<u>Enterprise Products Partners L.P.</u>
146 FERC ¶ 61,115 (2014)

In this proceeding the Commission addressed its market-based rate methodology in detail in light of the D.C. Circuit's decision in *Mobil*. 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 clarified that when conducting the detailed cost analysis for unused but useable alternatives, the applicant pipeline's tariff rate is not presumed to be a proper proxy for the competitive price. Rather, the Commission determined that the competitive price to use as the benchmark to compare proposed alternatives in an origin market is the netback of the alternative that provides the lowest netback among used alternatives. 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.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

146 FERC ¶ 61,115
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Acting Chairman;
Philip D. Moeller, John R. Norris,
and Tony Clark.

Enterprise Products Partners L.P. and Enbridge Inc. Docket No. OR12-4-000

ORDER ON REHEARING

(Issued February 20, 2014)

1. On June 28, 2012, the Commission *sua sponte* granted rehearing of its order denying 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.[1] In the Order Granting Rehearing, the Commission sought comments concerning the proper interpretation of the decision of the Court of Appeals for the D.C. Circuit in *Mobil Pipeline Co. v. FERC*, 676 F.3d 1098 (D.C. Cir. 2012), 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.

2. The Commission sets forth below its assessment of the impact of *Mobil* on its policy and procedures for reviewing an application from an oil pipeline seeking a market power determination, including the application of Enterprise/Enbridge.

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

BACKGROUND

3. On December 2, 2011, Enterprise/Enbridge filed an application for authority to charge market-based rates on a planned reversal of Seaway. Twenty parties filed motions to intervene. Six parties filed substantive comments protesting the request for market-based rate authority for the origin and destination points on the reversed Seaway pipeline.[2]

4. On April 17, 2012, the D.C. Circuit issued an order in the *Mobil* proceeding.[3] *Mobil* concerned the appeal of a crude oil pipeline, Pegasus, seeking to charge market-based rates. The Commission had rejected Pegasus' application, finding that the pipeline possessed significant market power.[4] The court reversed the Commission, finding that Pegasus faced numerous competitive alternatives and therefore could not exercise market power.

5. On May 7, 2012, the Commission issued its Order on Application for Market Power Determination, rejecting Enterprise/Enbridge's application.[5] 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.

6. On June 28, 2012, the Commission granted rehearing for the purpose of further consideration, seeking comments on the proper interpretation of *Mobil* as it relates to applications for market power determinations by oil pipelines.

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[2] The protestors are: (1) Suncor Energy Marketing Inc., Canadian Natural Resources Limited, Continental Resources, Inc., Denbury Onshore LLC, and Husky Marketing and Supply Company (collectively, Joint Shippers); (2) the Canadian Association of Petroleum Producers ("CAPP"); (3) Cenovus Energy Marketing Services LTD, Encana Marketing (USA) Inc., and Nexen Energy Marketing U.S.A. Inc. (collectively, Cenovus); (4) Apache Corporation, Chevron Products Company and Noble Energy, Inc. (collectively, Apache); (5) the Domestic Energy Producers Alliance (DEPA); and (6) the Independent Petroleum Association of America (IPAA).

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

[4] *Mobil Pipe Line Co.*, 133 FERC ¶ 61,192 (2010), *vacated*, *Mobil Pipe Line Co. v. FERC*, 676 F.3d 1098 (D.C. Cir. 2012)

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

20140220-3037 FERC PDF (Unofficial) 02/20/2014

COMMENTS ON REHEARING

Initial Comments

7. Several parties filed comments, including additional parties seeking to intervene in response to the Order Granting Rehearing.[6] The Commission grants all motions to intervene out of time.

8. Enterprise/Enbridge states that *Mobil* explicitly rejected the Commission's method of identifying good alternatives in terms of price through the use of a netback analysis based on a hypothetical 15 percent increase in the assumed competitive transportation rate. The court instead, argues Enterprise/Enbridge, adopted a "reasonably available" standard for determining good alternatives. Enterprise/Enbridge also argues that when an applicant for market-based rate authority is a new entrant into an already-competitive market, such an entrant makes the market more competitive. Finally, Enterprise/Enbridge states the Commission should retroactively award the pipeline market-based rate authority commencing May 14, 2012.

9. The Association of Oil Pipe Lines (AOPL) expressed concern regarding the Commission's recent rulings regarding market based rates, and stated that the Commission seemed to depart from the fundamental notion that, in a competitive market, market forces will set rates much more effectively than regulation. AOPL states that the recent rulings seem to reflect a narrow focus on the pipeline-applicant's existing ratepayers, rather than shippers as a class, resulting in the Commission picking winners and losers in the market rather than letting competitive markets work.

10. Further, AOPL states that this approach runs counter to the public interest over the long term. AOPL asserts that if the Commission denies market-based rates to pipelines that operate in markets that are clearly competitive, this could have a chilling effect on capital investment, which would, in turn, cause shippers to have fewer alternatives available to them. AOPL states that the Commission's recent rulings appear to indicate a diminished faith in markets and an unwarranted retreat from the Commission's longstanding market-based rate policies. AOPL believes that the holding in *Mobil* is consistent with the Commission's previously articulated goals, and it urges the Commission to return to the core principles of Order No. 572[7] and its decisions in

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[6] Motions for Leave to Intervene out of Time were filed by the Association of Oil Pipe Lines (AOPL) and Airlines for America (A4A).

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

20140220-3037 FERC PDF (Unofficial) 02/20/2014

Explorer[8] and *Longhorn*:[9] (1) that the market-based rate analysis must be solely rooted in, and not stray from, the concept that a good alternative for the pipeline-applicant's shippers is an alternative that is reasonably available to those shippers in such market; (2) the level of the pipeline-applicant's regulated rate is irrelevant to rendering a decision on an application for market based rates; and (3) an entrant into a previously competitive market typically will make that market more competitive, rather than render a previously competitive market uncompetitive.

11. The Domestic Energy Producers Alliance (DEPA) submits that *Mobil* should have no effect on the May 7 Order, which the Commission should reaffirm on rehearing. DEPA states that the Commission correctly found that Enterprise/Enbridge's application for permission to charge market-based rates as its initial rates must be denied "given the applicant's failure to provide detailed cost data, a fundamental element of market power analysis, which Enterprise/Enbridge acknowledges cannot be provided at this time."[10] DEPA stresses that the Commission's rules do not permit the use of market-based rates as initial rates.[11] Because the *Mobil* decision did not involve a request for market-based rates as initial rates, DEPA asserts that nothing about the holding calls into question the correctness of the May 7 Order.

12. The Independent Petroleum Association of America (IPAA) states that the Commission properly interpreted and applied *Mobil* to the May 7 Order. Further, IPPA submits that the court did not dispute the Commission's criteria for judging applications for market-based rates; the present case involves different operational attributes than the Pegasus, and Seaway lacks an operating history and initial rates, which are fundamental requirements for granting market-based rate authority.

13. Airlines for America (A4A) notes that *Mobil* specifically endorsed Order No. 572 and the principles the Commission has historically applied in implementing that order. Therefore, A4A asserts that *Mobil* should have little or no effect on the Commission's established rate regulations and policies for determining whether an oil pipeline can exercise market power in a particular market. A4A stated that the court signaled its intention not to make sweeping changes to the approach the Commission takes to market-

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[8] *Explorer Pipeline Co.,* 87 FERC ¶ 61,374 (1994).

[9] *Longhorn Partners Pipeline, L.P.*, 83 FERC ¶ 61,345 (1998).

[10] May 7 Order at P 47.

[11] *See* 18 C.F.R. §§ 342.1 and 342.2 (2013).

20140220-3037 FERC PDF (Unofficial) 02/20/2014

based rate applications, but to determine whether the Commission properly applied Order No. 572.

14. A4A states the court identified the proper question as to whether an applicant can exercise market power is whether the pipeline could profitably raise rates above competitive levels for a significant period of time because of a lack of competition, and whether there are alternatives to a firm's services that constrain its ability to profitably charge prices above competitive levels for a significant amount of time, both consistent with long-standing Commission precedent. A4A asserts that price information is a necessary and integral component of the analysis, and that this approach is endorsed by the D.C. Circuit decision. Further, states A4A, the burden of proof in a market-based rate proceeding is on the applicant pipeline, and the Commission's decision to reject the Seaway application in the absence of any evidence of the competitive rate level or the competitiveness of the alternatives to the Seaway pipeline accords with *Mobil* and Order No. 572.

15. The JFK Fuel Committee (Fuel Committee) agrees with and adopts the comments of A4A, stating that in *Mobil*, the court simply concluded that the Commission did not properly apply Order No. 572 principles to the unique and distinct facts presented by the application of the Pegasus pipeline, and therefore there is no reason for the Commission to re-evaluate its decision in the May 7 Order or to reconsider its regulations and policies regarding the evaluation of applications for market-based rates.

16. Cenovus submits that the Commission acted appropriately in denying the application for market-based rate authority filed in the proceeding due to its lack of supporting cost-of-service data. Further, Cenovus states that if the Commission determines that this rationale is no longer valid, the Commission should deny the application on other grounds or convene an evidentiary hearing.

17. Cenovus asserts that, though *Mobil* held that a pipeline's cost of service rate does not necessarily represent a reasonable proxy for competitive rates in the context of a market power analysis, such data is needed to evaluate the economic viability of claimed alternatives to pipeline services. Further, states Cenovus, nowhere in *Mobil* does the D.C. Circuit suggest that the cost-of-service data is no longer relevant and should not be required by the Commission when evaluating applications for market-based authority. Cenovus states that if the Commission determines that cost-of-service data are no longer required to perform a market power analysis, the Commission should deny the application based on other numerous deficiencies in the market power analysis identified in the May 7 Order, or convene a formal evidentiary hearing to consider the application further.

18. The Canadian Association of Petroleum Producers (CAPP) states that the central basis for the *Mobil* decision was the heavy reliance on a single aspect of the record—the size of the pipeline. CAPP submits that Seaway is twice the size of Pegasus and is

20140220-3037 FERC PDF (Unofficial) 02/20/2014

planned to be up to twelve and one-half times its size, rendering an analogy to Pegasus moot. Further, CAPP states that the court's determination that the Commission strayed from a reasoned analysis by using the pipeline's tariff rate as a benchmark for the competitive rate in its examination of the rates the pipeline might charge under a regime of market based rates is moot as well, since the May 7 Order made no use of the tariff rate of the Seaway pipeline in its analysis.

19. Joint Shippers argue that nothing in the *Mobil* decision suggests that the Commission's basic regulatory framework embodied in Order No. 572 and existing precedent is deficient. The court, argues Joint Shippers, did not reject the Commission's established requirement that competitive alternatives must be good alternatives in terms of price. Joint Shippers point out that because the court did not reject the Commission's requirement that good competitive alternatives must be comparable to an applicant pipeline in terms of price, the May 7 Order is not contrary to *Mobil* in denying the Enterprise/Enbridge application for lack of information necessary for a netback price analysis. Further, the Joint Shippers state that because Enterprise/Enbridge have not proposed a competitive rate, or even suggested how an appropriate proxy for the competitive rate could be determined, there is no need to address or consider the rejection of the regulated rate as a proxy for the competitive rate in *Mobil*.

20. Apache states that nothing in *Mobil* undermined the Commission's regulations or methodology for reviewing oil pipeline market-based rate applications, and that Enterprise/Enbridge's market-based rate case failed to meet those established standards. Apache notes that the court cited the Commission's existing regulations on market-based rates for the general proposition that a pipeline must demonstrate that it lacks market power in its product and geographic markets in order to qualify for market-based rates.[12]

21. Apache asserts that *Mobil* did not dispense with the Commission's requirement that a pipeline seeking market-based rate authority must show competitive alternatives exist that are sufficient to constrain its ability to charge rates in excess of a competitive level. It also asserts that the Commission properly determined that Enterprise/Enbridge failed to provide a netback analysis, or any other analysis of price associated with the alleged alternatives, and therefore failed to establish that alternatives identified in their market power analysis were competitive alternatives sufficient to constrain the pipeline's ability to exercise market power. Further, Apache states that Enterprise/Enbridge did not ask for a waiver from the Commission's regulations, and that Enterprise/Enbridge has the potential to raise prices by withholding its capacity from the oversupplied and bottlenecked Cushing market, since Seaway may not have pipeline competition in the Cushing market to the Texas Gulf Coast until 2015.

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[12] 18 C.F.R. §§ 342.4(b) and 348(c)(1)(2) (2013).

Reply Comments

22. Enterprise/Enbridge state that the interveners misinterpret *Mobil*. Applicants argue that the court held the Commission's Pegasus netback approach produced irrational results inconsistent with "basic economic and competition principles," and pointed out several flaws in the netback approach that caused the method to yield incorrect results. Enterprise/Enbridge further state that the Commission cannot continue to apply the Pegasus netback approach as if the court had not ruled, and the Commission must adhere to the economic and competition principles set forth in *Mobil* when deciding individual cases.

23. Enterprise/Enbridge state that the court did not rely on any analysis of price data when it concluded that there were "numerous competitive alternatives" to the Pegasus pipeline in its origin market. Applicants also point out that, according to the court, if the pipeline raised its rates above competitive levels, the producers and shippers of Western Canadian crude oil would choose one of the many alternative outlets available to them. Applicants state that the netback approach is not useful where there are short-term regional differentials in the price of the commodity transported, since short-term differentials are consistent with competition and do not establish market power. Applicants point out that there are several other pipeline projects that are planned between Cushing and the Gulf Coast that will erode the current price differential and provide additional competition to constrain Seaway's rates, and Seaway is planning to expand capacity over the next two years, contrary to Apache's charge that Seaway is withholding capacity.

24. Enterprise/Enbridge also assert that the Pegasus netback approach should not be used where the pipeline seeking a determination that it lacks market power is a new entrant into an already competitive market; rather, the Commission should determine whether the market was competitive prior to entry. Applicants state that there is no valid basis to reject the Seaway application without a hearing, and that the Commission has never rejected a market-based rate application for any market without first setting the matter for hearing. Applicants further state that the request for initial market-based rates is not in itself a justification for summarily rejecting the application, since the Commission has previously permitted initial market-based rates where the application is approved prior to initiation of the service in question.

25. AOPL reiterates its contention that *Mobil* rejected the use of a netback or delivered price analyses to determine good alternatives. AOPL states that, in reaching the conclusion that there were competitive alternatives to Pegasus, the court stated, without reference to the specified facts or circumstances, the approximate focus of the Commission's review as a matter of law is to examine the "alternatives reasonably available to consumers and the cross-elasticity of demand." AOPL further asserts that the court's reasonably available alternatives approach is consistent with well settled economic and competition principles. Further, AOPL states that *Mobil* cannot be

20140220-3037 FERC PDF (Unofficial) 02/20/2014

reasonably interpreted as implying, or even allowing the Commission to review a competitive rate proxy to demonstrate that a pipeline lacks market power; the court relied on the basic principle that shippers would choose one of the many alternative outlets available to them if the pipeline were to raise its rate above a competitive level, and those other outlets thereby constrain the rates that Pegasus can charge. AOPL states that the court clearly held that the Commission's denial of market-based rates to Pegasus was unreasonable because the netback pricing analysis failed to take into account the many reasonably available in the origin market; as such, *Mobil* requires that the Commission's good alternatives standard includes all reasonably available alternatives. AOPL states that the concerns expressed are based on a shortsighted view of a market frozen in time, which fails to take into account the realities of the changing dynamics in a competitive marketplace. AOPL submits that the implementation of the reasonably available alternatives standard is required by *Mobil* as a matter of law, as well as by basic and economic competition principles.

26. CAPP submits that the Commission should return to its first principles in defining relevant markets, including reiterating and applying the smallest market principle in defining the origin market for a crude oil pipeline and defining the geographic market narrowly, using the "small but significant and non-transitory increase in price" (SSNIP) or similar standard to determine whether and to what extent any extension of this market is warranted in a given instance. CAPP notes that Enterprise/Enbridge and AOPL's reliance on *Mobil* for the "reasonably available standard" is misplaced, as they ignore the context of the finding.

27. CAPP asserts that the SSNIP test with the smallest market principle is fully consistent with *Mobil*, and the reasonably available standard is really nothing more than the SSNIP methodology the Commission has relied upon for years. CAPP further states that the Commission should recognize that a new entrant may actually increase market concentration, depending on the size of the pipeline, the market, and other factors. CAPP encourages the Commission to reemphasize its prior findings that market-based rates should be employed only where they serve to facilitate efficiency, and that if applicants intend to dispute the relevance or applicability of a pipeline's regulated rate as a proxy for the competitive rate, they should be obligated to furnish and justify any alternative measurement of a long-term competitive rate.

28. CAPP notes that the origin market for Enterprise/Enbridge remains in dispute, as well as the computation of Enterprise/Enbridge's share of the origin market, since Enterprise/Enbridge's data were not aggregated with that of Enbridge's Ozark pipeline system, rendering the resulting market concentration as understated. CAPP notes that new entrants may have beneficial competitive effects, either in the abstract or in a specific factual context, and the Commission must answer in any instance whether the new entrant can exercise market power based on the facts presented. Further, CAPP states, pipeline expansions under the Interstate Commerce Act (ICA) continue to be

undertaken under a wide array of contractual and tariff provisions. CAPP notes that Enterprise/Enbridge concedes in its comments that it will increase crude oil prices at Cushing, which is *prima facie* evidence of market power even in the origin market as defined in the application. Finally, CAPP states, Enterprise/Enbridge cites no authority for the proposition that they should be granted retroactive authorization to charge market-based rates, and it is impossible to ascertain whether any shipper would have made use of such services if a hypothetical rate were in effect and no basis for imputing a market-based rate to such services when none was on file as of the time the service was rendered.

29. Cenovus states that Enterprise/Enbridge has failed to provide a sufficient basis to grant rehearing of the May 7 Order, and did not provide any reason to conclude that cost data are no longer relevant or that the Commission acted improperly by denying the application for its failure to include such data. Further, Cenovus states that Enterprise/Enbridge's contention that the pipeline lacks market power in its origin and destination markets is a factual question that requires evidentiary analysis. Cenovus also disagrees with AOPL's characterization that the court endorsed certain bedrock principles that must be reflected in the Commission's market-based rate policies. Cenovus states that the court's decision was driven to a substantial degree by the specific facts presented in the *Mobil* case. The court, states Cenovus, did not provide any generic guidance or otherwise indicate how it might have ruled if a different factual scenario had been presented. Cenovus also disagrees with AOPL's characterization that the court held that regulated rates are irrelevant when reviewing applications for market-based rate authority; rather, Cenovus asserts the court merely found that, under the specific facts presented in that case, the pipeline's regulated rate was not a reasonable proxy for competitive rates.

30. A4A asserts that AOPL's proposal to change the approach to evaluating market based rate applications the Commission has applied since Order No. 572 would be more appropriately explored through a notice and comment rule-making. A4A also points out that AOPL provides no basis for overturning the Commission precedent requiring the evaluation of alternatives available to each shipper in a market, rather than shippers as a class in the market. Further, A4A argues that finding an alternative is reasonably available is only the first step in defining good alternatives. A4A further states that a netback analysis is still required to define good alternatives, since the court never ruled out the use of a netback or delivered price analyses when appropriate.

DISCUSSION

31. The basic question is whether the decision in *Mobil* altered the Commission's long standing approach to analyzing market power applications of oil pipelines, or whether the court merely applied those policies and procedures to the specific facts concerning the Pegasus pipeline and found that the Commission erred in its findings. A review of the *Mobil* decision clearly demonstrates the latter. Accordingly, the Commission reaffirms

20140220-3037 FERC PDF (Unofficial) 02/20/2014

the holding of the May 7 Order that *Mobil* did not fundamentally alter the Commission's regulatory regime concerning market power applications of oil pipelines.[13]

32. The court in *Mobil* first identified Order No. 572 as the guide for the Commission's consideration of applications for market-based rate authority.[14] The court then set forth the Commission's definition of market power as "the ability profitably to maintain prices above competitive levels for a significant period of time."[15] The court stated that in adopting this definition of market power, the Commission "decided to adhere to well-settled economic and competition principles in determining whether an oil pipeline possesses market power."[16] Ultimately, the court held that when the Commission decided to follow basic economic and competition principles, as it has under Order No. 572, the Commission must adhere to these principles in deciding individual cases.[17] The language concerning Order No. 572 and the Commission's approach to market power applications clearly shows that the court in no way intended to overturn or fundamentally alter the Commission's long-standing procedures.[18] Rather than criticize the Commission's regulatory framework for analyzing market power of oil pipelines, the court instead faulted the Commission for failing to properly apply this framework to Pegasus' application.

33. We are therefore left with the court's finding that the Commission's policies and procedures for oil pipeline market power applications, as set forth in Order No. 572 and the Commission's regulations, were not followed. To ensure those policies are followed in the present as well as future proceedings, the Commission, below, will reiterate the steps necessary for an oil pipeline to demonstrate a lack of market power.

34. Order No. 572, as codified in Part 348 of the Commission's Rules of Practice and Procedure,[19] established filing requirements and procedures with respect to an application

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[13] May 7 Order at P 32.

[14] *Mobil*, 676 F.3d at 1100 (citing Order No. 572).

[15] *Mobil*, 676 F.3d at 1100.

[16] *Id*.

[17] *Id*. at 1104.

[18] This point is made by Enterprise/Enbridge in its comments. Enterprise/Enbridge Reply Comments at 24 (proper application of the principles from the *Mobil* decision does not require any change to the Commission's regulations).

[19] 18 C.F.R. pt. 348 (2013).

20140220-3037 FERC PDF (Unofficial) 02/20/2014

by an oil pipeline for a determination that it lacks significant market power in the markets in which it proposes to charge market-based rates.[20] 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.[21] The Commission uses this information to determine whether the oil pipeline lacks significant market power in the relevant markets.

Geographic Markets

35. The Commission requires an oil pipeline seeking to charge market-based rates to describe the geographic markets, both origin and destination, in which it seeks to make a showing that it lacks significant market power.[22] The Commission does not require an oil pipeline to file pursuant to any particular geographic market definition, but believes that the appropriate geographic markets should be determined in each proceeding based on its facts.[23] In the *Mobil* proceeding, participants disagreed on the proper definition of the origin market for the Pegasus pipeline.[24] While the *Mobil* decision did not explicitly adopt a particular geographic market definition, it did cite Trial Staff's definition as consisting of the competitive alternatives available for producers and shippers of Western Canadian crude oil to transport or sell their crude oil.[25] The Trial Staff found that,

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[20] Order No. 572 at 31,177. Order No. 572 was a companion to Order No. 561, which continued the Commission's policy of allowing an oil pipeline to attempt to show that it lacks significant market power. *Revisions to Oil Pipeline Regulations pursuant to Energy Policy Act*, Order No. 561, FERC Stats. & Regs. ¶ 30,985 (1993), *order on reh'g and clarification*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 (1994).

[21] Order No. 572 at 31,187.

[22] *Id*. at 31,187-89.

[23] *Id*. at 31,188.

[24] The Commission found the destination market competitive based on the application, and the issue was not litigated. *Mobil Pipe Line Co.*, 121 FERC ¶ 61,268 (2007).

[25] *Mobil*, 676 F.3d at 1101. This definition combines the geographic market with the list of competitive alternatives available in that market. Narrowing a geographic market to competitive alternatives is an additional step discussed below.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

although the injection point for Pegasus was in Illinois, the proper geographic market for a crude oil pipeline resided in the crude oil production fields from where the crude actually shipped on the pipeline derived.[26] Trial Staff, using actual operational data from the pipeline, traced the crude oil that Pegasus actually received (Western Canadian crude) backwards from its injection point to the production fields in order to identify all potential alternatives to Pegasus.[27] This definition reflects the reality of the origin market for crude pipelines. Producers of crude oil seek to dispose of their product out of the production field by the most economic (profitable) means available.

36. Several parties filed comments concerning the proper determination of a geographic market. Enterprise/Enbridge concurs with Trial Staff's argument in *Mobil* that the location of a geographic crude oil origin market is dictated by the location and shape of the crude oil basin that produces the oil transported out of the origin market.[28] Enterprise/Enbridge identifies Cushing, OK as a major oil trading hub,[29] and states that there is an excess supply of crude oil at Cushing.[30] Enterprise/Enbridge does not indicate the specific source (i.e. production field) of crude oil that will ship on Seaway and therefore does not identify which production basin should serve as the origin market.

37. CAPP argues that the Commission should begin the definition of the origin market at the point of origin of the pipeline.[31] CAPP states that the use of a hub, such as Cushing, is a reasonable starting point, and that a Bureau of Economic Analysis Economic Area (BEA) is a logical extension of a hub.[32] Enterprise/Enbridge argue that in this proceeding CAPP's approach restricted the Cushing origin market to the Tulsa BEA, resulting in the exclusion of nine of the eleven refineries in the area, generating an improperly narrow definition of the origin market and excluding the majority of the reasonably available competitive alternatives. Enterprise/Enbridge point out that CAPP

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[26] Ex. No. S-10 at 13. This is a fundamental difference between crude oil and refined products markets.

[27] *Id*. at 13-14.

[28] Enterprise/Enbridge Initial Comments at 24-24, Reply Comments at 15.

[29] Enterprise/Enbridge Reply Comments at 13.

[30] *Id*. at 16.

[31] CAPP Reply Comments at 7.

[32] *Id*. at 16.

uses the anticipated future capacity of the Seaway pipeline, while including only current capacity of Seaway's competitors, thus distorting the analysis.

38. Finally, Apache claims that the May 7 Order found all of Enterprise/Enbridge's proposed alternatives were outside of Seaway's origin point at the Cushing Hub.[33] Apache misunderstands the May 7 Order. The May 7 Order differentiated prior cases that had relied on BEAs for determining good alternatives. The May 7 Order made no determination concerning the scope of the Cushing Hub or the propriety of utilizing a hub as a geographic origin market.

39. The Commission finds that, consistent with *Mobil*, the proper geographic origin market for crude oil pipelines is the production field from where the crude oil being shipped on the pipeline derives. This may be the production field in which the pipeline is physically located. However in certain origin markets, inbound pipelines also provide crude oil from other production fields which may constitute the origin of crude actually shipped on the pipeline applicant. Consistent with Order No. 572, applicant pipelines may offer other evidence in meeting its burden to establish any definition of the geographic market. The Commission is also not preventing any party from presenting a geographic market based on BEAs or hubs, or any combination thereof. The determination of a geographic market is a fact-specific inquiry and must be determined on a case-by-case basis.

Product Market

40. An oil pipeline seeking to charge market-based rates must identify the product market or markets for which it seeks to establish that it lacks significant market power.[34] Under the ICA, the Commission regulates the transportation of oil by pipelines.[35] Thus, the transportation of a particular product is an appropriate product definition. However, disposition of product (i.e., local usage or refiners) is a relevant element of a market-power analysis as well.[36] As with the geographic market, the Commission does not require a specific product market definition; the pipeline must identify the product market or markets for which it seeks to establish that it lacks significant market power.

[33] Apache Reply Comments at 11.

[34] Order No. 572 at 31,189.

[35] 49 U.S.C. app. 1(1)(b) (1988) (cited in Order No. 572 at 31,189).

[36] Order No. 572 at 31,190.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

41. In *Mobil*, participants disagreed as to the proper product market definition. Trial Staff argued that the appropriate product market definition was the transportation of crude oil.[37] Trial Staff noted that, while Western Canadian heavy sour crude oil accounted for 98 percent of the actual shipments on Pegasus, the fact that the pipeline was capable of shipping other grades of crude supported a finding that the product market included all crude oil.[38] Shippers argued that because current shippers shipped 98 percent of Western Canadian heavy sour crude, only the transportation of Western Canadian heavy sour crude should define the product market.[39]

42. *Mobil* did not explicitly adopt a product market definition. However, at several points in the decision the court noted that Pegasus shipped only three percent of all Western Canadian crude oil. Given the importance the court placed on this statistic, the narrow product market definition purported by shippers which did not include the transportation of all grades of Western Canadian crude would seem too narrow. However, the court did not go so far as to adopt Trial Staff's definition of the transportation of all crude oil. Thus, it is unclear what guidance, if any, was provided by *Mobil* in regard to product market definition.

43. In its comments, Enterprise/Enbridge acknowledged that when defining a product market the relevant analysis concerns cross-elasticity of demand. *Mobil* cited the principle of cross-elasticity of demand. The Supreme Court has found that the outer boundaries of a product market can be identified by the reasonable interchangeability, or cross-elasticity of demand, between the product and possible substitutes.[40] In general terms, cross-elasticity requires identifying the choices available, focusing on whether consumers will shift from one product to another in response to changes in their relative costs. 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 price increase above competitive levels. 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.

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[37] Ex. S-10 at 10.

[38] *Id*. at 12.

[39] Ex. SCN-17 at 33-34.

[40] *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962).

20140220-3037 FERC PDF (Unofficial) 02/20/2014

44. The Commission determines that the product market(s) for an oil pipeline consists of that service or those services which the pipeline holds itself out as offering.[41] The appropriate product market in a market-power analysis includes (1) those services for which the applicant seeks to charge market-based rates, and (2) any product that could discipline the exercise of market power over those products. If an oil pipeline applicant seeks to offer market-based transportation service solely for heavy crude, the product market will contain heavy crude transportation as well as the disposition of heavy crude in the market and any product that exhibits a suitable cross-elasticity with heavy crude transport. If an oil pipeline applicant seeks market-based rates for all forms of crude oil transportation, the product market could expand accordingly to include all crude transport, or be divided into separate product markets, again based on cross-elasticity between products. In the context of a crude oil origin market, only transportation of those products available from the production fields (i.e., the geographic market) is to be included in the product market. As with the geographic market, the Commission will allow the oil pipeline applicant to propose any product market definition, with the burden to justify the definition solely on the applicant. The determination of a product market is a fact-specific analysis and must be determined on a case-by-case basis.

Competitive Alternatives

45. The Commission requires oil pipeline applicants seeking a market power determination to describe available transportation alternatives in competition with the pipeline in the relevant markets, and other competition restraining the pipeline's rates in those markets.[42] Alternatives may include other pipelines, rail, barges, trucks, refiners and local consumption.[43] The Commission does not exclude any alternative form of competition. However, the burden is on the applicant pipeline to justify an alternative's inclusion in the market power analysis.[44] The fact that an alternative is located within the production field or within a certain proximity to the pipeline does not alone establish that an alternative is a good alternative. As discussed below, additional data is required for an alternative located within a geographic market to be deemed a "good" alternative in terms of both availability and price. For an alternative to be competitive, it must possess the ability to discipline, or prevent, a potential increase in price above the competitive level

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[41] *See, e.g., Potomac Elec. Power Co. v. U.S.*, 584 F.2d 1058 (D.C. Cir. 1978).

[42] Order No. 572 at 31,191.

[43] *Id*. Local consumption in the case of crude oil includes crude oil refineries in the origin market.

[44] *Id*.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

by the pipeline applicant. A competitive alternative also must be available to receive product diverted from the applicant in response to a price increase, and must be of the same quality as the applicant.[45] *Mobil* did not alter this analysis.

46. Whether an alternative was competitive, and the methodology for determining whether an alternative was competitive, constituted the single largest point of contention in the *Mobil* proceeding. Trial Staff and the pipeline applicant found numerous competitive alternatives, whereas shippers found no alternatives sufficiently competitive with Pegasus to restrain the pipeline. The court found that the record evidence showed that producers and shippers of Western Canadian crude oil have numerous competitive alternatives to Pegasus for transporting and selling their crude oil.[46]

47. Competitive alternatives are determined through an examination of price. The price to the shipper after all costs of delivery is known as the netback.[47] When comparing alternative means to transport or dispose of crude oil out of an origin market, a simple price comparison will not produce accurate results. A shipper will choose a higher-priced transportation alternative if the price of crude in a destination market exceeds the transportation price differential. Put more simply, a shipper will spend $2 more transporting crude to one destination over another if that destination's price for crude oil exceeds by over $2 the price at the alternative destination. Thus, comparing simply the cost of transportation does not give an accurate picture of what competitive alternatives exist.

48. A traditional netback analysis identifies good alternatives based on a comparison of the netback a shipper receives for a barrel of oil over various alternatives. The netback a shipper receives from the applicant, historically determined using the applicant's tariff rate as a proxy for the competitive price, is compared with netbacks of other alternatives within the geographic market. Alternatives with a netback within a certain range of that produced by the applicant were considered good alternatives.[48] In the *Mobil* proceeding, however, factors were present to forego a traditional netback analysis. The primary reason was an appropriate benchmark price, a necessary element in a traditional netback analysis, did not exist.[49] As stated, in prior proceedings the oil pipeline applicant's tariff

[45] *See Koch Gateway Pipeline Co.*, 66 FERC ¶ 61,385 (1994).

[46] *Mobil*, 676 F.3d at 1104.

[47] *Shell Pipeline Co., L.P.*, 103 FERC ¶ 61,236, at 61,901 n.16 (2003).

[48] Ex. S-1 at 16.

[49] Ex. S-10 at 18.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

rate served as an appropriate proxy for the competitive price to be used in the netback analysis.[50] However, due to certain market characteristics not present in prior proceedings, the tariff rate for Pegasus could not serve as an appropriate proxy.

49. The primary concern over using Pegasus' tariff rate as a proxy for the competitive price centered on the excess demand for transportation on Pegasus, and how this excess demand demonstrated that the tariff rate was below, perhaps far below, the competitive price. Absent a price restraint such as a tariff that prevents a pipeline from raising its transportation rate, a pipeline facing excess demand for access to its pipeline will increase price to a point where the demand for transportation equals the capacity, or supply, of the pipeline. As a competitive price is by definition at the point where supply and demand intersect, excess demand occurs when a price is below the competitive level. Using a proxy that is significantly below the competitive price in a traditional netback analysis could yield improper results, for any price increase from the point of the tariff rate up to the competitive level could be mistaken for an exercise of market power where no such market power exists.

50. The court found that Pegasus' regulated tariff rate was not an appropriate proxy for the competitive rate, thus a netback analysis utilizing the tariff rate was not appropriate in that case.[51] Enterprise/Enbridge claims that the *Mobil* decision stands for the proposition that a pipeline's regulated rate can never be an appropriate proxy for the competitive rate, and that the Commission ignored this ruling in its May 7 Order by requiring the regulated rate be used as a proxy for the competitive rate.[52] Neither claim is accurate. While *Mobil* does hold that an applicant's tariff rate may in certain instances not serve as an appropriate proxy,[53] factors that influence whether the applicant's tariff rate would serve as such include excess demand at the regulated tariff rate.[54] Conversely, if there is not excess demand at an applicant's tariff rate, such an absence could serve as evidence that such a rate is an appropriate proxy. Further, the May 7 Order is clear that

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[50] *See Buckeye Pipeline Co.*, 53 FERC ¶ 61,473 (1990), *order on reh'g*, 55 FERC ¶ 61,084 (1991); *see also SFPP, L.P.*, 93 FERC ¶ 63,023, at 65,124 (2000) (prevailing rate is a fair approximation of the competitive rate).

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

[52] Enterprise/Enbridge Reply Comments at 21-22.

[53] *See* Apache Reply Comments at 7.

[54] May 7 Order at P 32; *see also* Cenovus Reply Comments at 5.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

the tariff rate may not necessarily be an appropriate proxy for the competitive price.[55] In accordance with the court's ruling in *Mobil*, the Commission reaffirms its holding in the May 7 Order that for purposes of a netback analysis, the applicant's tariff rate cannot be presumed to be a proper proxy for the competitive price.[56]

51. As demonstrated in *Mobil*, a pipeline's regulated rate can be below, even far below, a competitive price level. A4A in its comments argues that a regulated rate is designed to approximate a competitive rate, and that a competitive price would be close to marginal cost.[57] This argument is incomplete. In a hypothetical functional market with one buyer and one seller, it is reasonable to infer that the terms of their voluntary transaction will result in a price that is close to the seller's marginal costs. However, in a market with multiple sellers, the competitive price is determined by the marginal costs of the marginal supplier, the supplier with the highest marginal costs (which may or may not be the pipeline applicant). A fully depreciated pipeline, such as Pegasus, could have significantly lower marginal costs than other alternatives in the market, and could therefore raise its rates above its own marginal costs. While certain commenters would label this price increase above the applicant's marginal costs an exercise of market power, it is merely a pipeline utilizing its lower costs while increasing price to the competitive level.

52. Apache criticizes the *Mobil* decision, arguing that the court's holding that the regulated rate could be below the competitive rate is a "slippery slope" that leaves no other benchmark against which to measure market power. This is erroneous. As the court held in *Mobil*, and as discussed in detail above, it is improper to simply presume, without any analysis of costs or market dynamics, that the regulated rate of a pipeline seeking a market power determination is a valid proxy for the competitive price. It is also contrary to the Commission's prior orders on market based rates, which have explicitly stated the expectation that market-based rates will exceed cost-of-service rates.[58] In any market, a seller's underlying costs of production are a factor in

[55] May 7 Order at P 32.

[56] *Id*. Cenovus states that the May 7 Order denied Enterprise/Enbridge's market power application upon finding that the applicant failed to provide sufficient cost-of-service data. This is not correct. Cost of service data is not, and indeed has never, been a requirement in a market power application. While prior cases have used the applicant's tariff rate as a proxy, there has been no requirement that the tariff rate be cost based. Tariff rates that are negotiated rates or settlement rates have been used as proxies.

[57] A4A Reply Comments at 10.

[58] Order No. 572 at 31,181.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

determining its market price. These costs certainly serve as a floor to what the seller's price will be. Only if the specific seller is the marginal seller in the market, however, will its costs factor directly into the determination of a competitive market price.

53. The more fundamental question becomes whether a traditional netback analysis is always necessary, or even relevant, in a market power analysis for oil pipelines. As to whether a traditional netback analysis is always necessary, the answer is no. As demonstrated in *Mobil*, certain factual aspects of a market power determination may make a traditional netback analysis unwarranted or unnecessary for the determination of whether an alternative is a competitive alternative. However, while a traditional netback analysis may no longer be necessary in certain proceedings, what remains necessary, and what remains a fundamental element of a market-power analysis, is that competitive alternatives must be determined competitive in terms of price.

54. As *Mobil* held, market-power analyses focus on whether there are alternatives to a pipeline's service that constrain its ability to profitably charge prices above competitive levels for a significant period of time.[59] For an alternative to be a good alternative, it must be competitively priced.[60]

55. As the May 7 Order held, a traditional netback analysis is not the only method for determining whether an alternative is a good alternative in terms of price.[61] While a traditional netback analysis was not performed in *Mobil*, there was an analysis of netbacks (i.e., price) used to determine whether an alternative was in fact a competitive or "good" alternative. In the *Mobil* proceeding, Trial Staff's testimony established that all alternatives being used in the origin market were "good" alternatives in terms of price.[62] This understanding was grounded in basic economic and competition principles. In a market, the competitive price will be the netback of the alternative that provides the lowest netback among used alternatives (the "marginal netback"). Shippers in this market will seek to earn the highest netback among available alternatives, and will use

[59] *Mobil*, 676 F.3d at 1100.

[60] *Id*. at 1102.

[61] Both Enterprise/Enbridge and Apache incorrectly claim that the May 7 Order set forth a requirement to conduct a netback analysis. Enterprise/Enbridge Initial Comments at 4, 16; Apache Initial Comments at 9. The May 7 Order clearly stated that a netback would only be required "in the absence of a rational or workable means to evaluate competitive choices." May 7 Order at P 39.

[62] Ex. S-10 at 17.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

the alternative with the highest netback until it no longer offers capacity. Shippers will then seek to ship on the alternative offering the next highest netback, and so on until the marginal netback is reached. The marginal netback is the lowest netback generated among used alternatives. Thus, all used alternatives produce netbacks at or above the marginal netback and are therefore competitively priced. The key is that nothing being used offers a negative netback, or was unprofitable to the shipper.[63] Thus, while the analysis differed from the traditional netback analysis conducted in prior cases, *Mobil* did include a review of netback data in determining whether an alternative was competitive in terms of price.

56. 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. It would simply not be rational for a shipper to use an alternative that was not profitable in that it produced a negative netback. Usage also demonstrates that the used alternative provides a higher netback than any alternative that is available but not being used. Shipper behavior concerning the use of an alternative is sufficient evidence of the economic viability of an alternative. Usage thus becomes the necessary "proxy" for determining whether an alternative is in fact a good alternative in terms of price,[64] and data concerning usage satisfies the Commission's requirement as set forth in the May 7 Order that price data be provided in order to demonstrate that an alternative is a good alternative in terms of price.[65]

57. To argue, as Enterprise/Enbridge and AOPL do, that a market power analysis can completely ignore netbacks (i.e. price) violates basic economic and competition principles. Enterprise/Enbridge and AOPL misunderstand or are simply incorrect when asserting that *Mobil* ignored the issue of netbacks in reaching its conclusions concerning Pegasus. Rather, the court, while not relying on a traditional netback analysis, determined that all alternatives being used to dispose of crude oil out of the origin market produced a positive netback to shippers. Determining that an alternative is in fact a competitive or good alternative in terms of price does not necessarily require that the competitive price be calculated or even known, and therefore does not require a traditional netback analysis. Economic behavior of market participants, combined with knowledge of netback prices, allows for a determination of competitive alternatives.

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[63] Trial Staff Reply Brief, Docket No. OR07-21-000, at 29.

[64] *See* A4A Comments at 8 (some proxy for the competitive rate is required).

[65] May 7 Order at P 32.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

58. CAPP argues that pipeline applicants should be required to furnish evidence of the long-term competitive rate for purposes of conducting the market power analysis.[66] CAPP concedes that this information was not in the record of the Pegasus proceeding, and played no role in the court's decision in *Mobil*. 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. To hold otherwise creates an unnecessarily narrow view of the requisite price data required by the May 7 Order.

59. Several commenters raise an issue concerning use of the applicant's netback vis-a-vis the marginal netback when determining good alternatives. A4A argues that any alternative producing a netback significantly below that of the applicant is not a good alternative.[67] A4A claims that if shippers continue to use a pipeline that raises its rates, even if the resulting netback exceeds other competitive alternatives, such an increase in rates is an exercise of market power.[68] Apache argues that it is appropriate that the Commission determines good alternatives by comparing the netback of the applicant to each alternative.[69] Enterprise/Enbridge and AOPL, conversely, argue that such an approach devolves into a corridor-type analysis where only those alternatives serving the same origin and destination would be competitive alternatives.[70]

60. The question in market power analyses is whether an alternative can discipline an increase in price above the competitive level. As demonstrated in *Mobil*, it is not necessarily a question of whether the applicant can raise its current rates. By measuring market power by use of the marginal netback, all alternatives that could prevent an anti-competitive increase in price will be included as competitive alternatives. Focusing on the marginal netback also addresses the concerns of Enterprise/Enbridge and AOPL on whether focusing on netbacks results creates a corridor-type analysis.

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.

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[66] CAPP Initial Comments at 11.

[67] A4A Initial Comments at 9.

[68] A4A Reply Comments at 6.

[69] Apache Initial Comments at 11.

[70] Enterprise/Enbridge Initial Comments at 15, AOPL Comments at 26.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

Enterprise/Enbridge and AOPL argue that *Mobil* adopted a broader "reasonably available" alternative test in determining good alternatives.[71] Enterprise/Enbridge states that *Mobil* made clear that both currently-used and reasonably available alternatives are by definition "good alternatives."[72] AOPL claims that in *Mobil*, the court affirmed the propriety of assessing market power by considering reasonably available alternatives to be good alternatives.[73] AOPL states that the "reasonably available" standard is consistent with well-settled economic and competition principles.[74] AOPL argues that market behavior should dictate what alternatives are considered good alternatives.[75]

62. Enterprise/Enbridge and AOPL are inconsistent in their description of the "reasonably available" standard. At times, Enterprise/Enbridge states that an alternative must be used *and* reasonably available, yet other times within the same argument they claim an alternative is a good alternative if it is used *or* reasonably available.[76] AOPL argues in support of a reasonably available standard, but at certain times argues that an alternative must be both available *and* competitively priced.[77] AOPL explicitly states that under its "Theory of Revealed Preferences" an alternative that can operate *profitably* in the market is a "revealed preference" of market participants and is appropriately considered a reasonably available (i.e., good) alternative.[78]

63. Other commenters reject the "reasonably available" test as inconsistent with *Mobil* as well as Commission policy and precedent. A4A states that the court in *Mobil* held that a good alternative must be both reasonably available and competitively priced.[79] A reasonably available standard, argues A4A, requires an improper presumption that the

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[71] Enterprise/Enbridge Initial Comments at 9, Reply Comments at 2. AOPL Initial Comments at 8.

[72] Enterprise/Enbridge Initial Comments at 18.

[73] AOPL Initial Comments at 8.

[74] *Id*. at 13.

[75] AOPL describes this as the "Theory of Revealed Preferences." *Id*. at 25.

[76] Enterprise/Enbridge Reply Comments at 6-7.

[77] AOPL Comments, Affidavit of Dr. Michael J. Webb at p. 15-16.

[78] AOPL Reply Comments at 8.

[79] A4A Initial Comments at 9.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

alternative is competitively priced.[80] Apache argues that the mere existence of an alternative cannot itself constrain an exercise of market power unless it is competitively priced.[81]

64. The "reasonably available" standard proposed by Enterprise/Enbridge and AOPL ignores the fundamental requirement that in determining whether an alternative is a good alternative, it must be affirmatively shown that the proposed alternative is a good alternative in terms of price. The court in *Mobil* held that whether an alternative is a good alternative involves both reasonable availability as well as the cross-elasticity of demand, the extent to which consumers will respond to a price increase.[82] Enterprise/Enbridge argue that cross-elasticity of demand is only relevant when determining product markets, not geographic markets. Enterprise/Enbridge is incorrect. Just as in the product market, cross-elasticity of demand is relevant for determining competitive alternatives. Cross-elasticity in the context of a geographic market definition evaluates how far consumers will go to obtain a product or service in response to a given price increase, as well as how likely it is that a price increase for a product in a particular location will induce outside suppliers to enter the market.[83] In the context of oil pipelines, cross-elasticity evaluates how far can and will shippers transport crude away from the applicant pipeline in response to an increase in price, and whether outside sources expand into the origin market in response to a price increase. Focusing solely on availability ignores this second prong in identifying good alternatives; that consumers can and will switch to an alternative location or source for crude oil disposition when faced with an increase in price only if the alternative is competitively priced.[84]

65. While unused but available alternatives may in fact be good alternatives, the determination of whether unused but useable (i.e., available) alternatives are also competitive alternatives, in accordance with *Mobil* and the May 7 Order, must be established through a detailed price analysis. The purpose of a traditional netback analysis is to identify whether other alternatives with lower netbacks than the marginal

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[80] A4A Reply Comments at 12 (citing Order No. 572 at 31,183 ("the Commission cannot presume the existence of competition or that a competitive price will be within a just and reasonable range.")).

[81] Apache Reply Comments at 4.

[82] *Mobil*, 676 F.3d at 1102.

[83] *See Heerwagen v. Clear Channel Comm.*, 435 F.3d 219, 227 (2nd Cir. 2006).

[84] A4A Reply Comments at 5.

netback (i.e., higher priced) are possibly "good" alternatives and should be included in the analysis.[85] Unused alternatives, based on shipper behavior, offer lower or equal netbacks than the marginal netback. A detailed price analysis is necessary to overcome the implication from shipper behavior that the alternative is not price competitive and therefore not being used.

66. In upholding the use of a detailed price analysis in a market power determination, the Commission recognizes that *Mobil* did not hold that a netback analysis was an inappropriate tool in a market power proceeding.[86] Enterprise/Enbridge and AOPL are incorrect in stating that *Mobil* explicitly rejected the use of netback analyses.[87] The court instead held only that in the case of Pegasus, where excess demand rendered the tariff rate an inappropriate proxy for the competitive price, and an appropriate proxy was not offered, a netback would not have produced useful results.[88]

67. AOPL argues that netback analyses should no longer be utilized by the Commission because they produce misguided results.[89] AOPL states that, under *Mobil*, the Commission is not even allowed to review a competitive price proxy when deciding whether an oil pipeline has market power.[90] The Commission acknowledges that, like any analytical tool, a netback analysis containing flawed data can produce flawed results. The fundamental element of a proper netback analysis has been and remains the use of an accurate competitive price proxy. If the proxy is too low, alternatives that are in fact competitively priced will be improperly excluded. Alternatively, a proxy that is too high will allow non-competitive alternatives to be deemed good alternatives. However, the use of a proper netback analysis was not abolished by the court in *Mobil*. A proper netback analysis is still necessary when other price data, such as usage, is not available, or where applicants seek to include unused but available outlets as competitive alternatives. It is at the discretion of the applicant whether to include or exclude this analysis in its market based rate application. A traditional netback analysis can still be introduced by a pipeline applicant or any other participant to demonstrate the existence

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[85] Ex. S-14 at 21.

[86] A4A Initial Comments at 10. Apache Initial Comments at 4.

[87] Enterprise/Enbridge Initial Comments at 6. AOPL Reply Comments at 4.

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

[89] AOPL Comments at 17.

[90] AOPL Reply Comments at 7.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

of, or lack of, market power. Such an analysis should be judged based on the specific facts of the case.

68. When conducting a detailed price analysis, the first step in determining whether a useable alternative is in fact a competitive alternative requires an overall calculation of supply and demand in the geographic market. 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. If such disposition capacity is less than that contained in the origin market, no further analysis is required. An available alternative that is unused even during the existence of excess demand is not an economic alternative, for otherwise shippers would avail themselves of the alternative to relieve the excess demand. If overall supply and demand is at equilibrium, or disposition capacity exceeds demand, the analysis can go further. Where there is an excess supply of disposition capacity, alternatives may still be competitively priced though not currently being used. To determine this, the competitive rate must be determined.

69. As discussed, due to alternatives being measured by netback and not the actual transportation rate, the competitive price in an origin market analysis will equal the lowest netback provided by used alternatives, also known as the marginal netback.[91] The marginal netback is calculated by ranking the netbacks offered by used alternatives until the lowest is reached. Once the marginal netback is determined, any available alternatives providing a lower netback are analyzed to determine whether a sub-marginal netback is within an acceptable range to still discipline a potential price increase by the applicant pipeline above the competitive level.

70. This list of competitive alternatives within a geographic market will thus include used alternatives, and useable alternatives that are shown to be competitive alternatives in terms of price. Usage provides justification for determining that an alternative is a good alternative in terms of price. Comparison with the marginal netback provides justification for including unused but useable alternatives in the list of competitive alternatives. Pipelines and other participants may offer detailed price analyses to include or challenge the inclusion of any alternative on a case-by-case basis.

Market Share and Market Concentration Measures

71. While a market may have numerous used and useable competitive alternatives, that does not end the analysis. Market share and market concentration measures are taken once good alternatives are determined. As stated by Apache, the mere existence of some alternative does not in itself constrain an applicant for market-based rates from

[91] *See* discussion *supra* P 55.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

charging in excess of the just and reasonable rate.[92] Even a market with many used alternatives may, in the presence of an alternative with a large market share, be anti-competitive.

72. The appropriate methodology for determining market share and market concentration was not addressed by *Mobil*.[93] Both Apache and AOPL argue that *Mobil* found that Pegasus had a three percent market share in the origin market.[94] This is not accurate. While *Mobil* found the fact that Pegasus transported three percent of Western Canadian crude important, this does not mean that Pegasus had a three percent market share. If that were the case, a single pipeline with no alternatives could still have a small market share. Market share and market concentration are calculated amongst the good alternatives, not in comparison with the capability of the production field.

73. When determining market share, it is the percentage of the market, and not the actual size of the pipeline, that is relevant. A relatively small pipeline could have a 100 percent market share, whereas a large pipeline could have a miniscule market share, depending on good alternatives. Contrary to the claims of Cenovus, it is certainly not relevant that the Seaway pipeline has a larger capacity than Pegasus.[95] Nor did the court in *Mobil* limit its holding to a pipeline of Pegasus's small size, as claimed by Apache.[96] CAPP requests that the Commission adopt a "miniscule" size standard to determine whether *Mobil* is applicable to a given case.[97] As discussed, the actual size of a pipeline is not in and of itself a relevant statistic. Market share is the appropriate measure.

74. As set forth in Order No. 572, the Commission continues to find it useful to obtain a showing of market concentration using the Herfindahl-Hirschman Index (HHI).[98] The

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[92] Apache Reply Comments at 4 (citing *Arizona Public Service Co. v. United States*, 742 F.2d 644, 650-51 (D.C. Cir. 1984)).

[93] Trial Staff in Pegasus presented multiple market share calculations.

[94] AOPL Initial Comments at 11. Apache Reply Comments at 14. Other commenters potentially confuse this issue as well. *See* Cenovus Comments at 3.

[95] Cenovus Initial Comments at 3.

[96] Apache Reply Comments at 14.

[97] CAPP Initial Comments at 11.

[98] Order No. 572 at 31,192. The HHI index calculates market concentration by summing the squares of individual market shares of all the firms in the market. For

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20140220-3037 FERC PDF (Unofficial) 02/20/2014

Commission, as it did in Order No. 572, will not establish market power screens establishing a rebuttable presumption in connection with market power determinations.[99] However, the Commission continues to allow and finds useful HHI calculations based on capacity.[100]

75. Several commenters discuss the issue, raised in *Mobil*, of the effect of introducing a new entrant into a previously-competitive market. Enterprise/Enbridge argues that "competitive alternatives that already exist and are currently being used by market participants do not cease to be alternatives after a new pipeline enters the market."[101] AOPL states that the Commission must adhere to the principle that an entrant into a previously competitive market typically will make the market more competitive.[102]

76. The court in *Mobil* observed that, in general, the introduction of a new alternative into a highly competitive market increases competition.[103] The court also recognized that the validity of this conclusion depends upon the size of the entrant, and that a large entrant into a previously-competitive market could still potentially exercise market power.[104] This observation does not alter the analysis an oil pipeline applicant must provide when requesting market-based rate authority. To determine whether a market is competitive, and to calculate the potential market share of the new entrant, the same processes as detailed above must be followed.

77. Finally, as set forth in Order No. 572, oil pipeline applicants may set forth any additional factors that bear on the issue of whether the applicant lacks significant market power in the relevant markets.[105]

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example, if each of four firms has a 25 percent market share, the HHI for the market would be 2500.

[99] *Id.* at 31,185.

[100] *Id.* at 31,193.

[101] Enterprise/Enbridge Initial Comments at 18.

[102] AOPL Initial Comments at 18.

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

[104] *Id.*

[105] *Id.*

20140220-3037 FERC PDF (Unofficial) 02/20/2014

Enterprise/Enbridge's Application for Market Power Determination

78. The Order Granting Rehearing stated that the Commission would address the *Mobil* decision both generally as it affected the Commission's policies, as well as in relation to Enterprise/Enbridge's application in this proceeding.

79. Upon addressing the merits of Enterprise/Enbridge's application, the Commission first examines the pipeline's request for a waiver to file market-based rates as initial rates. While the Commission is aware that the Seaway pipeline is operating under cost-based rates, the application was filed prior to such operation and therefore a waiver of Commission Rule 342.2 remains necessary.[106]

80. As the *Mobil* proceeding established, a significant portion of the required market power analysis is based on the actual usage of the applicant pipeline. For example, concerning Pegasus, Trial Staff used actual operational data to trace the crude oil that Pegasus actually shipped backwards from the injection point to the production fields in order to identify the geographic market.[107] The Commission in this Order on Rehearing has determined that the proper geographic origin market for crude oil pipelines is the production field from where the crude oil actually being shipped on the applicant derives. Absent any actual operational data, the geographic market cannot be properly identified and the market power analysis cannot be completed. This is but one area where actual operational data is paramount for making a market power determination.

81. The fact that Enterprise/Enbridge cannot identify with specificity what will be shipped on its Seaway pipeline is evident in its application. Enterprise/Enbridge claims that potential shippers "may be transporting locally produced crude oil or crude oil that was delivered to the origin market from external producing areas."[108] Enterprise/Enbridge states that "[t]he options available to potential shippers on the Reversed Seaway Pipeline depend on the origin of the crude oil being shipped."[109]

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[106] Commission Rule 342.2 states that initial rates can only be established by filing cost, revenue and throughput data, or by filing a sworn affidavit that the rate is agreed to by at least one non-affiliated person who intends to use the service. 18 C.F.R. § 342.2 (2013). Market-based rates cannot serve as initial rates absent a waiver of Rule 342.2.

[107] Ex. S-10 at 13-14. Trial Staff also used actual usage data to determine the product market and in determining the list of competitive alternatives.

[108] Application at A-23.

[109] Application at A-24.

20140220-3037 FERC PDF (Unofficial) 02/20/2014

Absent actual operational data, such uncertainty would result in an incomplete and potentially erroneous market power determination.

82. Given the absence of operational data, and the presence of numerous protests to the application, the Commission denies Enterprise/Enbridge's request for a waiver of Rule 342.2.

83. The Commission, as stated above, is aware that Seaway is in fact operating under initial rates that do not violate Rule 342.2, and that any subsequent grant of market-based rate authority would not require a waiver of Rule 342.2. Enterprise/Enbridge is therefore within its discretion to file an application for market-based rate authority pursuant to the policies and procedures of the Commission as further discussed and explained above.

The Commission orders:

Enterprise/Enbridge request for waiver of Rule 342.2 is denied.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Document Content(s)

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