128 FERC ¶ 61,278
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Suedeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

Magellan Pipeline Company, L.P. Docket No. OR09-9-000

ORDER GRANTING APPLICATION FOR
MARKET POWER DETERMINATION

(Issued September 25, 2009)

1. On June 2, 2009, Magellan Pipeline Company, L.P. (Magellan) filed an application for a market power determination seeking authority to charge market-based rates for the transportation of refined petroleum products from its origin at Houston, Texas to its destination at Tulsa, Oklahoma.[1] As discussed below, the Commission finds that Magellan lacks significant market power in the West Gulf Coast[2] origin market and the Tulsa-Bartlesville, Oklahoma BEA[3] (Tulsa BEA) destination market and will permit Magellan to charge market-based rates on this segment of its system.

I. **Background**

2. Magellan, a subsidiary of Magellan Midstream Partners, L.P. and Magellan GP, LLC, is a common carrier petroleum products pipeline that is subject to the Commission's jurisdiction under the Interstate Commerce Act. Magellan receives

[1] On August 25, 2009, Magellan filed supplemental information with the Commission reflecting its parent company's acquisition of Longhorn Partners Pipeline., L.P. (Longhorn), which transports refined petroleum products from Houston, TX to El Paso, TX. In the original application, Magellan lists Longhorn as a potential competitor in the origin market. Magellan revised the market share and Herfindahl-Hirschman Index calculations in the August 25th filing.

[2] Comprised of the Gulf Coast area from Corpus Christi, Texas through Lake Charles, Louisiana and the surrounding BEAs.

[3] The U.S. Department of Commerce, Bureau of Economic Analysis, defines certain groups of counties, which have as their nucleus an economic center, as "BEAs."

petroleum products via pipeline in the vicinity of Houston from a majority of the refineries in the Gulf Coast area from Corpus Christi, Texas through Lake Charles, Louisiana. Petroleum products are shipped from the origin market to the Tulsa BEA destination market via Magellan's pipeline, which consists of (1) a 16-inch diameter pipeline that begins at Magellan's East Houston, Texas tank farm and extends northward for approximately 199 miles to Magellan's Frost, Texas tank farm; and (2) a 12-inch diameter pipeline that continues northward from the Frost tank farm for approximately 207 miles, where it connects with Magellan's Central System at Duncan, Oklahoma and continues 215 miles into the Tulsa BEA for distribution in the Tulsa market and various markets throughout the Midwest.

II. Description of the Filing

3. Magellan seeks market-based rate authority for the transportation of petroleum products to address the substantial seasonal demand fluctuation that it faces on a subset of its system. Magellan asserts it will achieve a consistent high-level of throughput during the entire year because the increased rate flexibility will enable it to utilize its available capacity more effectively. Magellan's application describes its various sources of competition and provides statistical analyses in support of its position.[4] In addition, Magellan states that the Commission has found both the Houston and Tulsa markets to be competitive and has granted market-based rate authority to pipelines with greater capacity than itself.[5] Thus, Magellan claims that the application, and the statements filed with and in support of it, demonstrate that it should be granted market-based ratemaking authority for the Houston, Texas to Tulsa, Oklahoma portion of its system.

4. Magellan defines the relevant product market as the transportation and delivery of all pipelineable refined petroleum products,[6] which include motor gasoline, distillates (diesel fuel and No. 2 home heating oil), aviation gasoline, and jet fuel.

A. Origin Market

5. The proposed origin market consists of seven BEAs: (1) Austin-Round Rock, TX; (2) Beaumont-Port Arthur, TX; (3) Corpus Christi-Kingsville, TX; (4) Houston-

[4] Magellan includes with its application the direct testimony of Dr. George R. Schink and Mr. Stanley W. Rogers supporting its position.

[5] *See*, *Longhorn Partners Pipeline, L.P.*, 83 FERC ¶ 61,345, at 62,381 (1998); *Explorer Pipeline Co.*, 87 FERC ¶ 61,374, at 62,385, 62,388, 62,389-91 (1999); and *Williams Pipe Line Co.*, 68 FERC ¶ 61,135, at 61,675, 61,696 (1994).

[6] *Buckeye Pipe Line Co.*, 53 FERC ¶ 61,473, at 62,663-64 (1990).

Baytown-Huntsville, TX; (5) Lake Charles-Jennings, LA; (6) McAllen-Edinburg-Pharr, TX; and (7) San Antonio, TX. Magellan's product receipt points in the Gulf Coast are located in East Houston and Galena Park, TX. At these receipt points, Magellan states that it is able to receive refined products from refineries in Corpus Christi and Beaumont-Port Arthur, TX and Lake Charles, LA via connecting pipelines, as well as from Houston, TX. According to Magellan, there are 19 refineries in the origin market, none of which are solely dependent on it for outbound shipments. Magellan asserts that at least nine major pipelines carry refined petroleum products from the Western Gulf Coast origin market to most locations east of the Rocky Mountains in the Southwest through Phoenix, AZ. Magellan also notes that Gulf Coast refineries have access to outbound barges or tankers to carry shipments throughout the Midwest, to the Atlantic Coast, and to foreign ports.

6. To determine Magellan's market power in the origin market, its witness, Dr. Schink, calculates market shares and Herfindahl-Hirschman Indexes (HHI)[7] of market concentration. The data compiled to calculate market power include the level of local consumption, waterborne shipments out of the market, and the capacity of Magellan and other pipelines to move refined petroleum products out of the market.[8] According to Magellan, trucks and a virtual web of pipelines serve local consumption and move products throughout the origin market. Magellan asserts that the market share of each local distributor is very low, making the HHI contribution from local consumption virtually zero. Local consumption absorbs 15.1 percent of the origin market's refined supply.

[7] HHI measures the likelihood of a pipeline exerting market power in concert with other sources of supply. An HHI is derived by squaring the market shares of all the firms competing in a particular geographic market and adding them together. The HHI can range from just above zero, where there are a very large number of competitors in the market, to 10,000, where the market is served by a monopolist. A high HHI indicates significant concentration. This means that a pipeline is more likely to be able to exercise market power either unilaterally or through collusion with rival firms in the market. The HHI figures of 1,800 and 2,500 or lower are indicators typically used by pipelines applying for market-based rate authority to reflect what they consider is an accurate depiction of tolerable levels of concentration based on the Department of Justice and Federal Trade Commission *1992 Horizontal Merger Guidelines*. A threshold of 1,800 would be met if a market were served by between five and six equally sized competitors. The 2,500 threshold would indicate a market served by four equally sized competitors.

[8] The data is based on 2007 deliveries, except for waterborne shipments, which are based on 2006 deliveries.

7. Magellan argues that like the local distribution market, the barge and tanker industry is very competitive with low barriers to entry, translating into a negligible HHI contribution for waterborne shipments. By Magellan's calculations, waterborne shipments absorb 12.7 percent of the origin market's supply and are a substantial factor in this market.

8. Magellan describes the HHI and market share for the movement of petroleum products out of the market from two different perspectives: (1) effective capacity and (2) adjusted capacity. The effective capacity market share is the percentage of capacity based on the total capacity of all of the pipelines. Magellan estimates its 2007 capacity to be 332 MBD, which gives it an effective capacity market share of 6.6 percent and an effective capacity-based HHI of 1,665. [9]

9. Magellan's second methodology is the Department of Justice (DOJ) *Oil Pipeline Deregulation Study* method, or adjusted capacity, which assumes that each supplier has an equal probability of making a delivery into the market, regardless of the size of its pipeline or refinery. Theoretically, each supplier captures an equal share of demand. If each supplier has the capability of supplying an equal share, then each supplier will be assigned a capability to supply this amount. However, if a supplier does not have the capacity to supply an equal share, then the amount of product over the maximum capacity is assigned to the remaining pipelines equally. Accordingly, Magellan calculated its adjusted-capacity based market share to be 9.2 percent for inter- and intrastate movements, which yields an HHI of 728.

10. In addition, Magellan calculates the excess capacity ratio, or the total effective capacity divided by the refinery capacity, to be 1.38. This means pipelines in the origin market have the ability to absorb 38 percent more refined products than local refineries can produce. Magellan asserts that this is more than five times its total outbound capacity.

11. In an effort to dispel any notion that the origin market is unjustifiably large or inclusive, Magellan also calculates HHIs for only the Houston BEA, where its pipeline originates. In this scenario, the effective capacity-based HHI is 1,772 and the adjusted capacity HHI is 539. Its effective capacity market share is 9.6 percent and the adjusted capacity market share is 9.2 percent.

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[9] Magellan owns four pipelines carrying product out of the Western Gulf Coast market. Magellan states its share of total effective capacity for all four pipelines is 6.6 percent, but is only 1.3 percent for the intrastate pipeline. The HHI is calculated based on Magellan's total outbound capacity, not just its interstate capacity.

B. Destination Market

12. In the proposed Tulsa BEA destination market, Magellan states that it competes with several internal supply sources, including two local refineries, Sinclair and Sunoco; three pipelines, Explorer, ConocoPhillips, and SemGroup (recently idled but could readily be returned to service); and a river port facility. Magellan also estimates that there are thirteen external supply sources within effective trucking distance of the destination market and are potential competitors.

13. As in the analysis of the origin market, Magellan computes HHIs using effective and adjusted capacity measures for the destination market. For each of these capacity measures, Magellan performs analyses with competing suppliers located only within the Tulsa BEA and with external competitors included. Magellan also calculates two sets of HHIs and market shares, one including and the other excluding the dormant SemGroup pipeline,[10] for all of the internal and external cases. When considering external suppliers, Magellan posits several possible situations. First, Magellan includes external suppliers as competitors if they fall within either a (1) 75-mile or (2) 100-mile radius of the Tulsa BEA. Second, Magellan includes only suppliers where delivered price for gasoline is cost effective. For this two criteria are used: (1) the potential competitor's delivered price is no more than 1 percent above the highest delivered price; and (2) the potential delivered price is no more than 2 percent above the highest delivered price.[11] A summary of the HHI and market share analyses is in the tables below. The highest HHI calculated by Magellan from the above scenarios in the destination market is 2,026 with an 18.9 percent market share, which is within the 1,800 to 2,500 range and with limited market power. Magellan estimates its delivery-based market share for local consumption to be 1.8 percent and the excess capacity ratio in the Tulsa BEA to be 4.10 or higher.

Internal Sources Only

Table 1.

	Effective Capacity		Adjusted Capacity	
	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup
HHI	1,845	2,026	1,667	2,000
Market Share	17.7%	18.9%	16.7%	20.0%

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[10] The SemGroup pipeline was recently idled but could readily be returned to service.

[11] This replicates the analysis presented by Dr. Jonathan D. Ogur in *Buckeye Pipe Line Co*. 53 FERC ¶ 61,473 (1990), to establish the competitiveness of external suppliers.

Including External Sources:
75- and 100-Mile Radius

Table 2.

	Effective Capacity				Adjusted Capacity			
	75-Mile Radius		100-Mile Radius		75-Mile Radius		100-Mile Radius	
	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup
HHI	1,512	1,653	1,353	1,462	1,428	1,668	1,289	1,480
Market Share	15.9%	16.6%	15.3%	16.0%	14.9%	17.6%	13.9%	16.2%

Including External Sources:
1% and 2% Delivered Gasoline Price Criteria

Table 3.

	Effective Capacity				Adjusted Capacity			
	1% Criteria		2% Criteria		1% Criteria		2% Criteria	
	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup	Including SemGroup	Excluding SemGroup
HHI	1,681	1,859	1,432	1,551	1,584	1,884	1,344	1,553
Market Share	17.3%	18.4%	14.6%	15.3%	17.1%	20.2%	14.1%	16.4%

III. Interventions and Protests

14. Pursuant to section 348.2(g) of the Commission's regulations, interventions or protests to Magellan's application were required to be filed by August 3, 2009. No party filed interventions or protests.

IV. Discussion

15. Section 348.1(c) of the Commission's regulations requires an oil pipeline seeking a market power determination and authority to charge market-based rates to (1) define the relevant product and geographic markets, including both destination and origin markets; (2) identify the competitive alternatives for shippers, including potential competition and other competition constraining the pipeline's ability to exercise market power; and (3) compute the market concentration and other market power measures based on the information provided about competitive alternatives.[12]

16. The Commission has reviewed the information filed by Magellan and concludes that Magellan does not have significant market power over the origin and destination markets that Magellan designated for market-based rates.

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[12] 18 C.F.R. § 348.1(c) (2009).

17. The Commission concludes that Magellan's market share in the Western Gulf Coast origin market, the competitive alternatives available, and the absence of any evidence to the contrary, establish that Magellan cannot exercise market power in the Western Gulf Coast origin market. This is reflected by the Western Gulf Coast's low HHIs, which are indicative of a large number of competitors. Though it is important to remember that the Commission has not imposed stringent guidelines regarding HHI figures in oil pipeline cases,[13] they are nonetheless often utilized as competitive market indicators. Magellan has also shown that there are a number of competing pipelines and that waterborne petroleum product deliveries account for a significant portion of demand in the origin market.[14] In addition, Magellan's analysis of a narrower definition of an origin market illustrates the competitiveness of the Houston BEA in and of itself.

18. Magellan's destination market shares and HHIs similarly demonstrate that the Tulsa BEA is competitive. The effective-capacity market share is always less than 20 percent and the HHI for the destination market is always less than 2,100. The results from each of the Tulsa BEA scenarios compare favorably with HHI initial screening figures and market share percentages found to be acceptable in the *Buckeye*[15] and *Williams*[16] cases. The significant excess capacity in the destination market suggests that Magellan's competitors would be able to capture business from Magellan quickly if it raised rates above competitive levels.

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[13] In previous cases, the Commission used an HHI of 2500 as an initial screen, and then reviewed the pipeline's market share and other factors in order to determine whether the pipeline possessed significant market power. *Williams Pipe Line Company*, 68 FERC ¶ 61,136, at 61,670-72 (1994) (*Williams*), 71 FERC ¶ 61,297, at 62,127 (1995); *Buckeye Pipe Line Company*, 53 FERC ¶ 61,473, at 62,666-68 (1990) (*Buckeye*), 55 FERC ¶ 61,084, at 61,254 (1991).

[14] In *Williams Pipeline Co.*, 71 FERC ¶ 61,291, at 62,138 (1995), for example, the Commission found that lack of market power existed in one market where waterborne capacity was expandable and waterborne movements accounted for 10 percent or more of the total deliveries in the market.

[15] The Commission accepted an HHI of 2561and market share of 43.7 percent and an HHI of 3051 and market share of 28.5 percent for the Pittsburgh, PA and Columbus, OH delivery markets, respectively.

[16] The Commission accepted an HHI of 2606 and a market share of 35 percent, an HHI of 2381 and market share of 39 percent, and an HHI of 2048 and a market share of 34 percent for Minneapolis/St. Paul, MN, Dubuque, IA, and Davenport, IA delivery markets, respectively.

19. Granting Magellan the authority to charge market-based rates is consistent with prior Commission determinations and objectives. The Commission permitted Longhorn Partners Pipeline and Explorer Pipeline Company to charge market-based rates in the Western Gulf Coast origin market and Williams Pipeline Company, and Explorer Pipeline Company was given such authority in the Tulsa BEA destination market.[17] Moreover, the ratemaking flexibility that Magellan seeks is consistent with the Commission's objectives in Order No. 572 to establish efficient pricing in the face of market conditions with substantial seasonal demand fluctuations.[18] These factors are further supported by the absence of any protest by Magellan's shippers.

20. Based upon the preceding discussion, the Commission finds that Magellan lacks significant market power in the Western Gulf Coast origin market and over deliveries to the Tulsa BEA market. The Commission authorizes Magellan to make a filing under section 6 of the Interstate Commerce Act to charge market-based rates for transportation to delivery points as more fully described in its application.

<u>The Commission orders:</u>

(A) Magellan's application for a determination that it lacks market power in the markets analyzed in this decision is granted.

(B) Magellan may file a tariff to charge market-based rates as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[17] *See* footnote 5.

[18] *Market-Based Ratemaking for Oil Pipelines*, Order No. 572, FERC Stats. & Regs. ¶ 31,007 (1994).