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

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

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

Colonial Pipeline Company requested market-based rates for the transportation of refined petroleum products in its Gulf Coast origin and destination markets.[467] In 2000, the Commission found that even if the criticisms of Colonial's geographic markets, alternative sources, and cost studies are taken into account, the market share and market concentration statistics for the BEAs alone showed Colonial lacked market power in its destination markets. For its origin markets, the Commission outlined the required analysis to determine good alternatives in terms of price, and directed its staff to conduct a conference to explore those facts.

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

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

---

[467] *Colonial*, 92 FERC ¶ 61,144 at 61,528-29.
[468] *Id.* at 61,532.
[469] *Id.*
[470] *Id.*

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

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

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

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

[471] *Id.*
[472] *Colonial*, 92 FERC ¶ 61,144 at 61,532-33.
[473] *Id.* at 61,533.
[474] *Id.* at 61,538.
[475] *Id.* at 61,533-34.
[476] *Id.* at 61,534 n.20.
[477] *Colonial*, 92 FERC ¶ 61,144 at 61,534-35.
[478] *Id.* at 61,535.

waterborne sources of supply within the BEA, were within acceptable levels based on Commission precedent.[479]

In the Baton Rouge-New Orleans market, Colonial included both the New Orleans and Baton Rouge BEAs within a combined geographic market and also included external supply sources within 75 to 100 miles of the expanded area.[480] Intervenors provided a detailed cost study that showed supply alternatives in the New Orleans BEA could not compete on price with Colonial's pipeline terminal in the Baton Rouge BEA based on a threshold price increase of either 15 percent or 0.5 cents/gallon above Colonial's transportation tariff rate.[481] The Commission agreed that "if Colonial wants to use relevant markets containing alternatives external to a BEA, Colonial must demonstrate that the external sources are indeed good alternatives based on cost studies."[482] Further, the Commission found Colonial's adoption of a standard mileage radius external to a BEA disregarded cost and did not justify the inclusion of those external sources in the market power statistics.[483] However, Colonial provided market power statistics for a Baton Rouge BEA only geographic market.[484] The Commission also excluded waterborne sources within this BEA, and calculated an effective capacity HHI of 2006 and a market share of 20.52 percent, well within statistics found by the Commission as evidence of a lack of market power.[485]

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

[479] *Id.* at 61,535-36.
[480] *Id.* at 61,536.
[481] *Id.* at 61,536-37.
[482] *Colonial*, 92 FERC ¶ 61,144 at 61,537.
[483] *Id.*
[484] *Id.*
[485] *Id.* at 61,537-38.
[486] The intervenors subsequently withdrew their protests, and the Commission approved Colonial's market-based rate authority in the remaining Western Gulf Coast and Baton Rouge-New Orleans origin markets. *See Colonial Pipeline Co.*, 95 FERC ¶ 61,210 (2001). In addition, the Commission later approved market-based rate authority for Colonial in its Gulf Coast and Philadelphia/New York City origins and Philadelphia/New York City destination areas. *See Colonial Pipeline Co.*, 95 FERC ¶ 61,377 (2001).