103 FERC ¶ 61,236
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Shell Pipeline Company L.P. Docket No. OR02-10-000

ORDER ON APPLICATION FOR MARKET POWER DETERMINATION
AND ESTABLISHING HEARING PROCEDURES

(Issued May 23, 2003)

1. On July 9, 2002, Shell Pipeline Company LP (Shell) filed an application for a market power determination pursuant to 18 C.F.R. § 348.1. Shell seeks permission to implement market-based rates for transportation of petroleum products from tw markets (St. Louis, MO and Chicago, IL) and to six destination markets (Champaign, IL; Chicago, IL; Evansville, IN; Indianapolis, IN; St. Louis, MO; and Toledo, OH). The Commission finds that Shell lacks significant market power in its Chicago origin market and in its Champaign destination market. The Commission will establish a hearing to determine Shell's ability to exercise market power in the St. Louis origin market, and the Chicago, Evansville, Indianapolis, St. Louis and Toledo destination markets. The Commission also denies Shell's petition for waiver of the requirements of 18 C.F.R. § 342.2 to permit it to establish initial rates on the 2Rivers Pipeline under the market-based rate methodology.[1] This order is in the public interest because it will enable transportation rates to reflect changing competitive conditions in markets where Shell lacks market power and allow further review in those markets where it is inconclusive whether Shell lacks significant market power.

Background

2. Shell requests market-based rate authority for origins and destinations on three inter-market, relatively long-haul petroleum products pipelines which transport motor

[1]Section 342.2 of the Commission's regulations provides that an oil pipeline must justify an initial rate by filing cost, revenue and throughput data or filing an affidavit stating that the rate is agreed to by at least one non-affiliated shipper.

gasoline, distillates and jet fuel in the Midwest. The 14-inch Northline operates between Wood River, IL and Des Plaines, IL, and makes deliveries to terminals in the Champaign and Chicago markets. The 12-inch Eastline operates between Wood River, IL and Lima, OH, and makes deliveries to terminals in the Champaign, Indianapolis and Toledo markets. The 12 inch 2Rivers Pipeline, running from Wood River, IL to Robinson, IL and Mount Vernon, IN, is currently under construction and will make deliveries to terminals in Evansville. Shell also seeks market-based rates for its intramarket 6 inch St. Louis line that transports product within the St. Louis BEA market from Wood River, IL to St. Louis, MO.

Instant Filing

3. Shell seeks a declaration that it lacks significant market power in two BEA[2] origin markets and six BEA destination markets. Section 348.1 of the Commission's regulations requires an oil pipeline seeking a market power determination in order to charge market-based rates to: (1) define the relevant geographic and product markets, including both destination and origin markets; (2) identify the competitive alternatives for shippers, including potential competition and other competition constraining the pipeline's ability to exercise market power; and (3) compute the market concentration and other market power measures based on the information provided about competitive alternatives.

4. Shell defines the relevant product market as refined petroleum products consisting of motor gasoline, distillates, and jet fuel. Shell states that its relevant origin markets are the Chicago and St. Louis BEAs and the relevant destination markets are the Champaign, Chicago, Indianapolis, Evansville, St. Louis and Toledo BEAs. Shell concludes that the appropriate starting point for determining the geographic destination markets should be the BEA surrounding the delivery locations served by Shell. Shell states its conclusion is supported by the fact that BEAs generally represent areas of economic activity and that the Commission has endorsed BEAs generally in the past, but also by the Commission's specific determination that BEAs were appropriate in Buckeye, which involved a number of the same markets served by Shell.[3] Shell also uses the BEA as its origin market definition.

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[2] Each BEA is an "Economic Area" defined by the Bureau of Economic Analysis of the U.S. Department of Commerce. These areas were redefined in 1995 to reflect more current commuting and trading patterns.

[3] Citing, Buckeye Pipe Line Company, Opinion No. 360, 53 FERC ¶ 61,473 at 62,665-66 and n. 42 (1988), order on reh'g, Opinion No. 360-A, 55 FERC ¶ 61,084 (1991) (Buckeye).

5. For each destination BEA market, Shell computed a Herfindahl-Hirschman Index (HHI)[4] using the Commission's Capacity Based Method[5] and the Department of Justice (DOJ) Method.[6] In addition, Shell computed these HHI measurements to reflect external suppliers within 75 and 100 miles of the BEA. Shell also computed the excess capacity[7] in each destination market and Shell's market share percentage. For its two origin markets,

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[4]HHI measures the likelihood of a pipeline exerting market power in concert with other sources of supply. An HHI is derived by squaring the market shares of all the firms competing in a particular geographic market and adding them together. The HHI can range from just above zero, where there are a very large number of small competitors in the market, to 10000, where the market is served by a single monopolist. A high HHI indicates significant concentration. This means that a pipeline is more likely to be able to exercise market power either unilaterally or through collusion with rival firms in the market.

[5]The capacity-based method measures the effective capacity available after allowing for pipeline, refinery, truck, and barge capacity that may be committed to serving other markets and, therefore, not available to serve the market at issue. This measure also specifically allows for the additional capacity to which shippers could turn if the pipeline were to attempt to raise its rates above competitive levels. Under this methodology, each company is allocated a share of capacity based upon the lesser of its capacity or the total market's consumption. This number is then divided by the aggregate of these effective capacity measures to yield each company's calculated capacity share; these numbers are squared and aggregated to derive a capacity-based HHI. This method causes pipelines or refineries with larger capacities to be allocated a larger share of the market.

[6]Under this methodology, the total consumption for a market is divided by the number of participants in the market, and the result is allocated to each competitor (i.e., initially equal market shares). If a company does not have the capacity to transport its allocation, it is assumed to be able to supply its capacity while its remaining market share is equally allocated across the other companies with unmet capacity. Once all consumption has been allocated, the result is each company's calculated capacity share; these numbers are squared and aggregated to derive the DOJ adjusted capacity HHI.

[7]Excess capacity ratio is calculated by dividing effective capacity available to serve a market by the annual consumption in the market. The effective capacity includes all the refinery, pipeline, truck, and barge capacity that is available to serve a market. The effective capacity may be less than the nominal engineering capacity because portions of a pipeline's or another entity's capacity may be required to serve other markets and are therefore not available to serve the market being analyzed.

Shell computes HHI measurements using the Commission's Shipment Based Method,[8] the Commission's Capacity Based Method,[9] the Department of Justice Method, and Shell's Market Share percentage.

Interventions and Protests

6. On August 8, 2002, Phillips Petroleum Company, and its subsidiaries Tosco Corporation and Toscopetro Corporation (Tosco) filed to intervene and protest Shell's petition for waiver of the Commission's regulations. Tosco is currently a shipper on Shell's pipeline system from origin points covered by the application to destination points covered by the application. On August 23, 2002, Shell responded to Tosco's August 8, 2002 request for intervention and protest.

7. On September 9, 2002, Tosco filed a motion to intervene and protest of Shell's market-based application, and a request for discovery and hearing in this proceeding. On October 28, 2002, Shell filed an answer to Tosco's September 9, 2002 protest and request for discovery and hearing. On November 12, 2002, Tosco filed an answer to Shell's October 28, 2002 answer.

Discussion

Uncontested Markets

8. Shell states that it does not export any product from the Chicago origin market. Instead, it delivers the entire product it receives in the Chicago market to various destinations within the Chicago market. Shell states that in the Chicago BEA origin market, it has an HHI of only 146 under the DOJ approach and 788 under the FERC Staff approach - in both cases well under the most conservative threshold.

9. In the Champaign BEA destination market, Shell asserts that its HHI is 2,000 using either the DOJ approach or the FERC Staff approach to calculate effective capacity - in both cases well below the 2500 threshold. Shell states that it has a capacity-based market share of 20%, and a delivery-based market share well below the 50% level that the ALJ in

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[8]A shipment-based HHI is derived using estimated shipments based upon actual shipments that pipelines made from an origin market.

[9]A capacity-based HHI is based upon the estimated effective capacity pipelines have to move products from an origin market; thus, it addresses whether there is additional capacity to move products from a market in the event of a price increase by the applicant.

Williams[10] indicated would cause concern. Shell submits that if product sources located within 75 to 100 miles of the BEA are included, as they clearly should be given that trucks regularly traverse such distances, the HHIs drop well below 1800, the most conservative threshold.

10. No party challenged either the Chicago origin market or Champaign destination market. A review of Shell's market power statistics applicable to the non-protested markets show that the market power values computed by Shell fall within the levels acceptable under Commission precedent.[11] Accordingly, Shell will be permitted to implement market-based rates in these unchallenged markets.

Contested Destination Markets

Shell's Application

11. Shell asserts that a market should be presumed workably competitive if it has an HHI of less than 2500, the threshold which was adopted by the DOJ in its deregulation report. Shell asserts that even at HHIs substantially above that level, a pipeline should not be deemed to have market power if its market share is less than 50 percent.

12. In the Chicago BEA destination market, Shell states that its HHI is 1,081 using the DOJ approach and 1,575 under the FERC Staff approach - in both cases well below the most conservative threshold. Shell asserts that it has a capacity-based market share of 6.8%, and a delivery-based market share well below the 50% level. Shell states that if

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[10]Williams Pipe Line Company, 68 FERC ¶ 61,136 (1994), order on reh'g, 71 FERC ¶ 61,291 (1995) (Williams).

[11]In Buckeye, Williams, Kaneb Pipe Line Operating Partnership, L.P. (Kaneb), and Longhorn Partners Pipeline, L.P. (Longhorn) the Commission used an HHI range of 1800 to 2500 as an initial screen, and then reviewed the pipeline's market share and other factors in order to determine whether the pipeline possessed significant market power. Buckeye, 53 FERC at 62,666-68, 55 FERC at 61,254; Williams, 68 FERC at 61,670-72, 71 FERC at 62,127; Kaneb, 83 FERC ¶ 61,183 at 61,761; and Longhorn, 83 FERC ¶ 61,345 at 62,381. The HHI figures of 1800 and 2500 are indicators typically used by pipelines applying for market based rates to reflect what they feel is an accurate depiction of tolerable levels of concentration based on DOJ's Oil Pipeline Deregulation study and DOJ's/FTC's 1992 Merger Guidelines. In the Williams case, the Commission accepted HHIs as high as 2600 and market shares as high as 39 percent and concluded that Williams lacked significant market power in the relevant markets.

product sources located within 75 to 100 miles of the BEA are included, the HHIs drop even further below the 1800 threshold.

13. In the Evansville BEA destination market, Shell states that its HHI is 1,507 using the DOJ approach - well below 1,800, the most conservative threshold -- and 1,961 under the FERC Staff approach - just above the most conservative threshold, but well below the 2,500 standard. Shell states that it has a capacity-based market share of 21.5%, and a delivery-based market share well below the 50% standard. Shell states that if product sources located within 75 to 100 miles of the BEA are included, the HHIs drop even lower.

14. In the Indianapolis BEA destination market, Shell states that its HHI is 1,429 using the DOJ approach - well below the most conservative threshold - - and 2,062 under the FERC Staff approach - well below the standard threshold. Shell states that it has a capacity-based market share of 11.9%, and a delivery-based market share well below the 50% level. Shell states that if product sources located within 75 to 100 miles of the BEA are included, the HHIs under both approaches are below the 1800 threshold.

15. In the St. Louis BEA destination market, Shell states that the HHI is 1,322 using the DOJ approach and 1,719 under the FERC Staff approach - below the most conservative threshold under either approach. Shell states that it has a capacity-based market share and a delivery-based market share of 0. Shell states that if product sources located within 75 to 100 miles of the BEA are included, the HHIs drop even further below the most conservative standard.

16. In the Toledo BEA destination market, Shell states that its HHI is 1,325 using the DOJ approach and 1,422 under the FERC Staff approach - well below the most conservative threshold under either approach. Shell states that it has a capacity-based market share of 14.7% and a delivery-based market share well below the 50% standard. Shell states that if product sources located within 75 to 100 miles of the BEA are included, the HHIs drop even further below the most stringent standard.

Tosco's Protest

17. Tosco contends that Shell's application fails to provide information and analysis required by Order No. 572,[12] e.g., the location of competing pipeline terminals, and the cost and mileage data in specific reference to the terminals and major consuming markets of alternative oil pipelines. Tosco argues that Shell adopts a BEA as a relevant geographic market without providing any market-specific justification. Tosco claims Shell's application relies heavily on the fact that the Commission has found that various BEAs contained in the application were found in other oil pipeline market-based applications to have lacked market power.

18. Tosco states that even if the Commission were to accept Shell's BEA methodology, the application of that methodology suffers from three problems. First, Tosco contends Shell's application treats a pipeline that runs through a BEA as a within-BEA competitor even when the pipeline does not serve a terminal in that BEA as a within BEA competitor. Second, Tosco states that Shell treats subsidiary pipelines as independent competitors where a controlling parent also serves the BEA. Third, Tosco claims Shell measures trucking distances between sources and markets "as the crow flies," even though trucks actually travel indirect and longer "road miles." Tosco states that correction of the first two problems results in higher HHIs for the Indianapolis and Evansville BEAs as represented in the below table. Tosco contends correction of the third problem would result in an increase in all HHIs based on a 75 or 100-mile extension of the BEA, but with limited information provided in Shell's application, it was not practical to calculate the magnitude of the increase.

19. Tosco argues that Shell's methodology of adopting the BEA as the relevant geographic market is flawed and as a result has redefined the geographic destination markets and computed HHI statistics based on a delivered cost methodology. Tosco states that under this methodology it identified the sources of supply that are competitive in each county by calculating the delivered cost of product from terminals served by Shell and from each potentially competitive source. Tosco states the calculations are based on posted prices at each source and the cost of trucking the product from the source to the county. Tosco considered a source competitive in a county if the delivered cost from a source did not exceed the lowest delivered cost for the county by more than 15 percent of Shell's most competitive terminal for that county. Tosco redefined the geographic market within each BEA to include only those counties in which at least one terminal served by Shell was found to be competitive. Tosco calculated HHIs for the redefined markets based upon the

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[12] Market-Based Ratemaking for Oil Pipelines, FERC Stats. & Regs., Regulations Preambles, January 1991-June 1996 ¶ 31,077 (1994), in which the Commission adopted the regulations governing applications for market power determinations at Part 348 of the Commission's regulations, 18 C.F.R. Part 348 (2002).

capacity of Shell and other competing sources. The following chart, developed by Tosco, shows the HHI results from Shell's application and Tosco's protest.

BEA	Shell's Results Capacity-Based HHI	Shell's Results As Adjusted by Tosco	Tosco's - Delivered Cost Methodology
Chicago	1,575		4,020
Evansville	1,961	2,432	5,907
Indianapolis	2,062	2,475	1,865
St. Louis	2,189		3,076
Toledo	1,422		1,847

20. Tosco contends its analysis indicates that Shell may be shielded from price competition in the Chicago, Indianapolis, and Toledo destination markets. Tosco states that it identified a large number of counties in these markets where it does not appear that Shell is price-competitive under the delivered-cost analysis. Tosco cites two possible non-cost factors for such an occurrence: (1) prorationing, which may prevent some shippers from obtaining adequate space on a lower-cost pipeline; and (2) a preference of shippers to move product which originates at their own refinery or other supply source even though another pipeline might offer a lower delivered cost.

21. Tosco contends the existence of ownership relationships among the pipelines serving the destination markets would affect market power. Tosco points out that three pipelines serving one or more of the five protested destination markets are owned by partnerships in which at least one other pipeline serving the same market holds an ownership interest. Tosco claims that Shell assumes that the parent pipelines face independent competition from the subsidiary. Tosco argues that although it adjusted the HHI calculation to account for these ownership relationships in the Evansville market, Tosco finds that pipeline ownership could affect the analysis of market power in each of the other protested destination markets.

Shell's Answer

22. With regard to Tosco's claims that Shell failed to provide cost and mileage data in specific reference to the terminals and major consuming markets of alternative pipelines,

Shell states that the costs of Shell's competitors are not available to Shell, nor should they be. Shell contends that rather than attempt to estimate such costs or mileage data, Shell argues that it has provided deliveries, by zip code, based on 150 thousand bills of lading from terminals operated by Shell's affiliates. Shell contends that actual shipments are far preferable to any hypothetical cost-based models. Shell also states that contrary to Tosco's claims, Shell's application included information regarding the location and capacities of competitive suppliers.

23. Shell states that Tosco declined to provide relevant information requested by Shell that would be necessary to replicate the delivered price results reflected in Tosco's protest. Shell contends that methodology contains serious flaws and produces anomalies and sometimes bizarre results. First, Tosco uses a criterion or “screen” to determine which suppliers are price effective competitors that is unduly and unrealistically narrow, and departs from past precedent and practice. Shell claims that wholesale rack prices for refined products at a refined products terminal generally span a range of three cents per gallon, yet Tosco's delivered price methodology relies on a competitive margin of up to 15% of the Shell's most competitive rate and only includes in Shell's Chicago destination market those counties where Shell’s rate is within one-tenth of a cent of the lowest cost supplier in the county.

24. Shell states that although Tosco substituted road miles instead of air miles used by Shell, the road miles used by Tosco apparently have been obtained from a free, internet service called MapQuest, which Shell claims to be unreliable.

25. Shell contends that the price data used by Tosco to calculate rack prices is based on the average of the unbranded daily low posting for conventional clean gasoline. As explained by Shell, the appropriate starting point for calculating rack prices should be the market clearing price which is set by the marginal supplier in the market which is substantially higher than the low posting. Shell claims its analysis of the daily price postings documents that the marginal supplier’s price during the period considered by Tosco is approximately three cents per gallon above the low posting. Shell contends Tosco used OPIS postings for conventional gasoline in the Chicago area where it is illegal under EPA mandates to sell conventional gasoline.

26. Shell claims Tosco’s delivered cost analysis is based on wholesale rack prices and completely disregards price constraints imposed by competition from suppliers from various origins which may, and often do, have very different production (refining) costs. As a result, refiners (in the Gulf Coast) with lower marginal costs have the ability to constrain rates on pipelines that also serve refiners (in the Mid-Continent) with higher marginal costs. Shell asserts that Tosco's approach completely fails to take this market dynamic into account.

27. Shell contends that there are numerous unexplained and inexplicable anomalies in Tosco's analysis. Looking only at the Chicago BEA destination market, Shell asserts that the Commission should find it remarkable that Tosco computes an HHI in the present case of as high as 4,020. Shell asserts that the Commission should also find it remarkable that Tosco determines that consumption is 114 MBD, while Cook County which is within the Chicago BEA and which encompasses the better part of the City of Chicago, consumes 232.1 MBD of refined product, almost twice that amount. Shell submits that the Commission should find it still more remarkable that, notwithstanding that Shell delivers products to two terminals within Cook County, Tosco excludes Cook County from the Chicago destination market. Shell states that these and other apparently inexplicable anomalies suggest that Tosco's analysis is seriously flawed and highly unreliable.

28. Shell states that to determine how the results shown in its application would change, if at all, based on Tosco's delivered cost methodology, correcting for Tosco's three most obvious and egregious errors, Shell recalculated HHIs for all of the destination markets at issue. Shell states that Tosco's three errors are use of: (1) an unduly narrow competitiveness criterion; (2) conventional gasoline in reformulated gasoline markets; and (3) trucking cost calculations based on MapQuest-generated road mile estimates. Shell states that because the recalculation does not correct for the other errors in Shell's analysis, for example, disregard of origin price competition, the results of this recalculation must be viewed as being biased against Shell. Despite this inherent bias, Shell states that the results of this recalculation are remarkably similar to the calculations shown in Shell's application in this matter, and therefore confirm that Shell lacks significant market power in any of the markets at issue here. Shell's results are in the following table:

BEA	Application HHI	1 Cent Margin HHI	3 Cent Margin HHI
Champaign	2,000	2,002	1,300
Chicago	1,575	1,502	1,122
Indianapolis	2,062	2,247	2,010
Evansville	1,961	N/A	N/A

St. Louis	2,189	2,490	1,929
Toledo	1,422	1,726	1,175

29. Shell contends that the three analytical flaws identified by Tosco as distorting Shell's BEA methodology are illusory. Regarding the Indianapolis BEA, Shell states that is has not been the Commission's position in prior market-based rate matters to exclude a pipeline that traverses a BEA, competes in that BEA, but does not have a terminal in that BEA from being included as a BEA competitor. Shell states that in Williams, a Commission staff witness calculated whether it would be cost-effective to a pipeline passing through a market to build a terminal. Shell argues that it uses the same methodology used by the Commission staff witness in Williams, and found that it would be cost-effective for the pipeline without a terminal in the Indianapolis BEA to construct one.

30. With the regard to the second flaw involving the Evansville BEA, Shell claims that Tosco's position that the full capacity of a pipeline that is owned by several parties with no party having an ownership share of more than 50 percent should be assigned to partner which is operating the company is inconsistent with previous determinations of the Commission and Department of Justice. With regard to the third flaw, its use of as the crow flies miles, Shell claims air miles were used to measure trucking distances in prior market-based proceedings to develop 75- and 100- mile trucking radii. Shell contends that switching from air mileage to a road mileage criteria excludes only a small subset of external suppliers and does not make a significant difference.

Commission Decision

31. Order No. 572[13] requires that an oil pipeline seeking market-based rates describe the geographic markets in which it claims to lack significant market power. The Commission also requires the oil pipeline to justify its method of defining the relevant

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[13]Market-Based Ratemaking for Oil Pipelines, FERC Stats. & Regs., Regulations Preambles, January 1991-June 1996, ¶ 31,007 (1994).

origin and destination markets. Although the Commission does not require any particular geographic market definition, the Commission stated that it

> expects that oil pipelines will propose to use BEAs as their geographic markets. In that event, the burden will be on the oil pipeline to explain why its use of BEAs or any other definition of the geographic market is appropriate. If a pipeline uses BEAs, it must show that each BEA represents an appropriate geographic market.[14]

32. In addition, the Commission stated that it "believes that the appropriate geographic markets should be determined in each proceeding based on its facts. The burden is on the proponent of any particular definition."[15] It is practical to presume that a BEA is a reasonable approximation of a relevant geographic market, even in cases where the applicant has not provided detailed evidence demonstrating that all of the alternatives within the BEA are indeed good alternatives. However, that is merely a rebuttable presumption.

33. The parties to a proceeding in which an oil pipeline seeks to implement market-based rates always should be permitted to challenge the use of a BEA as a relevant geographic market. If their protests raise reasonable doubt about a particular BEA as an appropriate geographic market, the applicant must provide a detailed justification of the BEA as a relevant market, including a demonstration that all of the alternatives within the BEA are good alternatives in terms of price.

34. In Order No. 572, the Commission did not require that good alternatives be justified in any particular way. However, the Commission suggested that comparative costs could be an effective means of justifying good alternatives to the pipeline's service. Order No. 572 points out that, in general, it is delivered prices, not transportation rates, that must be compared. The Commission stated that

> where competitive alternatives constrain the applicant's ability to raise transport prices, the effect of such constraints are ultimately reflected in the price of the commodity transported. Hence, the delivered commodity price (relevant product price plus transportation charges) generally will be the

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[14] Id. at 31,188.

[15] Id.

relevant price to be analyzed for making a comparison of the alternatives to a pipeline's services.[16]

35. In TE Products Pipeline Company, L.P.,[17] the Commission clarified that in the case of protested geographic markets applicants must justify their geographic markets and alternatives based on detailed cost analyses. The Commission stated that

> It is clear from an examination of these precedents that, in the case of protested geographic markets, applicants must justify their geographic markets and alternatives based on detailed cost analyses. One approach to doing so is to perform a detailed laid-in cost study that would identify the set of economic ("good") alternatives in the market from which market shares and HHI indices may be computed. If the applicants choose to develop delivery-based and capacity-based HHI analyses, they should show, for a delivery-based measure, that adjusted delivery figures reflect either what occurs in a market or what reasonably is expected to occur. For a capacity-based measure, the analysis should show that capacity-based measures make it reasonable to infer that these are good divertable alternatives and that the quantity is supported. The Commission prefers the use of a delivered price analysis in determining whether an alternative is a good alternative in a destination market. If an alternative source has not been shown to be a good alternative, it should not be included in the relevant geographic market and used in market share, HHI, or other market power statistics. Such statistics are meaningless if all of the alternatives are not good alternatives.[18]

36. This case presents the Commission with a dispute involving issues of material fact involving the appropriate definitions for the contested destination markets and the resulting HHI statistics for those geographic markets. Our review of Tosco's protest raises a reasonable doubt about the appropriateness of Shell's geographic market definitions and the resulting market statistics calculated for the contested destination markets. The Commission finds that the evidence presented by Shell is insufficient to permit a determination as to whether Shell lacks market power in its contested destination markets.

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[16]Id. at 31,189. The delivered price is the appropriate price for destination markets. In origin markets, the focus is on alternatives available to the shipper for getting product out of a particular location. Thus, it is the netback (price to the shipper after all costs of delivery) that should be compared in determining good alternatives.

[17]92 FERC ¶ 61,121 (2000).

[18]Id. at 61,467.

Accordingly, the Commission will set the Chicago, Evansville, Indianapolis, St. Louis and Toledo destination markets for hearing.

Contested Origin Market

Shell's Application

37. In the St. Louis BEA origin market, Shell states that it has an HHI of only 61 under the DOJ approach and 575 under the FERC Staff approach - in each case well under the most conservative threshold. Shell states that it has a capacity-based market share of 9.7% and a receipt-based market share which are also well below any level which should be cause for concern. Moreover, Shell states that the Commission has repeatedly determined that market forces will constrain ratemaking in this market.

Tosco's Protest

38. Tosco contends that a normal HHI analysis does not adequately capture the market reality of the St. Louis origin market because all three of the existing lines for which Shell seeks to charge market-based rates originate at Tosco’s Wood River refinery which is the principal source of product shipped over those lines and may be the only source. Tosco concludes that the relevant geographic origin market is limited to Tosco’s Wood River refinery and the only non-Shell alternatives are few and unsatisfactory.

39. Tosco claims the only other outbound lines connected to Wood River are Marathon’s east and north lines. Tosco claims that the east line will not transport jet fuel and is frequently prorated, and the north line is occasionally prorated. Tosco states it could reach Explorer and perhaps other outbound pipelines only through the use of intervening facilities, but the cost of using such facilities would create an obstacle. Tosco states that a remaining alternative would be using a local pipeline network serving the St. Louis market. However, Tosco questions how much output the local market could absorb given that the output of the refinery is nearly as large as the entire estimated consumption of the St. Louis BEA.

40. Tosco contends that its ability to use non-Shell pipelines is contractually limited by a 15-year agreement governing the disposition of much of the output of the refinery it has with a trading company and Shell affiliate. Tosco states that beginning in 2000 it was required to sell 95 percent of the gasoline output and 50 percent of the diesel output, and as of 2005 it is required to sell 75 percent of the gasoline output and 50 percent of the diesel output at a price specified in the contract. Tosco contends that the price it receives is a netback price calculated by subtracting Shell’s FERC tariff for shipments to points on Shell’s north and east line from specified Chicago prices. Tosco argues the agreement

insulates a large portion of the volumes on Shell's lines from price competition because no matter what tariff rate Shell charges, Shell or its affiliates will effectively receive that tariff rate through the netback price that Tosco must accept for those volumes.

Shell's Answer

41. Shell disputes Tosco's claim that it has no economically viable alternative to using Shell to transport refined products from its Wood River refinery. While Tosco is in the best position to know what its alternatives (or lack of alternatives) are, Shell states that Tosco has not come forward with any probative evidence in this regard.

42. To the contrary, Shell claims that the Tosco Wood River refinery has other viable alternatives to Shell. Shell states that Phillips owns a pipeline system that is capable of accomplishing many of the same outbound movements made by Shell. Further, Shell states there is a pipeline linking the Tosco refinery to the Phillips pipeline and there is an existing pipeline from the Tosco refinery that crosses the Phillips pipeline that could be interconnected. Shell states that the cost of using the existing Phillips pipeline system by the Tosco refinery would be the marginal cost of shipping the incremental barrels, which should be quite low, since it excludes capital costs.

43. Shell states that Tosco's claim that there are no incremental refined product sales opportunities in the St. Louis area is incorrect. Shell states that the Premcor refinery, which was shut down on October 1, 2002, is estimated to have been producing about 52.0 MBD of light refined pipelineable products. Shell states that as a result the Tosco refinery has the opportunity to compete to supply an additional 52.0 MBD of light refined petroleum products to Premcor's customers located in the St. Louis area and outside the St. Louis area. Shell states there is an existing pipeline from the Tosco refinery to the site of the closed Premcor refinery that gives the Tosco refinery access to all of Premcor's customers via the pipelines originating at the Premcor refinery.

44. Shell states that it is not a party to the offtake agreement entered into between Tosco and Shell Trading US Company (formerly Equiva Trading) and thus is not bound by its terms. Moreover, Shell states that agreement was negotiated by sophisticated companies which must be presumed to have been aware that Shell could apply for market-based rates under the Commission's regulations. In any case argues Shell, Tosco has significant flexibility, notwithstanding the agreement, to ship on pipelines other than Shell, and has significant flexibility to force the renegotiation of price terms in the event of substantial increases in Shell's rates.

Commission Decision

45. In order to justify each of its origin markets, Shell must show that each alternative outlet is a good alternative in terms of price for each shipper in the market. While it appears that Shell's shipment-based and capacity-based HHI and market share calculations do not indicate the presence of market power in the St. Louis origin market, Tosco asserts that Shell has overstated the good alternatives so that its HHIs for this market are too low. The Commission finds that the evidence presented by Shell and the Tosco is insufficient for the Commission to determine whether Shell lacks market power in the St. Louis origin market. Accordingly, the Commission will set this market for hearing.

Request for Waiver of Section 342.2

46. Section 342.2 of the Commission's regulations requires that initial rates for new services be established on the basis of either a cost-of-service showing or evidence of the agreement of at least one non-affiliated shipper. Shell is seeking waiver of this regulation with regard to its 2Rivers Pipeline which is currently under construction. Shell proposes that it be permitted to establish initial rates on the 2Rivers Pipeline under the market-based rate methodology.

Shell's Position

47. Shell provides four reasons why the Commission should waive the Section 342.2 regulations. First, Shell contends the 2Rivers line will serve an origin market and destination market which will be highly competitive. Second, Shell states that the Commission has already granted market-based rates for the St. Louis origin market to three other pipelines and has previously granted market-based rates to one pipeline serving the Evansville destination market. Third, Shell argues that the Commission has used the rationale that a new entrant must charge competitive rates in a market being served by existing suppliers in order to attract customers.[19] Shell claims there is precedent for waiving the filings to establish initial rates for an oil pipeline under construction.[20] Fourth, Shell states that although the Commission considered and rejected requests for rehearing of its initial rate regulations adopted in Order No. 561 that would not include market-based rates as an initial rate methodology, neither of the two concerns regarding the justification of initial rates on a market-power basis articulated by the Commission in Order No. 561-A are present in this case. Shell claims the first concern was that an initial rate for new service may represent no more than an additional receipt or delivery point on an existing system, and the second that market-based rates may only be charged after the Commission

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[19] New York State Electric & Gas Corp., 81 FERC ¶ 61,020 (1997) (NYE&G).

[20] Longhorn Partners Pipeline, L.P., 83 FERC ¶ 61,345 at 62,381 (1998) (Longhorn).

has determined that such ratemaking methodology is appropriate and lawful.

Tosco's Protest

48. Tosco argues that Shell's request for special treatment is based on the false premise that it has met its burden of establishing a lack of market power with respect to the new service on its 2Rivers line. Tosco claims that contrary to Shell's assertion, prior findings that other oil pipelines lack market power in certain geographic areas do not justify the assumption that Shell will also lack market power. Tosco contends that the NYG&E case cited by Shell differs from the instant case because in NYG&E none of the protesting parties objected to the pipeline's market-based rate proposal and that proceeding involved a new entrant with an extremely small market share. Tosco contends that the Longhorn decision does not support a waiver of regulations because Longhorn was allowed to establish initial market-based rates only after a complete pipeline-specific market power analysis and determination by the Commission. Finally, Tosco states that there is no compelling need for a waiver of the regulations to allow the establishment of initial rates without a cost-of-service justification since Shell will still be required to perform an annual cost of-service analysis under Opinion 154-B in order to comply with page 700 of the Commission's Form No. 6 annual report.

Shell's Answer

49. Tosco argues that Shell's request for special treatment is based on the false premise that it has met its burden of establishing a lack of market power with respect to the new seShell states that Tosco is not and may never be a shipper on the 2Rivers line. As a result, Shell contends Tosco lacks standing to intervene in this matter with regard to the petitions which pertain solely to 2Rivers. Shell contends Tosco's argument against waiver of the regulations consists largely of the contention that the regulations require what they require; Tosco does not even attempt to respond to Shell's several arguments why those regulations should be waived in this case. Shell argues Tosco's suggestion that there is no compelling reason for a waiver of the regulations to allow the establishment of initial rates without a cost-of-service justification disregards the fact that, as the Commission itself has recognized, rates set on the basis of competition are more efficient than rates set on the basis of cost-of-service concepts. Shell concludes that if the Commission determines that the 2Rivers system is workably competitive in its origin and destination markets, then it should allow those rates to be competitively justified.

Commission Decision

50. The Commission has set for hearing both the origin market (St. Louis) and destination market (Evansville) applicable to the 2Rivers Pipeline. Thus, until the Commission completes a market power determination for those markets, there will be no decision that market-based rates are applicable. As provided in Order No. 561-A, market-based rates may only be charged after the Commission has determined that such ratemaking methodology is appropriate and lawful. Thus, Shell's request for waiver is denied as premature. This is not inconsistent with Longhorn because in that case Longhorn was permitted to file market-based rates as initial rates only after the Commission had completed its market power determination and found that Longhorn lacked significant market power. Should the Commission here ultimately find a lack of significant market power in the markets pertaining to the 2Rivers Pipeline before service is initiated on that line, Shell can renew its request for waiver.

The Commission orders:

(A) The Commission grants Shell's request to charge market-based rates for the Chicago origin market and the Champaign destination market.

(B) Pursuant to the authority of the Interstate Commerce Act, particularly Sections 13(1) and 15(1) thereof, and the Commission's regulations, a hearing is established to determine whether Shell has market power in the St. Louis origin market, and the Chicago, Evansville, Indianapolis, St. Louis and Toledo destination markets.

(C) Pursuant to Section 375.304 of the Commission's regulations, 18 C.F.R. § 375.304 (2002), the Chief ALJ shall designate a Presiding ALJ for the purpose of conducting a hearing. The Presiding ALJ is authorized to conduct further proceedings pursuant to this order and the Commission's Rules of Practice and Procedure.

(D) Shell's petition for waiver of Section 342.2 of the Commission's regulations with regard to rates for its 2Rivers Pipeline is denied.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.