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.[568] Enterprise/Enbridge requested market-based rates as the initial rate on the reversed pipeline.[569] The product market was defined in the application as the "transportation of crude oil."[570] 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.[571] Enterprise/Enbridge defined the destination market as either the entire Gulf Coast refining area or the more narrowly tailored Houston to Lake Charles area.[572]

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.

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

[568] *Enterprise Products Partners*, 139 FERC ¶ 61,099 at P 5.
[569] *Id.* PP 1, 5.
[570] *Id.* P 7.
[571] *Id.* P 8.
[572] *Id.* P 14.

transportation in Enterprise/Enbridge's origin and destination markets.[573] 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."[574] 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.[575] The Commission concluded that "price was indeed part of the court's review of Pegasus' origin market."[576]

The Commission found that the evidence presented was insufficient to determine whether alternatives were good in terms of cost.[577] Further, the Commission declined to set the matter for hearing because no proxy for the competitive price existed from which to calculate good alternatives.[578] 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.[579] 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.[580] "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."[581]

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.[582] 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.[583]

2. *<u>On Rehearing the Commission Reaffirmed its Market-Based Rate Methodology but Modified How to Determine Good Alternatives in Terms of Cost</u>*

On rehearing, the Commission concluded that the *Mobil* court did not fundamentally alter the Commission's methodology for analyzing market power.[584] 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.[585] Based on this conclusion, the Commission reiterated its general methodology for determining whether an oil pipeline has

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[573] *Enterprise Products Partners*, 139 FERC ¶ 61,099 at PP 21, 41.
[574] *Id.* P 32.
[575] *Id.*
[576] *Id.*
[577] *Id.* P 33.
[578] *Id.*
[579] *Enterprise Products Partners*, 139 FERC ¶ 61,099 at PP 40-41.
[580] *Id.* PP 39, 41.
[581] *Id.* P 47.
[582] *Enterprise Products Partners L.P.*, 139 FERC ¶ 61,255, at P 2 (2012).
[583] *Id.* P 3.
[584] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 31.
[585] *Id.*

significant market power.[586] 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.[587] 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."[588] 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.[589] 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.[590] This definition also reflected the reality of the origin market for crude oil pipelines.[591] "Producers of crude oil seek to dispose of their product out of the production field by the most economic (profitable) means available."[592] This definition does not necessarily apply to refined products pipelines,[593] 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.[594]

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.[595] 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;"[596] (2) be "available to receive product

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[586] *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.

[587] *Id.* P 35.

[588] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 39.

[589] *Id.*

[590] *Id.* PP 35, 39.

[591] *Id.* P 35.

[592] *Id.*

[593] *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).

[594] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 39.

[595] *Id.* P 45.

[596] *Id.*

diverted from the applicant pipeline in response to a price increase"[597] in line with the finding in *SFPP* that alternatives have available capacity;[598] and (3) be "of the same quality as the applicant."[599]

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."[600] The Commission held, however, that a detailed netback cost analysis was not always required to make this determination.[601] 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.[602] This relies on shipper behavior "to implicitly demonstrate that the alternative is economic or profitable to that shipper."[603] The Commission determined that it simply was not "rational for a shipper to use an alternative that was not profitable."[604] 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.[605] 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."[606]

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.[607] The Commission directed as a first step a calculation of overall supply and demand for the disposal of crude oil in the origin market.[608] "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."[609] If the demand for disposition capacity exceeds supply, no further analysis is required.[610] 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."[611] If disposition capacity exceeds demand or they are at equilibrium, the analysis can

[597] *Id.*
[598] *See SFPP*, 84 FERC ¶ 61,338 at 62,498-99.
[599] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 45.
[600] *Id.* P 53; *see also id.* P 54 ("For an alternative to be a good alternative, it must be competitively priced.").
[601] *Id.* P 53.
[602] *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.").
[603] *Id.* P 56.
[604] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 56.
[605] *Id*.
[606] *Id.*
[607] *Id.* P 65.
[608] *Id.* P 68.
[609] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 68.
[610] *Id.*
[611] *Id*.

go further into a detailed netback analysis because "alternatives may still be competitively priced though not currently being used."[612]

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."[613] 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."[614] The Commission coined this competitive netback price among used alternatives as the "marginal netback."[615] 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."[616] 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."[617] 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.[618] 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."[619] 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.

<u>Product Market</u>. 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.[620] 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

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[612] *Id.*
[613] *Id.* PP 50, 52.
[614] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 55.
[615] *Id.*
[616] *Id.*
[617] *Id.*
[618] *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.*
[619] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 70.
[620] *Id.* P 40.

rates, and (2) any product that could discipline the exercise of market power over those products."[621]

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).[622] 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.[623] Therefore, the Commission did not draw any conclusions as to the guidance offered by this court opinion.[624]

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.[625] "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."[626] 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.[627]

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)."[628]

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.

<u>Market Power Statistics</u>. The Commission found that market share and market concentration statistics are calculated once good alternatives are determined.[629] The

[621] *Id.* P 44.
[622] *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).
[623] *Mobil*, 676 F.3d at 1100-02.
[624] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 42.
[625] *Id.* P 43.
[626] *Id.*
[627] *Id.*
[628] *Id.* P 44.

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.[630] 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.[631]

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.[632] 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."[633]

<u>Enterprise/Enbridge's Application is Denied</u>. 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."[634] 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.[635] Therefore, the Commission concluded that "[a]bsent actual operational data, such uncertainty would result in an incomplete and potentially erroneous market power determination."[636] 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.[637]

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 origin market (or marginal supplier in a destination market) as evidenced through a detailed cost study.

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[629] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at PP 71-72.
[630] *Id.* P 72.
[631] *Id.* P 74.
[632] *Id.* P 76.
[633] *Id.* (*citing Mobil*, 676 F.3d at 1103).
[634] *Enterprise Products Partners*, 146 FERC ¶ 61,115 at P 80.
[635] *Id.* P 80 & n.107.
[636] *Id.*
[637] *Id.*