

<sup>263</sup> *Id.* at 61,672-73.

<sup>264</sup> *Id.* at 61,674.

<sup>265</sup> *Id.*

<sup>266</sup> *Id.* at 61,675.

<sup>267</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,675.

<sup>268</sup> *Id.* at 61,674.

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*

BEAs along its pipeline route.<sup>271</sup> Instead, Williams assumed its full pipeline capacity was available to serve each BEA it traversed.<sup>272</sup>

The Commission found that when analyzing excess capacity it should be adjusted to take into account deliveries committed to other markets.<sup>273</sup> In addition, simple statistical comparisons between markets based on physical capacity was insufficient to understand the impact of excess capacity because of the distinction between physical capacity availability and the potential to increase market deliveries.<sup>274</sup> This is because the ability to increase market deliveries is also related to price fluctuations and other economic factors.<sup>275</sup> Therefore, the Commission directed a comparative analysis of excess capacity that relied on judgment, not straight statistical comparisons.<sup>276</sup> The Commission determined that the judge had properly carried out that analysis.<sup>277</sup>

Analysis of Particular Markets. In Opinion No. 391, the Commission found that of Williams' thirty-two markets it lacked market power in thirteen and had market power in nineteen.<sup>278</sup> In reversing the judge and finding market power, the Commission generally found that the inclusion of certain external sources in the market share and HHI calculations was improper. The Commission would then recalculate the HHIs and market share excluding the improper external sources, and find them excessive without offsetting circumstances. For example, in the Eau Claire BEA, the Commission eliminated two external sources, which based on the record were too far from the BEA (196 miles) or had no viable terminals to serve the market.<sup>279</sup> The recalculated HHI of 3000 coupled with a 59 percent delivery based market share indicated market power, and finding no offsetting circumstances in the record, concluded Williams failed in its burden to show a lack of market power.<sup>280</sup>

Similarly, in sustaining the judge's determinations that Williams had market power, the Commission typically found market shares close to 50 percent and HHIs above 2500. The Commission rejected Williams' contentions that certain alternative supplies were sufficient to offset those market power statistics. The Commission reasoned that those alternative supplies were either properly excluded because they were too far from the BEA to serve as viable alternatives, or were already included in the HHI and market share calculations.<sup>281</sup> In the Duluth BEA for example, Williams contended that certain internal and external alternative transportation sources were evidence of its lack of market power. The Commission determined that Williams' proposed alternatives were insufficient to offset its 60 percent market share and

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<sup>271</sup> *Id.*

<sup>272</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,674.

<sup>273</sup> *Id.*

<sup>274</sup> *Id.*

<sup>275</sup> *Id.*

<sup>276</sup> *Id.*

<sup>277</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,674.

<sup>278</sup> *Id.* at 61,675-86.

<sup>279</sup> *Id.* at 61,679.

<sup>280</sup> *Id.* at 61,679.

<sup>281</sup> *Id.* at 61,682-85.

HHI of 2500 given that those alternatives were already factored into the market share and HHI calculations.<sup>282</sup>

In sustaining the judge's determinations of a lack of market power, the Commission generally found that the external sources included were appropriate, HHIs below or near 2500, and market shares less than 50 percent. For example, in the Minneapolis/St. Paul BEA, the shippers contested the inclusion of certain external sources in the market share and HHI calculations.<sup>283</sup> The Commission found they were properly included and coupled with a market share of 35 percent and the presence of viable competitors, the Commission found Williams lacked market power even with an HHI over 2500.<sup>284</sup>

Therefore, generally, the Commission found that an HHI over 2500, a market share of close to 50 percent, or some combination thereof, without mitigating circumstances, was sufficient evidence to establish market power.<sup>285</sup> However, as noted above, the Commission found Williams lacked market power in the Minneapolis/St. Paul BEA even where the HHI was

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<sup>282</sup> *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,683.

<sup>283</sup> *Id.* at 61,682.

<sup>284</sup> *Id.*

<sup>285</sup> Viewed from a purely market share and market concentration perspective, the Commission found that Williams had significant market power in the following BEA markets:

- Topeka (HHI 3333; market share 46 percent);
- Duluth (HHI above 2500; 60 percent market share);
- Rochester (HHI above 2500; 60 percent market share);
- Sioux City (HHI above 2500; market share 51 percent);
- Omaha (HHI 2786; market share 46 percent);
- Grand Island (HHI above 2500; market share 62 percent);
- Sioux Falls (HHI above 2500; market share 49 percent);
- Aberdeen (HHI above 2500; market share 49 percent);
- Quincy (HHI 2026; market share 74 percent);
- Cedar Rapids, Waterloo, and Ft. Dodge (HHIs between 1800 and 2500; market shares 81 percent, 99 percent, and 98 percent, respectively);
- Springfield (HHI over 3000; market share 38 percent);
- Eau Claire (HHI over 3000; market share 59 percent);
- Des Moines (HHI over 2500; market share 78 percent);
- Kansas City (HHI over 2500; market share 63 percent);
- Lincoln (HHI over 3000; market share 65 percent);
- Fargo (HHI over 3000; market share 51 percent);
- Grand Forks (HHI over 3000; market share of 56 percent).

*Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,682-86. Viewed from a purely market share and market concentration perspective, the Commission found that Williams lacked significant market power in the following BEA markets:

- Minneapolis/St. Paul (HHI over 2500; market share of 35 percent);
- Wausau (HHI of 1801; market share of 37 percent);
- Dubuque (HHI of 2381; market share of 39 percent);
- Davenport (HHI of 2048; market share of 34 percent);
- Columbia (HHI of 1738; market share of 49 percent).

*Id.* at 61,677-78, 61,682.

over 2500 because of the presence of other mitigating factors, including a market share of 35 percent.

Form of Lighthanded Regulation. With respect to the form of lighthanded regulation permitted in the thirteen markets where Williams lacked market power, the Commission left the rates in those markets free from any ongoing rate constraint.<sup>286</sup> In contrast to *Buckeye*, no price caps or monitoring requirements were imposed on Williams in those markets. The Commission remanded the issue of the appropriate base rates for the remaining nineteen uncompetitive markets.<sup>287</sup>

## 2. Opinion No. 391-A Further Clarifies and Modifies the Market Power Analysis

Upon rehearing, Williams and several intervenors urged the Commission to reconsider certain markets, primarily contending that various alternative transportation sources should be included or excluded from the analysis, which would subsequently change the HHI and market share calculations. The Commission made several important findings on the appropriate market power analysis, particularly in regards to the evidence that would support alternative sources of transportation. The Commission's reliance on detailed cost data to justify alternative sources of transportation would later lead to a requirement for such data in certain limited circumstances.

Market Concentration and HHI. Again, parties requested that the Commission set certain HHI numbers as a threshold for a lack of market power. In this case, Williams requested a holding that an HHI of 1800 should serve as irrefutable evidence of a lack of market power.<sup>288</sup> Again, the Commission declined for the time being.<sup>289</sup>

Exchanges. On rehearing, the Commission put to rest that exchanges, which are transfers of ownership of oil or a refined petroleum product at a specific location, are entitled to little weight in the market power analysis. Specifically, the Commission stated that “[w]hile exchanges may obviate the use of specific pipeline corridors between two markets, they do not obviate the need for ultimate delivery into [a market].”<sup>290</sup> Further, the Commission stated that the consideration of exchanges as a mechanism to combat market power is the equivalent of “double counting” because the use of supply capacity to calculate HHI already considers the alternative sources of delivery into a market, including exchanges.<sup>291</sup>

Ability to Sustain Price Increase as Threshold for Market Power. Intervenor, Texaco, also requested rehearing regarding the Columbia BEA based upon Williams' 49 percent market share and evidence that Williams had recently raised the rates within this market by 44 percent.<sup>292</sup> Again, the Commission found that significant price increases alone are not indicative of market power.<sup>293</sup> “The existence of competition does not automatically imply an inability to

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<sup>286</sup> *Id.* at 61,695-96.

<sup>287</sup> *Id.*

<sup>288</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,127.

<sup>289</sup> *Id.* at 62,128.

<sup>290</sup> *Id.* at 62,129.

<sup>291</sup> *Id.*

<sup>292</sup> *Id.* at 62,144.

<sup>293</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,145.

raise rates or even that low rates should prevail. The existence of competition means that price increases above efficient, market-driven equilibrium prices will not be sustainable for any length of time.”<sup>294</sup> The Commission found that Texaco had failed to proffer evidence to show that the price increases were evidence of a lack of competition.<sup>295</sup> For example, Texaco neglected to discuss a price freeze that occurred on the pipeline and its relation to the recent increase in price.<sup>296</sup> Importantly, Texaco failed to compare Williams’ rates with other alternatives in the market.<sup>297</sup> Absent any showing the price increase was indicative of market power or incongruent with competitors’ prices, the Commission declined to grant rehearing.<sup>298</sup>

Alternative Sources of Transportation and Analysis of Particular Markets. Williams contended that the Commission’s various findings on the viability of truck transportation of petroleum products were overly conservative.<sup>299</sup> Williams submitted surveys of gas station operators, refineries, and truck transportation providers that supported the cost and capacity viability of truck transportation in excess of 100 miles from BEAs.<sup>300</sup> In perhaps its most important finding in Opinion No. 391-A, the Commission granted rehearing on this issue to consider Williams’ evidence on the economic viability of truck transportation where appropriate in the market:

[I]n reassessing the viability of external sources, we have carefully examined the record evidence highlighted by Williams in its rehearing request concerning truck deliveries to the individual BEAs and the relative costs of truck, barge, and alternative pipeline deliveries into these markets. Williams[’] sponsored exhibits... validate its claim that specified external sources competitively serve the individual BEA markets and, thus, should be included in the assessments of those markets. Williams’ exhibits include refinery, truck, and gas station surveys that document truck shipments by origin and destination, as well as extensive tables for each BEA that compare transportation costs for Williams with those of a number of internal and external sources. These cost tables provide pipeline tariffs and a consistent reference guide to trucking costs for distances ranging from eight to 425 miles. On rehearing, the Commission is now persuaded that these comparative cost tables provide a sound basis on which to evaluate the ability of external sources to serve a market competitively, as the comparative costs are highly relevant in determining whether a source can represent effective competition.<sup>301</sup>

In utilizing the data on cost competitiveness of truck transportation, the Commission reassessed Williams’ market power in several markets. For example, in Opinion No. 391, the Commission had excluded alternate sources from consideration that were in excess of 100 miles from the Kansas City BEA, recalculated the HHI and market shares for that region, and

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<sup>294</sup> *Id.*

<sup>295</sup> *Id.*

<sup>296</sup> *Id.*

<sup>297</sup> *Id.*

<sup>298</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,145.

<sup>299</sup> *Id.* at 62,123.

<sup>300</sup> *Id.*

<sup>301</sup> *Id.* at 62,124.

concluded Williams had market power.<sup>302</sup> Upon rehearing in Opinion No. 391-A, the Commission included a refinery and pipeline terminal as external sources that were more than 100 miles from the BEA on the basis that truck transportation from these sources to the BEA was economically viable pursuant to Williams' cost and delivery surveys.<sup>303</sup> The Commission recalculated the HHI to be 2400 and Williams' market share to be 36 percent.<sup>304</sup> Based on these figures, the Commission found that Williams demonstrated its lack of market power in the Kansas City BEA.<sup>305</sup> This reliance on cost comparison data to justify alternative sources of transportation in excess of the BEA would later become a requirement in specified circumstances.<sup>306</sup>

In the Commission's revaluation of the Quincy BEA, it found that a presumption of competitiveness arises from the presence of a waterborne transportation alternative that is significant, accounting for at least 10 percent of deliveries, and expandable. Williams contended in its request for rehearing that the Commission erred in not recognizing the strong competitive effects of barge facilities located in the center of the BEA.<sup>307</sup> The Commission noted that the DOJ report on Oil Pipeline Deregulation determined that "the existence of waterborne traffic, coupled with expandable capacity for waterborne deliveries, makes an oil market competitive."<sup>308</sup> The Commission adopted a modified presumption advanced by Trial Staff. "The staff in the past has suggested a more conservative approach, holding that expandable waterborne capacity, coupled with waterborne deliveries that account for at least 10 percent of total deliveries into a market, create a presumption of competition in that market. We will adopt this more conservative approach."<sup>309</sup> The Commission found that "barge deliveries into this BEA account for some 28 percent of total deliveries."<sup>310</sup> "Accordingly, because the conditions in the Quincy market satisfy [the] presumption, we find that Williams does not have significant market power in this market...[d]espite the seemingly high HHI for this BEA [of 3100]..."<sup>311</sup>

While declining to establish particular thresholds or benchmarks of market power, the Commission generally found in analyzing particular markets that an HHI above 2500, or the combination of an HHI of 2500 with a market share nearing 50 percent, without mitigating circumstances, was sufficient evidence to establish market power.<sup>312</sup> The market share and

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<sup>302</sup> *Id.* at 62,134-35.

<sup>303</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,135.

<sup>304</sup> *Id.* at 62,134-35.

<sup>305</sup> *Id.*

<sup>306</sup> *See TE Products*, 92 FERC ¶ 61,121 at 61,465-67; *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 53-56, 68-70.

<sup>307</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,137.

<sup>308</sup> *Id.* at 62,137-38, 62,138 n.71.

<sup>309</sup> *Id.* at 62,138.

<sup>310</sup> *Id.* at 62,137.

<sup>311</sup> *Id.* at 62,138.

<sup>312</sup> *Williams*, Opinion No. 391-A, 71 FERC ¶ 61,291 at 62,138-39, 62,143-44. From a purely market share and market concentration perspective, the Commission found Williams had significant market power in the following BEA markets:

- Des Moines (HHI of 2897; recalculated market share unclear);
- Grand Forks (HHI of 3500; recalculated market share unclear).

market concentration statistics found indicative of market power in the Williams proceeding would later be cited with approval by the Commission in numerous matters.<sup>313</sup> The Commission also made a significant finding that alternative sources of transportation outside the BEA should be included where it was shown that they are cost competitive through studies on truck transportation from those sources to the BEA. In addition, the Commission created a presumption that a market is competitive if there is a significant and expandable waterborne source of competition.

**C. Energy Policy Act of 1992 and Rulemaking Order No. 572 on Oil Pipeline Market-Based Rates**

In the Energy Policy Act of 1992, Congress ordered the Commission to formulate a “simplified and generally applicable ratemaking methodology for oil pipelines” and a “final rule to streamline procedures...relating to oil pipeline rates in order to avoid unnecessary regulatory costs and delays.”<sup>314</sup> The legislative history demonstrates that Congress intended to remedy perceived problems it felt characterized the methodology and procedure of oil pipeline ratemaking.<sup>315</sup> In response, the Commission issued a series of three related rulemaking proceedings, the principal provisions of which took effect on January 1, 1995.<sup>316</sup>

In Order No. 572, the Commission permitted the continued use of market-based rates on a case-by-case basis and set forth the procedure and filing requirements for a pipeline requesting market-based rates. The Commission adhered to its approach of defining the product and geographic markets, and then analyzing a number of factors to assess the pipeline’s market power in those defined markets. The Commission did not alter in Order No. 572 the substantive findings on its market power analysis developed in the *Buckeye* and *Williams* proceedings, except notably where it added the requirement that the applicant pipeline define and establish a lack of market power in its geographic origin markets in addition to its destination markets.

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From a purely market share and market concentration perspective, the Commission found Williams lacked significant market power in the following BEA markets:

- Springfield (HHI of 1800; market share of 38 percent);
- Kansas City (HHI of 2400; market share of 36 percent);
- Lincoln (HHI of 1542; recalculated market share unclear);
- Quincy (HHI of 3100; recalculated market share unclear; significant and expandable waterborne presumption applicable);
- Omaha (HHI of 2300; recalculated market share unclear);
- Eau Claire (HHI of 2500; recalculated market share unclear);
- Fargo (HHI of 2500; recalculated market share unclear);
- Columbia (HHI of 1800; market share 49 percent).

*Id.* at 62,133-45.

<sup>313</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).

<sup>314</sup> Pub. L. No. 102-486, 106 Stat. 2776, 3010 (1992), reprinted in 42 U.S.C. § 7172 note.

<sup>315</sup> See Steven Reed & Pantelis Michalopoulos, *Oil Pipeline Regulatory Reform; Still in the Labyrinth?*, 16 ENERGY L.J. at 74 (citing 138 CONG. REC. H3489 (daily ed. May 20, 1992) (statement of Rep. Brewster)).

<sup>316</sup> As with the EPAct, the new rules do not apply to the Trans Alaska Pipeline System (TAPS) or any pipeline that delivers oil into TAPS. See Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,961.

1. Order No. 561 Establishes Indexing as the Generally Applicable Ratemaking Tool and Order No. 571 Permits Cost-of-Service Rates in Defined Circumstances

First, in Order No. 561, the Commission enshrined an indexing mechanism as the generally applicable oil pipeline ratemaking tool.<sup>317</sup> In summary, the Commission determined that for existing pipelines the percentage movements of an automatic index (the Producer Price Index—Finished Goods, minus 1 percent, which was subsequently increased) would serve as a cap on individual pipeline rates for particular transportation movements.<sup>318</sup> The initial ceiling applicable to each pipeline rate would be set at the level of the pipeline’s rate on December 31, 1994 (as adjusted by the index published by the Commission in May 1994).<sup>319</sup> This ceiling rate then rises and falls annually by the percentage change in the index.<sup>320</sup> Having determined the cap, the pipeline may, but is not compelled to, raise its rates up to the ceiling rate applicable to that index year.<sup>321</sup> If, on the other hand, the index decreases, and the rate exceeds the new ceiling as a result, the pipeline must decrease its rate to the new ceiling.<sup>322</sup> Order No. 561 provided that the initial rate for new pipeline services (subsequently subject to the index cap) is to be set either by filing a cost of service submission, or by filing a rate with the support of one non-affiliated shipper (subject to being supported by cost of service submissions should protests be filed).<sup>323</sup>

The principal effect of indexing is to preserve the value of existing rates in real (i.e. inflation-adjusted) terms.<sup>324</sup> The perceived benefits of the indexing system are simplicity, increased incentives for efficiency, protection of shippers against rate increases in excess of inflation,<sup>325</sup> the ability to “change rates rapidly to respond to competitive forces,” and the reduction in the “time and expense traditionally associated with filing rate cases.”<sup>326</sup>

In a separate rulemaking proceeding, Order No. 571 established that cost-of-service rate filings would remain relevant outside of setting the initial rate, but only as an alternative to indexing and only under certain defined circumstances.<sup>327</sup> An oil pipeline may charge rates through cost-of-service filings if it demonstrates “that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index” such that the index ceiling rate would be unjust and unreasonable.<sup>328</sup> Likewise, a shipper can

<sup>317</sup> The provisions of Order No. 561 discussed herein were memorialized in 18 C.F.R. §§ 342.0-342.4, 343.0-343.5.

<sup>318</sup> Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,952; 18 C.F.R. § 342.3. However, the Commission also instituted a five-year review process: every five years the Commission will review the selection of the index and re-assess how well it has tracked industry costs, as evidenced from Form 6 data. Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,952. Subsequently, the index has been changed by rulemaking to the Producer Price Index—Finished Goods, plus 2.65 percent. *Five-Year Review of Oil Pricing Index*, 133 FERC ¶ 61,228, at P 1 (2010). Therefore, the ceiling rate for each pipeline rises and falls every year in correlation with the percentage increase and decrease in the Producer Price Index for Finished Goods plus 2.65 percent.

<sup>319</sup> Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,953-54.

<sup>320</sup> 18 C.F.R. § 342.3(d).

<sup>321</sup> 18 C.F.R. § 342.3(a).

<sup>322</sup> Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 at 31,099; 18 C.F.R. § 342.3(e).

<sup>323</sup> 18 C.F.R. § 342.2.

<sup>324</sup> Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,950.

<sup>325</sup> *Id.* at 30,948-49.

<sup>326</sup> *Id.* at 30,950-51.

<sup>327</sup> Order No. 571, FERC Stats. & Regs. ¶ 31,006.

<sup>328</sup> 18 C.F.R. § 342.4(a).

challenge rate changes within the index ceiling by raising reasonable grounds that the rates from indexing are substantially in excess of recovering actual costs incurred by the pipeline.<sup>329</sup> Once a party makes the showing entitling it to cost-of-service review, the orders contemplate no substantive change in the Opinion No. 154-B methodology.<sup>330</sup> Therefore, indexed rates are presumptively just and reasonable, and although the presumption can be rebutted in some instances based on cost-of-service data, those instances are narrowly defined.

## 2. Order No. 572 Establishes Filing Requirements and Procedures for Market-Based Rates

Order No. 572 provided that market-based rates would remain an option for oil pipelines. Order No. 572 also outlined the filing requirements for oil pipelines that seek to charge market-based rates and provided procedures applicable to those filings.<sup>331</sup> The order did not alter the substantive analysis of its market power inquiry as developed in the *Buckeye* and *Williams* proceedings discussed above, except in a few limited circumstances. Likewise, contrary to proposals submitted by various commenters, the Commission refrained from endorsing any generally applicable definitions for the product or geographic markets, and again declined to adopt numerical thresholds or benchmarks of market power. Generally applicable definitions of the product and geographic markets and numerical benchmarks of market power would come through the adjudicatory process. Primarily, Order No. 572 outlined the information a pipeline must submit with its application for market-based rates—information which measures the pipeline’s market power in its relevant markets.

First, the Commission explained why market-based ratemaking is needed. The Commission noted that market-based ratemaking comports with the “spirit” of the Energy Policy Act “by retaining a light-handed regulatory method to complement the indexing approach adopted as the generally applicable ratemaking methodology.”<sup>332</sup> In addition, market-based ratemaking “will be of use...where the oil pipeline needs the flexibility to...engage in competitive pricing in order to react to changes in market conditions....”<sup>333</sup> Therefore, market-based rates provide an oil pipeline flexibility to change prices in response to market conditions either quicker than or in excess of the rate allowed by indexing. Further, the Commission found that market-based rate pricing would be “both efficient and just and reasonable” because when neither the buyer nor the seller have market power it is rational to assume the terms of their voluntary exchange are reasonable and the seller makes only a normal return on its investment.<sup>334</sup> The Commission also explained that it was not adopting market-based ratemaking as the primary ratemaking methodology because it “is not generally applicable.”<sup>335</sup> Instead, the application of market-based rates is pipeline specific, and as directed in *Farmers II*, “the existence of competition or that a competitive price will be within a just and reasonable range” cannot be presumed or implied.<sup>336</sup>

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<sup>329</sup> 18 C.F.R. § 343.2(c)(1).

<sup>330</sup> See Steven Reed & Pantelis Michalopoulos, *Oil Pipeline Regulatory Reform; Still in the Labyrinth?*, 16 ENERGY L.J. at 84-85.

<sup>331</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007.

<sup>332</sup> *Id.* at 31,179.

<sup>333</sup> *Id.* at 31,179-80.

<sup>334</sup> *Id.* at 31,180.

<sup>335</sup> *Id.* at 31,183.

<sup>336</sup> *Id.*

Next, the Commission explained that it was not yet adopting substantive standards, guidelines, or numerical thresholds to be used in determining whether a pipeline has market power. Several commenters requested that the Commission allow a pipeline to use the relevant BEA as the geographic market without further justification, and define the product market for refined petroleum products as “delivered pipelineable petroleum products.”<sup>337</sup> Commenters also proposed certain HHI and market share numbers that would establish rebuttable or irrebuttable screens of market power.<sup>338</sup> The Commission rejected these requests and proposals. First, there was a lack of consensus from the participants on what those standards and thresholds should be.<sup>339</sup> Second, the Commission believed that it still lacked the necessary experience to adopt specific definitions for the product and geographic markets or adopt thresholds for market power.<sup>340</sup> But, the Commission stated that “as more experience is gained, precedent can serve as well as presumptions to provide guidance.”<sup>341</sup> This would ultimately be the case, as the Commission established in later adjudicatory proceedings a presumption in favor of BEAs as the geographic market for refined petroleum pipelines and indicated certain market power statistics that would cause it to find market power.

Form of Lighthanded Regulation. The Commission proposed in the Notice of Proposed Rulemaking that once a lack of significant market power was established there would be no generic constraints on price levels, over their duration, nor any ongoing mechanism to monitor the rates.<sup>342</sup> Several commenters requested that price caps and term limits be imposed on market-based rates similar to those used in *Buckeye*.<sup>343</sup> The Commission concluded that there was no need to set generic rules constraining price or duration that would apply to all market-based rate proceedings.<sup>344</sup> Instead, all such issues could be considered in the context of individual cases in light of the circumstances in those matters.<sup>345</sup>

The Commission did establish specific filing requirements applicable to requests for market-based rate authority. These specific requirements are set forth in nine required statements detailed below that the pipeline must submit along with its application for market-based rates. “The Commission is requiring the oil pipelines to essentially file the same information as the Commission has analyzed in the past in oil pipeline proceedings with respect to market power determinations.”<sup>346</sup>

Geographic Markets. Statement A requires the pipeline to “describe the geographic markets in which the carrier seeks to establish that it lacks significant market power” and “explain why the carrier’s method for selecting the geographic market is appropriate.”<sup>347</sup> Again,

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<sup>337</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,185-86.

<sup>338</sup> *Id.* at 31,185.

<sup>339</sup> *Id.* at 31,179.

<sup>340</sup> *Id.* at 31,185.

<sup>341</sup> *Id.*

<sup>342</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,186.

<sup>343</sup> *Id.* at 31,186-87.

<sup>344</sup> *Id.* at 31,187.

<sup>345</sup> *Id.*

<sup>346</sup> *Id.*

<sup>347</sup> 18 C.F.R. § 348.1(c)(1).

the Commission did not mandate or presume the use of BEAs as the geographic market, and required that if BEAs are used, the pipeline “must show that each BEA represents an appropriate geographic market.”<sup>348</sup> It also posited that something other than a BEA could be used, such as a “given radius around [an oil pipeline’s] terminals.”<sup>349</sup> The “burden will be on the oil pipeline to explain why its use of BEAs or any other definition of the geographic market is appropriate.”<sup>350</sup>

Of particular note and one of the substantive changes implemented, the Commission added the requirement that the oil pipeline include origin markets in its evidentiary presentation in addition to destination markets. Specifically, “[t]he carrier must include the origin market and the destination market related to the service for which it proposes to charge market-based rates.”<sup>351</sup> “This will provide interested parties with complete information about competition at the supply and delivery ends of the pipeline system.”<sup>352</sup> The Association of Oil Pipelines contested the inclusion of origin markets because analyzing each end of point-to-point service would significantly increase the burden on oil pipelines even though there was little concern of monopsony power in origin markets.<sup>353</sup> The Commission, however, concluded that it was still concerned about the possibility of monopsony power.<sup>354</sup>

In a related finding, the Commission stated that a protestant in response to an application to charge market-based rates could come forward with evidence that a point-to-point corridor approach should be used in a particular case.<sup>355</sup> The Commission did not, however, require the oil pipeline to file a market analysis of each point-to-point corridor at the initial filing stage.<sup>356</sup> In addition, the Commission recognized, as was done in *Williams*, that a point-to-point corridor approach may provide an inaccurate picture of market concentration and could improperly exclude competitive alternatives.<sup>357</sup>

Product Market. Oil pipelines are required in Statement B to “identify the product market or markets for which the carrier seeks to establish that it lacks significant market power.”<sup>358</sup> The Commission reiterated that it was not requiring a specific definition of the product market, but left it to the pipeline to explain and establish the appropriateness of its proposal.<sup>359</sup> At a minimum, however, the Commission required the product market to be distinguished between the transportation of crude oil and the transportation of refined petroleum products.<sup>360</sup> Opening the door to revisit the finding in *Buckeye* and *Williams* that the relevant product market for refined petroleum is all pipelineable petroleum products, the Commission stated that “products transportation could be delineated by type, such as motor gasoline,

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<sup>348</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,188.

<sup>349</sup> *Id.*

<sup>350</sup> *Id.*

<sup>351</sup> 18 C.F.R. § 348.1(c)(1).

<sup>352</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,188.

<sup>353</sup> *Id.*

<sup>354</sup> *Id.* at 31,189.

<sup>355</sup> *Id.* at 31,188.

<sup>356</sup> *Id.*

<sup>357</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,188.

<sup>358</sup> 18 C.F.R. § 348.1(c)(2).

<sup>359</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,189.

<sup>360</sup> *Id.*

distillates, or jet fuel.”<sup>361</sup> Likewise, the Commission offered that “[c]rude oil transportation could further be divided to include transportation of natural gas liquids...” for example.<sup>362</sup>

Description of Facilities and Services. In Statement C, the pipeline “must describe the carrier’s own facilities and services in the relevant markets identified in statements A and B...”<sup>363</sup> The Commission provided that Statement C should include all pertinent data about the pipeline’s facilities and services, and provided a non-exhaustive list of relevant information:

For example, without limitation, the oil pipeline would have to include data on the capacity of its facilities, on its throughput, on its receipts in its origin markets, on its deliveries in its destination markets and to its major consuming markets, and the mileage between its terminals and its major consuming markets. Data should be supplied for each commodity carried, such as jet fuel, gasoline, etc.<sup>364</sup>

Similarly, in Statement F, the oil pipeline is required to submit maps showing the details of its transportation facilities, terminals, and markets, along with the location of any proposed transportation alternatives.<sup>365</sup>

Alternative Sources of Transportation. In Statement D, the pipeline “must describe available transportation alternatives in competition with the carrier in the relevant markets and other competition constraining the carrier’s rates in those markets.”<sup>366</sup> To the extent available, the pipeline must include “data similar to that provided for its own facilities and services in Statement C, including cost and mileage data in specific reference to the oil pipeline’s terminals and major consuming markets.”<sup>367</sup> The Commission noted that possible transportation alternatives would include “[o]ther pipelines, including private pipelines and those passing through the geographic market but without terminals, pipelines passing near the geographic market, barges, trucks, and refineries within the geographic market.”<sup>368</sup>

In assessing possible alternatives, the Commission implied that a cost comparison between the applicant pipeline and alternatives based on delivered product price as opposed to just the transportation rate component of the product price would most likely be necessary:

Under the ICA, the Commission regulates the transportation of oil by pipeline. In a market power analysis, the Commission must determine the oil pipeline’s ability to exercise market power over this transportation service. However, a market power analysis in general cannot be made solely in the context of transportation rates. Where competitive alternatives constrain the applicant’s ability to raise transport prices, the effect of such constraints are ultimately reflected in the price of the commodity transported. Hence, the delivered commodity price (relevant

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<sup>361</sup> *Id.*

<sup>362</sup> *Id.*

<sup>363</sup> 18 C.F.R. § 348.1(c)(3).

<sup>364</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,190-91.

<sup>365</sup> *Id.* at 31,192; *see also* 18 C.F.R. § 348.1(c)(6).

<sup>366</sup> 18 C.F.R. § 348.1(c)(4).

<sup>367</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,191.

<sup>368</sup> *Id.*

product price plus transportation charges) generally will be the relevant price to be analyzed for making a comparison of the alternatives to a pipeline's services. However, in some instances such as for origin markets or crude oil pipelines, it may be appropriate to make a case based only on transportation rates. A pipeline may elect to file such a case and a protestant may argue that such a case is appropriate.<sup>369</sup>

In Statement E, the oil pipeline "must describe potential competition in the relevant markets. To the extent available, the statement must include data about the potential competitors, including their costs, and their distance in miles from the carrier's terminals and major consuming markets."<sup>370</sup>

Market Concentration and Market Share. Statement G requires the pipeline to "set forth the calculation of the market concentration of the relevant markets using the Herfindahl-Hirschman Index."<sup>371</sup> The HHI calculation "must include the oil pipeline and the competitive alternatives set forth in Statements D and E" and the "burden is on the oil pipeline to justify the individual market shares used in calculating the HHIs."<sup>372</sup>

Statement G also requires the pipeline to set forth its market share in the relevant markets.<sup>373</sup> The Commission requires the pipeline to submit market share statistics that provide both actual delivery and capacity information found favorable in the *Williams* proceeding. Therefore, the market share calculation must be "based on [the applicant pipeline's] receipts in its origin markets and its deliveries in its destination markets" if the HHIs are not based on actual receipts and deliveries, but some other factor like capacity shares.<sup>374</sup> "For example, if the destination HHIs are based on capacity determined market shares, the oil pipeline would have to submit a calculation showing its share of the market based on deliveries in the respective destination markets."<sup>375</sup>

Statement G "must also set forth the calculation of other market power measures relied on by the carrier."<sup>376</sup> In conformance with the presumption of competitiveness from significant and expandable waterborne alternatives found in *Williams*, Opinion No. 391-A, the Commission stated this could include "evidence about water transportation as an indication that the oil pipeline lacks significant market power."<sup>377</sup>

Excess Capacity, Competition from Vertically Integrated Companies, Buyer Power, and Profitability. Statement H requires the pipeline to "describe any other factors that bear on the issue of whether the carrier lacks significant market power in the relevant markets."<sup>378</sup> As non-

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<sup>369</sup> *Id.* at 31,189.

<sup>370</sup> 18 C.F.R. § 348.1(c)(5).

<sup>371</sup> 18 C.F.R. § 348.1(c)(7).

<sup>372</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192.

<sup>373</sup> 18 C.F.R. § 348.1(c)(7).

<sup>374</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192.

<sup>375</sup> *Id.*

<sup>376</sup> 18 C.F.R. § 348.1(c)(7).

<sup>377</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,192-93.

<sup>378</sup> 18 C.F.R. § 348.1(c)(8).

exclusive examples, the Commission cited excess capacity, competition with vertically integrated companies, the pipeline's profitability, and buyer power.<sup>379</sup>

Proposed Testimony and Procedural Requirements. The Commission also adopted certain procedural requirements in connection with market-based rate applications. Statement I requires the pipeline to "include the proposed testimony in support of the application" that will serve "as the carrier's case-in-chief, if the Commission sets the application for hearing."<sup>380</sup> Protests must be submitted within sixty days after the application is filed setting forth detailed grounds for opposing an application.<sup>381</sup> This includes "responding to [the pipeline's] statement of position and information, and, if the protestant desires, presenting information of its own pursuant to Statements A-I."<sup>382</sup> Neither the pipeline's application, nor the protests, will have the benefit of any discovery. "The Commission believes that the oil pipeline and the protestants should have sufficient information available from public sources or their own experience to submit their cases."<sup>383</sup>

"The Commission, after examination of the oil pipeline's application and any protests, will issue an order in which it will rule summarily on the application or, if appropriate, establish additional procedures and the scope of the investigation. Additional procedures may or may not involve a hearing before an administrative law judge."<sup>384</sup> The Commission adopted regulations 18 C.F.R. §§ 348.1 and 348.2 to memorialize these filing and procedural requirements.

## **V. POST ORDER NO. 572 MARKET-BASED RATE CASES**

In the post Order No. 572 proceedings, the Commission maintained its framework of defining the applicant pipeline's product and geographic markets, and then determining the pipeline's market power in those defined markets through an assessment of certain factors. This included an adherence to the substitutability analysis to defining the product market outlined in the *Buckeye* proceeding. The basic purpose for defining the geographic market has remained the same as well. The process of identifying viable competition to the pipeline has been the subject of significant litigation, however. In determining the cost competitiveness of proposed alternative sources of transportation, the Commission first moved from a judgment based approach to a more mechanical application of certain price increase threshold. Then most recently, the Commission found that all used alternatives would be included in the market power statistics, and unused alternatives would only be included if the relevant market was not capacity constrained and only if their costs were within an acceptable range to the competitive price as evidenced by detailed cost studies.

In addition, the Commission narrowed the factors it would principally cite to when assessing an applicant pipeline's market power in its defined markets to market concentration and market share. The Commission also identified the market power statistics it would find

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<sup>379</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,193.

<sup>380</sup> 18 C.F.R. § 348.1(c)(9).

<sup>381</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,194; *see also* 18 C.F.R. § 348.2(g)-(h).

<sup>382</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,194; *see also* 18 C.F.R. § 348.2(g)-(h).

<sup>383</sup> Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,196.

<sup>384</sup> *Id.* at 31,194; *see also* 18 C.F.R. § 348.2(i).

indicative of market power were those articulated through its adjudicatory process and in particular the *Williams* proceeding. The evolution of the Commission's analysis is detailed below.

A. ***Kaneb Pipe Line Proceeding Outlines When to Deviate from BEA Geographic Areas for Refined Petroleum Pipelines***

In the first market-based rate application after Order No. 572, the Commission concluded for the first time that the use of a BEA as the geographic market was inappropriate. This finding lays the basis in later proceedings for how participants can rebut a BEA as the appropriate geographic market. In addition, for that same geographic market, the market power statistics found indicative of a lack of market power are noteworthy and have been cited by the Commission in subsequent proceedings.

Kaneb Pipe Line Operating Partnership requested market-based rates from the Commission for refined petroleum products in six destination markets.<sup>385</sup> Kaneb defined the geographic destination markets as the relevant BEAs, and its origin markets as 75 mile radiuses around certain refineries.<sup>386</sup> In what would become a pattern in later applications by other pipelines, Kaneb provided HHI and market share numbers based on various delivery and capacity based formulations. Kaneb provided HHI numbers based on total capacity and "effective capacity," which was the lesser of total capacity or consumption, recognizing the "common situation where any one pipeline's available capacity exceeds the total usage of the relevant market."<sup>387</sup> Kaneb also provided market share numbers based on actual deliveries (as required by Order No. 572 since its HHI numbers were capacity based) and effective capacity.<sup>388</sup> Kaneb's application was initially protested, but subsequently unopposed. The Commission went on to grant Kaneb's application, but modified one of the relevant destination markets.

Geographic Market. The Commission found that Kaneb's use of BEAs as the relevant destination markets was "generally appropriate and consistent with the methods used by the Commission in the *Buckeye* and *Williams* cases."<sup>389</sup> However, the Commission found that the particular characteristics of the "Casper BEA and the location of Kaneb's terminal in that BEA," made it inappropriate for designation as the relevant market.<sup>390</sup>

Kaneb's Cheyenne terminal is located in the far southeastern corner of the Casper BEA. The Casper BEA is extremely large, and covers all but six counties of Wyoming and includes small parts of Utah and Idaho. Using the Casper BEA as the relevant market places Kaneb's Cheyenne terminal in the same market as the Wyoming counties of Lincoln and Uinta whose nearest border is over 248 straight line miles from Cheyenne. Further, use of the Casper BEA would also include in the relevant external market four refineries in Salt Lake City, Utah and one

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<sup>385</sup> *Kaneb*, 83 FERC ¶ 61,183 at 61,759.

<sup>386</sup> *Id.* at 61,760.

<sup>387</sup> *Id.*

<sup>388</sup> *Id.*

<sup>389</sup> *Id.* at 61,761.

<sup>390</sup> *Kaneb*, 83 FERC ¶ 61,183 at 61,761.

refinery in Pocatello, Idaho. Lincoln and Unita counties are served by these Salt Lake and Pocatello refineries. However, Kaneb has not explained how these refineries exert a significant effect on the market power of its Cheyenne terminal that is such a great distance from the destinations served by these refineries.<sup>391</sup>

Therefore, the Commission concluded the use of the Casper BEA was inappropriate because of the abnormally large size of the BEA and because sources of transportation or competition, including the applicant pipeline's terminal and certain refineries, were in separate areas of that BEA.<sup>392</sup> Instead, the Commission found that the relevant destination market was the discrete cities around Kaneb's terminal.<sup>393</sup>

Particular Markets Analyzed. The Commission approximated the characteristics of the redrawn geographic market and determined that it resulted in an effective capacity HHI of 2742.9.<sup>394</sup> "However, this data also shows that the excess capacity in this market is over three times the market size..." and "Kaneb's effective share is less than 30%."<sup>395</sup> These factors led the Commission to find Kaneb did not have significant market power in the redrawn destination market, even with an HHI above 2500.<sup>396</sup>

In summary, the Commission redrew the geographic market from the relevant BEA where it was abnormally large, the applicant pipeline's terminal and alternative sources were in distant corners of the BEA, and no justification that alternate sources of supply within the larger BEA could serve as effective competition to the pipeline's terminal was provided. After the Commission adopted a presumption in favor of BEAs as the appropriate geographic market for refined petroleum pipelines, the circumstances identified in *Kaneb* served as a basis to rebut the presumption in favor of BEAs. Further, the Commission found that an HHI of 2742.9 did not result in a finding of market power where market share was less than 30 percent and significant excess capacity existed in the market.

#### **B. SFPP, L.P. Proceeding Examines Geographic Origin Markets**

In 1998 in SFPP, an origin market was contested and litigated for the first time. It provided the Commission with the opportunity to examine the origin market inquiry, and articulate what alternative transportation sources would be considered competitive in an origin market. The Commission defined an origin market as the geographic area around an applicant pipeline's receipt terminal where viable competition existed to transport the relevant product. Similar to a destination market, the goal was to identify the area that included viable competition to the applicant pipeline. The Commission provided that to be viable, a proposed alternative must be physically able to transport additional capacity or have the ability to add capacity at reasonable cost. The Commission order on SFPP's application provides guidance on the

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<sup>391</sup> *Id.*

<sup>392</sup> *Id.*

<sup>393</sup> *Id.*

<sup>394</sup> *Id.*

<sup>395</sup> *Kaneb*, 83 FERC ¶ 61,183 at 61,761.

<sup>396</sup> *Id.*

definition and basic goal in defining the geographic origin market, and what it means for an alternative source of transportation to be available.

1. Order on Application for Market-Based Rates Outlines Geographic Origin Market Inquiry

SFPP, LP requested market-based rates over its short 3.8 mile pipeline that transported refined petroleum products from Sepulveda, CA to Watson Station, CA.<sup>397</sup> SFPP defined the destination market as Watson Station, CA.<sup>398</sup> SFPP proposed the three California counties of Ventura, Los Angeles, and Orange as the origin market, but as an alternative, proposed the two refineries directly connected to its pipeline as the origin market.<sup>399</sup> SFPP provided delivery based and capacity based (not effective or adjusted capacity) HHI and market share statistics for its destination market and for both proposed origins.<sup>400</sup>

The Commission found that SFPP did not have market power in its destination market as the HHI of 1,742 and market share of 27 percent “are well within the HHIs and market shares under which the Commission has previously found that pipelines lack market power” citing the *Williams, Buckeye, and Kaneb* proceedings.<sup>401</sup>

Geographic Origin Market and Alternative Sources of Transportation. The Commission then turned to its first in-depth analysis of a contested origin market. The principal inquiries were the proper size of the origin market and what reasonable alternatives were available to SFPP’s pipeline to transport product out of the origin market. First, the Commission provided that “the test for determining origin markets” is the “area which includes all means by which refiners whose products currently move through...[SFPP’s pipeline] can dispose of their production elsewhere.”<sup>402</sup> And “the focus of the analysis” is “on whether customers using...[SFPP’s pipeline] have competitive alternatives that would enable them to avoid...[SFPP’s pipeline] in the event SFPP charged monopolistic prices.”<sup>403</sup>

SFPP had proposed that its current shippers were connected, or could be connected, to a series of pipelines which themselves were interconnected to yet others in its proposed three county origin.<sup>404</sup> But, SFPP failed to provide any detail about how its current shippers could ship through this proposed alternative network, and therefore, the Commission found that SFPP did not present sufficient evidence to justify its three county origin market.<sup>405</sup>

The Commission found that the more narrowly defined origin market consisting of the refineries that use SFPP’s pipeline was the proper origin market to analyze.<sup>406</sup> But, whether

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<sup>397</sup> *SFPP*, 84 FERC ¶ 61,338 at 62,490.

<sup>398</sup> *Id.* at 62,491.

<sup>399</sup> *Id.*

<sup>400</sup> *Id.* at 62,491-92.

<sup>401</sup> *Id.* at 62,494 & n.8.

<sup>402</sup> *SFPP*, 84 FERC ¶ 61,338 at 62,496.

<sup>403</sup> *Id.*

<sup>404</sup> *Id.*

<sup>405</sup> *Id.*

<sup>406</sup> *Id.*

other pipelines and trucking could serve as viable alternatives in that market was contested in connection with the calculation of HHI and market power. The protesters contended that proposed alternatives were not reasonable given their physical limitations.<sup>407</sup> The Commission set the matter for hearing because SFPP had failed to completely address the protestors' issues in its application.<sup>408</sup> The Commission envisioned evidence would be developed at the hearing as to whether there was current available capacity on proposed alternatives and whether capacity could be expanded at reasonable cost.<sup>409</sup> In addition, the Commission directed consideration of how much alternative capacity was needed to limit SFPP's exercise of market power, and whether SFPP's inability to exercise market power over one shipper protected other shippers, "given the pipeline's inability to price discriminate among customers."<sup>410</sup>

Therefore, the Commission found that a proper origin geographic market is the area that includes all means by which shippers of the applicant pipeline can dispose of their production elsewhere. The Commission directed an examination into the competitiveness of proposed alternatives in SFPP's more narrowly defined origin market. As reiterated later in the *Enterprise/Enbridge* proceeding, the Commission found that for proposed alternatives to be competitive they must be physically capable of serving as alternatives.

## 2. SFPP Failed to Justify Proposed Alternative Sources of Transportation in Origin Market

The judge denied SFPP's application for market-based rates finding that SFPP had not established that it lacked market power in the origin market.<sup>411</sup> Interestingly, the Commission affirmed without citing any HHI, market share, or other market power statistics, which is anomalous and not repeated by the Commission to date. The Commission also found that even where the two refineries directly connected to SFPP's pipeline had viable physical alternatives for transportation based on actual deliveries through other sources, SFPP failed to satisfy its ultimate burden of establishing there were sufficient competitive alternatives for a terminal company or its upstream customers.<sup>412</sup> The Commission's focus in subsequent cases has been on the market power statistics in the pipeline's markets as a whole, without focusing on market power over particular shippers or buyers.

Alternative Sources of Transportation. Regarding alternative pipelines for the terminal company, the Commission found that the terminal itself did not have sufficient alternatives because the use of alternative pipelines would require an additional terminal fee that would make its terminal uncompetitive in terms of price.<sup>413</sup> Further, there was insufficient evidence in the record on whether the terminal's upstream customers reasonably could have used alternative pipelines.<sup>414</sup> In addition, the Commission found there was insufficient evidence on the viability of trucking alternatives because even though trucking was cost competitive locally, there was insufficient evidence as to what volume of product the terminal shipped that was compliant with

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<sup>407</sup> *Id.* at 62,498.

<sup>408</sup> *SFPP*, 84 FERC ¶ 61,338 at 62,498.

<sup>409</sup> *Id.* at 62,498-99.

<sup>410</sup> *Id.*

<sup>411</sup> *SFPP, L.P.*, 102 FERC ¶ 61,240, at 61,713 (2003), *reh'g denied*, 104 FERC ¶ 61,136 (2003).

<sup>412</sup> *Id.* at 61,718.

<sup>413</sup> *Id.* at 61,719-20.

<sup>414</sup> *Id.* at 61,720.

local environmental laws.<sup>415</sup> Without those volumes, it was unclear how much product could be diverted to local trucking.<sup>416</sup> Likewise, the Commission found that volumes to the Los Angeles International Airport and export shipments through the Los Angeles and Long Beach harbors were unsubstantiated.<sup>417</sup> While providing general claims those sources could serve as alternatives, there was no capacity or cost information provided.<sup>418</sup>

The Commission found that the record failed to establish sufficient alternatives to SFPP for the terminal company, and therefore, concluded that SFPP was precluded from charging all companies market-based rates.<sup>419</sup>

### **C. Explorer Pipeline Company Proceeding Addresses Corridor Geographic Markets**

In this proceeding, the Commission began its practice of citing the *Williams* case in particular for the market power statistics that would cause it to find market power. Further, corridor markets, which define the geographic market by origin and destination pairs, were considered in detail by the Commission. While the Commission has generally not applied a corridor market analysis in these proceedings, discussion of this analysis is instructive when dealing with a pipeline with only one origin and destination market, as was the case in the *Mobil* proceeding discussed in detail below. In this case, similar to the holdings in the *Williams* proceeding, the Commission found the applicant pipeline's ability to raise prices between its origin and destination pairs was not necessarily indicative of market power. Rather, the Commission determined that may mean simply that the pipeline's current rates are below competitive levels. Instead, the Commission focused on the actual physical alternatives available to shippers to transport product from the relevant origin and destination pairs to assess the competitiveness of the market. Later in the *Enterprise/Enbridge* proceeding, the Commission determined that actual used alternatives are necessarily competitive in terms of price from their use by shippers.

In Explorer Pipeline Company, the intervenors alleged that the geographic markets should be assessed on a corridor basis because Explorer had market power during peak demand periods in the origin and destination markets, and other routes were more inefficient, costly, and provided lower quality service. The Commission stated that such general allegations would not suffice to warrant consideration of a corridor approach in the future, but it would consider them in this case. The Commission determined that even if Explorer's market power was determined on a corridor basis, it did not have market power over transportation of refined petroleum products from the Gulf Coast to the Midwest.

Explorer operated a 1,400 mile petroleum products pipeline system from the Gulf Coast to the Midwest United States.<sup>420</sup> Explorer requested permission to charge market-based rates for the transportation of refined petroleum products in its origin markets of Houston (which

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<sup>415</sup> *Id.* at 61,721.

<sup>416</sup> *SFPP*, 102 FERC ¶ 61,240 at 61,721.

<sup>417</sup> *Id.* at 61,722.

<sup>418</sup> *Id.*

<sup>419</sup> *Id.* at 61,723.

<sup>420</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,385.

consisted of a conglomerate of 7 BEAs), the Tulsa BEA, and the St. Louis BEA to its destination markets of the Houston, Dallas, Tulsa, St. Louis and Chicago BEAs.<sup>421</sup> The origin markets were uncontested and approved by the Commission.<sup>422</sup> The St. Louis and Chicago destination BEAs were contested and analyzed in detail by the Commission.<sup>423</sup>

Market Power Statistics. In its St. Louis and Chicago destination markets, Explorer included certain alternative supply sources that were within 100 miles of the BEA as reasonable alternatives.<sup>424</sup> The impact of the external sources was weighted based on the counties in the BEA that the source could actually serve from the transportation assumptions involved.<sup>425</sup> Explorer calculated delivery based market shares in these markets at 30.2 percent.<sup>426</sup>

Indicative of the approach in later proceedings, Explorer provided the Commission with multiple methodologies for calculating HHI: “the Commission’s Delivery Based Method, the Commission’s Effective Capacity Method, and the Department of Justice (DOJ) Adjusted Capacity Method.”<sup>427</sup> The delivery based method represented the applicant’s estimated percentage of actual deliveries into the market.<sup>428</sup> The Effective Capacity Method provided for the lesser of a pipeline’s capacity and the consumption in the market.<sup>429</sup> In this case, the effective capacity was also adjusted to remove “pipeline, refinery, truck, and barge capacity that may be committed to serving other markets and is therefore not available to serve the market at issue.”<sup>430</sup> The last methodology used was the DOJ Adjusted Capacity Method, which assumes equal market share among competitors to calculate HHI.<sup>431</sup>

The resulting HHI numbers ranged from 558 to 1936, and the Commission found that those numbers compared favorably with those in the *Williams* proceeding. “None of these figures rise to the level of combination of a 2500 HHI and a 46 percent market share that the

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<sup>421</sup> *Id.*

<sup>422</sup> *Id.* at 62,389.

<sup>423</sup> *See id.* at 62,390.

<sup>424</sup> *Id.* at 62,385-86.

<sup>425</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,385 n.10. Therefore, the weight accorded external sources in the market share and HHI calculation varied depending on the portion of the BEA it could serve. *Id.* “The greater the area reached, the greater the weight will be accorded the external source in the calculation of the HHI.” *Id.*

<sup>426</sup> *Id.* at 62,389.

<sup>427</sup> *Id.* at 62,390.

<sup>428</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,389.

<sup>429</sup> *See Buckeye*, Opinion No. 360, 53 FERC ¶ 61,473 at 62,670.

<sup>430</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,389.

<sup>431</sup> *Id.* at 62,390 n.28. The DOJ method is calculated as follows:

[It] divides total consumption in a market by the number of competitors in the market, with each competitor initially allocated an equal share. Each company that has insufficient capacity to supply its allocation is assumed to supply its full capacity, and the remaining supply is allocated evenly among all remaining companies with excess capacity. The process is repeated until all consumption in the market has been allocated. The result is used as each company’s market share in the HHI calculation.

Commission found unacceptable in *Williams*.<sup>432</sup> Further, the amount of excess capacity in these markets was over 3.4 times consumption even in peak demand periods.<sup>433</sup>

Geographic Market (Corridor Market). The Commission found that the traditional analysis yielded a finding of no market power.<sup>434</sup> The protesters contended that these low market power statistics were not relevant because they were based on annualized numbers and did not reflect Explorer's market power during the summer peak period.<sup>435</sup> They further contended that the proper analysis was a corridor geographic market because of the constrained capacity during peak periods, and contended that alternative routes were inefficient, inconvenient, more costly, and provided lesser quality service.<sup>436</sup>

The Commission noted that it had consistently rejected the use of corridor markets for several reasons, including: (1) that the real economic concern of shippers is the delivered product and its price rather than whether the product travels between specific locations on a pipeline, and (2) it eliminates from consideration competitive suppliers who bring product to markets without utilizing the specific corridors.<sup>437</sup> The Commission found that the protesters' general assertions of peak demand market power did not compel further examination based on a corridor geographic market. However, in light of the importance of transportation of petroleum products between the Gulf Coast and the Midwest, the Commission considered them anyway.<sup>438</sup> It did state explicitly that since Order No. 572 placed the burden on the protesting parties to establish that a corridor approach was appropriate, "in future cases if the pipeline demonstrates that its origin and destination markets are within the limits of market evaluations previously accepted by the Commission, such general assertions may not be sufficient to warrant consideration of a corridor-based analysis."<sup>439</sup>

Between the Gulf Coast and St. Louis, the Commission found at least five competing pipelines linking the areas, that barges served as effective competition between these areas even if not as efficient as the pipeline in question, and excess capacity ratios existed even during peak demand periods.<sup>440</sup> The Commission found similar alternatives and excess capacity existed between the Gulf Coast and Chicago BEA.<sup>441</sup> The Commission also found unpersuasive the concern that Explorer could raise prices during the peak period as uncorrelated with market power:

[T]he ability to raise prices does not mean that Explorer has significant market power; it may simply mean that the current rates for peak period service are below the competitive market price. Explorer publishes rates to the entire St. Louis BEA, not necessarily a point-to-point rate that serves only one customer. An

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<sup>432</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,390 (citing *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,685-86).

<sup>433</sup> *Id.*

<sup>434</sup> *Id.* at 62,391.

<sup>435</sup> *Id.* at 62,388.

<sup>436</sup> *Id.* at 62,388-89.

<sup>437</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,388 (citing *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,660-61).

<sup>438</sup> *Id.* at 62,391.

<sup>439</sup> *Id.* at 62,389.

<sup>440</sup> *Id.* at 62,391-93.

<sup>441</sup> *Id.* at 62,392-94.

attempt by Explorer to exercise significant market power by increasing rates above the competitive market price in a market where it lacks significant market power will result in reduced total volumes to that market and a consequent reduction in Explorer's revenues. This potential loss of revenue serves to constrain Explorer's rates to all of the shippers in the St. Louis destination market, not just the ones that may have direct access to transportation alternatives they deem comparable to Explorer's service.<sup>442</sup>

The Commission also noted that "at least some differential pricing, *i.e.* pricing based on demand, is lawful and appropriate in the oil pipeline industry."<sup>443</sup> "Differential pricing, when constrained by effective competition, can materially improve the efficiency of transportation markets by allocating capacity to those shippers who value it the most, particularly in markets involving different degrees of geographic or seasonal variation."<sup>444</sup>

Therefore, the Commission permitted Explorer to charge market-based rates even if the geographic market was considered on a corridor basis given the significant actual alternatives in point to point service between the Gulf Coast and the Midwest, and the excess capacity available on these alternatives.<sup>445</sup> Further, the Commission found protests concerning potential price increases during peak demand periods unavailing and not necessarily indicative of market power.

**D. *TE Products Pipeline Matter Establishes a Rebuttable Presumption in Favor of BEAs for Refined Petroleum Pipelines and Requires Detailed Cost Comparisons to Justify a Rebutted BEA, an Expanded BEA, or Alternative Sources Outside a BEA***

In 2000, in the TE Products Pipeline Company (TEPPCO) proceeding, the Commission established a rebuttable presumption in favor of BEAs for refined petroleum pipelines. The Commission held that if an applicant refined petroleum pipeline defines its geographic markets as the relevant BEAs, alternative sources of transportation within the BEA will be included in the market power statistics unless protesters and intervenors raise a reasonable doubt as to the appropriateness of the use of BEAs. If protesters and intervenors raise a reasonable doubt about the use of BEAs, the applicant pipeline will have to provide detailed cost data justifying the alternative sources within the BEA are viable in terms of cost. Likewise, if an applicant pipeline does not use the relevant BEAs as its geographic market or includes alternative sources of transportation outside the BEAs, cost studies showing the included alternative sources are cost competitive will have to be provided. The Commission did not directly overrule the presumption in favor of BEAs for refined petroleum pipelines in the *Enterprise/Enbridge* proceeding or in Opinion No. 529. The Commission did modify in those proceedings when detailed cost studies are required to justify proposed alternative sources of transportation.

TEPPCO requested permission to charge market-based rates for the transportation of refined petroleum products from its origin points in the West Gulf Coast, Shreveport, and Indianapolis areas to destination points in Houston, Beaumont, Shreveport, Little Rock,

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<sup>442</sup> *Explorer*, 87 FERC ¶ 61,374 at 62,392.

<sup>443</sup> *Id.* at 62,394.

<sup>444</sup> *Id.*

<sup>445</sup> *Id.* at 62,395.

Memphis, St. Louis, Indianapolis/Evansville, Chicago, Cincinnati, Dayton, and Toledo.<sup>446</sup> TEPPCO started with the relevant BEAs as the geographic markets, but then either included external sources within 75 to 100 miles of the BEA or expanded the geographic region beyond the BEA.<sup>447</sup> The Commission granted authority to charge market-based rates in the uncontested markets, the Indianapolis and Chicago origin markets and the Houston, Beaumont, St. Louis, Indianapolis/Evansville, Chicago, and Toledo destination markets.<sup>448</sup> The Commission then analyzed each contested market, and either set the market for hearing or directed its staff to conduct a conference to explore the market's particular facts.<sup>449</sup> The Commission did so on the basis that the contested geographic markets included alternative sources outside the BEA or were geographic markets in excess of the relevant BEAs, and no party had provided persuasive, verifiable cost comparisons that justified the various alternative sources included in their market power statistics.

Geographic Market and Alternative Sources of Transportation. In assessing the appropriate geographic market and the viable alternative sources, the Commission established a rebuttable presumption in favor of BEAs for refined petroleum pipelines, and included the requirement that cost justification must be provided to justify a rebutted BEA:

It is practical to presume that a BEA is a reasonable approximation of a relevant geographic market, even in cases where the applicant has not provided detailed evidence demonstrating that all of the alternatives within the BEA are indeed good alternatives. However, that is merely a rebuttable presumption. The parties to a proceeding in which an oil pipeline seeks to implement market-based rates always should be permitted to challenge the use of a BEA as a relevant geographic market. If their protests raise reasonable doubt about a particular BEA as an appropriate geographic market, the applicant must provide a detailed justification of the BEA as a relevant market, including a demonstration that all of the alternatives within the BEA are good alternatives in terms of price.<sup>450</sup>

The Commission then established that detailed cost data comparing proposed alternative sources to the applicant pipeline is also needed to justify geographic markets different than BEAs or to include alternative sources outside BEAs in the market power statistics. The Commission noted that in the *Buckeye* and *Williams* proceedings, the Commission started with the BEAs as the relevant geographic market, but included alternative sources outside the BEAs based on studies that showed those sources were competitive in terms of cost.<sup>451</sup> It concluded that in protested geographic markets that are different than BEAs or that included alternative sources outside the BEA, detailed cost analyses are necessary to support the geographic market and proposed alternative sources.<sup>452</sup> The Commission recognized that mechanical mileage limits from BEAs were also inappropriate because distance itself may not be indicative of viability. A

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<sup>446</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,462.

<sup>447</sup> *Id.* at 61,463-64.

<sup>448</sup> *Id.* at 61,462.

<sup>449</sup> *Id.*

<sup>450</sup> *Id.* at 61,465-66.

<sup>451</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,466.

<sup>452</sup> *Id.* at 61,467.

high wholesale price, for example, may prevent a nearby alternative from being competitive, and vice-versa for a more distant alternative.<sup>453</sup>

The Commission noted that one way to analyze costs is to perform a “laid-in cost study” that identifies the good economic alternatives available in the market.<sup>454</sup> Generally, a laid-in cost study compares the cost of proposed alternative sources of transportation to the competitive price. At this time, the applicant pipeline’s tariff was often used as a proxy for the competitive price. Therefore, in a cost study for a destination market, the wholesale price at the applicant pipeline’s terminal plus trucking costs to each county within the relevant geographic market would be compared with the wholesale price at each proposed alternative source’s terminal plus trucking costs to those same counties.<sup>455</sup> Alternative sources of transportation would be included in the geographic market and market power statistics if they provided buyers a delivered price that was within a certain threshold increase above the applicant pipeline. For the Little Rock destination market, TEPPCO included alternative sources in excess of 100 miles based on a laid-in cost study comparing each alternative source’s costs with TEPPCO’s costs to each county in the Little Rock BEA.<sup>456</sup> TEPPCO had used bills of lading, trucking surveys, and analyses of posted price movements at terminals to calculate the wholesale price and trucking costs.<sup>457</sup> Intervenor contested numerous inputs in the cost study, and provided their own cost studies that showed sources 75 miles outside the BEA were not economical.<sup>458</sup>

The Commission found several errors in TEPPCO’s cost study, including that the provided gas station surveys revealed only a very small number of gas stations received deliveries from sources in excess of 100 miles from the BEA. In addition, the wholesale prices in some external markets were substantially higher than the Little Rock BEA suggesting they could not be good alternatives, and TEPPCO failed to detail where the per-gallon per-mile prices used to calculate the trucking costs were derived.<sup>459</sup> The Intervenor’s cost-studies provided individual price quotes for truck movements, but also failed to identify their origin.<sup>460</sup> The Commission stated that “[a]lthough the trucking cost information provided by the protesting parties is more detailed than TEPPCO’s, consisting of individual quotes for transporting gasoline and diesel fuel, the protesters do not disclose the sources of this information, thus it cannot be verified.”<sup>461</sup> It determined that, “despite the appearance that TEPPCO possesses significant market power in the Little Rock destination market, the Commission will set this market for hearing in order to develop a more complete and accurate record that will permit a conclusive market power ruling to be made.”<sup>462</sup>

The Commission made similar findings for the other contested markets. In the Shreveport/Arcadia destination market, for example, TEPPCO expanded the size of the

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<sup>453</sup> *Id.* at 61,474.

<sup>454</sup> *Id.* at 61,467.

<sup>455</sup> *See id.* at 61,468 n.46.

<sup>456</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,468.

<sup>457</sup> *Id.*

<sup>458</sup> *Id.*

<sup>459</sup> *Id.* at 61,471.

<sup>460</sup> *Id.*

<sup>461</sup> *TE Products*, 92 FERC ¶ 61,121 at 61,472.

<sup>462</sup> *Id.*

geographic market to twice the size of the Shreveport BEA.<sup>463</sup> The Commission held that “TEPPCO must show that each alternative supply source included in the expanded geographic market has the ability to constrain TEPPCO’s ability to exercise market power within that market.”<sup>464</sup> Having failed to provide accurate and verifiable cost studies, the Commission set the matter for hearing.<sup>465</sup>

In TEPPCO, the Commission established a rebuttable presumption in favor of BEAs for refined petroleum pipelines. The recent *Enterprise/Enbridge* and Opinion No. 529 proceedings did not directly overrule this presumption. In addition, the Commission in TEPPCO established a requirement that an applicant pipeline must justify through detailed and verifiable cost studies alternative sources of transportation within a BEA if a reasonable doubt as to their appropriateness has been raised, alternative sources within a geographic market that is different than the relevant BEAs, and any alternative sources of transportation outside a BEA.<sup>466</sup> The Commission has modified the circumstances when detailed costs studies are required to justify alternative sources of transportation in the *Enterprise/Enbridge* and Opinion No. 529 proceedings.

**E. Colonial Pipeline Company Proceeding Establishes Netback Cost Study for Determining Good Alternatives in a Geographic Origin Market**

The Commission established in the *Colonial* proceeding that cost studies were required to justify proposed alternative sources of transportation in an origin market similar to the cost study requirements in a destination market. For an origin market, the Commission adopted a “netback” cost analysis that required a comparison of the price a shipper receives for selling its products when using the applicant pipeline and when using proposed alternative sources of transportation. The Commission also followed the detailed cost study formulation established in the TEPPCO proceeding that used a threshold price increase to compare proposed alternative sources. The Commission in this case did not make a finding on the appropriate threshold price increase, however, instead relying on a range of different price increases to gauge the competitiveness of proposed alternatives.

In addition, the Commission signaled in this proceeding that it would now principally cite to the market share and market concentration statistics in its determination of market power. Other factors that the Commission had cited in prior proceedings, such as excess capacity, begin to be omitted in the reasoning for the Commission’s findings on market power.

Colonial Pipeline Company requested market-based rates for the transportation of refined petroleum products in its Gulf Coast origin and destination markets.<sup>467</sup> In 2000, the Commission found that even if the criticisms of Colonial’s geographic markets, alternative sources, and cost

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<sup>463</sup> *Id.* at 61,473.

<sup>464</sup> *Id.* at 61,474.

<sup>465</sup> *Id.*

<sup>466</sup> This matter was settled before a hearing was conducted. See *TE Products Pipeline Co., L.P.*, 95 FERC ¶ 61,108 (2001). TEPPCO’s successor company, Enterprise TE Products Pipeline Company LLC, subsequently applied for market-based rate authority in three locations, which was denied. See *Enterprise TE Products Pipeline Co. LLC*, 137 FERC ¶ 61,027, at PP 1, 6 (2011); *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157.

<sup>467</sup> *Colonial*, 92 FERC ¶ 61,144 at 61,528-29.

studies are taken into account, the market share and market concentration statistics for the BEAs alone showed Colonial lacked market power in its destination markets. For its origin markets, the Commission outlined the required analysis to determine good alternatives in terms of price, and directed its staff to conduct a conference to explore those facts.

Geographic Markets and Alternative Sources of Transportation. Colonial proposed two origin markets based on conglomerations of numerous BEAs: (1) the Western Gulf Coast Origin Market, which consisted of seven BEAs, including Beaumont, Austin, Houston, San Antonio, and Lake Charles; and (2) the Baton Rouge-New Orleans Origin Market consisting of six BEAs, including Jackson, Biloxi, Mobile, New Orleans, and Baton Rouge.<sup>468</sup> Colonial defined these origin markets by identifying the refineries or inbound port facilities that did or could use its outbound pipeline, and included those locations along with the local areas served by those facilities.<sup>469</sup> The intervenors challenged these origin markets as unsupported by cost studies that showed how it was feasible for shippers on one end of these large geographic markets to economically access alternatives located substantial distances away.<sup>470</sup>

The Commission agreed that the facts needed to be explored further, and directed how outbound transportation alternatives were to be analyzed in an origin market:

Conceptually, the question to ask in defining origin markets is what are the “good” economic alternatives to shippers that would be putting products on the pipeline at each of Colonial’s origin terminals for shipment to destination terminals by Colonial. The focus is on good alternatives to the shipper for getting the product out of a particular location or disposing of the product elsewhere. Thus, in determining whether proposed alternatives are good alternatives in terms of price, it is the netback to the shipper (price to shipper after all costs of delivery) that should be compared in determining good alternatives for origin markets. If the netback to the shipper from using a given potential alternative is not high enough to prevent Colonial from exercising market power, that alternative is not a good alternative and should not be included in the relevant origin geographic market.<sup>471</sup>

Therefore, the Commission directed that for an outbound transportation alternative to be considered in the origin market it must provide the shipper a netback price for its commodity that includes all costs for delivering the product that is high enough to serve as a viable alternative in the event the applicant pipeline attempts to charge a monopolistic price. The Commission directed its staff to convene a conference to explore the facts regarding Colonial’s origin markets.<sup>472</sup>

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<sup>468</sup> *Id.* at 61,532.

<sup>469</sup> *Id.*

<sup>470</sup> *Id.*

<sup>471</sup> *Id.*

<sup>472</sup> *Colonial*, 92 FERC ¶ 61,144 at 61,532-33.

Colonial defined its destination markets as the Beaumont-Port Arthur BEA, the Lafayette BEA, the Jackson BEA, and a conglomeration of the Baton Rouge and New Orleans BEAs.<sup>473</sup> Only the Jackson and Baton Rouge-New Orleans destination markets were challenged.<sup>474</sup> For the Jackson BEA, Colonial provided market power statistics for the BEA alone and for the BEA plus certain external sources within 75 to 100 miles.<sup>475</sup> Colonial justified the external sources through a detailed cost study, which included all alternatives as good alternatives whose costs were within a 0.5 cent threshold increase in Colonial's tariff transportation rate. The Commission noted that the threshold price increase methodology was the typically required analysis. "In demonstrating good alternatives in terms of price, the Commission typically requires that the alternatives be no higher than some threshold price, which is a given amount above the competitive or some other appropriate base price. The increase in price above the base price is the price increase threshold."<sup>476</sup>

Intervenors provided their own cost study which showed that even with a 45% increase over Colonial's tariff transportation rate, sources outside the Jackson BEA could serve only 4-5% of the BEA area.<sup>477</sup> The Commission agreed that serving only a fringe area of the BEA did not justify including the alternative source within the market power statistics.<sup>478</sup> However, the Commission found that the market power statistics for the Jackson BEA alone of 2500 for HHI and 25 percent for market share, which excluded external sources and eliminated contested waterborne sources of supply within the BEA, were within acceptable levels based on Commission precedent.<sup>479</sup>

In the Baton Rouge-New Orleans market, Colonial included both the New Orleans and Baton Rouge BEAs within a combined geographic market and also included external supply sources within 75 to 100 miles of the expanded area.<sup>480</sup> Intervenors provided a detailed cost study that showed supply alternatives in the New Orleans BEA could not compete on price with Colonial's pipeline terminal in the Baton Rouge BEA based on a threshold price increase of either 15 percent or 0.5 cents/gallon above Colonial's transportation tariff rate.<sup>481</sup> The Commission agreed that "if Colonial wants to use relevant markets containing alternatives external to a BEA, Colonial must demonstrate that the external sources are indeed good alternatives based on cost studies."<sup>482</sup> Further, the Commission found Colonial's adoption of a standard mileage radius external to a BEA disregarded cost and did not justify the inclusion of those external sources in the market power statistics.<sup>483</sup> However, Colonial provided market power statistics for a Baton Rouge BEA only geographic market.<sup>484</sup> The Commission also excluded waterborne sources within this BEA, and calculated an effective capacity HHI of 2006

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<sup>473</sup> *Id.* at 61,533.

<sup>474</sup> *Id.* at 61,538.

<sup>475</sup> *Id.* at 61,533-34.

<sup>476</sup> *Id.* at 61,534 n.20.

<sup>477</sup> *Colonial*, 92 FERC ¶ 61,144 at 61,534-35.

<sup>478</sup> *Id.* at 61,535.

<sup>479</sup> *Id.* at 61,535-36.

<sup>480</sup> *Id.* at 61,536.

<sup>481</sup> *Id.* at 61,536-37.

<sup>482</sup> *Colonial*, 92 FERC ¶ 61,144 at 61,537.

<sup>483</sup> *Id.*

<sup>484</sup> *Id.*

and a market share of 20.52 percent, well within statistics found by the Commission as evidence of a lack of market power.<sup>485</sup>

Therefore, in *Colonial*, the Commission further articulated the type of cost analysis required to justify the inclusion of alternatives in the market power analysis. *Colonial* is still instructive on the type of detailed cost analysis when required by the circumstances. In those cases in an origin market, the netback price paid to the shipper, deducting all costs of delivery, when using alternative transportation must be high enough to prevent the applicant pipeline from charging monopolistic rates. In this case, the parties used a range of hypothetical price increases over the applicant pipeline's transportation tariff rate as a proxy to gauge the competitiveness of proposed alternatives. The Commission did not reach a conclusion as to the proper threshold price increase, instead setting the origin market for conference, while concluding that the destination markets were competitive without the inclusion of any external sources.<sup>486</sup> In finding that Colonial lacked market power in its destination markets, the Commission cited only the market share and market concentration statistics.

**F. Sunoco Pipeline L.P. Proceeding Outlines Reasonable Grounds to Challenge a BEA Geographic Market**

The Commission in the Sunoco Pipeline, L.P. (SPLP) proceeding detailed the types of evidence participants could provide to rebut a BEA geographic market. Sunoco requested approval to charge market-based rates for its refined petroleum products pipeline located in the Midwest and Northeast United States.<sup>487</sup> The Commission ruled on SPLP's application in 2006. The Commission found that BEAs of small to medium size without remote supply sources are appropriate geographic markets for refined petroleum pipelines. The Commission found in this case that general challenges will not shift the burden to the pipeline to provide detailed cost studies to justify the BEA as the geographic market and the inclusion of alternative sources within the BEA in those circumstances.

In addition, the Commission reiterated that bills-of-lading or other surveys that do not provide cost justification are not sufficient to satisfy a pipeline's burden to justify the cost viability of alternative sources when a detailed cost study is required.

Geographic Market and Alternative Sources of Transportation. SPLP proposed BEAs as the geographic market for each of its origin and destination locations, and included external sources within 75 to 100 miles of those BEAs.<sup>488</sup> SPLP provided a bills-of-lading survey that analyzed its affiliate's actual truck movements to support its geographic markets.<sup>489</sup> The

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<sup>485</sup> *Id.* at 61,537-38.

<sup>486</sup> The intervenors subsequently withdrew their protests, and the Commission approved Colonial's market-based rate authority in the remaining Western Gulf Coast and Baton Rouge-New Orleans origin markets. *See Colonial Pipeline Co.*, 95 FERC ¶ 61,210 (2001). In addition, the Commission later approved market-based rate authority for Colonial in its Gulf Coast and Philadelphia/New York City origins and Philadelphia/New York City destination areas. *See Colonial Pipeline Co.*, 95 FERC ¶ 61,377 (2001).

<sup>487</sup> *Sunoco*, 114 FERC ¶ 61,036 at PP 1, 4.

<sup>488</sup> *Id.* PP 20, 25.

<sup>489</sup> *Id.* P 25.

intervenors challenged the BEAs as too broad, and unjustified by any detailed cost analyses.<sup>490</sup> The Commission found that in contrast to the BEA disregarded in *Kaneb*, “[t]he BEAs addressed in SPLP’s application are relatively small or medium in size, and most of the BEA suppliers are within close proximity of each other and the population centers of the BEAs.”<sup>491</sup> Therefore, the Commission concluded that the intervenors had failed to raise a reasonable doubt as to the appropriateness of the BEAs because they were not large and did not have discrete or remote suppliers.<sup>492</sup>

In addition, the intervenors challenged the use of bills-of-lading studies to justify the inclusion of external sources to the BEAs.<sup>493</sup> The Commission agreed in this case that detailed cost studies were required to justify alternative sources outside of a BEA:

In this case, the Commission finds that SPLP’s bills-of-lading study is not sufficient justification for including alleged good alternatives that are from 75 to 100 miles outside a BEA. This study only proves that external supply was delivered into a BEA from an SPLP-affiliated terminal outside the BEA. It does not demonstrate that all of the alternatives...[outside] the BEA are good alternatives in terms of price.<sup>494</sup>

Later, in the *Enterprise/Enbridge* proceeding, the Commission found that evidence that alternatives are actually used is sufficient evidence of their cost competitiveness to justify their inclusion in the market power statistics.<sup>495</sup>

Regarding SPLP’s application, the Commission in the Cleveland, Harrisburg, Scranton, Pittsburgh, and Toledo destination markets found that the market power statistics for the BEAs alone were unacceptable or borderline unacceptable based on the Commission precedent in *Williams*.<sup>496</sup> Further, SPLP failed to provide adequate support to justify external sources up to 100 miles from the BEA that would bring the market power statistics in line with Commission precedent.<sup>497</sup> The Commission set those markets for hearing to address these factual issues.<sup>498</sup>

During settlement negotiations the intervening parties withdrew their interventions and comments.<sup>499</sup> Trial Staff conducted its own market power analysis in the relevant markets and remained concerned regarding SPLP’s market power in the Harrisburg destination market.<sup>500</sup> SPLP agreed to modify its application to request market-based rate authority for only a discrete

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<sup>490</sup> *Id.* P 26.

<sup>491</sup> *Id.* P 31.

<sup>492</sup> *Sunoco*, 114 FERC ¶ 61,036 at P 31; *See Shell*, 103 FERC ¶ 61,236 at PP 19, 35-36 (finding cost studies by intervenor, among other contentions, raised reasonable doubt in using BEA as the destination market).

<sup>493</sup> *Sunoco*, 114 FERC ¶ 61,036 at P 32.

<sup>494</sup> *Id.*

<sup>495</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 53-56, 70.

<sup>496</sup> *Sunoco*, 114 FERC ¶ 61,036 at PP 82-83 (*citing Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,677-78, 61,682-86).

<sup>497</sup> *Id.*

<sup>498</sup> *Id.* P 84.

<sup>499</sup> *See Sunoco Pipeline, L.P.*, 118 FERC ¶ 61,266, at P 3 (2007).

<sup>500</sup> *Id.* PP 5-6.

portion of the Harrisburg BEA market.<sup>501</sup> Trial Staff agreed to support the renewed application after that modification was made, and the Commission granted the renewed application.<sup>502</sup>

**G. Court of Appeals in Mobil Pipe Line Company Proceeding Overturns Results of Netback Cost Study**

In the Mobil Pipe Line Company proceeding, the Commission was faced with the unique situation of a small pipeline with the only transportation route in an origin market to a lucrative wholesale destination market. The Commission in 2010 concluded through its netback analysis approach that there were no good alternatives to Mobil's pipeline in terms of cost. The D.C. Circuit Court of Appeals reversed in April 2012, however, relying in large part on Trial Staff's testimony and positions before the Commission. The court found that the broad market indicators, which showed that Mobil had only a three percent market share in the transportation of the total production in the relevant basin, clearly indicated that Mobil did not have market power in the origin market. And while not specifically overruling the Commission's detailed cost analysis approach to determining good cost alternatives, the court pointed out the areas in that analysis that were faulty. The Commission recently outlined in detail the implications of this decision on its market-based rate methodology and modified the requirements necessary to show that alternative sources are viable in terms of cost.

**1. Commission Finds Mobil Lacks Market Power in Gulf Coast Destination Market but Sets Upper Midwest Origin Market for Hearing**

Mobil Pipe Line Company requested market based rates for its Pegasus pipeline, which transported almost entirely heavy sour Western Canadian crude oil from a single receipt point in Patoka, Illinois (south of Chicago) to a sole destination point in Nederland, Texas (the Beaumont/Port Arthur area of the U.S. Gulf Coast).<sup>503</sup> The crude oil reached Mobil's single receipt point from a production area in Western Canada by other pipelines.<sup>504</sup>

Mobil proposed for its destination market either a vast area of the Gulf Coast that included portions of Texas, Louisiana, Mississippi, and Alabama, or a somewhat more limited area from Houston to Lake Charles.<sup>505</sup> There were no specifically articulated protests or evidentiary supported contentions against Mobil's lack of market power in its destination market.<sup>506</sup> The Commission found that even for the more narrowly tailored Houston to Lake Charles geographic market, the market power statistics were well below what would cause concern.<sup>507</sup> In addition, the Commission found that waterborne crude deliveries accounted for a significant portion of demand in this destination market citing *Williams'* waterborne presumption

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<sup>501</sup> *Id.* P 6.

<sup>502</sup> *Id.* PP 5-6, 9.

<sup>503</sup> *Mobil Pipe Line Co.*, 121 FERC ¶ 61,268, at P 4 (2007).

<sup>504</sup> *Id.*

<sup>505</sup> *Id.* P 5.

<sup>506</sup> *Id.* P 16.

<sup>507</sup> *Id.*

of a lack of market power.<sup>508</sup> Therefore, the Commission determined that Mobil lacked market power in its more narrowly defined Houston to Lake Charles destination market.<sup>509</sup>

For its origin market, Mobil proposed an “Upper Midwest Origin Market” that contained its Patoka receipt point and a conglomeration of at least eight separate BEAs in seven states (Minnesota, Wisconsin, Michigan, Illinois, Indiana, Ohio, and Kentucky).<sup>510</sup> The intervenors contested the origin market as overly broad and unsupported by a netback cost analysis.<sup>511</sup> The Commission cited the required netback analysis articulated in *Colonial*, and found that there was no cost based evidence in the record to determine Mobil’s market power in the origin market.<sup>512</sup> Therefore, the matter was set for hearing.<sup>513</sup>

## 2. Netback Analysis Reveals Mobil Has No Competition

The Commission affirmed the judge’s finding that Mobil had market power in its Upper Midwest origin geographic market even though the Pegasus pipeline transported only a small portion of the relevant product from the origin market. The finding was based on the netback cost analysis that found that shippers had no good alternatives to Mobil’s pipeline in terms of netback price. The cost study found a high netback price for Mobil because it provided transportation service from the Upper Midwest to the Gulf Coast destination market, which offered a significantly higher wholesale price than other destination markets. At the time, Mobil was the only pipeline transportation option from the Upper Midwest to the Gulf Coast. In addition, the threshold price increase used to compare potential alternative sources of transportation was calculated from the benchmark of Mobil’s transportation tariff, which was arguably well below the competitive rate as evidenced by the significant excess demand that existed for transportation services on the pipeline. Therefore, the Commission found that Mobil was a monopolist from its lone access to the Gulf Coast market and its ability to significantly raise its price above its current transportation rate.

Product Market. The Commission affirmed the judge’s determination to limit the product market to the “transportation of Western Canadian heavy sour crude oil.”<sup>514</sup> The judge and the Commission focused their inquiry, as was done in *Buckeye*, on substitution factors, “i.e., whether alternatives are available that would constrain the exercise of market power by [Mobil] in the event it attempted to raise its rates.”<sup>515</sup> Mobil contended that it was capable of transporting all types of oil and the product market should not be so narrowly limited.<sup>516</sup> Trial Staff also supported Mobil’s broader product market definition to include the transportation of all crude oil.<sup>517</sup>

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<sup>508</sup> *Mobil*, 121 FERC ¶ 61,268 at P 16 (citing *Williams*, Opinion 391-A, 71 FERC ¶ 61,291 at 62,138).

<sup>509</sup> *Id.*

<sup>510</sup> *Id.* P 19.

<sup>511</sup> *Id.* P 10.

<sup>512</sup> *Id.* PP 22-23.

<sup>513</sup> *Mobil*, 121 FERC ¶ 61,268 at P 24.

<sup>514</sup> *Mobil*, 133 FERC ¶ 61,192 at PP 27-29.

<sup>515</sup> *Id.* P 28.

<sup>516</sup> *Id.* P 29.

<sup>517</sup> *Id.* P 28.

The Commission found that substitution for the transportation of other types of crude oil was not practically possible when viewed from an economic and operations standpoint. “Shippers have made a choice to ship Western Canadian heavy sour crude oil on the pipeline, which accounts for 98 percent of the volumes....”<sup>518</sup> Further, there was no evidence that Mobil could ship “sufficient amounts of non-heavy crude oil that would provide an ongoing business opportunity for shippers.”<sup>519</sup> Therefore, the Commission affirmed the narrowly defined product market because other forms of crude oil were not practical substitutes to Western Canadian heavy sour crude.<sup>520</sup>

Geographic Market and Alternative Sources of Transportation. The judge used a “threshold netback analysis,” which first established a threshold netback price to compare all potential alternative sources of transportation.<sup>521</sup> The threshold netback price was calculated by subtracting the netback payment shippers would receive on Mobil by a threshold price increase.<sup>522</sup> The judge used a 15 percent increase in Mobil’s transportation tariff rate as the threshold increase.<sup>523</sup> An alternative was considered a “good alternative” if it offered “shippers a netback greater than or equal to the threshold netback.”<sup>524</sup>

Mobil and Trial Staff contested each of the inputs into this netback analysis, and the use of a netback analysis at all under the circumstances of the case. First, they contended that Mobil’s transportation tariff rate should not serve as the “competitive benchmark” from which to calculate the threshold price increase.<sup>525</sup> They asserted that Mobil’s transportation rate could not be the competitive rate because there was excess demand on the pipeline (suggesting the tariff transportation rate was too low).<sup>526</sup> The Commission agreed with the judge that excess demand in and of itself was not proof that the prevailing rate was unjust and unreasonable “because it would essentially eliminate the use of the tariff rate as the competitive rate....”<sup>527</sup> The Commission reasoned that excess demand was likely to be present for any pipeline seeking market-based rates because an oil pipeline was unlikely to go through the exercise of seeking market-based rates unless there was some excess demand that would allow it to raise its rates above the cost-of-service or index rate.<sup>528</sup>

Mobil also contested the use of the 15 percent increase in its transportation rate as the threshold price increase, and instead advocated for a 1-2 percent increase in the delivered

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<sup>518</sup> *Id.*

<sup>519</sup> *Mobil*, 133 FERC ¶ 61,192 at P 28.

<sup>520</sup> *Id.*

<sup>521</sup> *Id.* P 14.

<sup>522</sup> *Id.* PP 14-15.

<sup>523</sup> *Id.*

<sup>524</sup> *Mobil*, 133 FERC ¶ 61,192 at P 14. Specifically, and for illustrative purposes, the judge calculated a netback price for the sale of Western Canadian crude on the Gulf Coast via Mobil’s pipeline to average \$51.27 per barrel for the first 10 months of 2007. *Id.* P 34. Mobil’s transportation tariff rate of \$1.218 multiplied by 15 percent would equal \$0.1827 and serve as the threshold price increase. *Id.* P 15. Therefore, if an alternative provided a netback price equal to or greater than \$51.0873 per barrel (\$51.27 minus \$0.1827) it would be considered a good alternative and included in the market power statistics.

<sup>525</sup> *Id.* P 17.

<sup>526</sup> *Id.*

<sup>527</sup> *Mobil*, 133 FERC ¶ 61,192 at P 20.

<sup>528</sup> *Id.*

product price as the appropriate threshold increase.<sup>529</sup> The Commission stated that the initial decision in *Buckeye*, subsequently affirmed by the Commission, adopted a 15 percent increase in the pipeline's tariff as the appropriate measure of market power.<sup>530</sup> The contention that *Buckeye*'s finding as to market power was concerned with an increase in the delivered product price, not transportation rates, was disregarded. The Commission determined that netback prices or delivered product prices are used in the netback or laid-in cost study to determine viable alternatives, but the transportation rate must be used for the threshold price increase component of those detailed cost studies.<sup>531</sup> The Commission reasoned that "[s]ince an oil pipeline can only increase its transportation rates, tying the increase to any other benchmark would not make any sense."<sup>532</sup> Further, linking the threshold price increase to the commodity price of oil as opposed to the transportation rate "would essentially allow pipelines to make massive price increases [if granted approval to charge market-based rates by the Commission] because transportation rates are a small portion of the overall delivered product price."<sup>533</sup>

In addition, Mobil and Trial Staff contested the use of a netback analysis at all, and instead advocated as was argued in *Explorer* and *Sunoco* for example, for the inclusion of all alternative suppliers that were actually used by current Mobil shippers.<sup>534</sup> Mobil and Trial Staff contended that used alternatives necessarily had to be profitable from their use.<sup>535</sup> The Commission found that it "must use a netback analysis to determine whether an alternative was comparable in terms of price..." as opposed to the actual used alternative approach.<sup>536</sup> The Commission determined that even if an alternative was used, and therefore, provided at least some positive netback, it may not provide enough of a netback price to serve as a check on an increase in rates reflective of market power.<sup>537</sup> The Commission found that only through a netback analysis could that be definitively established.<sup>538</sup>

The Commission also affirmed the judge's exclusion of certain origin markets because the proposed alternative transportation sources in those markets were not good alternatives in terms of availability. Reiterating the capacity availability criterion articulated in *SFPP*, the Commission found that an alternative must have excess capacity and there must be an accessible route for shippers to reach that alternative.<sup>539</sup>

The judge calculated a netback price based on ten months of data for the alternatives located in the Upper Midwest region and compared them to Mobil's netback price from the Gulf Coast.<sup>540</sup> The judge concluded there were no good alternatives to Mobil's pipeline in terms of

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<sup>529</sup> *Id.* P 23.

<sup>530</sup> *Id.* P 24 (citing *Buckeye*, 50 FERC ¶ 63,011 at 65,049; *Buckeye*, Opinion No. 360, 53 FERC 61,473 at 62,666).

<sup>531</sup> *Id.*

<sup>532</sup> *Mobil*, 133 FERC ¶ 61,192 at P 24.

<sup>533</sup> *Id.*

<sup>534</sup> *Id.* P 32.

<sup>535</sup> *Id.*

<sup>536</sup> *Id.* P 41.

<sup>537</sup> *Mobil*, 133 FERC ¶ 61,192 at P 41.

<sup>538</sup> *Id.*

<sup>539</sup> *Id.* P 39.

<sup>540</sup> *Id.* P 34.

price.<sup>541</sup> Therefore, the judge determined the HHI was 10,000 with Mobil controlling a 100 percent market share.<sup>542</sup> Based on its affirmance of the judge in most material respects, the Commission affirmed the determination that Mobil had market power in its origin market.

Potential Competition and Broad Indicators of Market Power. The Commission rejected consideration of broad indicators that suggested Mobil did not have market power. For instance, Mobil and Trial Staff contended that Mobil could not exercise market power because of the small amount of Western Canadian crude oil that it actually transported relative to what was produced.<sup>543</sup> Similarly, Mobil and Trial Staff contended that Mobil's entry into an already competitive market would prevent Mobil from exercising any market power.<sup>544</sup> In addition, Trial Staff contended that the netback price differential in this case was simply the result of supply and demand of crude oil in the Midwest and Gulf Coast, not anything related to Mobil's transportation rate.<sup>545</sup> Finally, Mobil contended that potential competition should impact the market power analysis.<sup>546</sup> The Commission rejected the consideration of potential competition and the other cited broad indicators of a lack of market power as "only appropriate in a close case" and unnecessary given Mobil's clear market power in its origin market under the netback analysis.<sup>547</sup>

Therefore, the Commission affirmed the judge's netback analysis that calculated alternatives to the Midwest in comparison to Mobil's Gulf Coast destination. Given the large netback differential from the disparity in the wholesale price of crude, the judge and the Commission found there were no good alternatives to Mobil's transportation route to the Gulf Coast.

### 3. D.C. Circuit Court of Appeals Finds Broad Market Indicators Clearly Evidence Mobil Lacked Significant Market Power

In reviewing the Commission decision in *Mobil*, the D.C. Circuit Court of Appeals found that the broad market indicators, including Mobil's mere three percent market share in the transportation of Western Canadian crude and its entry into an already competitive market, clearly evidenced a lack of market power. Therefore, the court vacated the Commission's denial of Mobil's application for market-based rate authority as unreasonable. The court did not, however, directly overrule the Commission's requirement for a detailed cost analysis to justify the cost competitiveness of proposed alternative sources of transportation.

The court began with a brief description and history of Mobil's Pegasus pipeline. Until April 2006, Pegasus transported about 66,000 barrels of crude oil each day from the Gulf Coast to the Midwest.<sup>548</sup> Development of Western Canadian oil sands, however, caused Mobil to

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<sup>541</sup> *Id.* Specifically, the judge calculated a netback price of \$46.77 per barrel for alternatives in the Upper Midwest, well below the threshold netback price of \$51.0873 per barrel. See *Mobil*, 133 FERC ¶ 61,192 at PP 14-15, 34.

<sup>542</sup> *Id.* P 35.

<sup>543</sup> *Id.* P 50.

<sup>544</sup> *Id.* P 51.

<sup>545</sup> *Id.* P 52.

<sup>546</sup> *Mobil*, 133 FERC ¶ 61,192 at P 48.

<sup>547</sup> *Id.* at P 54.

<sup>548</sup> *Mobil*, 676 F.3d at 1100.

reverse the direction of the pipeline to transport Western Canadian crude southward.<sup>549</sup> “Importantly, Pegasus transports only about 66,000 barrels of Western Canadian crude oil each day—which is about three percent of the 2.2 million barrels of Western Canadian crude oil produced each day.”<sup>550</sup> The court also recounted the procedural history of the case, and quoted Trial Staff’s testimony at length on the reasons why Staff supported a finding that Mobil lacked market power in its origin market.<sup>551</sup>

Since Pegasus transported almost exclusively Western Canadian crude oil, the court found that the proper market to consider was the transportation of all Western Canadian crude oil.<sup>552</sup> Therefore, the court held that the proper inquiry was:

[W]hether producers and shippers of Western Canadian crude oil must rely so heavily on Pegasus for transportation of their crude oil that Pegasus can be said to possess market power—that is, whether Mobil could profitably raise rates on Pegasus above competitive levels for a significant period of time because of a lack of competition.<sup>553</sup>

The court found that potential competitive alternatives included “pipelines that transport crude oil out of the area” and “local refineries.”<sup>554</sup>

The court concluded that the answer to whether Mobil had market power was an “emphatic no,” given that Pegasus transported only three percent of the Western Canadian crude oil produced each day.<sup>555</sup> “As the staff noted, the critical statistic is that about 97 percent of Western Canadian crude oil gets to refineries by means other than Pegasus.”<sup>556</sup> The court also highlighted the fact that Pegasus was a new entrant into an already competitive market. Again citing Trial Staff, the court found that logic dictated that a further entrant would increase competition, not render the market uncompetitive.<sup>557</sup>

While not overruling the Commission’s requirement for a detailed cost study to justify alternative sources of transportation, the court pointed out faulty areas in that analysis. First, the court noted that the Commission’s analysis showed that Mobil could raise its rates 15 percent above its current transportation tariff rate if it was allowed to charge market-based rates. The court found this revelation unremarkable, and determined the Commission’s error was in using Mobil’s regulated tariff rate as the competitive benchmark:

As FERC’s expert staff explained, the 15 percent figure demonstrates only that Pegasus’s regulated rate is below the competitive rate. The regulated rate does not reflect Pegasus’s full value to Western Canadian crude oil producers and

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<sup>549</sup> *Id.*

<sup>550</sup> *Id.* at 1100-01.

<sup>551</sup> *Id.* at 1101-02.

<sup>552</sup> *Id.* at 1102.

<sup>553</sup> *Mobil*, 676 F.3d at 1102.

<sup>554</sup> *Id.* at 1102-03.

<sup>555</sup> *Id.* at 1102.

<sup>556</sup> *Id.* at 1103.

<sup>557</sup> *Id.*

shippers. Therefore, the possibility that the market rate might be higher than the regulated rate does not show that Pegasus possesses market power.<sup>558</sup>

Therefore, similar to the findings by the Commission in the *Williams* and *Explorer* proceedings, the court found that the ability to increase price was not necessarily indicative of market power.

Likewise, the court found that the short-term price variation between the Gulf Coast and the Midwest, “which may temporarily make Gulf Coast refineries (and thus Pegasus) an attractive outlet,” did not result in a finding of market power.<sup>559</sup> Rather, taking advantage of differential pricing was consistent with competition and an efficient market.<sup>560</sup> To make the point, the court cited the Commission in *Explorer*, that “[d]ifferential pricing, when constrained by effective competition, can materially improve the efficiency of transportation markets by allocating capacity to those shippers who value it the most, particularly in markets involving different degrees of geographic or seasonal variation.”<sup>561</sup> The implication is that a price differential is not evidence per se of market power. Instead, it improves competition by signaling that more pipeline investment is needed to reduce the wholesale price differential, while also allocating transportation capacity among shippers who can make the most profit from that differential.

Therefore, the court concluded that “the Commission jumped the rails by treating the Pegasus pipeline as the rough equivalent of a bottleneck or essential facility for transportation of Western Canadian crude oil.”<sup>562</sup> The court concluded that the Commission’s denial of Mobil’s application to charge market-based rates was unreasonable.<sup>563</sup> In doing so, the court relied on the broad market indicators of Mobil’s mere three percent market share in the transportation of Western Canadian crude oil and its new entry into an already competitive market.

#### 4. Market-Based Rates Granted on Remand

On remand, in August 2012, the Commission granted Mobil’s application to charge market-based rates.<sup>564</sup> Separately, in March 2013, the Commission denied the intervenors’ request to reopen the record to demonstrate the price differential between the Midwest and Gulf Coast was not temporary, and to calculate a competitive rate different from the tariff rate to use as a benchmark in the netback analysis.<sup>565</sup> The Commission found these new factual determinations would not undermine the findings in *Mobil* that the pipeline lacked market power from its small market share of the total Western Canadian crude production.<sup>566</sup> “[T]he underlying conclusion of the court is that Pegasus is so small with so many competitors that it would be unable to charge anything but the competitive rate, thus negating the need to calculate

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<sup>558</sup> *Mobil*, 676 F.3d at 1103-04.

<sup>559</sup> *Id.* at 1104 (citing *Longhorn*, 83 FERC ¶ 61,345 at 62,380 (“[A]ny price differential between the origin and destination markets does not confer monopolistic power upon [the pipeline], but rather it promotes competition.”)).

<sup>560</sup> *Id.*

<sup>561</sup> *Id.* (citing *Explorer*, 87 FERC ¶ 61,374 at 62,394).

<sup>562</sup> *Id.*

<sup>563</sup> *Mobil*, 676 F.3d at 1105.

<sup>564</sup> *Mobil Pipe Line Co.*, 140 FERC ¶ 61,104, at P 6 (2012).

<sup>565</sup> *Mobil Pipe Line Co.*, 142 FERC ¶ 61,175, at PP 13-16 (2013).

<sup>566</sup> *Id.* P 15.

a competitive rate to replace the regulated rate used by the Commission as a benchmark.”<sup>567</sup> Therefore, the Commission stated that a detailed cost analysis was unnecessary, at least under the facts in *Mobil*.

**H. Enterprise/Enbridge Proceeding Reaffirms Existing Market-Based Rate Methodology but Modifies Requirement To Show Good Alternatives in Terms of Cost**

Enterprise Products Partners, L.P. and Enbridge Inc. (Enterprise/Enbridge) announced their intention to reverse the flow on their existing crude oil pipeline, the Seaway pipeline, to provide transportation from Oklahoma to the Gulf Coast.<sup>568</sup> Enterprise/Enbridge requested market-based rates as the initial rate on the reversed pipeline.<sup>569</sup> The product market was defined in the application as the “transportation of crude oil.”<sup>570</sup> Enterprise/Enbridge provided that the origin market and alternative competitors existed in Oklahoma, Kansas, Northwest Texas, as well as the production areas in Western Canada and the Permian Basin that would use the pipeline.<sup>571</sup> Enterprise/Enbridge defined the destination market as either the entire Gulf Coast refining area or the more narrowly tailored Houston to Lake Charles area.<sup>572</sup>

Within weeks of the D.C. Circuit Court of Appeals’ decision in *Mobil*, in May 2012, the Commission denied the market-based rate application of Enterprise/Enbridge based on the inability to calculate the required netback cost to determine good alternatives. The inability was caused by the absence of a competitive price to benchmark the threshold price increase component of the netback analysis. The Commission thereafter, however, granted rehearing and reopened the record *sua sponte* to more fully consider the implications of the *Mobil* decision.

On rehearing, the Commission reaffirmed its basic methodology for analyzing whether a pipeline should be permitted to charge market-based rates, i.e., the product and geographic markets are defined and then certain factors reflective of the pipeline’s market power in those defined markets are assessed. The Commission modified, however, some important aspects of that methodology. Importantly, the Commission determined that actual used alternatives are deemed competitive in terms of price from their use by shippers. For unused but useable alternatives to be cost viable the relevant market cannot be capacity constrained and their costs must be shown to be within an acceptable range to the competitive price through a detailed cost study. The Commission also framed the geographic origin market for crude oil pipelines as the production basin(s) where the oil the pipeline transports originates, while leaving open alternative possibilities such as BEAs or hubs. Regarding Enterprise/Enbridge’s application, the Commission again denied the request to charge market-based rates on the Seaway pipeline as the initial rate. The Commission found that until operational data were available to establish the relevant originating production basins and used alternatives, market power could not be adequately analyzed.

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<sup>567</sup> *Id.*

<sup>568</sup> *Enterprise Products Partners*, 139 FERC ¶ 61,099 at P 5.

<sup>569</sup> *Id.* PP 1, 5.

<sup>570</sup> *Id.* P 7.

<sup>571</sup> *Id.* P 8.

<sup>572</sup> *Id.* P 14.

1. Initially Commission Denied Application To Charge Market-Based Rates Because of the Lack of Detailed Cost Analysis To Justify Good Alternatives

Among other reasons, the intervenors contended Enterprise/Enbridge's application was facially deficient because it failed to provide any cost justification for the alternative sources of transportation in Enterprise/Enbridge's origin and destination markets.<sup>573</sup> The Commission agreed that even with the *Mobil* court's focus on market share in actual transportation of the entire relevant production basin, not the ability of alternatives to be price competitive, price data remained "an indispensable part of the analysis."<sup>574</sup> The Commission determined that while the *Mobil* court's ruling rested primarily on the Pegasus pipeline's market share, at least some price data was required to ascertain which alternatives were viable in order to calculate the market share statistics.<sup>575</sup> The Commission concluded that "price was indeed part of the court's review of Pegasus' origin market."<sup>576</sup>

The Commission found that the evidence presented was insufficient to determine whether alternatives were good in terms of cost.<sup>577</sup> Further, the Commission declined to set the matter for hearing because no proxy for the competitive price existed from which to calculate good alternatives.<sup>578</sup> The Commission stated that the point in conducting the cost analysis is to determine whether the applicant pipeline could raise rates above the competitive level, and therefore, some proxy for the competitive level had to be used to make the calculation.<sup>579</sup> In this case, since Enterprise/Enbridge had no tariff on file to serve as the competitive proxy and had failed to offer any other proxy, no cost comparison could be conducted.<sup>580</sup> "In sum, denial of Enterprise/Enbridge's application is appropriate given the applicants' failure to provide detailed cost data, a fundamental element of a market power analysis, which Enterprise/Enbridge acknowledges cannot be provided at this time."<sup>581</sup>

Shortly thereafter in June 2012, however, the Commission granted rehearing and reopened the record *sua sponte* for the purpose of reconsidering the effect of the *Mobil* decision on Enterprise/Enbridge's market-based rate application.<sup>582</sup> In addition, and more broadly, the Commission reopened the record to consider the effect of the *Mobil* decision on the Commission's overall policies in assessing an application for market-based rates.<sup>583</sup>

2. On Rehearing the Commission Reaffirmed its Market-Based Rate Methodology but Modified How to Determine Good Alternatives in Terms of Cost

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<sup>573</sup> *Enterprise Products Partners*, 139 FERC ¶ 61,099 at PP 21, 41.

<sup>574</sup> *Id.* P 32.

<sup>575</sup> *Id.*

<sup>576</sup> *Id.*

<sup>577</sup> *Id.* P 33.

<sup>578</sup> *Id.*

<sup>579</sup> *Enterprise Products Partners*, 139 FERC ¶ 61,099 at PP 40-41.

<sup>580</sup> *Id.* PP 39, 41.

<sup>581</sup> *Id.* P 47.

<sup>582</sup> *Enterprise Products Partners L.P.*, 139 FERC ¶ 61,255, at P 2 (2012).

<sup>583</sup> *Id.* P 3.

On rehearing, the Commission concluded that the *Mobil* court did not fundamentally alter the Commission’s methodology for analyzing market power.<sup>584</sup> Instead, the Commission found that the *Mobil* court applied the Commission’s definition and policies on market power to the facts of the case and found the Commission erred in its findings.<sup>585</sup> Based on this conclusion, the Commission reiterated its general methodology for determining whether an oil pipeline has significant market power.<sup>586</sup> But the Commission clarified and modified several aspects of that methodology, including the proper geographic origin market for crude oil pipelines, the product market determination, and importantly, how to determine good alternatives in terms of cost.

Geographic Market and Alternative Sources of Transportation. The Commission reiterated its requirement that an oil pipeline define the geographic markets in which it seeks to establish a lack of significant market power.<sup>587</sup> The Commission found that for crude oil pipelines the proper origin market is generally “the production field from where the crude oil being shipped on the pipeline derives.”<sup>588</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>589</sup> The Commission determined this was consistent with *Mobil* where Trial Staff traced the crude oil that the Pegasus pipeline received for transportation backwards from its injection point to the production fields based on operational data in order to identify all potential alternatives.<sup>590</sup> This definition also reflected the reality of the origin market for crude oil pipelines.<sup>591</sup> “Producers of crude oil seek to dispose of their product out of the production field by the most economic (profitable) means available.”<sup>592</sup> This definition does not necessarily apply to refined products pipelines,<sup>593</sup> and the Commission did not foreclose a different origin market for crude oil pipelines based on BEAs or hubs, for example, if justified by the particular facts of a case.<sup>594</sup>

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<sup>584</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 31.

<sup>585</sup> *Id.*

<sup>586</sup> *Id.* P 34. The Commission again outlined its general methodology for determining whether an oil pipeline has market power:

As set forth in Order No. 572, the Commission requires oil pipelines to first define the relevant markets for which to determine market power. Further, the Commission requires oil pipelines to identify the competitive transportation alternatives for its shippers, including potential competition and other competition constraining its rates. Finally, the oil pipeline must compute the market concentration for the relevant market(s) and other market power measures.

*Id.*

<sup>587</sup> *Id.* P 35.

<sup>588</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 39.

<sup>589</sup> *Id.*

<sup>590</sup> *Id.* PP 35, 39.

<sup>591</sup> *Id.* P 35.

<sup>592</sup> *Id.*

<sup>593</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 35 n.26, 39; see *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 40 (approving refined petroleum pipeline’s methodology for identifying geographic market where it limited its analysis to a 125-mile radius around its terminal and then excluded counties where the pipeline’s delivered price was not competitive).

<sup>594</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 39.

The Commission also reiterated the requirement that oil pipelines define the competitive transportation alternatives in their relevant markets in order to determine the market share and market concentration statistics in those markets.<sup>595</sup> The Commission held that for an alternative to be “competitive” it must: (1) be able “to discipline, or prevent, a potential increase in price above the competitive level by the applicant pipeline;”<sup>596</sup> (2) be “available to receive product diverted from the applicant pipeline in response to a price increase”<sup>597</sup> in line with the finding in *SFPP* that alternatives have available capacity;<sup>598</sup> and (3) be “of the same quality as the applicant.”<sup>599</sup>

The Commission analyzed in detail the first requirement of a good alternative, *i.e.*, its price competitiveness. The Commission held that “a fundamental element of a market-power analysis” remains that “competitive alternatives must be determined competitive in terms of price.”<sup>600</sup> The Commission held, however, that a detailed netback cost analysis was not always required to make this determination.<sup>601</sup> Instead, the Commission found commensurate with the *Mobil* court, *Explorer*, and contentions made in *Sunoco* that actual used alternatives are necessarily competitive in terms of price.<sup>602</sup> This relies on shipper behavior “to implicitly demonstrate that the alternative is economic or profitable to that shipper.”<sup>603</sup> The Commission determined that it simply was not “rational for a shipper to use an alternative that was not profitable.”<sup>604</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>605</sup> Usage “demonstrates that the used alternative provides a higher netback than any alternative that is available but not being used” and serves as a “proxy for determining whether an alternative is in fact a good alternative in terms of price.”<sup>606</sup>

For unused but “useable” alternatives (those that have available capacity and are of equal quality), a detailed price analysis is still required, however, to establish those alternatives are competitive in terms of price in certain circumstances.<sup>607</sup> The Commission directed as a first step a calculation of overall supply and demand for the disposal of crude oil in the origin market.<sup>608</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>609</sup> If the demand for

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<sup>595</sup> *Id.* P 45.

<sup>596</sup> *Id.*

<sup>597</sup> *Id.*

<sup>598</sup> See *SFPP*, 84 FERC ¶ 61,338 at 62,498-99.

<sup>599</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 45.

<sup>600</sup> *Id.* P 53; see also *id.* P 54 (“For an alternative to be a good alternative, it must be competitively priced.”).

<sup>601</sup> *Id.* P 53.

<sup>602</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>603</sup> *Id.* P 56.

<sup>604</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 56.

<sup>605</sup> *Id.*

<sup>606</sup> *Id.*

<sup>607</sup> *Id.* P 65.

<sup>608</sup> *Id.* P 68.

<sup>609</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 68.

disposition capacity exceeds supply, no further analysis is required.<sup>610</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>611</sup> If disposition capacity exceeds demand or they are at equilibrium, the analysis can go further into a detailed netback analysis because “alternatives may still be competitively priced though not currently being used.”<sup>612</sup>

The Commission also clarified that when conducting the detailed netback analysis for unused but useable alternatives, the applicant pipeline’s tariff rate is not “presumed to be a proper proxy for the competitive price.”<sup>613</sup> Rather, the Commission determined that the competitive price to use as the benchmark to compare proposed alternatives is the “netback of the alternative that provides the lowest netback among used alternatives.”<sup>614</sup> The Commission coined this competitive netback price among used alternatives as the “marginal netback.”<sup>615</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>616</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>617</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>618</sup> The Commission did not specify in this proceeding a threshold range by which proposed useable alternatives would be deemed competitive.

Therefore, the Commission modified the cost data required to establish a proposed alternative is competitive in terms of cost. In conformance with the *Mobil* court (and positions advanced in the *Explorer* and *Sunoco* proceedings for example), the Commission found that evidence that alternatives are actually used suffices to establish an alternative is cost competitive. “Usage provides justification for determining that an alternative is a good alternative in terms of price.”<sup>619</sup> For useable (but 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 netback as evidenced through a detailed cost study. The acceptable range was not specified in this proceeding however.

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<sup>610</sup> *Id.*

<sup>611</sup> *Id.*

<sup>612</sup> *Id.*

<sup>613</sup> *Id.* PP 50, 52.

<sup>614</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 55.

<sup>615</sup> *Id.*

<sup>616</sup> *Id.*

<sup>617</sup> *Id.*

<sup>618</sup> *Id.* P 69. A similar analysis is undertaken for a destination market where the competitive price is set by the “marginal supplier” in the market. *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 19. 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. *Id.*

<sup>619</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 70.

Product Market. The Commission reiterated the requirement that an applicant oil pipeline must identify the product market(s) in which it seeks to establish a lack of significant market power.<sup>620</sup> The Commission clarified that “[t]he appropriate product market in a market-power analysis includes (1) those services for which the applicant seeks to charge market-based rates, and (2) any product that could discipline the exercise of market power over those products.”<sup>621</sup>

The Commission determined that it was unclear what guidance could be drawn from the *Mobil* proceeding regarding the proper product market. The Commission in *Mobil* 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>622</sup> The *Mobil* court 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>623</sup> Therefore, the Commission did not draw any conclusions as to the guidance offered by this court opinion.<sup>624</sup>

The Commission confirmed that the relevant analysis in defining the product market is the cross-elasticity of demand between the products for which market-based rate authority is sought and possible substitutes.<sup>625</sup> “For purposes of crude oil pipelines, the question is whether the transportation or disposition of different grades or types of crude oil (heavy vs. light, low vs. high sulfur for example) could serve to discipline a potential increase above competitive levels.”<sup>626</sup> By way of illustration, the Commission offered the following scenario:

If a price increase for the transportation of heavy crude would potentially cause producers to shift their demands to light crude transport, these products would generally both be included in one product market. If however a price increase on heavy crude could not be disciplined by such a shift, they would not exhibit a significant cross-elasticity and would instead constitute separate product markets.<sup>627</sup>

For crude oil origin markets, the Commission directed that the product market is generally limited to “those products available from the production fields (i.e., the geographic market).”<sup>628</sup>

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<sup>620</sup> *Id.* P 40.

<sup>621</sup> *Id.* P 44.

<sup>622</sup> *Mobil*, 133 FERC ¶ 61,192 at PP 27-29 (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>623</sup> *Mobil*, 676 F.3d at 1100-02.

<sup>624</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 42.

<sup>625</sup> *Id.* P 43.

<sup>626</sup> *Id.*

<sup>627</sup> *Id.*

<sup>628</sup> *Id.* P 44.

Therefore, the Commission found that the product market includes the products for which the pipeline requests market-based rates and all products that serve as substitutes to those products through an analysis of cross-elasticity of demand.

Market Power Statistics. The Commission found that market share and market concentration statistics are calculated once good alternatives are determined.<sup>629</sup> The Commission found that the market power statistics are not calculated in comparison with the capability of the production field, but instead amongst the good alternatives, which include used alternatives as discussed above.<sup>630</sup> The Commission noted that it “continues to find it useful to obtain a showing of market concentration” using HHI, and continues to find HHI calculations based on capacity useful.<sup>631</sup>

The Commission declined to find that the entry of a pipeline into a previously competitive market necessarily means that the pipeline will lack market power.<sup>632</sup> Instead, the market power analysis is the same because the circumstances will dictate the presence or absence of market power. The Commission stated, as was noted by the *Mobil* court, “that a large entrant into a previously-competitive market could still potentially exercise market power.”<sup>633</sup>

Enterprise/Enbridge’s Application is Denied. The Commission declined Enterprise/Enbridge’s application to charge market based rates as the initial rates on the reversed Seaway pipeline because “a significant portion of the required market power analysis is based on the actual usage of the applicant pipeline.”<sup>634</sup> This included, for example, operational data to determine the production basins from which the crude oil transported on the pipeline originates and the used competitive alternatives to the pipeline.<sup>635</sup> Therefore, the Commission concluded that “[a]bsent actual operational data, such uncertainty would result in an incomplete and potentially erroneous market power determination.”<sup>636</sup> The Commission offered that Enterprise/Enbridge was within its discretion to file an application for market-based rates once operational data was available to conduct the proper analysis.<sup>637</sup>

In sum, the Commission maintained its general methodology for analyzing a pipeline’s market power. Namely, the Commission will first define the pipeline’s product and geographic markets, and then assess market power statistics and other factors reflective of the pipeline’s market power in those defined markets. The Commission reiterated that the proper analysis to determine the product market involves examining the cross-elasticity of demand to identify substitutes. The Commission did, however, modify how it would determine the cost viability of proposed alternatives. Used alternatives are deemed competitive in terms of price. For unused but useable alternatives, the relevant market must not be capacity constrained and the proposed alternative’s costs must be within an acceptable range to the competitive marginal netback in an

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<sup>629</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 71-72.

<sup>630</sup> *Id.* P 72.

<sup>631</sup> *Id.* P 74.

<sup>632</sup> *Id.* P 76.

<sup>633</sup> *Id.* (citing *Mobil*, 676 F.3d at 1103).

<sup>634</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 80.

<sup>635</sup> *Id.* P 80 & n.107.

<sup>636</sup> *Id.*

<sup>637</sup> *Id.*

origin market (or marginal supplier in a destination market) as evidenced through a detailed cost study.

## **VI. CONCLUSION**

An oil pipeline will be permitted to charge whatever rates it can negotiate in the marketplace, or market-based rates, if it lacks significant market power in its relevant product and geographic markets.<sup>638</sup> As a general matter, the Commission will analyze an oil pipeline's application to charge market-based rates by first defining the pipeline's product and geographic markets, and then assessing certain factors reflective of the pipeline's market power in those defined markets. The Commission has established over time that the key indicators of market power it will cite to make this determination are market share and market concentration.<sup>639</sup> The Commission has also established the market share and market concentration statistics that will cause it to find market power (generally HHI over 2500, market share over 50 percent, or a combination of HHI close to 2500 and market share nearing 50 percent).<sup>640</sup> Other factors, such as potential competition and excess capacity will generally only be cited in close cases.<sup>641</sup> Therefore, one of the principal disputes now centers on the geographic market and what alternative sources should be included in the market share and market concentration statistics.

In the past, the Commission required cost studies to justify that alternative sources of transportation were good alternatives in terms of price. This ensured that competition was not simply assumed, as foreclosed in *Farmers II*, but established through detailed evidence. The D.C. Circuit Court of Appeals' decision in *Mobil*, however, cast doubt on the continued need for a detailed cost analysis. The court in that case simply relied on the applicant pipeline's market share in actual transportation of the entire source basin's production.<sup>642</sup> In addition, the *Mobil* decision pointed out certain areas in the Commission's required cost analysis that did not meet judicial approval.<sup>643</sup> In response, the Commission clarified that good alternatives in terms of cost necessarily include all alternatives that are actually used.<sup>644</sup> For unused but useable alternatives to be determined cost competitive, the market must not be capacity constrained (otherwise shippers would take advantage of their availability) and their costs must be within an acceptable range to the competitive price as evidenced through a detailed cost study.<sup>645</sup>

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<sup>638</sup> See Order No. 572, FERC Stats. & Regs. ¶ 31,007 at 31,186-87.

<sup>639</sup> See *Colonial*, 92 FERC ¶ 61,144; *Mobil*, 133 FERC ¶ 61,192 at P 54.

<sup>640</sup> See, e.g., *Kaneb*, 83 FERC ¶ 61,183 at 61,761; *SFPP*, 84 FERC ¶ 61,338 at 62,494 & n.8; *Williams*, Opinion No. 391, 68 FERC ¶ 61,136 at 61,677-78, 61,682-86.

<sup>641</sup> See *Mobil*, 133 FERC ¶ 61,192 at P 54; *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 54.

<sup>642</sup> *Mobil*, 676 F.3d at 1102-03.

<sup>643</sup> *Id.* at 1103-04.

<sup>644</sup> *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 53-56, 70.

<sup>645</sup> *Id.* PP 68-70; *Enterprise TE Products*, Opinion No. 529, 146 FERC ¶ 61,157 at P 19.