121 FERC ¶ 61,268
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Mobil Pipe Line Company Docket No. OR07-21-000

ORDER ON APPLICATION FOR MARKET POWER DETERMINATION AND ESTABLISHING HEARING PROCEDURES

(Issued December 20, 2007)

1. On August 24, 2007, Mobil Pipe Line Company (MPLCO) filed an application for a market power determination seeking authority to charge market-based rates on its existing Pegasus pipeline system (Pegasus) for the transportation of crude oil from Pegasus' origin at Patoka, Illinois, to its destination at Nederland, Texas.

2. On October 23, 2007, The Canadian Association of Petroleum Producers (CAPP) filed a motion to intervene, protest, request for discovery and hearing procedures, and proffer of supporting materials. CAPP maintains that MPLCO fails to justify its request for market-based rate authority for the origin and destination points on Pegasus. On the same day Suncor Energy Marketing Inc. (Suncor) and Canadian Natural Resources Limited (CNRL) filed a joint motion to intervene, protest, and request for summary denial or discovery and hearing. Suncor and CNRL allege that MPLCO employs overly broad and arbitrary market definitions and fails to provide specific facts pertinent to the issue of market power along the Pegasus line.[1]

3. As discussed below, the Commission finds that MPLCO lacks significant market power in its Houston to Lake Charles destination market. However, MPLCO's request for summary disposition of the protests is denied, as there are factual disputes over whether MPLCO lacks market power in the origin market served by its pipeline. Therefore the Commission will establish a hearing to determine whether MPLCO has the ability to exercise market power in the challenged origin market of Patoka, Illinois.

[1] Both interventions and protests were timely filed under the requirements of 18 C.F.R. § 348.2(g) (2007).

Setting the matter for hearing here ensures an adequate factual basis to determine whether authorization to charge market-based rates will result in rates that are just and reasonable.

I. Background

4. Pegasus, a common carrier, transports crude oil subject to the Commission's jurisdiction under the Interstate Commerce Act. Pegasus, a 20-inch diameter crude oil pipeline system that originates in Patoka, Illinois (south of Chicago) and terminates in Nederland, Texas (the Beaumont/Port Arthur area on the U.S. Gulf Coast), entered service in April 2006. Pegasus is owned and operated by MPLCO, a wholly-owned affiliate of ExxonMobil Corporation. Pegasus' sole receipt point is in Patoka. In Patoka, the shippers on Pegasus currently ship almost entirely heavy sour Canadian crude that is transported from the Edmonton, Alberta vicinity by either the Enbridge/Mustang pipelines or the Express/Platte/WoodPat pipelines. Pegasus' sole destination is Nederland. MPLCO states that Pegasus has been making deliveries to the Sunoco terminal in Nederland since April 2006 and, later in 2007, will begin making deliveries to the Chevron terminal in Nederland. The ultimate end users of the crude oil transported by Pegasus are refiners located in PADD III.[2]

II. Description of the Filing

5. MPLCO seeks market-based rate authority for transportation of crude oil to the counties within the United States Department of Energy/Energy Information Administration Refining District (EIA Refining Districts) that contain the U.S. Gulf Coast refineries supplied by pipeline or barge from the Nederland, Texas terminals served by Pegasus and that receive waterborne deliveries of crude oil. The proposed destination market consists of 30 counties in Texas, 38 parishes in Louisiana, 6 counties in Mississippi, and 2 counties in Alabama (Gulf Coast market).[3] In the alternative, MPLCO proposes a narrower destination market consisting of 21 counties in Texas and 2 parishes in Louisiana (Houston to Lake Charles market). MPLCO states that the Texas and Louisiana U.S. Gulf Coast Refining Districts together include a total of thirty-four refineries located on the Gulf Coast in PADD III. Seventeen are located in the Texas Gulf Coast Refining District and another 17 are located in the Louisiana Gulf Coast

---

[2] PADD's (Petroleum Administration for Defense Districts) are collections of states defined by the United States Department of Energy/Energy Information Administration. PADD III includes the states of New Mexico, Texas, Arkansas, Louisiana, Mississippi, and Alabama.

[3] Statement A, Table A.3 of MPLCO's application identifies the counties included MPLCO's Gulf Coast destination market.

Refining District. The two Gulf Coast Refining Districts together are served by seven crude oil pipelines other than Pegasus. MPLCO also points to the local crude oil production that competes with Pegasus and the waterborne deliveries of crude oil that comprise 94 percent of the total crude inputs of local refineries. In light of this, MPLCO claims the appropriate geographic destination market for Pegasus consists of at least the Houston to Lake Charles market, but that the more appropriate geographic destination market is the broader Gulf Coast market.

6. MPLCO also seeks permission to charge market-based rates on Pegasus from the Upper Midwest Origin Market, which contains Pegasus' receipt point at Patoka and includes the states of Minnesota, Wisconsin, Michigan, Illinois, Indiana, Ohio, and Kentucky. MPLCO asserts that the Upper Midwest Origin market contains 15 petroleum refineries and 3 outbound crude oil pipelines.

7. Furthermore, MPLCO states that it is planning to expand capacity on Pegasus from 66,000 to 96,000 barrels per day by early 2009. MPLCO seeks permission to charge market-based rates on Pegasus to provide MPLCO with the pricing flexibility necessary to respond to its competitive environment and to justify the Pegasus expansion without requiring shipper commitments of 10 years or more in length.

8. MPLCO asserts that its application describes in detail the various sources of competition that MPLCO's Pegasus system faces in these markets, and has set forth widely-accepted statistical analyses in support of its position that it lacks significant market power in these origin and destination markets.[4] Thus, MPLCO claims that the application, and the statements filed with, and in support of, the application, demonstrate that market-based ratemaking authority is appropriate for Pegasus.

III. Interventions, Protests, Comments, and Answers

9. On October 23, 2007, Suncor and CNRL filed a joint motion to intervene, protest, and request for summary denial or discovery and hearing.[5] Both Suncor and CNRL state that they have a substantial economic interest in MPLCO's application since both companies are shippers on MPLCO's Pegasus system. Suncor and CNRL state that during the period from October 2006 until September 2007, Suncor shipped

---

[4] MPLCO included with its application the direct testimony of Dr. George R. Schink and Mr. Thomas Martenak that it argues support its position.

[5] Suncor and CNRL included with their joint motion to intervene, protest, and request for summary denial or discovery and hearing the verified statement of David D. Armstrong and affidavit of Dr. Daniel S. Arthur.

approximately 10,000 barrels per day and CNRL shipped approximately 24,800 barrels per day through the Pegasus line, which collectively equates to approximately 52.7 percent of the capacity of Pegasus.

10. Suncor and CNRL argue that MPLCO has failed to justify its request for market-based rate authority with respect to the proposed origin market. Suncor and CNRL state that under Order No. 572, an applicant for market-based rate authority has the burden of presenting information which "will permit the Commission to make informed decisions about market power and prevent the possibility of abuse of market power."[6] Suncor and CNRL contend that MPLCO's application uses an overly-broad and arbitrary definition of the origin market and fails to provide specific facts which are necessary to measure market power of MPLCO in the origin market. Suncor and CNRL assert that when the relevant facts are considered and the origin market properly defined, MPLCO's application vastly overstates the level of competition and understates the extent of MPLCO's market power by simply listing competitive alternatives in the absence of any economic analysis. Suncor and CNRL state that market power is further impacted by certain physical barriers or impediments to some of the alternatives proposed by MPLCO. Thus, Suncor and CNRL argue the application cannot serve as an adequate evidentiary basis for finding that MPLCO lacks market power in the relevant origin market.

11. On October 23, 2007, CAPP filed a motion to intervene, protest, request for discovery and hearing procedures and proffer of supporting materials. CAPP states that its membership represents virtually the entirety of the producing sector of the Canadian Petroleum industry. Furthermore, CAPP maintains that its members produce most of the crude oil and other petroleum products originating in Canada and destined for markets in the U.S., including a significant proportion of the supplies currently transported by the Pegasus system. CAPP argues they have a substantial economic interest in MPLCO's application since its members contract for term services provided by Pegasus in order to transport Canadian-produced oil supplies to markets in the U.S. Gulf Coast.

12. CAPP protests the requested authority to charge market-based rates. CAPP argues that MPLCO has failed to justify its request for market-based rate authority with respect to the origin and destination points on the Pegasus line. Specifically, CAPP asserts the application fundamentally fails to address the commercial circumstances under which Pegasus operates currently and in the foreseeable future. In addition, CAPP avers the application fails to acknowledge: (1) the growing need for additional U.S. refinery feedstocks from crude oil suppliers in Canada; (2) the substantial and continuing growth in available supplies of heavy crude oil from western Canada; (3) the saturation of

---

[6] *Market-Based Ratemaking for Oil Pipelines*, Order No. 572, FERC Stats. & Regs. ¶ 31,007, at 31,180 (1994).

limited, regional refining capacity in the U.S. Midwest; and (4) the resulting constraints of transportation routes from Canadian suppliers to refineries in the U.S. Gulf Coast.

13. On October 29, 2007, MPLCO filed a letter with the Commission stating it would request summary disposition of the protests in a forthcoming filing and answer to the interventions and protests. On November 2, 2007, Suncor and CNRL filed a letter opposing MPLCO's suggested answer, as being outside the bounds of the Commission's market-based rate filing regulations. On November 5, 2007, CAPP filed a letter with the Commission reiterating the concerns of Suncor and CNRL.

14. MPLCO filed a motion for leave to file an answer and an answer to the protests on November 7, 2007 (answer). In its answer, MPLCO asserts that the issues raised by the protests do not raise any significant material issues of fact that cannot be resolved on the basis of law and policy. Accordingly, MPLCO requests that the Commission grant MPLCO's application for market-based rates and avoid the burden and expense of hearings before an administrative law judge, an initial decision, and briefs on exception.

IV. Discussion

15. Section 348.1(c) of the Commission's regulations requires an oil pipeline seeking a market power determination and authority to charge market-based rates to: (1) define the relevant product and geographic markets, including both destination and origin markets; (2) identify the competitive alternatives for shippers, including potential competition and other competition constraining the pipeline's ability to exercise market power; and (3) compute the market concentration and other market power measures based on the information provided about competitive alternatives.[7]

16. Although CAPP states that, "the applicant has failed to justify its request for market-based rate authority with respect to the origin and destination points on the Pegasus line"[8] CAPP fails to elaborate or provide any evidence in support of its assertion that MPLCO has market power in its Nederland, Texas destination market. The Commission has examined the portion of MPLCO's filing that addresses this market and concludes that MPLCO's market share in the Houston to Lake Charles destination market, the competitive alternatives available, and the absence of any evidence or convincing arguments to the contrary establish that MPLCO cannot exercise market power in the Houston to Lake Charles destination market. This is reflected particularly

[7] 18 C.F.R. § 348.1(c) (2007).

[8] CAPP Protest at page 3.

by the Houston to Lake Charles Herfindahl-Hirschman Index (HHI)[9] of 167 – a level indicative of a large number of competitors. In addition, MPLCO has shown that there are a number of competing pipelines and that waterborne crude oil deliveries account for significant portion of demand in the Houston to Lake Charles destination market.[10] Accordingly, the Commission finds that MPLCO lacks significant market power in serving the Houston to Lake Charles destination market. In view of this determination, it is unnecessary for the Commission to consider the broader Gulf Coast market to validate MPLCO's lack of significant market power.

17. MPLCO's application for a market power determination seeks authority to charge market-based rates in one origin market and one destination market. Those two markets, however, are joined for purposes of the market-based transportation sought here by only the single MPLCO pipeline. The origin and destination markets here thus are inextricably linked by that one pipeline. In these circumstances, the Commission concludes that it cannot ensure just and reasonable market-based rates for transportation over the MPLCO pipeline by considering market power in either the origin market or the destination market independent of the other market. Therefore, MPLCO will not be permitted to charge market based rates for transportation of crude oil until it is determined that MPLCO lacks significant market power in both its origin and destination markets.

---

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

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

18. In analyzing MPLCO's protested origin market definition, the Commission first looks to Order No. 572,[11] which requires that an oil pipeline seeking market-based rates describe the geographical 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 origin market. 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 the pipeline uses BEAs, it must show that each BEA represents an appropriate geographic market.[12]

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."[13]

19. MPLCO identifies its origin market as the Upper Midwest Origin Market, which contains Pegasus' receipt point at Patoka and encompasses seven states: Minnesota, Wisconsin, Michigan, Illinois, Indiana, Ohio, and Kentucky. MPLCO identifies fifteen refineries located in its origin market which MPLCO maintains are alternative destinations to volumes delivered to Pegasus. Although MPLCO did not propose to use a BEA to define the geographic market for its origin market, the fifteen refineries MPLCO identifies as alternatives encompass at least eight separate BEAs. This departs from the Commission's long-standing reliance on BEAs as the starting points for defining relevant geographic markets. In *Colonial*, where geographic markets were protested because they included alternative supply sources located outside a single BEA, the Commission stated

---

[11] *Market-Based Ratemaking for Oil Pipelines*, Order No. 572, FERC Stats. & Regs. ¶ 31,007, 31,180 (1994).

[12] *Id.* at 31,188. Each BEA is an "Economic Area" defined by the Bureau of Economic Analysis of the U.S. Department of Commerce. BEA's economic areas define the relevant regional markets surrounding metropolitan or micropolitan statistical areas. They consist of one or more economic nodes--metropolitan or micropolitan statistical areas that serve as regional centers of economic activity--and the surrounding counties that are economically related to the nodes. The Bureau redefined these areas in 2004 to reflect more current commuting and trading patterns, which resulted in an increase in the number of BEAs from 172 to 179.

[13] *Id.*

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."[14]

20. The parties to a proceeding in which an oil pipeline seeks to implement market-based rates can always challenge the relevant geographic market. If their protests raise reasonable doubt about a particular geographic market, the applicant must provide a detailed justification of the relevant market, including a demonstration that all of the alternatives within the market are good alternatives in terms of price.[15]

21. 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 sets the stage by pointing out that, in general, it is delivered prices, not transportation rates, which 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 relevant price to be analyzed for making a comparison of the alternative to the pipeline's services.[16]

22. In *Colonial*, the Commission clarified that 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."[17] There the Commission stated 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, for origin markets the Commission determined it is the netback to the shipper (price to shipper after all costs of delivery) that should be compared in determining whether proposed alternatives are good alternatives in terms of price.[18]

---

[14] *Colonial Pipeline Co.*, 92 FERC ¶ 61,144, at 61,537 (2000) (*Colonial*).

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

[16] *Market-Based Ratemaking for Oil Pipelines,* Order No. 572, FERC Stats. & Regs. ¶ 31,007, at 31,189 (1994).

[17] *Colonial Pipeline Co.*, 92 FERC ¶ 61,144, at 61,532 (2000).

[18] *Id.*

23. Furthermore, as described above, when protests raise reasonable doubt concerning the appropriateness of geographic market definitions, the Commission requires the applicant to justify its proposed geographic markets and alleged alternatives based on a detailed cost analysis. Thus, in order to justify its origin market, MPLCO must show that each alternative outlet is an alternative in terms of price for each shipper in the market.[19] While MPLCO's 1,394 capacity-based HHI and 9.3 percent market share calculations do not appear to indicate the presence of market power in the origin market, nonetheless, the protestors assert that MPLCO has improperly enlarged the market and overstated the good alternatives so that its HHI for the market is too low.[20] In fact, protestors argue that when the market is properly defined and only "good alternatives" are considered, the resulting HHI calculation ranges from 3,600 to 10,000.[21] The Commission finds that the evidence presented by MPLCO and the protestors is insufficient for the Commission to determine whether MPLCO lacks market power in the defined origin market.

24. Accordingly, we deny the request by the protestors and MPLCO for summary disposition of this application as parties have raised numerous issues of material fact which must be resolved in an evidentiary hearing. Thus, a hearing will be established to define the appropriate origin market and to determine whether MPLCO lacks significant market power in that market as so defined. We also defer the protestors' request for discovery to the Administrative Law Judge (ALJ). This is only the second instance of an application for authority to charge market-based rates for a crude oil pipeline and presents novel issues regarding transportation of heavy sour crude oil originating in Canada with deliveries to refineries in the U.S.

25. MPLCO's motion filed on November 7, 2007, to answer the protests of CAPP and Suncor and CNRL is denied because it is not permitted by the regulations and good cause has not been shown to grant waiver of the regulations.[22]

---

[19] *See Shell Pipeline Co. L.P.*, 103 FERC ¶ 61,236, at 61,901 (2003) and *TE Products Pipeline Co. L.P.*, 92 FERC ¶ 61,121, at 61,467 (2000).

[20] Suncor and CNRL Protest at page 4.

[21] Suncor and CNRL Protest at page 7 and CAPP Protest at pages 6 and 7.

[22] Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. э 385.213, prohibits answers to protests unless otherwise permitted by the decisional authority.

<u>The Commission orders</u>:

(A) As discussed in the body of this order, the Commission finds that MPLCO lacks significant market power in its Houston to Lake Charles destination market.

(B) Pursuant to the authority of the Interstate Commerce Act, particularly section 15(1) thereof, and the Commission's rules and regulations, a hearing is established to define the appropriate origin market and to determine whether MPLCO lacks significant market power in that market as so defined.

(C) Pursuant to section 375.304 of the Commission's regulations, 18 C.F.R. § 375.304 (2007), 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) MPLCO's motion to file an answer to the protests is denied.

(E) Protestors' motion to conduct discovery is deferred for ruling by the ALJ.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.