152 FERC ¶ 61,203
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Philip D. Moeller, Cheryl A. LaFleur,
Tony Clark, and Colette D. Honorable.

Enterprise Products Partners L.P. and Enbridge Inc. — Docket No. OR12-4-001

ORDER ON REHEARING

(Issued September 15, 2015)

1. On February 20, 2014, the Commission issued an Order on Rehearing, upholding the denial of the application of Enterprise Products Partners L.P. (Enterprise) and Enbridge Inc. (Enbridge) (Enterprise/Enbridge, or Applicants) for authority to charge market-based rates on the Seaway Crude Pipeline Company System (Seaway) from Cushing, Oklahoma to the U.S. Gulf Coast, and setting forth the Commission's approach to evaluating applications from oil pipelines for market-based rate authority.[1] The Commission had sought comments concerning the proper interpretation of the decision of the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit or court) in *Mobil Pipeline Co. v. FERC*[2] as it related to the Seaway application, as well as its impact on the Commission's established rate regulations and policies for determining whether an oil pipeline can exercise market power.

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[1] *Enterprise Products Partners L.P. and Enbridge Inc.*, 146 FERC ¶ 61,115 (2014) (Order on Rehearing).

[2] *Mobil Pipe Line Co. v. FERC*, 676 F.3d 1098 (D.C. Cir. 2012) (*Mobil*).

2. On March 24, 2014, Airlines for America (A4A)[3] and Suncor Energy Marketing Inc. and Husky Marketing and Supply Company (Suncor) (collectively Shippers), filed requests for rehearing challenging many aspects of the Order on Rehearing. On April 8, 2014, Apache Corporation, Chevron Products Company, and Noble Energy, Inc., (collectively ACN) filed a Motion for Reconsideration and Clarification.

3. In this order, the Commission denies rehearing.

BACKGROUND

4. This proceeding initially began when, on December 2, 2011, Enterprise/Enbridge filed an application for authority to charge market-based rates on the planned reversal of Seaway. Six parties protested the request for market-based authority for the origin and destination points on the reversed Seaway pipeline. On May 7, 2012, the Commission rejected Enterprise/Enbridge's application.[4] The Commission found that Enterprise/Enbridge had not provided the necessary data to evaluate competition in terms of price, and that such data could not be provided for a pipeline without any operational history.

5. Just prior to the issuance of the May 7, 2012 Order, the D.C. Circuit issued a decision concerning an application for market-based rate authority for ExxonMobil's Pegasus pipeline.[5] The Commission had rejected Pegasus' application, finding that the pipeline possessed market power.[6] The court reversed the Commission, finding that Pegasus faced numerous competitive alternatives and therefore could not exercise market power.

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[3] A4A's members are: Alaska Airlines, Inc.; American Airlines, Inc.; Atlas Air, Inc.; Delta Air Lines, Inc.; Federal Express Corporation; Hawaiian Airlines; JetBlue Airways Corp.; Southwest Airlines Co.; United Airlines, Inc.; and United Parcel Service Co. Air Canada is an associate member.

[4] *Enterprise Products Partners L.P. and Enbridge Inc.*, 139 FERC ¶ 61,099 (2012) (May 7 Order).

[5] *Mobil*, 676 F.3d 1098.

[6] *Mobil Pipe Line Co.*, 133 FERC ¶ 61,192 (2010), *vacated*, *Mobil*, 676 F.3d 1098.

6. On June 28, 2012, in response to the issuance of *Mobil*, the Commission *sua sponte* granted rehearing of its order denying the application of Enterprise/Enbridge for authority to charge market-based rates, and sought comments on the proper interpretation of *Mobil* as it related to applications for market-based rate authority by oil pipelines.[7] After reviewing the *Mobil* decision, the underlying Commission proceeding, and the numerous comments filed, the Commission in the Order on Rehearing once again rejected the application, and provided an analysis of oil pipeline procedures for market-based rate applications consistent with the *Mobil* decision.[8]

7. In the Order on Rehearing, the Commission found that the *Mobil* decision did not fundamentally alter the Commission's methodology for analyzing applications for market-based rate authority from oil pipelines.[9] Specifically, the Commission reaffirmed that in order for an alternative to be a "good" alternative, it must be available, must be of comparable quality to the applicant, and must be able to discipline a potential price increase by the applicant above the competitive level.[10]

REQUESTS FOR REHEARING

8. A4A requested a limited rehearing of the Commission's February 20, 2014 Order on Rehearing. While A4A agrees with the ultimate decision to deny the application to charge market-based rates on Seaway, A4A argues the Commission expressed a fundamental misunderstanding of a number of basic economic principles. Specifically, A4A states the Commission erroneously assumes that "the point where supply and demand intersect" necessarily, and by definition, represents the "competitive price,"[11] and erroneously states that "the competitive price is determined by the marginal costs of the marginal supplier, the supplier with the highest marginal costs."[12] A4A claims these statements contradict standard economic principles and theory and will likely lead the

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[7] *Enterprise Products Partners L.P. and Enbridge Inc.*, 139 FERC ¶ 61,255 (2012).

[8] Order on Rehearing, 146 FERC ¶ 61,115.

[9] Order on Rehearing, 146 FERC ¶ 61,115 at P 31.

[10] Order on Rehearing, 146 FERC ¶ 61,115 at P 45.

[11] A4A Request for Rehearing at ¶ 2(quoting Order on Rehearing, 146 FERC ¶ 61,115 at P 49).

[12] A4A Request for Rehearing at ¶ 2 (quoting Order on Rehearing, 146 FERC ¶ 61,115 at P 51).

Commission to greatly overstate the number of good alternatives with a competitive price, an unreasonable position as even a monopolist's price, which is by definition a price above the competitive level, represents a market clearing price established where "supply and demand intersect."[13]

9. A4A argues that by assuming all used alternatives are good alternatives, the Commission assumes, without any evidentiary basis, that the existing market is effectively competitive and ignores the fact that, when faced with constraints in the supply of pipeline capacity, shippers will use any alternative that returns a profit regardless of whether the alternatives would discipline the applicant pipeline from charging a rate above the competitive price level.[14] A4A states the Commission's analysis ignores the purpose of identifying good alternatives, which is to determine whether there are alternatives to the pipeline to which shippers could turn to restrain the pipeline's ability to raise its price above the competitive level.[15]

10. A4A also states the Commission erred in assuming that excess demand for the pipeline's capacity indicates that the tariff rate for the pipeline is below the competitive price.[16] A4A states the Commission assumes, without evidentiary support or basis, that at the point where there is no excess demand, the price is by definition competitive.[17] A4A also argues the Commission failed to recognize that the commodity price base differential between two locations could be well above the relevant competitive price for pipeline transportation, and argues this failure was a fatal flaw in the Commission's Order on Rehearing.[18]

11. A4A argues that the Commission's analysis, in blindly assuming usage demonstrates competitiveness when identifying competitive alternatives, without identifying a reasonable proxy for the competitive price, results in the entire market power analysis being compromised. They also contend the market shares and corresponding Herfindahl-Hirschman Index values (HHIs) calculated under the

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[13] A4A Request for Rehearing at ¶ 1-2.

[14] A4A Request for Rehearing at ¶ 2.

[15] A4A Request for Rehearing at ¶ 3.

[16] A4A Request for Rehearing at ¶ 4.

[17] A4A Request for Rehearing at ¶ 4.

[18] A4A Request for Rehearing at ¶ 5.

Commission's methodology can be misleading and meaningless, and the presence or lack of market power cannot be reliably determined.[19]

12. Suncor requests rehearing of the ruling that all used alternatives are presumed to be competitive with a pipeline applying for market-based rate authority without regard for actual price data (to properly assess whether on a relative basis, an alternative is a good alternative) and without consideration of a reasonable proxy for the competitive transportation rate.[20] Further, Suncor takes issue with the Order on Rehearing's failure to consider or address reply comments submitted by Joint Shippers;[21] specifically, how the "used" alternative test is unable to detect market power because it cannot identify true competitive alternatives.[22] Suncor notes if the Commission applies the "used" alternative test to future applications for market-based rates, the result is likely to be a landslide of market-based rate applications relying on long lists of "used" alternatives without comparative delivered price data.[23] Suncor argues the ultimate consequence is likely to be widespread grants of market-based rate authority to oil pipelines without a meaningful determination that they lack significant market power.[24] Suncor states the pipelines most inclined to take advantage of the misguided "used" alternative standard are those pipelines that do have market power and therefore profit most from the absence of effective regulation.[25]

13. ACN filed a motion for reconsideration and clarification of the Order on Rehearing. ACN is concerned that some of the Commission's statements providing additional "guidance" as to what is required for a pipeline to demonstrate a lack of market power, especially in the area of what qualifies as "competitive" alternatives, are not qualified or conditioned, as they have been in the past.[26] ACN expresses a concern

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[19] A4A Request for Rehearing at ¶ 6.

[20] Suncor Request for Rehearing at ¶ 1.

[21] Joint Shippers include Suncor Energy Marketing, Inc., Canadian Natural Resources Limited, Continental Resources, Inc., and Husky Marketing and Supply Company.

[22] Suncor Request for Rehearing at ¶ 4.

[23] Suncor Request for Rehearing at ¶ 4.

[24] Suncor Request for Rehearing at ¶ 4.

[25] Suncor Request for Rehearing at ¶ 4.

[26] ACN Motion for Reconsideration and Clarification at ¶ 2.

that if these statements are taken out of context and stand on their own, it could result in a determination that many more oil (and potentially natural gas) pipelines lack market power. ACN states the Order on Rehearing could be read to diminish the historical barriers to qualification for market-based rates, and provides in its pleading a practical example based on the record in Seaway's pending rate case (Docket No. IS12-226-000) demonstrating the flaws in certain of the assumptions in the Order on Rehearing regarding how to identify competitive alternatives.[27]

14. The Liquids Shippers Group[28] filed amicus curiae comments. The Liquids Shippers Group (LSG) submits the Commission erred in issuing new rules of general applicability in the Order on Rehearing without developing an evidentiary record or implementing a rulemaking to examine its positions.[29] LSG argues the Commission did not hold a hearing on Seaway's application, nor did it convene a technical conference or other fact-finding proceeding to examine the complex and economics-driven issues raised by the *Mobil* decision; further, the Commission did not seek comments from the industry on these matters via a rulemaking, but rather issued new rules of general applicability at the rehearing phase of a pipeline-specific proceeding in an analytical vacuum.[30]

DISCUSSION

15. The arguments in the requests for rehearing center primarily on whether the Commission's methodology for selecting a competitive price proxy for use in the market power analysis for oil pipelines, as detailed in the Order on Rehearing, is appropriate. As discussed in the Order on Rehearing, a proxy for the competitive price is a paramount component of the market power analysis. In *Mobil*, the court identified the harm of selecting an inappropriate proxy, one that was below the competitive price.[31] The court held that it is improper to simply presume, without any analysis of costs or market

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[27] ACN Motion for Reconsideration and Clarification at ¶ 3. The Commission notes that many of ACN's statements in its motion are points of contention currently pending in Docket No. IS12-226-000.

[28] For the purpose of this filing, the Liquids Shippers Group includes Anadarko Energy Services Company, ConocoPhillips Company, Devon Gas Services LP., Encana Marketing (USA) Inc., Marathon Oil Company, Murphy Exploration & Production Company-USA, and WPX Energy Marketing LLC.

[29] LSG Amicus Curiae Brief at ¶ 4.

[30] LSG Amicus Curiae Brief at ¶ 4.

[31] *Mobil*, 676 F.3d 1098 at 1103.

dynamics, that the regulated rate of a pipeline seeking a market power determination is a valid proxy for the competitive price.[32]

16. The Order on Rehearing discussed the scenario, faced by both the Pegasus pipeline and Seaway, where a traditional netback analysis may not be relevant in a market power analysis for oil pipelines.[33] The Order on Rehearing made clear that while a traditional netback analysis may no longer be necessary in certain proceedings, good alternatives must always be competitive in terms of price.[34]

17. In the Order on Rehearing, the Commission presented a methodology consistent with Order No. 572[35], as well as the *Mobil* decision and basic economic principles, for determining a competitive price proxy.[36] This methodology, mirroring that presented in *Mobil*, focused on shipper behavior in the market. In the *Mobil* proceeding, Trial Staff's testimony, viewed favorably by the court, established that all alternatives being used in the origin market were good alternatives in terms of price.[37] Characterizing a used alternative as a good alternative in terms of price relies on shipper behavior to implicitly demonstrate that the alternative is an acceptable economic outlet to the shipper. It also recognizes that it would not be rational for a shipper to use an alternative that was unprofitable, or produced a negative netback.[38] Shipper behavior concerning the use of an alternative is sufficient evidence of the economic viability of that alternative, and usage thus becomes the necessary proxy for determining whether an alternative is competitive in terms of price.[39]

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[32] *Id.*.

[33] Order on Rehearing, 146 FERC ¶ 61,115 at P 53.

[34] Order on Rehearing, 146 FERC ¶ 61,115 at P 53. Availability and quality are the other requirements for a "good" alternative.

[35] *Market-Based Ratemaking for Oil Pipelines*, Order No. 572, FERC Stats. & Regs. ¶ 31,007 (1994), *aff'd sub nom. Ass'n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

[36] Contrary to the claims of LSG, the Commission in the Order on Rehearing did not institute new rules of general applicability, and therefore a rulemaking proceeding was not necessary.

[37] Trial Staff Ex. S-10 at 17, Docket No. OR07-21 (filed June 25, 2008).

[38] Order on Rehearing, 146 FERC ¶ 61,115 at P 56.

[39] Order on Rehearing, 146 FERC ¶ 61,115 at P 56.

18. On rehearing, the Shippers contend that focusing on usage when determining competitive alternatives could allow for the inclusion of many alternatives into the relevant market that are priced above the true competitive price. The Shippers instead argue that, despite the ruling in *Mobil*, the tariff rate of the applicant pipeline remains an appropriate proxy for use in a market power analysis.

A. Determination of a Competitive Price Proxy

19. The Shippers argue that the Commission's methodology for determining an appropriate proxy for the competitive rate allows for the selection of an improper proxy that is above the competitive level. While the Shippers agree that a market power analysis must identify an appropriate proxy for the price that would prevail in the competitive market,[40] they state that the Commission's focus on "used" alternatives fails to prevent supra-competitive priced alternatives from inclusion as good alternatives in the market. In essence, argue the Shippers, because a monopolist will be a "used" alternative, it and any other used alternatives priced above the true competitive level could be improperly included in the analysis and could indicate a competitive market where none exists.

20. The Shippers' arguments to demonstrate this perceived flaw in the Commission's methodology are two-fold. The Shippers first argue that the Commission's methodology for determining a competitive price proxy could result in a "cellophane trap" where a market currently dominated by a monopolist is instead mistakenly characterized as competitive. The Shippers also argue that the Commission's belief that any intersection of supply and demand is by definition a competitive price ignores the fact that a monopoly price is also at a point where supply and demand meet. By accepting any intersection of supply and demand as an appropriate price proxy, argue the Shippers, the Commission could allow alternatives charging supra-competitive prices to be included as good alternatives.

21. The Commission denies rehearing. The Commission's methodology for determining an appropriate proxy for the competitive price prevents the inclusion of alternatives that are charging supra-competitive rates. Further, the Shippers mischaracterize the Commission's statements concerning the intersection of supply and demand while failing to recognize that the competitive alternative analysis represents only one step of a multi-part test (including geographic market, product market, competitive alternatives, and market share and market concentration analysis) an oil pipeline must pass in order to demonstrate a lack of market power.

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[40] A4A Request for Rehearing at ¶ 15, Arthur Aff. ¶ 7.

22. The idea of the "cellophane fallacy" or "cellophane trap" derives from the Supreme Court decision in *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (*DuPont*). At the time, DuPont produced almost 75 percent of cellophane sold in the United States; however, cellophane constituted less than 20 percent of all flexible packaging material sold in the United States. The Court found that there was sufficient interchangeability, i.e., demand elasticity, between cellophane and other flexible packaging material to include all of these products in the same relevant product market. The decision has since been invoked when referring to a potential flaw in market analyses that fail to evaluate whether demand elasticity is a result of a company already charging a monopoly price, which would increase the likelihood that consumers would switch from one product to another but would not be indicative of a competitive market.[41]

23. Demand elasticity identifies the products that consumers will switch to given a price increase.[42] Elasticity of demand, however, is an accurate test to determine whether two products are good alternatives only if each is being offered at a true competitive price (rather than at a price that seems to have the indicia of competitiveness, but is really a price reflecting the exercise of market power). This is the "cellophane fallacy."[43] A monopolist will increase price until the loss of customers due to the price increase is no longer offset by the increased revenue from remaining customers. At that price point, a monopolist – even though it has already charged more than a firm in a truly competitive market could have – has reached a point of high elasticity of demand *similar to* that of a firm in a truly competitive environment and will face competition from alternative suppliers.. This high elasticity of demand, while appearing similar to that seen in competitive markets, masks inflated prices and represents competition between a monopolist and high cost alternatives that would offer only minimal interchangeability at competitive price levels.[44]

24. Undertaking a market analysis at a monopolistic price can lead to the inclusion of good alternatives that are only good in comparison with the monopolistic price, yet would not be good alternatives at the competitive price. Stated differently, if the market contains a monopolist charging a supra-competitive price, then the only reason that the market contains certain other used alternatives is that the existence of the monopoly price made such alternatives profitable. Failing to acknowledge that demand elasticity could

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[41] *See U.S. v. Eastman Kodak Co.*, 63 F.3d 95, 105 (2d2nd Cir. 1995).

[42] *See Rebel Oil Co. Inc. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995).

[43] *See U.S. v. Eastman Kodak Co.*, 63 F.3d at103.

[44] *Id*.

occur at a monopoly price, resulting in the improper inclusion of alternatives into the market, is the proverbial "cellophane trap."

25. The Shippers argue that such a scenario could occur under the Commission's methodology of characterizing used alternatives as good alternatives. In essence, they argue that a market with a monopolist could contain other supra-competitive price alternatives, and by focusing solely on usage, the Commission's methodology couldresultresult in the same type of flawed market analysis that many commentators argue occurred in the *DuPont* decision.

26. Contrary to the Shippers' concerns, in order for the so-called "cellophane trap" to result from the Commission's methodology for determining a competitive price proxy, not only would a number of highly unlikely scenarios need to simultaneously occur, but even in such an unlikely scenario other elements of the Commission's overall methodology for determining market power would effectively prevent such a monopolist from acquiring market-based rate authority. Further, the Shippers ignore the fact that the methodology they propose resulted in a "reverse cellophane trap" in *Mobil*, where a price proxy below the actual competitive price resulted in the improper exclusion of good alternatives from the market.

27. The first factor required for the "cellophane trap" to occur is that a current market participant would not only need to possess market power, but also would have the ability to charge a monopoly price. The ability to charge a monopoly price would require that the monopolist not be subject to any form of cost-of-service rate regulation or similar restriction on the ability to raise price. In the *DuPont* case, for example, the prices of cellophane and other flexible packaging materials were not regulated. Absent the unrestricted ability to raise rates, the presence of a monopolist in the market would not result in entry of alternatives at supra-competitive rates, and the "cellophane trap" would be avoided. The oil pipeline industry, unlike the market analyzed in *DuPont*, is dominated by entities under some form of price regulation. The extent of this regulation minimizes the potential for a "cellophane trap" by reducing the likelihood that a current market participant has both market power, and the ability to extract a monopoly price.[45]

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[45] There is no singular way to avoid slipping into the "cellophane trap." It may at times be useful to ask not only what will happen if prices are increased from a current level (which may appear to be a competitive level but may not be), but also to ask what will happen if prices are decreased from said current level, since this will provide insight into both demand-side and supply-side substitution. The means to avoid being duped by the "cellophane fallacy" are essentially case-specific, since available data and determinative issues vary depending on circumstances. As discussed above, the regulated oil transportation industry operates in different circumstances from those of the wrapping materials market in the *DuPont* cellophane inquiry.

28. This set of characteristics, namely, that a market participant (a) is a monopolist, and (b) could raise rates above the competitive level, would not apply to the pipeline seeking market-based rate authority. An applicant pipeline is required to charge a regulated rate until it can affirmatively show that it does not possess significant market power. Thus, in the scenario created by the Shippers, an applicant pipeline seeking market-based rate authority would exist in a market that contained another alternative that was an unregulated monopolist. As the Commission's market power analysis is set up to determine whether the applicant possesses significant market power, it is unlikely that a pipeline in a market that contained an unregulated monopolist would itself have market power as well.

29. In addition, if an unregulated monopolist did exist in the market, and such monopolist charged a monopoly price so that alternatives charging supra-competitive prices would be "used" in the market, the Commission's methodologies concerning market shares and market calculations would effectively capture such a scenario and reflect a non-competitive market. The Commission's methodologies require market shares and market calculations for all market participants. The presence of a monopolist, even if not the applicant, would be reflected in the HHI and market share calculations. The analysis would show that the market contained an unregulated alternative with a high enough market share to exercise market power. Once identified, any potential non-competitive behavior by this alternative, and its effect on the applicant's market-based rate request, could be analyzed.

30. As a final note, the Commission in the Order on Rehearing held that the competitive price is the marginal cost of the marginal supplier, not the prevailing price. Even if an alternative in the market is exercising market power and charging a supra-competitive price, that price would not be a factor in determining the appropriate competitive price proxy. The Commission did not find that *any* market-clearing price was by definition a competitive price, or that prevailing prices are by definition just and reasonable rates.[46] Only actual costs are relevant under the Commission's methodology,

[46] The Supreme Court has held that the Commission cannot presume that all market clearing prices are just and reasonable. *See FPC v. Texaco, Inc.*, 417 U.S. 380 (1974).

and the burden is on the applicant to demonstrate that the costs utilized in its application for market-based rate authority are actual costs, and not those set above the marginal cost of the marginal supplier, by any means.[47]

31. In an argument related to the "cellophane trap" criticism, the Shippers challenge the Commission's statement in Paragraph 49 of the Order on Rehearing that "a competitive price is by definition at the point where supply and demand intersect."[48] The criticism is that monopoly prices also occur at a point where supply and demand intersect, and that by allowing any point where supply and demand meet to represent an appropriate competitive price proxy, the Commission risks having monopoly prices serving as proxies for competitive prices.

32. The Commission's statement in the Order on Rehearing that a competitive price is where supply and demand intersect is accurate if the underlying market studied is defined by buyers and sellers who are constrained by market forces from extracting monopoly pricing. The Shippers are also correct that not all points where supply and demand intersect can be characterized as a competitive price (if the underlying market is not competitive and hence defined by abuse of market power and monopoly pricing), but this argument is irrelevant, and the Shippers' arguments do not accurately reflect the Commission's statements in the Order on Rehearing relating to competitive price.

33. In Paragraph 49 of the Order on Rehearing, the Commission explained why a tariff rate may not be an appropriate proxy for the competitive price. One such instance occurred in *Mobil*, where the applicant pipeline experienced excess demand at its current tariff rate, demonstrating that the tariff rate was below the competitive price. To reach the competitive price, the pipeline's rate would need to increase to the point where supply and demand intersect. The Commission did not find that *any* point of intersection between supply and demand indicated a competitive price, or that a pipeline in all instances would stop increasing its price once it hit the competitive price level. The

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[47] This includes not only supra-competitive rates supported by an alternative's market power, but other means of setting rates above costs, to include settlement and negotiated rates. As an example, for an alternative that possessed both negotiated committed rates and cost-based uncommitted rates, it would be the cost-based uncommitted rates that would be the relevant rates for a market power analysis. This addresses the primary concerns raised by ACN in its Motion for Reconsideration and Clarification.

[48] Order on Rehearing, 146 FERC ¶ 61,115 at P 49.

Shippers themselves agree that both competitive prices and monopoly prices occur at points where demand intersects supply,[49] and the Commission concurs with this statement.

34. Shippers also raise several arguments specifically criticizing the Commission's finding that the decision by shippers to use an alternative is evidence as to that alternative's proper inclusion in the market. In the Order on Rehearing, the Commission stated that characterizing a used alternative as a good alternative in terms of price relies on shipper behavior to implicitly demonstrate that the alternative is economic or profitable to that shipper.[50] It would simply not be rational for a shipper, who engages in transactions at 'arms-length,' to use an alternative that was not profitable in that it produced a negative netback. Usage also was found to demonstrate that the used alternative provides a higher netback than any alternative that is available but not being used. The Commission ultimately held that shipper behavior concerning the use of an alternative is sufficient evidence of the economic viability of an alternative.[51] In its Amicus Brief, Liquids Shippers Group raises several potential scenarios where the decision to ship may not demonstrate a profitable decision.[52] As noted in the Order on Rehearing, if shippers can demonstrate that a used alternative is in fact producing a negative netback, and is unprofitable, such evidence would be relevant in determining whether an alternative, even if used, is a "good" alternative in terms of price.[53]

35. Finally, the Shippers maintain that just because an alternative could theoretically serve as an alternative, or does serve as an alternative but at a significantly higher price, does not make it a good alternative in terms of price.[54] The Shippers illustrate this argument by making reference to the often-raised example of carrying oil in buckets

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[49] A4A Request for Rehearing at ¶ 16.

[50] Order on Rehearing, 146 FERC ¶ 61,115 at P 56.

[51] Order on Rehearing, 146 FERC ¶ 61,115 at P 56.

[52] LSG Amicus Curiae Brief at 6-8.

[53] Order on Rehearing, 146 FERC ¶ 61,115 at P 55. While the Commission noted that it would not be rational, from an economics perspective, for a shipper to utilize an alternative that would generate a negative netback, if such a situation does occur shippers are encouraged to submit evidence as to why such an alternative should not be included as a good alternative to overcome this presumption.

[54] A4A Request for Rehearing at ¶¶ 64, 69, citing *Arizona Pub. Serv. Co. v. U.S.*, 742 F.2d 644 (D.C. Cir. 1984).

between origin and destination markets, arguing that just because a method of transportation exists does not make it a good alternative.[55] The Commission agreed with this sentiment in the Order on Rehearing and rejected the argument raised by Enterprise/Enbridge and others that "useable" or "reasonably available" alternatives be assumed good alternatives.[56] Evidence of the actual utilization of buckets in the interstate transport of oil, however, would of course be relevant in a market power analysis. Further, pipelines are required to demonstrate that alternatives are good alternatives in terms of price, availability, and quality. If an alternative is providing a similar service for significantly higher cost, it is questionable whether the alternative meets the quality requirement of a good alternative. The burden will be on the applicant to demonstrate this on a case-by-case basis.

B. Use of the Applicant's Tariff Rate as a Competitive Price Proxy

36. The Shippers argue that instead of examining usage and shipper behavior, the applicant's tariff rate should be used as the competitive price proxy. According to Dr. Arthur, the long-run marginal cost of the applicant pipeline, which he presumes is equal to the applicant's current tariff rate, should provide an upper bound on a competitive price.[57] The Shippers argue that any alternative that does not prevent the applicant from increasing its price above its tariff rate is not a good alternative and should be excluded from the market power analysis.

37. The Commission denies rehearing. In arguing that the applicant's tariff rate should serve as the presumptive competitive price proxy, the Shippers completely contradict the ruling in *Mobil*.[58] The *Mobil* proceeding demonstrated that the Commission cannot assume that the applicant's tariff rate is an appropriate proxy for the competitive price. The Shippers ignore the *Mobil* decision and argue that a pipeline charging rates significantly above its marginal costs (i.e., its current tariff rate) is exercising market power.[59]

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[55] A4A Request for Rehearing at ¶ 50.

[56] Order on Rehearing, 146 FERC ¶ 61,115 at P 64.

[57] Arthur Aff. ¶ 20.

[58] A4A Request for Rehearing at ¶ 42.

[59] A4A Request for Rehearing at ¶ 19.

38. In *Mobil*, the court was clear that an applicant's tariff rate could be below, perhaps significantly below, the competitive rate.[60] The court explained that the tariff rate in question did not "reflect Pegasus's full value to Western Canadian crude oil producers and shippers" and that the market rate might be higher than the regulated rate.[61] The Shippers, in conflict with the *Mobil* decision, state that any significant increase in price by the applicant pipeline above its current tariff rate is an exercise of market power, and that any price substantially above a pipeline's economic costs generates monopoly profits.[62] In essence, the Shippers challenge the Commission's market-based rate regime generally, stating that society's interests are only met when pipeline rates are restricted to the specific pipeline's long-run marginal costs.[63]

39. The Commission in the Order on Rehearing did not reject outright the use of the applicant's tariff rate as a proxy for the competitive price. The Commission in fact explicitly rejected Enterprise/Enbridge's argument that a pipeline's regulated rate could never serve as an appropriate proxy for the competitive price.[64] Instead, the Commission eliminated any presumption that using the applicant's tariff rate was appropriate in all circumstances. As the Commission held, it is improper to simply presume, without any analysis of costs or market dynamics, that the regulated rate of a pipeline is an appropriate proxy for the competitive price.[65] The Commission also explained why a tariff rate may not be an appropriate proxy for the competitive price. One such instance is where a pipeline experiences excess demand at its current tariff rate, demonstrating that the tariff rate is below the competitive price. To reach the competitive price, the pipeline's rate would need to increase to a point that eliminated excess demand. Conversely, if a pipeline is not experiencing excess demand at its current tariff rate, that is an indication that the tariff rate is not below the competitive price.

40. As discussed in the Order on Rehearing, the appropriate proxy for a competitive price is one that recognizes the marginal supplier: the supplier providing the lowest netback in the market. Only if the applicant is the marginal supplier will its costs be relevant in determining a competitive price proxy. While the Shippers' overall argument

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[60] *Mobil*, 676 F.3d at 1103.

[61] *Mobil*, 676 F.3d at 1103-04.

[62] A4A Request for Rehearing at ¶¶ 32-33.

[63] A4A Request for Rehearing at ¶ 49.

[64] Order on Rehearing, 146 FERC ¶ 61,115 at P 50.

[65] Order on Rehearing, 146 FERC ¶ 61,115 at P 52.

is that the applicant's tariff rate is the appropriate proxy, often in their pleadings they acknowledge the relevance of the marginal supplier in determining competitive price.[66] A4A states that whether a price represents a competitive price can be readily determined by examining the price in relation to *marginal* cost,[67] and admits that there are circumstances where a specific pipeline's cost-based rates are not an appropriate proxy for competitive rates.[68] Suncor agrees that the competitive price is tied to the costs of the *marginal* supplier.[69] Dr. Arthur states that the competitive price is close to the long-run marginal costs of the *marginal* supplier.[70] The Shippers however provide no support for the premise, made necessary by these statements, that the Commission should simply presume that the applicant pipeline is the marginal supplier.

41. One flaw in the Shippers' reasoning is their stated belief that all cost-of-service rates are meant to replicate competitive rates, and therefore any tariff rate is an appropriate proxy for a competitive price.[71] It is true that in a general sense, a cost-of-service rate is designed to simulate a firm's economic behavior in the market.[72] However, it is not the case that an individual firm's costs will serve to set the competitive price level in all circumstances. The Shippers ignore the fact that the idea of cost-of-service rates reflecting competitive prices arose at a time when utilities by and large were natural monopolies. In a natural monopoly, the regulated entity is the sole supplier and therefore, by definition, the marginal supplier. As such, the entity's costs were relevant for determining a competitive price proxy. Where multiple entities are selling into a market, one must first identify the marginal supplier and then examine that entity's costs when determining a competitive price proxy.

42. A necessary element of the Shippers' argument that the applicant's current tariff rate is an acceptable competitive price proxy is the premise that, in the long run, lower-cost pipelines will take business away from higher cost pipelines, and therefore the applicant's tariff rate will eventually serve as the long-run competitive price.[73] A4A

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[66] See A4A Request for Rehearing at ¶ 38.

[67] A4A Request for Rehearing at ¶ 16 (emphasis added).

[68] A4A Request for Rehearing at ¶ 53.

[69] Suncor Request for Rehearing at ¶ 20 (emphasis added).

[70] Arthur Aff. ¶ 18 (emphasis added).

[71] Suncor Request for Rehearing at ¶ 25.

[72] *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 961 (D.C. Cir. 2007).

[73] Arthur Aff. ¶ 21.

states that in a competitive market, prices would be driven to the supplier with the lowest costs, as these firms would out-compete firms with higher costs.[74] In regard to oil pipelines, A4A argues that a pipeline with lower costs will expand its capacity and take "all" shipments away from higher-priced pipelines.[75]

43. On a theoretical basis, the Shippers' economics on this matter are sound. However, unlike some businesses, oil pipelines cannot easily expand capacity in order to take *every* customer away from higher-priced competitors. Not only can expansion be time consuming, and involve a plethora of legal, geographic, political and engineering hurdles, expansion can involve costs far in excess of existing tariff rates or even competitor's rates. This is certainly true if a pipeline is expected to add sufficient capacity to absorb all of its competitors' shipments, which the Shippers argue will occur.[76] While entry and expansion are considered in the Commission's market-power analyses, it cannot be assumed that such entry and expansion will occur, or to what extent. Given the reality that not all pipelines will be able to cost-effectively expand and acquire all of a competitor's shipments, shippers will instead search out the alternative(s) providing the next highest netback until capacity is reached, and then move to the next highest netback and so on until the marginal supplier is reached.

44. A4A discusses at great length that in determining a competitive price proxy, it is the long-run marginal costs that are relevant.[77] However, long-run costs include entry and expansion costs. A4A agrees that a pipeline's rate is designed to recover all of its current costs, including a return on investment.[78] A pipeline's current tariff rate does not however include costs associated with hypothetical future expansions. At one point, A4A seems to acknowledge that tariff rates may not include expansion costs.[79] Yet it states that this would only occur where cost-based rates are based on a fully-depreciated rate base. A4A goes on to state that expansion capital costs are additional costs not

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[74] A4A Request for Rehearing at ¶ 47.

[75] A4A Request for Rehearing at ¶ 50.

[76] It is noted that the Pegasus pipeline transported approximately three percent of all Western Canadian crude oil out of the Hardisty origin market. For it to expand to absorb all of its competitors' shipments would have resulted in an expansion to nearly three million barrels per day of capacity.

[77] A4A Request for Rehearing at ¶ 35.

[78] A4A Request for Rehearing at ¶ 49.

[79] A4A Request for Rehearing at ¶ 54.

considered in current tariff rates and such information "could" provide a reasonable proxy for a competitive price level.[80] The Commission will not utilize a tariff rate that does not include expansion costs as a competitive price proxy when the appropriateness of such a proxy relies on the occurrence of expansion at the tariff rate. The Shippers have provided no basis for assuming that all oil pipelines can add sufficient capacity, at existing rates, to capture all shipments in the market.

45. TheShippers' arguments do not reflect a realistic view of oil pipeline markets and operational realities, do not provide a valid means of factoring expansion costs into a competitive price proxy, and there are general inconsistencies with which the Shippers treat the issue of expansion throughout their various pleadings. Dr. Arthur's arguments presented in his numerous hypotheticals are explicitly premised on the absence of capacity constraints, meaning entry and expansion are not significant barriers for oil pipelines.[81] Yet A4A argues that slow entry and expansion are "defining characteristics" of the oil pipeline industry,[82] and that the threat of entry and expansion by other pipelines does not serve as a significant check on a pipeline's ability to earn monopoly profits.[83] Despite identifying the significant difficulty oil pipelines face when attempting to expand, the Shippers argue that the refusal to expand is a potential exercise of market power akin to withholding capacity from the market.[84] The Commission cannot adopt the Shippers' arguments when they are simultaneously premised on both the high likelihood and significant unlikelihood of pipeline expansion.

46. The Shippers also are incorrect in arguing that an alternative must be a good alternative specifically in relation to the applicant to be included in the market power analysis.[85] This argument is related to the argument that the applicant's tariff rate is the appropriate proxy. "The Commission in *Colonial*," argues Suncor, "expressly recognized the critical importance of comparing alternatives on a relative basis and acknowledging that if a potential alternative does not render a high enough netback, it would be

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[80] A4A Request for Rehearing at ¶ 54, n.23.

[81] Arthur at ¶ 22, n.57.

[82] A4A Request for Rehearing at ¶ 29, citing *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1509, n.51 (D.C. Cir. 1984).

[83] A4A Request for Rehearing at ¶ 29.

[84] A4A Request for Rehearing at ¶ 27.

[85] Suncor Request for Rehearing at ¶ 12.

incapable of preventing a pipeline from exercising market power and therefore should not be included as part of the relevant origin market calculations."[86]

47. As discussed above, the argument that good alternatives must be as good as the applicant at the applicant's tariff rate was rejected in *Mobil*. While previous cases did use the applicant's tariff rate as a competitive price proxy, and future cases may also, only if the applicant's tariff rate represents the costs of the marginal supplier do potential alternatives need to provide a similar (or superior) netback. Further, the Commission in natural gas cases has recognized that examining netbacks on a relative basis compared with the applicant is no longer the presumptive approach to follow.[87]

48. When determining whether an applicant's tariff rate could serve as an appropriate proxy for the competitive price, the Commission held in the Order on Rehearing that the presence of excess demand at the tariff rate demonstrates that the applicant's rates are below the competitive rate.[88] This ruling was in line with the court's decision in *Mobil*, where excess demand on Pegasus demonstrated that its tariff rate was below the competitive price. A4A argues that excess demand can also occur when a monopolist restricts capacity and then subsequently increases price in the presence of increased demand, and therefore excess demand does not indicate that a tariff rate is below the competitive price.[89]

49. The Shippers' argument is without merit. The first flaw in their reasoning is failing to recognize that an oil pipeline, as a common carrier, cannot simply restrict access to the pipeline to increase demand. Further, the Commission, and indeed the D.C. Circuit, discussed excess demand as it related to whether an applicant's tariff rate was an appropriate proxy for the competitive price. As stated in the Order on Rehearing, "factors that influence whether the applicant's tariff rate would serve as (an appropriate proxy) include excess demand *at the regulated tariff rate*."[90] The Commission made no finding, and makes no finding now, on the relevance of excess demand generally.

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[86] Suncor Request for Rehearing at ¶¶ 28-29, citing *Colonial Pipeline Co.*, 92 FERC ¶ 61,144, at 61,532 (2000).

[87] *See UGI Storage Co., UGI Central Penn Gas, Inc.*, 134 FERC ¶ 61,239, at P 37 (2011).

[88] Order on Rehearing, 146 FERC ¶ 61,115 at P 49.

[89] A4A Request for Rehearing at ¶ 4.

[90] Order on Rehearing, 146 FERC ¶ 61,115 at P 50 (emphasis added).

50. In his affidavit, Dr. Arthur presents several hypotheticals that he argues demonstrate how the Commission's approach could result in a pipeline with market power attaining market-based rate authority. In one of his hypotheticals, he presents six pipelines, five of which have tariff rates that equal the price difference between the respective origin and destination markets. The sixth pipeline, the applicant for market-based rate authority, has a tariff rate far below the price differential. Dr. Arthur claims that the existence of this differential would allow the applicant to exercise market power, and indeed be a true monopolist facing no good alternatives.[91]

51. The primary flaw in Dr. Arthur's hypotheticals is that it is the same approach presented, and rejected, in the *Mobil* proceeding. In fact, Dr. Arthur's argument is directly contrary to the court's holding in *Mobil*. The Pegasus pipeline encountered a basin price differential far above its regulated tariff rate. The court was clear that such a differential did not confer market power on Pegasus. The court found that "short-term price variations that result in regional price differentials do not establish market power."[92] Dr. Arthur attempts to qualify his argument by stating that such price differentials are likely to persist given that entry and expansion of pipeline infrastructure is slow. In essence, he argues that a short-term price differential will not in fact be short term. However, this does not eliminate his argument's conflict with the *Mobil* decision; moreover, when supporting his argument Dr. Arthur states that there are no capacity constraints, which is inconsistent with his argument that slow entry and expansion (i.e., capacity constraints) do exist and therefore cannot serve to correct short-term price fluctuations.[93] The Shippers cannot use the lack of capacity constraints to support one aspect of their argument while claiming the existence of capacity constraints in support of another.[94]

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[91] Arthur Aff. ¶ 46.

[92] *Mobil*, 676 F.3d at 1104, citing *Longhorn Partners Pipeline, L.P.*, 83 FERC ¶ 61,345, at 62,380 (1998) ("[A]ny price differential between the origin and destination markets does not confer monopolistic power upon [the pipeline], but rather it promotes competition.").

[93] Arthur Aff. ¶ 22, n.57.

[94] To provide a demonstration of the Commission's approach as it compares to that proposed by the Shippers, the Commission sets forth in the appendix to this decision several hypotheticals.

C. Conclusion

52. The Commission's methodology for reviewing applications from oil pipelines for a determination that they lack market power and so should be granted market-based rate authority, as set forth in the Order on Rehearing, is consistent with Order No. 572 as well as the *Mobil* decision, and is well grounded in economic principles. The Shippers' arguments do not support any modifications to that established methodology.

The Commission orders:

The request for rehearing filed by the Shippers is denied, as discussed in the body of this order.

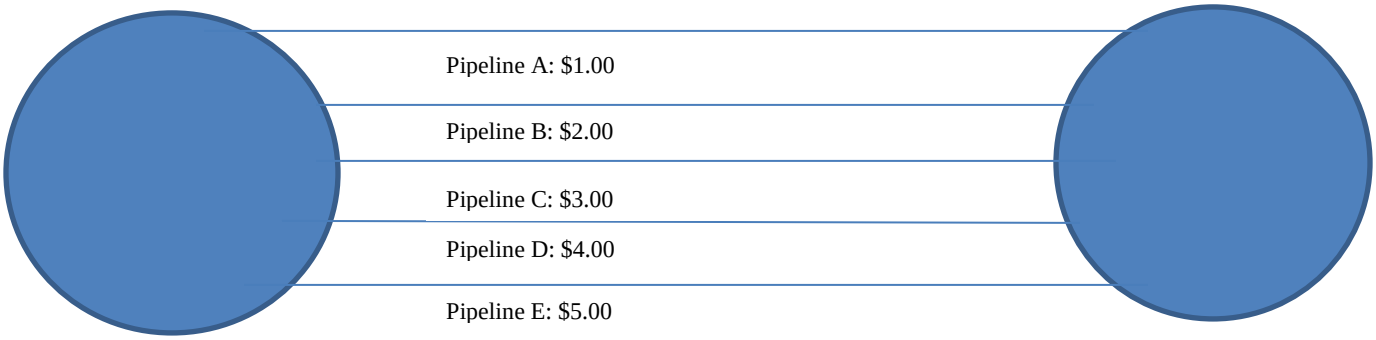
By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

APPENDIX

1. To provide another demonstration of the Commission's approach as it compares to that proposed by the Shippers, the figure below depicts five hypothetical 100,000 barrel per day (bpd) pipelines providing service between a crude oil production field (the origin market) and a location with significant refining capacity (the destination market).



The commodity price in the origin market is $50, and the commodity price in the destination market is $55. Total demand for capacity from the origin to the destination is 400,000 bpd.

2. Given this hypothetical, shippers will first seek to ship on pipeline A, where they will receive an ultimate netback price of $54 (destination commodity price minus transportation costs). When the capacity of pipeline A is reached, shippers will seek space on pipeline B which provides the next best netback price ($53), and so on until the overall demand of 400,000 bpd is met by shipping on pipelines A through D. Pipeline E, though economical, will not be utilized by shippers.

3. Under the Commission's analysis, the first four pipelines are used alternatives, and therefore are good alternatives in terms of price. The applicant could also do a detailed price test using the price of pipeline D (the marginal price of the marginal supplier) to determine whether pipeline E should also be included. In this scenario, pipeline D could increase its rates by nearly 25 percent (to $4.99) and still not lose any shipments to pipeline E. Under the traditional SSNIP price test,[95] pipeline E would not be a good

[95] SSNIP means "small but significant and non-transitory increase in price." The SSNIP test is used to determine whether a pipeline can profitably sustain a small but significant increase above competitive levels for a significant period of time. *Enterprise TE Products Pipeline Co.LLC*, Opinion No. 529, 146 FERC ¶ 61,157, at P 10 n.13 (2014).

alternative in terms of price. Ultimately, the market in this scenario would consist of four equally-sized pipelines, generating market shares of 25 percent each and an HHI of 2500.

4. Under the Shippers' approach, the competitive price would instead depend upon which pipeline filed for market-based rate authority. If it was pipeline A, the competitive price would be $1, and it would be assumed that pipeline A was the marginal supplier, even though pipelines B through D are at full capacity with higher costs, and B and C would have excess demand. Pipeline A, according to the Shippers' methodology, would be an absolute monopolist, with a 100 percent market share and an HHI of 10,000. This in fact is the exact argument that was raised by shippers on Pegasus in the *Mobil* proceeding.

5. If pipeline B was the applicant, instead of pipeline A, the competitive price would double to $2, without any changes to the costs of the pipelines or relative demands of the shippers. Pipeline B would have a 50 percent market share, with an HHI of 5,000. If pipeline C were the applicant, the pipeline would have a 33 percent market share and an HHI of 3267. Only if pipeline D were the applicant would the shippers' market calculations match those under the Commission's approach. Finally, if pipeline E were the applicant, the competitive price according to Shippers would still be the applicant's tariff rate. Thus, the competitive price would be $5, even though no shipper initially would pay $5 at current levels of demand. Pipeline E, an unused alternative, would suddenly have a 20 percent market share, and the HHI would be 2,000. It is unclear how Shipper's methodology would function if more than one, or even all of the pipelines filed for market-based rate authority simultaneously.

6. This hypothetical illustrates the fallacy of Shippers' arguments concerning use of an applicant pipeline's current tariff rate as a competitive price proxy. A true and accurate market picture is derived by following basic economic and competition principles, which require that a competitive price proxy be based on the costs of the marginal supplier. Focusing instead on the arbitrary decision of which pipeline (or pipelines) happens to seek market-based rate authority, and using that pipeline's tariff rate as the proxy, does not provide an accurate assessment of the relevant market.

7. The hypothetical also addresses a criticism by Shippers that the Commission has erred in focusing solely on the prevailing price in the market, instead of underlying costs.[96] In the hypothetical the market price, absent rate regulation, would be $4.99, the

[96] A4A Request for Rehearing at ¶ 54 ("[T]he Commission should not lose sight of the fact that competitive prices are tied to cost…and it is an evaluation of *costs* that should determine whether a price is or is not a reasonable proxy for a competitive price." (emphasis in original)); A4A Request for Rehearing at ¶ 15 ("[T]he Commission's definition of a competitive price mistakenly equates the 'competitive price' with the 'market price.'").

maximum amount the four lower priced pipelines could charge without losing any business to pipeline E. However, under the Commission's methodology, $4.99 is not the competitive price proxy. Instead, for purposes of the market power analysis the Commission uses the marginal costs of the marginal supplier, which in the hypothetical is $4.00, the cost of pipeline D. If the Commission were to use the likely prevailing rate of $4.99, pipeline E with a rate of $5.00 would be included as a good alternative. Utilizing marginal costs however results in pipeline E's exclusion as a good alternative. The Shippers' arguments concerning the use of marginal cost are by and large accurate; however this is only the case when the analysis focuses on the marginal costs of the marginal supplier.