ORAL ARGUMENT HAS NOT BEEN SCHEDULED

In the United States Court of Appeals for the District of Columbia Circuit

No. 11-1021

MOBIL PIPE LINE COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR REVIEW OF AN ORDER OF THE FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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October 4, 2011

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in the brief of Petitioner.

B. Ruling Under Review

Mobil Pipe Line Company, 133 FERC ¶ 61,192 (2010), JA 1192.

C. Related Cases

This case has not been before this Court or any other court. There are no related cases.

/s/ *Judith A. Albert*
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October 4, 2011

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GLOSSARY

ALJ	Administrative Law Judge
ALJ Decision	*Mobil Pipe Line Co*., 128 FERC ¶ 63,008 (2009)
Canadian Producers	Canadian Association of Petroleum Producers
Commission or FERC	Federal Energy Regulatory Commission
Hearing Order	*Mobil Pipe Line Co.*, 121 FERC ¶ 61,268 (2007)
ICA	Interstate Commerce Act
Merger Guidelines	1992 DOJ-FTC Horizontal Merger Guidelines
Mobil	Mobil Pipe Line Company
Order	*Mobil Pipe Line Co.*, 133 FERC ¶ 61,192 (2010)
Pegasus	Mobil Pipe Line Company's Pegasus pipeline system
Suncor/Canadian	Suncor Energy Marketing, Inc., and Canadian Natural Resources Limited

In the United States Court of Appeals for the District of Columbia Circuit

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MOBIL PIPE LINE COMPANY,
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FEDERAL ENERGY REGULATORY COMMISSION,
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ON PETITION FOR REVIEW OF AN ORDER OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission (Commission or FERC), affirming the decision of an Administrative Law Judge after an evidentiary hearing, reasonably determined that Mobil Pipe Line Company (Mobil) failed to demonstrate lack of market power over the transportation of crude oil at the Upper Midwest origin of its Pegasus pipeline (Pegasus) and, consequently, is not entitled to charge market-based rates for that transportation.

STATUTES AND REGULATIONS

The relevant statutes and regulations are contained in the Addendum to this brief.

INTRODUCTION

The Interstate Commerce Act (ICA) requires the Commission to ensure that oil pipeline rates are just and reasonable. *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1501-02 (D.C. Cir. 1984). Because a reasonable rate must be high enough to cover a pipeline's costs of providing service plus a reasonable rate of return, and must be low enough to protect shippers from exploitation, reasonableness determinations traditionally relied on cost-of-service analyses. *Id.* at 1502.

Where a market is competitive, however, FERC may rely upon market-based rates to ensure reasonableness. In a competitive market, "it is rational to assume that the terms of [the buyer's and seller's] voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment." *Tejas Power Corp. v. FERC*, 908 F.2d 998, 104 (D.C. Cir. 1990). To allow such rates, this Court requires a demonstration that market forces will keep prices at just and reasonable levels. *Farmers Union*, 734 F.2d at 1510. Thus, an oil pipeline has no right to charge market-based rates, and the Commission may only grant such authority

after the Commission has concluded that the pipeline lacks significant market power in the relevant markets. *Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1442-43 (D.C. Cir. 1996). *See also* 18 C.F.R. §§ 342.4 (oil pipeline ratemaking methods) and 348.1 (requirements for applying for market-based rates for oil pipelines). The burden is on the pipeline seeking market-based rate authority to demonstrate that the relevant markets are competitive. *See id.* § 348.1(c).

Here, Mobil sought authority to charge market-based rates for the transportation of crude oil on its Pegasus pipeline, from Pegasus's origin in the Upper Midwest to its destination in the Gulf Coast. The Commission found that Mobil lacked significant market power in the destination market, but established a hearing to determine whether Mobil can exercise market power in the origin market. *Mobil Pipe Line Co.*, 121 FERC ¶ 61,268 (2007) (Hearing Order), R 13, JA 430.[1]

The Administrative Law Judge (ALJ) found that Mobil had not demonstrated that there were good economic alternatives to Pegasus's service in Pegasus's origin market that would check Pegasus's ability to charge unjust and unreasonable rates. There is a significant and persistent price differential between the lower price refineries pay for crude oil in the Upper Midwest and the higher

[1] "R" refers to a record item. "JA" refers to the Joint Appendix page number. "P" refers to the internal paragraph number within a FERC order. "Exh." stands for "exhibit."

price they pay in the Gulf Coast, exceeding on average the price of transporting the crude oil from the Midwest to the Gulf. As Pegasus is the only pipeline transporting crude oil from its Upper Midwest origin to the Gulf Coast, Pegasus is uniquely situated to take advantage of this differential and raise its prices above just and reasonable levels if it is granted market-based rate authority.

Accordingly, the ALJ found that Mobil had not shown that Pegasus's origin market is sufficiently competitive that an award of market-based rate authority would result in just and reasonable rates, and recommended that the Commission deny Mobil's application for market-based rates. *Mobil Pipe Line Co*., 128 FERC ¶ 63,008 (2009) (ALJ Decision), R 99, JA 1069. The Commission affirmed. *Mobil Pipe Line Co.*, 133 FERC ¶ 61,192 (2010) (Order), R 112, JA 1192.

STATEMENT OF FACTS

I. STATUTORY AND REGULATORY BACKGROUND

A. FERC's Obligation To Ensure Just And Reasonable Rates

In 1906, Congress extended the definition of common carrier under the Interstate Commerce Act (ICA) to oil pipelines and required that their rates be just and reasonable. *See* 49 U.S.C. app. § 1(5)(a) (1988). In 1977, Congress transferred ICA oil pipeline regulatory authority from the Interstate Commerce Commission to the newly-created FERC.

FERC's regulation of oil pipeline transportation is subject to the ICA as it stood on October 1, 1977, 49 U.S.C. §§ 1-15 (1976), *reprinted in* 49 U.S.C. app. §§ 1-15 (1988). *See generally Ass'n of Oil Pipe Lines*, 83 F.3d at 1428 n.6 (explaining background of statute and its unusual citation format); *Resolute Natural Resources Co. v. FERC*, 596 F.3d 840, 841 (D.C. Cir. 2010) (same). Pursuant to 49 U.S.C. app. § 1(5)(a) (1988), FERC must ensure that oil pipeline rates are just and reasonable.

In 1982, the Commission held that, because the oil pipeline industry was generally competitive, rate regulation should serve only as a ceiling on "egregious prices," with market forces serving as the primary constraint on rates. *Williams Pipeline Co*., 21 FERC ¶ 61,260 at 61,639 n.441, 61,549 (1982). This Court found that this approach contravened the Commission's statutory obligation to ensure that rates are just and reasonable. *Farmers Union*, 734 F.2d at 1500. While the Commission can move to "lighthanded" regulation if the goals of the statute are met, the Commission must nevertheless demonstrate that market forces can be "relied upon to keep prices at reasonable levels." *Id*. at 1510.

B. Energy Policy Act of 1992

Oil pipeline cost-of-service proceedings can be lengthy and expensive. Accordingly, the Energy Policy Act of 1992 required the Commission to establish simplified ratemaking methodologies for oil pipelines. Congress, however,

retained the ICA § 1(5)(a) requirement that rates be just and reasonable. *Ass'n of Oil Pipe Lines*, 83 F.3d at 1429 (the Energy Policy Act was intended to "give pricing flexibility to oil pipelines, while preventing excessive rates and charges against any captive shippers") (citations omitted).

FERC responded with Order Nos. 561 and 572. *Revisions of Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, FERC Stats. & Regs. ¶ 30,985 (1993), 58 Fed. Reg. 58,753 (Nov. 4, 1993) (Order No. 561); *Market-Based Ratemaking for Oil Pipelines*, FERC Stats. & Regs. ¶ 31,007, 59 Fed. Reg. 59,148 (Nov. 16, 1994) (Order No. 572); *petitions for rev. consolidated and denied*, *Ass'n of Oil Pipe Lines*, 83 F.3d at 1428.

Order No. 561 established an indexing system under which rate increases are limited each year by a ceiling level that accounts for inflation. *See MarkWest Michigan Pipeline Co., LLC v. FERC*, 646 F.3d 30, 32 (D.C. Cir. 2011). Indexed rate increases are applied to baseline rates already deemed just and reasonable where, as relevant here, at least one shipper has agreed in writing to pay the rate and no other shipper has protested. *Id.*

The Commission intended indexing to be the primary ratemaking methodology. Order No. 561 at 30,947 ("cost-of-service, settlement, and market-based rate methodologies are alternatives to the generally applicable and required indexing approach") and 30,948 ("the Commission is allowing pipelines to depart

from indexing only in limited circumstances”). Market-based rates could continue as an option in “markets where the pipeline can demonstrate that it does not possess significant market power and its rates are therefore constrained by competition.” *Id*. at 30,948. *See also* 18 C.F.R. §§ 342.3 (rate indexing) and 342.4 (rate-changing methods other than indexing).

Order No. 572 set the framework for market-based rates. Such pricing would permit pipelines “to engage in competitive pricing in order to react to changes in market conditions, such as increased demand for its service.” Order No. 572 at 31,180. The indexing method, however, “sets the maximum lawful rate subject to exceptions which must be proven.” *Id*. at 31,181. Market-based ratemaking is such an exception, and a pipeline has the burden to demonstrate that its individual circumstances entitle it to such rates. Order No. 572 at 31,181.

The Commission did not adopt specific market power standards but promulgated regulations, 18 C.F.R. § 348.1, which guide its analysis of market-based rate applications. Section 348.1(c) requires an oil pipeline seeking authority to charge market-based rates to: (1) define the relevant product and geographic markets, including both origin and destination 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 the competitive alternatives. Order No. 572 at 31,185.

In applying the Order No. 572 framework, FERC has looked for guidance to the 1992 DOJ-FTC Horizontal Merger Guidelines (Merger Guidelines). The Merger Guidelines define market power as "the ability profitably to maintain prices above competitive levels for a significant period of time." Merger Guidelines Section 0.1 at 2, Exh. No. MPL-87 at 5, R 216, JA 101. An entity has market power if it can profitably impose a "small but significant and nontransitory" increase in price. Merger Guidelines Section 1.0 at 4, Exh. No. MPL-87 at 7, R 216, JA 103.

II. THE PROCEEDING BELOW

A. Mobil's Application

Pegasus is an 858-mile, 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). Pegasus initially transported crude oil from the Gulf Coast north to Upper Midwest refineries. ALJ Decision P 34, JA 1077. With development of Alberta tar sands oil reserves, Canadian shippers, needing new markets, sought to transport oil to the Gulf Coast. In 2006, Pegasus reversed its flow and began transporting crude oil from Patoka south to Nederland. *Id.* at PP 34-35, JA 1077-78.

Pegasus's shipments now consist almost entirely of heavy sour Canadian crude oil.[2] Hearing Order P 4, JA 431. The oil comes to Patoka by pipeline from Edmonton, Alberta, and Pegasus transports the oil to two Nederland terminals, Sunoco and Chevron. The ultimate end users are refiners located on the Gulf Coast. *Id.*

Initial rates for Pegasus following its reversal were set by agreement. Pursuant to this agreement, Mobil filed initial tariffs under which committed shippers paid a rate of $0.565 per barrel and uncommitted shippers $1.10 per barrel. The Commission accepted the initial rates as just and reasonable because: (1) at least one non-affiliated shipper agreed to the uncommitted rate and (2) no shipper protested the rate. ALJ Decision P 35, JA 1078. With indexing, the uncommitted tariff rate was $1.218 per barrel at the time Mobil initiated its market-based rate proceeding. *Id*.

From the start, Pegasus received many more requests for service than it could fulfill. ALJ Decision P 39, JA 1080. Pegasus is the only pipeline that transports crude oil from the Upper Midwest to the Gulf Coast. *Id*. P 43, JA 1081.

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[2] Crude oil is a mixture of thousands of compounds and is categorized as "heavy" or "light" depending on the relative abundance of heavier or lighter hydrocarbon molecules which occur in varying ratios and in different configurations. ALJ Decision P 108, n.26 (citing record evidence), JA 1105. "Sweet" crude oil contains less that 0.5 percent sulfur while "sour" crude oil contains more than 0.5 percent sulfur. *Id.* n.27, JA 1105.

Gulf Coast refiners offered higher prices for crude oil than did Upper Midwest refiners. *Id.* P 42, JA 1080 (citing numerous record sources). Shippers could make more money (the "netback differential") after paying pipeline transportation costs to the Gulf Coast than they could by selling to Upper Midwest refineries. *Id.*

In 2006, Mobil began exploring the possibility of expanding Pegasus's capacity by 30,000 barrels per day, *i.e.*, from a design capacity of 66,000 barrels per day to 96,000 barrels per day. *Id*. P 37, JA 1079. Rather than enter into agreements with shippers to support the new capacity, Mobil applied for market-based rate authority, arguing that the added ratemaking flexibility would lessen the financial risk associated with expansion. *Id*. P 38, JA 1079. Protests were filed by the Canadian Association of Petroleum Producers (Canadian Producers) and jointly by Suncor Energy Marketing, Inc., and Canadian Natural Resources Limited (Suncor/Canadian).

B. Hearing Order

The Commission found that Mobil had demonstrated that it lacked market power in the Nederland destination market. Hearing Order P 16, JA 434. However, significant factual issues existed regarding the origin market. In brief, Mobil defined the origin market as the Upper Midwest Origin Market, which contains Pegasus's receipt point at Patoka and includes the states of Minnesota, Wisconsin, Michigan, Illinois, Indiana, Ohio, and Kentucky. *Id.* P 6, JA 432.

Mobil asserted that this market is competitive because it contains 15 petroleum refineries and three outbound crude oil pipelines. Hearing Order P 6, JA 432.

In response, Suncor/Canadian asserted that Mobil's origin market definition was too broad and that Mobil had understated its market power by simply listing competitive alternatives in the absence of any economic analysis of those alternatives. *Id*. P 10, JA 433. Canadian Producers contended similarly that Mobil had failed to address the particular commercial circumstances in the Upper Midwest, including the continuing growth of crude oil supplies from Canada and the limited refining capacity in the Upper Midwest. *Id.* P 12, JA 433.

The Commission found that the evidence presented was insufficient to allow it to determine whether Mobil lacks market power in the origin market. *Id*. P 23, JA 438. Accordingly, it established an evidentiary hearing to define the appropriate origin market and to determine whether Mobil lacks significant market power in that market. *Id*. P 24, JA 438.

FERC provided guidance for the evidentiary hearing. Order No. 572 suggests that "comparative costs could be an effective means of justifying good alternatives to the pipeline's service," and that, in general, "it is delivered prices, not transportation rates, which must be compared." *Id*. P 21, JA 437 (citing Order No. 572 at 31,189). For origin markets, the question is whether there are good economic alternatives to shippers on the pipeline, which is determined by

comparing the netback to the shipper (price to shipper after all costs of delivery) from using the pipeline and possible alternatives. Hearing Order P 22, JA 437 (citing *Colonial Pipeline Co.* 92 FERC ¶ 61,144 at 61,532 (1992)).

C. The ALJ Decision

The ALJ, citing the Merger Guidelines and Commission precedent, defined market power as "the ability profitably to maintain prices above competitive levels for a significant period of time." ALJ Decision P 46, JA 1082 (citing Merger Guidelines Section 0.1 at 2, Exh. No. MPL-87 at 5, R 216, JA 101; *Colonial Pipeline Co.*, 92 FERC ¶ 61,144 at 61,534 n.20; *Explorer Pipeline Co*., 87 FERC ¶ 61,374 at 62,392 (1999); *SFPP, L.P*., 84 FERC ¶ 61,338 at 62,497 (1998); *Buckeye Pipe Line Co*., 53 FERC ¶ 61,473 at 62,666 (1990), *order on reh'g*, 55 FERC ¶ 61,084 (1991)); Order P 12, JA 1195. Accordingly, the test for market power is whether, if market-based rate authority were granted, the pipeline "could profitably sustain a 'small but significant and nontransitory increase in price.'" ALJ Decision P 46, JA 1082 (quoting Merger Guidelines Section 1.0 at 4, Exh. MPL-87 at 7, JA 103). The parties agreed on the propriety of this test, but disagreed on, *inter alia*, the definition of "competitive levels," *i.e*., the benchmark price on which the market power analysis is based. *Id.*

The ALJ, agreeing with Mobil's protesting shippers, found that the proper benchmark for the market analysis is the long-run competitive price. The ALJ

reasoned that a just and reasonable rate is designed to approximate the long-run competitive price under which firms recover their costs plus a normal return on investment. ALJ Decision PP 72, 80-83, JA 1091, 1094-95 (citing, *inter alia*, *Farmers Union*, 734 F.2d at 1501-02, 1508-10; *Tejas*, 908 F.2d at 1004).

The ALJ determined that Pegasus's prevailing tariff rate is a reasonable approximation of the long-run competitive price. *Id.* P 72, JA 1091. "[T]o determine whether a market-based rate would be just and reasonable, the benchmark rate used in the market power analysis must also be just and reasonable." *Id.* P 81, JA 1094 (*citing*, *inter alia*, *Farmers Union*, 734 F.2d at 1508-10). Pegasus's prevailing tariff rate is a good proxy for the long-run competitive price because the Commission had already accepted it as just and reasonable. *Id*. P 82-83, JA 1094-95; *see MarkWest*, 646 F.3d at 32 (under Order No. 561, baseline rate just and reasonable where one shipper has agreed to pay the rate and no shipper has protested).

The ALJ rejected Mobil's argument that the competitive level benchmark is whatever level the rate would reach if Mobil were not constrained by regulation. *See* ALJ Decision P 50, JA 1084. Mobil's theory improperly assumes that the market clearing rate is competitive. *Id*. P 75-77, JA 1092-93. The goal is to determine whether sufficient competitive alternatives exist to constrain Pegasus's rates. Assuming that "the rate Pegasus would be able to charge if granted market-

based authority would necessarily result from a truly workably competitive market" puts "the cart before the (winged) horse." ALJ Decision P 76, JA 1093.

The ALJ further concluded, based on the Merger Guidelines and Commission precedent, that the threshold for the "small but significant and nontransitory increase in price" was fifteen percent. *Id.* P 100, JA 1101. Here, using Pegasus's tariff rate of $1.218 per barrel, the threshold for the "small but significant and nontransitory increase in price" was $0.1827 per barrel (*i.e.* 18 cents). *Id.*

The ALJ then compared the average netbacks Pegasus shippers received from selling Western Canadian crude oil on the Gulf Coast with the average netback to shippers from selling in the Upper Midwest market. *Id.* P 271, JA 1162-63. Sales on the Gulf Coast yielded an average netback price of $51.27 per barrel for the first 10 months of 2007, and the Upper Midwest yielded $46.77 per barrel. *Id.* This resulted in a netback differential of $4.50 per barrel, which is significantly above the "small but significant and nontransitory increase in price" of 18 cents. *Id.* If Mobil were granted market-based rate authority, it would be able to capture this netback differential and increase Pegasus's prevailing rate of $1.218 per barrel by roughly $4.50 per barrel, to about $5.718 per barrel, a 369 percent increase over its regulated rate. *Id.* P 299, JA 1173. Additional

calculations using updated information found that Mobil could increase rates by 50 and 209 percent. ALJ Decision PP 272-73, 300-01, JA 1163, 1174.

Because Pegasus is the only pipeline that can transport crude oil from the Upper Midwest to the Gulf Coast, no other pipeline, refinery, or entity in Pegasus's origin market has the ability to effectively compete with Pegasus by charging less for transporting crude oil or otherwise granting Pegasus shippers a larger share of that basis differential. *Id*. P 86, JA 1096. Accordingly, there were no good economic alternatives to Pegasus's services. *Id*. P 298, JA 1173. Thus, the ALJ found that Mobil had not shown that Pegasus's origin market was sufficiently competitive that a grant of market-based rate authority would result in rates that were just and reasonable, and therefore the ALJ recommended that Mobil's application for market-based rate authority be denied. *Id*. P 1, JA 1069-70.

D. The Commission's Order

The Commission affirmed the ALJ Decision in all respects. Order P 1, JA 1192. The Commission found that "the ALJ engaged in a thorough analysis and appropriately determined that Mobil's Pegasus pipeline possesses market power and that the Commission should deny authority for Mobil to charge market-based rates." *Id*. P 9, JA 1195. The burden was on Mobil to demonstrate that market forces would constrain it from raising its rates above a just and reasonable level. *Id*. P 7, JA 1194. Mobil failed to establish that there are good economic

alternatives to Pegasus's services in the origin market that would check rates to reasonable levels, and therefore Mobil failed to show that the origin market was sufficiently competitive such that authority to charge market-based transportation rates would result in just and reasonable rates. *Id*. P 4, JA 1193.

SUMMARY OF ARGUMENT

Oil pipeline rates, by statute, must be just and reasonable. Where a market is competitive, FERC may rely upon market-based rates to ensure reasonableness if the Commission can find that market forces will keep prices at just and reasonable levels. Thus, an oil pipeline has no right to charge market-based rates, and the Commission grants such authority only after it has concluded that the pipeline lacks significant market power in the relevant markets. The burden is on the pipeline seeking market-based rate authority to demonstrate that the relevant markets are competitive.

A pipeline has market power if it can profitably maintain prices above a competitive level for a significant period of time. Because Pegasus is the only pipeline that transports crude oil from the Upper Midwest to the Gulf Coast, Pegasus has the unique ability, if granted market-based rate authority, to exploit the significant basis differential between the Upper Midwest and Gulf Coast markets. The ALJ found, after hearing, that granting Pegasus the authority to charge market-based rates would allow it to capture this basis differential through a dramatic price increase (369 percent) over Pegasus's tariff rate, and would not result in just and reasonable rates. The Commission affirmed the ALJ's analysis.

Mobil asserts that the ALJ erred in relying on a long-term benchmark, *i.e.* Pegasus's tariff rate, in its market power analysis, instead of the short-run market-

clearing price. However, to determine whether a market-based rate is just and reasonable, the benchmark rate used in the market power analysis must be just and reasonable. As this Court has found, a competitive market-clearing price can still exceed the zone of reasonableness, and Mobil has not shown that the market-clearing price would be just and reasonable. Conversely, Pegasus's tariff rate has been accepted by the Commission as just and reasonable, and therefore is an appropriate benchmark. A just and reasonable rate is designed to approximate the long-run competitive price under which firms recover their costs plus a reasonable return.

Mobil's precedent demonstrating that high prices can result from scarcity rather than market power is not persuasive. In those cases, a finding of competitive alternatives that check the ability to charge above-competitive rates preceded the conclusion that a temporary spike in prices above the long-run equilibrium can reflect scarcity. Mobil has demonstrated no such competition here that would prevent it from raising Pegasus's rates and absorbing the entire Upper Midwest - Gulf Coast differential for the foreseeable future, charging rates far in excess of its just and reasonable tariff rate without any loss of volume.

Nor was the Commission's netback analysis flawed by failure to adjust the objective market data to account for two BP refinery outages. The Commission reasonably affirmed the ALJ's decision not to selectively manipulate the objective

market evidence to adjust oil prices in the Upper Midwest, while disregarding the effects of any other events, including effects on the price of crude oil in the Gulf.

Mobil's purported evidence of competitive alternatives does nothing to undermine the Commission's analysis. The fact that Pegasus shippers have access to and use other alternatives for the sale of their crude oil does not mean that those alternatives are good alternatives to Pegasus in terms of price, *i.e*. that those alternatives can check Pegasus's ability to raise rates above competitive levels. Whether an alternative is a good alternative in terms of price can only be demonstrated through detailed cost comparisons, here through the use of a netback analysis. The netback analysis here demonstrated that there are no good alternatives to Pegasus in terms of price.

Mobil's arguments regarding future potential competitors fare no better. The Commission does not grant market-based rate authority solely on the premise that a future competitor will challenge an existing applicant's market power -- the potential existence of a future competitor does not show that the market within which the applicant currently operates is workably competitive. Rather, the Commission reasonably affirmed the ALJ's conclusion that Mobil had not shown that Pegasus's origin market was sufficiently competitive that authority to charge market-based rates would result in just and reasonable rates.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See*, *e.g.*, *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). A court must satisfy itself that the agency has "articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

The Commission's decisions regarding rate issues are entitled to broad deference, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 532 (2008) ("The statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions."); *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 951 (D.C. Cir. 2007) ("In reviewing FERC's orders, we are 'particularly deferential to the Commission's expertise' with respect to ratemaking issues.") (quoting *Ass'n of Oil Pipe Lines*, 83 F.3d at 1431). In particular, deference is due

to the Commission's expert judgment in evaluating applications for market-based rate authority. *See, e.g., Louisiana Energy and Power Auth. v. FERC*, 141 F.3d 364, 369 (D.C. Cir. 1998) (deference is due to FERC's "expert judgment" in defining the relevant product market in approving a market-based rate application).

This Court also gives substantial deference to the Commission's interpretation of its own regulations and precedents. *See NSTAR Elec. & Gas Corp. v. FERC*, 481 F.3d 794, 799 (D.C. Cir. 2007). *See also Amerada Hess Pipeline Corp. v. FERC*, 117 F.3d 596, 600-01 (D.C. Cir. 1997) (affording deference to FERC's interpretation of oil pipeline regulations implementing the Interstate Commerce Act).

Finally, as the Commission here adopted the ALJ's initial decision without modification, it did not need to repeat the findings and reasoning included in that decision. *See* 5 U.S.C. § 557(c); *Credit Card Service Corp. v. FTC*, 495 F.2d 1004, 1009-10 (D.C. Cir. 1974). "The Commission is not required to recapitulate the reasoning of the ALJ if it is satisfied that the initial decision and the reasoning underlying it are sound. We have not been left to guess at the Commission's findings or reasons; they are to be found in the ALJ's decision." *Boroughs of Ellwood City v. FERC*, 731 F.2d 959, 967 (D.C. Cir. 1984) (citations omitted).

II. THE COMMISSION REASONABLY DETERMINED THAT MOBIL FAILED TO SHOW THAT MARKET-BASED RATE AUTHORITY WOULD RESULT IN JUST AND REASONABLE RATES.

The Interstate Commerce Act requires that oil pipeline rates be just and reasonable. ICA §1(5)(a), 49 U.S.C. app. § § 1(5)(a) (1988). Under *Farmers Union*, the Commission "cannot presume the existence of competition or that a competitive price will be within a just and reasonable range." Order No. 572 at 31,183 (citing *Farmers Union*, 734 F.2d at 1510). Rather, to allow market-based rates, this Court requires a demonstration that market forces will keep prices at just and reasonable levels. *Farmers Union*, 734 F.2d at 1510. *See* Order P 7, JA 1194 ("market-based rates are still within the zone of reasonableness because a finding of a lack of market power would mean that market forces would constrain a pipeline from raising its rates above a just and reasonable level").

Accordingly, under the Commission's regulations, "[a] carrier may attempt to show that it lacks significant market power in the market in which it proposes to charge market-based rates." 18 C.F.R. § 342.4(b). Until the carrier establishes that it lacks such market power, it may not charge market-based rates. *Id*. *See* Order P 7, JA 1194 (an oil pipeline has no right to charge market-based rates, and the Commission may only grant such authority after the Commission has concluded that the pipeline lacks significant market power in the relevant markets); *Ass'n of Oil Pipe Lines*, 83 F.3d at 1442-43 (same); Order No. 572-A at 62,500 (same). *See*

also 18 C.F.R. § 348.1 (content of application for a market power determination). As demonstrated below, the Commission reasonably found that Mobil failed to meet this burden.

A. The Commission Reasonably Determined That, With Market-Based Rate Authority, Mobil Could Dramatically Increase Its Transportation Rates To Unjust And Unreasonable Levels.

The Merger Guidelines -- which the Commission uses for guidance in applying the framework of Order No. 572 to analyze market power -- define market power as "the ability to profitably maintain prices above competitive levels for a significant period of time." Order P 12, JA 1195; ALJ Decision P 46, JA 1082 (citing Merger Guidelines Section 0.1 at 2, Exh. No. MPL-87 at 5, JA 101). To evaluate whether an oil pipeline has this ability, the Commission considers whether the pipeline, if granted market-based rate authority, could profitably sustain a "small but significant and nontransitory increase in price." Order P 12, JA 1195; ALJ Decision P 46, JA 1082 (quoting Merger Guidelines Section 1.0 at 4, Exh. MPL-87 at 7, JA 103). The ALJ found that the proper benchmark for the competitive price level in this case is the long-run competitive price, and that Pegasus's prevailing tariff rate is a reasonable approximation of the long-run competitive price. Order P 13, JA 1196. The ALJ further concluded, based on the Merger Guidelines and Commission precedent, that the threshold for the "small but significant and nontransitory increase in price" was fifteen percent. *Id.* P 15, JA

1196. Here, using Pegasus's tariff rate of $1.218 per barrel, the threshold for the "small but significant and nontransitory increase in price" was $0.1827 per barrel (*i.e*. 18 cents). Order P 15, JA 1197.

The ALJ then compared the average netbacks Pegasus shippers received from selling Western Canadian crude oil on the Gulf Coast with the average netback to shippers from selling in the Upper Midwest market. Order P 34, JA 1203. For the first ten months of 2007, sales on the Gulf Coast yielded an average netback price of $51.27 per barrel, and the Upper Midwest yielded $46.77 per barrel. *Id*. This resulted in a netback differential of $4.50 per barrel, which is significantly above the "small but significant and nontransitory increase in price" of 18 cents. *Id*. If Mobil were granted market-based rate authority, it would be able to capture this netback differential and increase Pegasus's prevailing rate of $1.218 per barrel by roughly $4.50 per barrel, to about $5.718 per barrel, a 369 percent increase over its regulated rate. ALJ Decision PP 271, 299, JA 1162-63, 1173. Additional calculations based on other time periods found that Mobil could increase rates by 50 and 209 percent. Order P 34, JA 1203; ALJ Decision PP 272-73, 300-01, JA 1163, 1174.

Because Pegasus is the only pipeline that can transport crude oil from the Upper Midwest to the Gulf Coast, no other pipeline, refinery, or entity in Pegasus's origin market has the ability to effectively compete with Pegasus by charging less

for transporting crude oil or otherwise granting Pegasus shippers a larger share of that basis differential. ALJ Decision P 86, JA 1096. Thus, the ALJ found that granting Pegasus the authority to charge market-based rates would allow it to capture scarcity rent through a dramatic price increase that would not result in just and reasonable rates. Order P 35, JA 1203. The Commission affirmed the ALJ's analysis. *Id.* P 1, JA 1192.

B. The Commission Reasonably Used Pegasus's Tariff Rate As The Benchmark For The Market-Based Rate Analysis.

Mobil asserts that the Commission erred in using Pegasus's tariff rate as the benchmark for its analysis rather than a short-run market-clearing price that would approximately equal the (constantly changing) price differential between the Upper Midwest and the Gulf Coast. Br. 35 & n.3. As competitive rates can sometimes exceed long-run average costs, *id*. 30, Mobil asserts that its ability to raise its rates, "even significantly, above its long-run average costs is not necessarily indicative of market power." *Id*. 26.

However, under *Farmers Union*, the Commission can only grant market-based rate authority if it can find that the market-based rates will be just and reasonable. *Farmers Union*, 734 F.2d at 1510. "A regulatory environment (or lack thereof) that allows the pipeline to raise its rate without a competitive check, to such a level that it can capture much or all of the available economic rent from its shippers and thereby exceed a normal return on its investment, would not meet this

standard." ALJ Decision P 80, JA 1094. Accordingly, the ALJ reasonably found that, to determine whether a market-based rate is just and reasonable, the benchmark rate used in the market power analysis must be just and reasonable. *Id.* P 81, JA 1094. *See also* Order P 22, JA 1198 (finding that the proxy for the competitive price must be just and reasonable).

Mobil has not shown that the market clearing price would be just and reasonable. ALJ Decision PP 82, 84-85, JA 1094-96; Order P 22, JA 1198. Under *Farmers Union*, the Commission "cannot presume the existence of competition or that a competitive price will be within a just and reasonable range." Order No. 572 at 31,183 (citing *Farmers Union*, 734 F.2d at 1510). While "a relatively high short-run market price can be an effective incentive for entry or expansion, *Farmers Union* [] makes clear that the market price must not be so high above the truly competitive rate that the market price results in the exploitation of shippers by the pipeline. As the court noted, this can happen when the market price exceeds the zone of reasonableness." ALJ Decision P 85, JA 1096 (citing *Farmers Union*, 734 F.2d at 1501-02, 1508). Thus, although in individual cases the market price could coincide with the just and reasonable rate, the actual market price is not necessarily identical to the "true" market price, *i.e.*, the price that would result in a truly competitive market. *Id.* P 75, JA 1092 (citing *Farmers Union*, 734 F.2d at 1510).

Indeed, it is circular reasoning to begin with the assumption that the market clearing price is necessarily competitive, *i.e.*, the presumption that the market-clearing rate is competitive "assumes the conclusion of its analysis." Order P 21, JA 1198 (quoting ALJ Decision P 76, JA 1093). The purpose of the proceeding is to determine whether there are sufficient competitive alternatives to constrain Pegasus's rates to just and reasonable levels. "Clearly, the market power analysis should not begin with that very potential outcome: the benchmark price should not be based on the as yet unproven assumption – indeed the presumption – that the rate Pegasus would be able to charge if granted market-based authority would necessarily result from a truly competitive market." Order P 21, JA 1198 (quoting ALJ Decision P 76, JA 1093).

Conversely, Pegasus's tariff rate is a negotiated rate (with indexed increases) that was determined by the Commission to be just and reasonable. Order P 18, JA 1197; ALJ Decision PP 82, 87, JA 1094, 1096. *See MarkWest*, 646 F.3d at 32 (under Order No. 561, a baseline rate is just and reasonable where one shipper has agreed to pay the rate and no shipper has protested). A just and reasonable rate is a good proxy for the long-run competitive price of a pipeline's transportation services, as a just and reasonable rate is designed to approximate the long-run competitive price under which firms recover their costs plus a reasonable return on investment. ALJ Decision PP 83, 87, JA 1095, 1096 (citing *Farmers Union*, 734

F.2d at 1501-02, 1508-10; *Tejas*, 908 F.2d at 104; *Koch Gateway Pipeline Co.*, 85 FERC ¶ 61,013 at 61,045-46 (1998) ("An appropriate base price in a market power evaluation of this type is the long-run competitive price")). "Since under competition firms set their prices to recover costs, including a reasonable return, a regulated rate is designed to replicate that competitive situation." Order P 19, JA 1197 (quoting *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 14 (2007)). The Commission found this reasoning equally applicable to Mobil's negotiated tariff rate, "since it is unlikely that Mobil would agree to a rate that would not recover its long run average costs." *Id.*, JA 1198.

Further, Mobil failed to proffer a proxy for the competitive price that the Commission could find just and reasonable. Order PP 21-22, JA 1198. While Mobil argued before the Commission (and now before this Court) that it is improper to use a long-run competitive rate as the benchmark, Mobil was unable even to identify a short-run competitive rate to serve as a benchmark. *See* Order PP 21-22, JA 1198. *See also* Br. 35 n.3 ("Mobil and Staff further argued that, while the proper benchmark was the short-run competitive price, it was very difficult to determine that price.") Thus, the ALJ reasonably concluded that Pegasus's tariff rate was the only appropriate estimate on the record of the just and reasonable competitive price. Order PP 21-22, JA 1198; ALJ Decision P 89, JA 1098.

C. Mobil Failed To Demonstrate That Its Ability To Dramatically Increase Its Rate If Granted Market-Based Rate Authority Was Consistent With Competition.

Mobil asserts that, under Commission precedent, the ability to arbitrage a price differential is not evidence of market power, and therefore Mobil faults the Commission for treating Pegasus's ability to arbitrage the Upper Midwest – Gulf Coast price differential as evidence of market power. Br. 35-39.

The Commission's analysis is not, however, limited to Pegasus's ability to arbitrage a price differential. Rather, the point is that Pegasus is the only pipeline that can transport crude oil from the Upper Midwest to the Gulf Coast and exploit the netback differential between the two points. As a result, no other pipeline or entity in Pegasus's origin market has the ability to effectively compete with Pegasus, by charging less for transporting crude oil or otherwise granting Pegasus shippers a larger share of that basis differential. ALJ Decision P 86, JA 1096. *See also* Order PP 52-53, JA 1207-08. If Mobil were granted market-based rate authority, this differential would allow Mobil to profitably raise Pegasus's rate dramatically without the loss of volume. Order PP 35, 52-53, JA 1203, 1207-08; ALJ Decision P 311, 313, JA 1177, 1178. This ability to raise rates without the loss of volume demonstrates market power. *See CF Indus., Inc. v. STB*, 255 F.3d 816, 823 (D.C. Cir. 2001) ("although a firm in a competitive market cannot raise its prices without a net loss of revenue, a firm with market power can"); *id.* ("'A

defendant firm has market power if it can raise price without a total loss of sales. Market power . . . is large when a firm can profit by raising prices substantially without losing too many sales.'") (quoting IIA Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* P 501 at 85 (1995)).

This lack of effective competition distinguishes the cases Mobil cites for the proposition that "the ability to arbitrage price differentials is not necessarily evidence of market power." Br. 37. In *Longhorn Partners Pipeline, L.P.*, 83 FERC ¶ 61,345 at 62,380 (1998) (quoted Br. 37, 45), there was sufficient competition to check Longhorn's rates. ALJ Decision P 86, JA 1096. In *Longhorn*, the Commission found that "[a]ll of the alternative pipeline suppliers except one (Shell/Texaco from Odessa) have excess capacity to the smaller El Paso BEA market. If Longhorn decided to inflate its transportation prices, then companies potentially could sell their unused capacity at lower rates to counter and undercut Longhorn's increased rates." ALJ Decision P 86, JA 1096 (quoting *Longhorn*, 83 FERC at 62,381).

Similarly, in *Williams Pipe Line Co.*, 71 FERC ¶ 61,291 at 62,145 (1995) (quoted Br. 27), the Commission found a wide range of available alternatives to Williams' service, including four other pipeline terminals and two barge terminals. "The existence of competition means that price increases above efficient, market-

driven equilibrium prices will not be sustainable for any length of time." *Williams*, 71 FERC at 62,145. In *Explorer Pipeline Co.*, 87 FERC ¶ 61,374 at 62,391-92 (quoted Br. 28), the Commission determined that Explorer competed with at least five other pipelines, barges also delivered petroleum to the market in question, and there was large excess capacity and dynamic entry and exit of pipelines in the area. "An attempt by Explorer to exercise significant market power by increasing rates above the competitive market price in a market where it lacks significant market power will result in reduced total volumes to that market and a consequent reduction in Explorer's revenues." *Id*. at 62,392.

Thus, a finding of competitive alternatives that check the ability to charge above competitive rates must *precede* the conclusion that a spike in prices above long-run equilibrium reflects scarcity rather than market power. In *Interstate Natural Gas Ass'n of Am. v. FERC*, 285 F.3d 18 (D.C. Cir. 2002) (cited Br. 28-29), the Court found that the evidence supported the Commission's view that the relevant market enjoys considerable competition. *Id.* at 32. Under these circumstances, "brief spikes in moments of extreme exigency are completely consistent with competition, reflecting scarcity rather than monopoly." *Id.* Similarly, in *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964 (D.C. Cir. 2005) (cited Br. 29), the market in question was "workably competitive." *Id.* at 968. The Court found that "the presence of workable competition would suggest that many,

perhaps most, possibly all, of the bids [in question] will be due not to market power but to temporary scarcity." *Id.* In *Blumenthal v. FERC*, 552 F.3d 875, 882-83 (D.C. Cir. 2009) (cited Br. 29), the Court affirmed the Commission's finding that sellers lacked market power prior to concluding that temporary spikes in the market rates reflected existing scarcity.

In these cases, established competition permitted the conclusion that price spikes were the product of scarcity, not market power. Here, the existence of competition was not established; to the contrary, the Commission's analysis showed that Pegasus possesses a unique position in the market that permits exploitation of a price differential far in excess of the prevailing just and reasonable tariff rate without loss of volume. ALJ Decision PP 86, 311, 313, JA 1096, 1177, 1178; Order PP 52-53, JA 1207-08.

Finally, the Commission did not, as Mobil argues, engage in a corridor analysis. Br. 39-40. A corridor analysis would "require that the applicant show that there is competition for the transportation of the commodity between the specific origin and destination pair." *Explorer Pipeline Co.*, 87 FERC at 62,388. The Commission did not require that Mobil show there is transportation competition here. Rather, the Commission compared the netback from the Pegasus option with the netback from non-transportation options, such as local refineries, available to shippers in Pegasus's origin market. Order P 41, JA 1204-05.

D. The Commission Reasonably Declined to Adjust Its Netback Analysis For Selected "Anomalous" Market Conditions.

Mobil also asserts that the Commission's netback analysis was flawed because the Commission declined to adjust the analysis to account for two BP refinery outages that Mobil contends substantially depressed the price of Cold Lake crude oil at Hardisty, which was used to calculate the netback on sales to the Upper Midwest. Br. 52-53.

The Commission affirmed the ALJ's determination that it was improper to consider the effects of one variable without considering the effects of others. Order P 46, JA 1206; ALJ Decision PP 266-267, JA 1161- 62. While the BP refinery outages likely did have a significant impact on the market price of Cold Lake at Hardisty during much of 2007, the record showed that unplanned outages are normal fluctuations that the market takes into account. Order P 46, JA 1206; ALJ Decision P 266, JA 1161. Objective market data should not be manipulated by using two discrete events while ignoring all other events that occurred in the market. Order P 46, JA 1206; ALJ Decision PP 265-67, JA 1161-62. For example, the ALJ noted that there were significant impacts on the price for Mexican Maya (the proxy price for Cold Lake crude oil on the Gulf Coast) due to low residual fuel oil prices that should be taken into account if the refinery outages were considered. Order P 46, JA 1206; ALJ Order PP 267-68, JA 1161-62 (discussing evidence). Thus, the Commission agreed with the ALJ's decision "not

to go down the path of selectively manipulating the otherwise objective evidence." *Id*.

Although relied on by Mobil, *see* Br. 55-57, *OXY USA, Inc. v. FERC*, 64 F.3d 679, 693 (D.C. Cir. 1995), supports the Commission's determination here. *OXY* concerned the calculation of the relative value of petroleum products introduced into the common stream in the Trans Alaska Pipeline System. In the portion cited by Mobil, this Court overturned the Commission's determination to value distillates at the market price of proxy finished products, without any adjustment, when the other petroleum products were valued at the market price of raw materials. *Id*. at 693. As the goal of the valuation methodology "is to assign accurate relative values to the petroleum that is delivered to [the Trans Alaska Pipeline] and becomes part of the common stream," the Court held that "FERC must accurately value all cuts – not merely some or most of them – or it must overvalue or undervalue all cuts to approximately the same degree." *Id*.

Thus, the concern in *OXY* was not maximizing the accuracy of the valuation. Indeed, *OXY* rejected arguments that the Commission was compelled to use a more accurate methodology in lieu of a methodology found just and reasonable. *See* *OXY*, 64 F.3d at 691-92 ("[T]he Commission may approve the methodology proposed in the settlement agreement if it is 'just and reasonable;' it need not be the only reasonable methodology, or even the most accurate.")

Rather, the concern in *OXY* was whether the value of each of the different petroleum products was assessed in a comparable manner. *See, e.g., Exxon Co., U.S.A. v. FERC*, 182 F.3d 30, 38 (D.C. Cir. 1999) (cited Br. 56-57) ("We remanded [in *OXY*] in order that FERC might provide a methodology with a reasoned relative uniformity, knowing that absolute precision at any level of the cuts was unachievable. That is, we did not remand because the old method was inaccurate, but because it was unfairly nonuniform."); *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286, 1293 (D.C. Cir. 2000) ("we made clear in *OXY* that our concern was that the Commission use uniform methods"). Consistent with this principle, the Commission here reasonably declined to consider adjustments to the Upper Midwest netback calculation while ignoring potential adjustments to the other side of the equation – the Gulf Coast netback calculation. As directed by this Court in *OXY*, the Commission is required to value each to the same relative degree of accuracy.

III. MOBIL'S EVIDENCE OF ALTERNATIVES TO PEGASUS FAILED TO DEMONSTRATE THAT MOBIL LACKS MARKET POWER.

Mobil asserts that it demonstrated a lack of market power through evidence of alternatives to Pegasus, both currently available alternatives used by Pegasus shippers and potential future competition. Br. 41. For purposes of this market power analysis, a good alternative is one that can "check the pipeline's ability to raise rates if the Commission were to grant market-based rate authority." Order PP

30, 41, JA 1201, 1204-05. *See, e.g.*, Order No. 572 at 31,191 (requiring pipelines to identify “available transportation alternatives in competition with the oil pipeline in the relevant markets and other competition *constraining the oil pipeline’s rates in those markets*”) (emphasis added). As demonstrated below, the Commission reasonably determined that Mobil’s evidence failed to satisfy its burden to demonstrate the presence of good alternatives preventing the exercise of market power by Mobil.

A. Mobil’s Evidence Of Current Alternatives Failed To Demonstrate That Pegasus Lacks Market Power.

1. Mobil Failed To Demonstrate That Upper Midwest Refineries Were Good Alternatives to Pegasus.

Mobil states that the competitive alternatives to Pegasus “consist primarily of Upper Midwest refineries that process Western Canadian crude oil.” Br. 42. Because “[s]uch refineries provide an alternative outlet for volumes shipped on Pegasus,” Mobil concludes that such refineries “are reasonably interchangeable with Pegasus from a shipper’s perspective.” *Id.*

To constrain a pipeline’s rates, a good alternative must be: (1) readily available; (2) comparable in quality; and (3) comparable in price. Order P 31, JA 1202. Before the Commission, Mobil identified 15 refineries in the Upper Midwest that compete with Pegasus for crude oil. ALJ Decision P 123, JA 1110. While the ALJ found these refineries to be comparable to Pegasus, *id.* P 168, JA

1125, Mobil failed to demonstrate that these refineries were available to Pegasus shippers -- *i.e*. Mobil did not show that these refineries had excess capacity and a route to the refinery accessible to Pegasus shippers. *Id*. PP 134, 138, 168, JA 1114, 1115-16, 1125-26; Order PP 39, 40, JA 1204.

Further, Mobil failed to show that these refineries were comparable in price through a netback analysis. ALJ Decision P 196, JA 1135. *See* Order PP 41, 43, JA 1204-05 (affirming ALJ conclusion that a netback analysis is required to determine whether an alternative is comparable in price). When using a netback analysis in a market power determination, an alternative is considered a good economic alternative if it offers shippers a netback greater than or equal to the threshold netback. ALJ Decision P 90, JA 1098; Order P 41, JA 1204-05. In other words, a good economic alternative would check the applicant pipeline from increasing its rates by more than the small but significant nontransitory increase in price above the competitive level. ALJ Decision P 90, JA 1098; Order P 41, JA 1205.

Here, the threshold netback is $51.09 per barrel, calculated by subtracting the small but significant nontransitory increase in price (18 cents) from the $51.27 per barrel netback available on Pegasus for sales on the Gulf Coast. ALJ Decision P 271 n. 61, JA 1163. *See also id*. P 90, JA 1098 (explaining calculation of the threshold netback). The netback afforded by Mobil's alternatives to Pegasus's

services in the Upper Midwest ($46.77 per barrel), is $4.32 per barrel below the threshold netback of $51.09 per barrel. ALJ Decision P 271 n. 61, JA 1163. The Commission therefore reasonably concluded that there are no alternatives to Pegasus that are good alternatives in terms of price, *i.e.*, that would check Pegasus's ability to raise rates if it were granted market-based rate authority, and Pegasus's origin market was reasonably limited to only Pegasus itself. Order PP 34-35, 41-43, JA 1203; 1204-05; ALJ Decision P 196, JA 1135-36.

It should be noted that, on brief, Mobil points to 26 refineries identified by Commission Trial Staff as evidence of viable alternatives to Pegasus. *See* Br. 43 (citing ALJ Decision P 155, JA 1121). While the ALJ found that these 26 refineries were available and comparable to Pegasus, ALJ Decision P 155, JA 1121, no netback analysis was performed with regard to the 26 refineries identified by Commission Trial Staff, and therefore no showing was made that those alternatives were good alternatives to in terms of price. *Id*. P 190, JA 1133.

Mobil attempts to evade the netback analysis of alternatives entirely by relying upon "substantial evidence that competitive alternatives are available to, and in fact currently used by, Pegasus's shippers." Br. 42. In Mobil's view, "[t]hat shippers have numerous alternative outlets that are currently being used and that yield a 'positive' and 'profitable netback' is striking evidence that Pegasus lacks market power in its origin market." *Id*. at 44.

However, the fact that an alternative is used by Pegasus shippers does not demonstrate that the alternative is a good alternative to Pegasus in terms of price. ALJ Decision P 180, JA 1131; Order P 41, JA 1204-05. *See, e.g., NetCoalition v. SEC*, 615 F.3d 525, 542 (D.C. Cir. 2010) ("the existence of a substitute does not necessarily preclude market power"). The existence of used alternatives does not prove that such alternatives would check Pegasus's ability to raise its rates to unjust and unreasonable levels. ALJ Decision P 180, JA 1131; Order P 41, JA 1205. "It is, of course, well-accepted that a significant cost differential may render one product an ineffective restraint on the pricing of another, even if the two could otherwise serve as substitutes for one another." *CF Indus.*, 255 F.3d at 825 (barge transportation that exceeded the price of pipeline transportation by 18% would not "protect the [pipeline] shippers from [the pipeline's] 'unreasonable price increase'"). Likewise, in *Arizona Public Service Co. v. United States*, 742 F.2d 644, 650-51 (D.C. Cir. 1984), this Court rejected the Interstate Commerce Commission Review Board's finding that truck transportation was effective competition for a railroad where truck transportation was substantially more expensive:

> At the core of the 'effective competition' standard is the idea that there are competitive, market pressures on railroads deterring them from charging monopoly prices for transporting goods. *Of course, any such effective competition will always be relative to a particular price that the railroads charge*. At some point the availability of an alternative such as the horse and buggy or even people carrying oil in

> buckets theoretically prevents railroads from raising their rates beyond an outer bound. But the mere existence of some alternative does not in itself constrain the railroads from charging rates far in excess of the just and reasonable rates that Congress thought the existence of competitive pressures would ensure.

While shippers use alternatives that are profitable to them, Br. 43, that does not establish that the alternative is able to check Pegasus's ability to raise its rates to unjust and unreasonable levels, *i.e.*, that the alternative produces a profit comparable to that available through Pegasus. ALJ Decision P 180, JA 1131; Order P 41, JA 1204-05. The ALJ used a hypothetical netback analysis to illustrate why a used alternative may not be a good alternative in terms of price:

> Suppose the netback over an applicant pipeline is estimated at $100 per barrel, where the commodity price in the destination market is estimated as $101 per barrel and the regulated transportation rate of the applicant pipeline is $1 per barrel. Suppose also that because of capacity constraints and other factors, the netbacks on the alternatives to the pipeline range from $5 per barrel to $10 per barrel and that all these alternatives are used. According to [Mobil] and Staff's theory that a used alternative is a good economic alternative, the used alternative that offers the lowest netback, $5 per barrel, would be a good alternative. Further, according to [Mobil] and Staff's theory, the other nine alternatives that offer a higher netback than the marginal netback would also be good alternatives. But of course, these conclusions would defy common sense. It is obvious that an alternative that yields $5 per barrel or even a $10 per barrel netback is not comparable in terms of price with an applicant that yields a $100 per barrel netback.

ALJ Decision P 183, JA 1131-32.

Accordingly, the distinction between an alternative that is profitable to the shipper and one that is truly a good alternative to Pegasus in terms of price can

only be demonstrated through detailed cost comparisons. ALJ Decision P 181, JA 1131; Order P 33, JA 1202. Here, the detailed cost comparison has only been demonstrated through the use of a netback analysis. ALJ Decision P 181, JA 1131. "[I]n the absence of a rational or workable means to evaluate competitive choices presented by Mobil or Staff, a netback analysis was required." Order P 43, JA 1205. *See also* ALJ Decision P 181, JA 1131; Hearing Order P 22, JA 437 (citing *Colonial Pipeline Co*., 92 FERC ¶ 61,144 at 61,532 (2000) (for origin markets, the netback to the shipper should be compared in determining what proposed alternatives are good alternatives in terms of price)). Thus, while a profitable alternative may yield a positive netback that certain shippers will accept, a netback below the threshold netback -- as is the case here -- nonetheless demonstrates that the alternative is not a good economic alternative to Pegasus. ALJ Decision P 181, JA 1131; Order P 41, JA 1204-05.

2. Pegasus's Small Size Relative To The Western Canadian Crude Oil Market Does Not Demonstrate That Pegasus Lacks Market Power.

As additional indicia of alternatives available to Pegasus shippers, Mobil asserts that "the Upper Midwest market was competitive before Pegasus's direction was reversed; Pegasus remains a small participant in that market; more than 95 percent of Western Canadian crude oil is shipped to destinations other than the Gulf Coast; and Western Canadian producers are supporting major pipeline

projects to bring additional supplies of Western Canadian crude oil into the Upper Midwest." Br. 45-46 (citations omitted). *See also id*. at 43. These "indicia" likewise fail to meet Mobil's burden to show a lack of market power.

While Pegasus is too small to exert market power over the Upper Midwest crude oil market, "the proper consideration is not whether [Mobil] can exert market power over the overall Upper Midwest market but whether it can exert market power *over Pegasus' shippers*." ALJ Decision P 305, JA 1174-75. *See also* Order PP 50-51, 54, JA 1207, 1208. The test for market power is not whether Pegasus can affect the crude oil commodity market, but whether it can maintain an increase in *its rate* above the competitive level. ALJ Decision P 305, JA 1175. *See, e.g.*, *CF Indus*., 255 F.3d at 823 (affirming methodology for testing whether a firm is market dominant by asking whether it can increase its net revenues by raising its prices). As this Court has recognized, in granting market-based rates, "what matters is whether an individual seller is able to exercise anticompetitive market power, not whether the market as a whole is structurally competitive." *Blumenthal*, 552 F.3d at 882. Here, the netback analysis demonstrated that, if Mobil were granted market-based rate authority, it would be able to raise rates beyond a just and reasonable level without a loss of volume, as a result of its position as the sole pipeline able to take advantage of the significant basis differential between the Upper Midwest and Gulf Coast markets. ALJ Decision PP

86, 305, 311, 313, JA 1096, 1174-75, 1177, 1178. No other pipeline or entity in Pegasus's origin market would have the ability to effectively compete with Pegasus. ALJ Decision P 86, JA 1096.

As Pegasus has no true competitors, Pegasus's size "has no real meaning." *Id.* P 306, JA 1175. In the same way, the fact that alternatives in the Hardisty origin market were competitive with each other prior to Pegasus's reversal in 2006 does not demonstrate that they are good competitive alternatives to Pegasus in terms of price -- Pegasus alone transports crude oil from the Upper Midwest to the Gulf Coast, which permits exploitation of the basis differential between those two markets. *Id*. PP 307-308, JA 1175-76. *See also* Order PP 50-54, JA 1207-08. Pegasus's limited capacity on its unique route also explains why more than 95 percent of Western Canadian crude oil is shipped to destinations other than the Gulf Coast. *See* ALJ Decision PP 290, 313, JA 1170, 1178. Further, producer support for pipeline projects to bring additional Western Canadian crude oil into the Upper Midwest does not appear to aid Mobil, as the ALJ found that the Upper Midwest is already saturated with heavy sour crude oil, which is almost exclusively the type of crude oil transported on Pegasus. *Id*. P 290, JA 1170.

Mobil asserts that the Commission "committed the mirror image of the classic 'Cellophane fallacy.'" Br. 46. The so-called Cellophane fallacy is a reference to *United States v. du Pont de Nemours & Co.*, 351 U.S. 377 (1956),

which held that du Pont did not have monopoly power over the sale of cellophane, based upon the high cross-elasticity of demand between cellophane and other flexible wrapping materials. *See, e.g., United States v. Eastman Kodak Co.*, 63 F.3d 95, 103 (2d Cir. 1995) (describing the Cellophane fallacy). The fallacy arises because the decision failed to recognize that a monopolist always faces a high elastic demand -- the monopolist's products "are so overpriced that even inferior substitutes begin to look good to consumers." *Id.*

Here, Mobil argues that the Commission unduly restricted the pool of good alternatives based on a finding of low demand elasticity at Pegasus's tariff rate, *i.e.* the "mirror image" of the Cellophane fallacy. Br. 47. In Mobil's view, Pegasus's regulated tariff rate is below the competitive rate, so using the regulated rate to determine the existence of good alternatives unduly restricts the scope of such good alternatives. *Id.*

This argument presumes that the rate Pegasus could charge if it were granted market-based rate authority – *i.e.* the market-clearing rate – would be a competitive rate. ALJ Decision PP 75-77, JA 1092-93; Order P 21, JA 1198. This assumes away the fundamental question of whether Pegasus could exercise market power if granted market-based rate authority. ALJ Decision PP 75-77, JA 1092-93; Order P 21, JA 1198. If Pegasus could exercise market power, then the use of the market-clearing rate to determine good alternatives would result in the same nature of error

as the Cellophane fallacy itself – overstatement of the geographic market and the improper inclusion of alternatives as good alternatives to Pegasus. As the ALJ explained:

> Suppose that a pipeline hypothetically *did* have market power. If I improperly assumed that the pipeline's market clearing rate was competitive and used that rate as the benchmark in the market power analysis, I would likely include alternatives to the pipeline in my market share calculation that were not in fact good competitive alternatives. The improper inclusion of alternatives would in turn reduce my calculation of the pipeline's relative market share and would possibly lead me, again, to improperly conclude that the pipeline *did not* have market power. This phenomenon is known as the "Cellophane Trap."

ALJ Decision P 77, JA 1093 (citations omitted).

Indeed, as the ALJ and the Commission concluded, Mobil's reasoning is circular: Mobil assumes that all used alternatives are good alternatives to conclude that the short-run market-clearing price is competitive, and it assumes that the short-run market-clearing price is competitive to conclude that all used alternatives are good alternatives. ALJ Decision P 184, JA 1132; Order P 42, JA 1205. Applying this circular reasoning would completely undermine the Commission's requirement that a good alternative be comparable in terms of price. ALJ Decision P 186, JA 1133; Order P 42, JA 1205.

B. Mobil's Evidence Of Potential Competition Failed To Demonstrate That Pegasus Lacks Market Power.

Mobil contends that the Commission "ignor[ed] substantial evidence that potential competition constrains any ability Pegasus might otherwise have to exercise market power." Br. 48. Specifically, Mobil points to two "main sources" of potential competition in the future: (1) the planned Keystone XL and Enbridge/BP pipelines; and (2) projected refinery expansions in the Upper Midwest. *Id.* 49.

The Commission does not, however, grant market-based rate authority solely on the premise that a future competitor will challenge an existing applicant's market power to the extent necessary to ensure just and reasonable rates. ALJ Decision P 315, JA 1178; Order P 48, JA 1206. As the ALJ recognized, it would be inappropriate to rely on evidence of potential future competition to show that the market in which the applicant currently operates is workably competitive. ALJ Decision P 315, JA 1178; Order P 48, JA 1206. *See, e.g., NetCoalition*, 615 F.3d at 543 ("the SEC's duty is to ensure that fees are 'fair and reasonable' – not to predict that, with the entry of a competitor, they might someday get there").

Rather, the existence of potential future competition is merely "an ameliorating or mitigating aspect in the overall market power analysis. As such, it is like a tiebreaker in a close call on that very judgment." ALJ Decision P 315, JA 1178-79. *See also* Order P 54, JA 1208. "Here, there is no doubt to the conclusion

that [Mobil] possesses significant market power in the defined origin market, as there are no good alternatives to Pegasus's services. The overall market power analysis and testing bear out this conclusion." ALJ Decision P 315, JA 1179. As a result, the Commission reasonably concluded that "the ALJ properly determined that the impact of potential competition and other factors were only appropriate in a close case and were unnecessary here since Mobil clearly possessed market power in the relevant origin market." Order P 54, JA 1208.

Although unnecessary to the ultimate determination for this reason, the ALJ nevertheless considered and rejected Mobil's evidence of potential future competition. ALJ Decision P 315, JA 1179. While the Keystone XL pipeline may compete with Pegasus when it is placed into service, it would not affect the overall finding that Pegasus has significant market power as the market would still be highly concentrated with only two competitors. *Id*. P 339, JA 1185. Moreover, under the Merger Guidelines, the agency will generally consider "only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact." *Id*. P 317, JA 1179 (quoting Merger Guidelines Section 3.2 at 27, Exh. MPL-87, at 30, JA 126). The ALJ set the two-year window here at the close of the evidentiary hearing through early 2011. *Id.* P 321, JA 1180. Keystone XL's projected in-service date in late 2012 is outside this two-year window. *Id*. P 339, JA 1185. The ALJ concluded that it would be

"highly inappropriate" for Mobil to receive market-based rate authority at this time, when its only possible viable competitor had yet to provide one barrel of transportation services of Western Canadian heavy sour crude to the Gulf Coast. ALJ Decision P 339, JA 1185-86.

As for the Enbridge/BP pipeline, the ALJ found that there had been no development of the project since its announcement in August 2008, and that it would likely be delayed beyond 2012, thus placing it outside the two-year window for new entrants. *Id*. P 340, JA 1186. Further, there was no record evidence of shipper commitments on the pipeline. *Id*.

Mobil likewise failed to demonstrate that the projected refinery expansions in the Upper Midwest would create a good economic alternative to Pegasus and therefore be in a position to constrain Pegasus's rates. *Id*. P 331, JA 1183. Netback analyses indicate that existing Upper Midwest refineries are not comparable to Pegasus in terms of price. *Id*. Further, there is extensive evidence of saturation in the Upper Midwest, and well as inherent uncertainties in these highly capital-intensive projects. *Id*.

Accordingly, the ALJ concluded that Mobil had not demonstrated that the significant netback differential will be eliminated in the foreseeable future. ALJ Decision P 331, JA 1183. *See, e.g., United States v. Microsoft Corp*., 253 F.3d 34, 53-54 (D.C. Cir. 2001) (rejecting evidence of potential competition because the

test of interchangeability "required the District Court to consider only substitutes that constrain pricing in the foreseeable future, and only products that can enter the market in a relatively short time can perform this function"); *id*. at 57 ("Structural market power analyses are meant to determine whether potential substitutes constrain a firm's ability to raise prices above the competitive level; only threats that are likely to materialize in the relatively near future perform this function to any significant degree.")

Mobil's reliance on *United States v. Falstaff Brewing Corp*., 410 U.S. 526, 532-33 (1973); *FTC v. Proctor & Gamble Co*., 386 U.S. 568, 581 (1967); *FTC v. H.J. Heinz Co*., 246 F.3d 708, 717 & n.13 (D.C. Cir. 2001); and *United States v. Baker Hughes, Inc*., 908 F.2d 981, 988 (D.C. Cir. 1990), is misplaced. Br. 50-51. Those cases concern the positive competitive effect of existing potential competitors, *i.e*. the entity in question was "a potential competitor in the sense that it was so positioned on the edge of the market that it exerted beneficial influence on competitive conditions in that market." *Falstaff*, 410 U.S. at 532-33. *See also id*. at 531-32 ("The existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition that cannot be underestimated."). *See also Proctor & Gamble*, 386 U.S. at 581 ("It is clear that the existence of Proctor at the edge of the industry exerted considerable

influence on the market.”); *H.J. Heinz*, 246 F.3d at 717 n. 13 (“Existing firms know that if they collude or exercise market power to charge supracompetitive prices, entry by firms currently not competing in the market becomes likely, thereby increasing the pressure on them to act competitively.”); *Baker Hughes*, 908 F.2d at 989 (competing firms outside the U.S. were poised to enter the U.S. market).

These cases do not support the proposition that a potential competitor that does not currently exist, but may provide competition in the future, provides enough of a check on an applicant’s current ability to exercise market power to support granting market-based rates. Rather, until a project is actually in service, it is not available to Pegasus’s shippers and therefore is not a good alternative. ALJ Decision P 324, JA 1181. Pegasus’s shippers cannot divert their crude oil volumes to an alternative that is not yet available; such an alternative cannot reasonably constrain Pegasus’s rates. *Id.*

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the petition for review be denied and that the order on appeal be upheld in all respects.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief contains 11,708 words, not including the tables of contents and authorities, the glossary, the certificate of counsel and this certificate.

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ADDENDUM
STATUTES & REGULATIONS

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from one State or Territory of the United States, or the District of Columbia, to any other State or Territory of the United States, or the District of Columbia, or from one place in a Territory to another place in the same Territory, or from any place in the United States through a foreign country to any other place in the United States, or from or to any place in the United States to or from a foreign country, but only insofar as such transportation takes place within the United States.

(2) Transportation subject to regulation

The provisions of this chapter shall also apply to such transportation of passengers and property, but only insofar as such transportation takes place within the United States, but shall not apply—

(a) To the transportation of passengers or property, or to the receiving, delivering, storage, or handling of property, wholly within one State and not shipped to or from a foreign country from or to any place in the United States as aforesaid, except as otherwise provided in this chapter;

(b) Repealed. June 19, 1934, ch. 652, title VI, § 602(b), 48 Stat. 1102.

(c) To the transportation of passengers or property by a carrier by water where such transportation would not be subject to the provisions of this chapter except for the fact that such carrier absorbs, out of its port-to-port water rates or out of its proportional through rates, any switching, terminal, lighterage, car rental, trackage, handling, or other charges by a rail carrier for services within the switching, drayage, lighterage, or corporate limits of a port terminal or district.

(3) Definitions

(a) The term "common carrier" as used in this chapter shall include all pipe-line companies; express companies; sleeping-car companies; and all persons, natural or artificial, engaged in such transportation as aforesaid as common carriers for hire. Wherever the word "carrier" is used in this chapter it shall be held to mean "common carrier." The term "railroad" as used in this chapter shall include all bridges, car floats, lighters, and ferries used by or operated in connection with any railroad, and also all the road in use by any common carrier operating a railroad, whether owned or operated under a contract, agreement, or lease, and also all switches, spurs, tracks, terminals, and terminal facilities of every kind used or necessary in the transportation of the persons or property designated herein, including all freight depots, yards, and grounds, used or necessary in the transportation or delivery of any such property. The term "transportation" as used in this chapter shall include locomotives, cars, and other vehicles, vessels, and all instrumentalities and facilities of shipment or carriage, irrespective of ownership or of any contract, express or implied, for the use thereof, and all services in connection with the receipt, delivery, elevation, and transfer in transit, ventilation, refrigeration or icing, storage, and handling of property transported. The term "person" as used in this chapter includes an individual, firm, copartnership, corporation, company, association, or joint-stock association; and includes a trustee, receiver, assignee, or personal representative thereof.

(b) For the purposes of sections 5, 12(1), 20, 304(a)(7), 310, 320, 904(b), 910, and 913 of this Appendix, where reference is made to control (in referring to a relationship between any person or persons and another person or persons), such reference shall be construed to include actual as well as legal control, whether maintained or exercised through or by reason of the method of or circumstances surrounding organization or operation, through or by common directors, officers, or stockholders, a voting trust or trusts, a holding or investment company or companies, or through or by any other direct or indirect means; and to include the power to exercise control.

(4) Duty to furnish transportation and establish through routes; division of joint rates

It shall be the duty of every common carrier subject to this chapter to provide and furnish transportation upon reasonable request therefor, and to establish reasonable through routes with other such carriers, and just and reasonable rates, fares, charges, and classifications applicable thereto; and it shall be the duty of common carriers by railroad subject to this chapter to establish reasonable through routes with common carriers by water subject to chapter 12 of this Appendix, and just and reasonable rates, fares, charges, and classifications applicable thereto. It shall be the duty of every such common carrier establishing through routes to provide reasonable facilities for operating such routes and to make reasonable rules and regulations with respect to their operation, and providing for reasonable compensation to those entitled thereto; and in case of joint rates, fares, or charges, to establish just, reasonable, and equitable divisions thereof, which shall not unduly prefer or prejudice any of such participating carriers.

(5) Just and reasonable charges; applicability; criteria for determination

(a) All charges made for any service rendered or to be rendered in the transportation of passengers or property as aforesaid, or in connection therewith, shall be just and reasonable, and every unjust and unreasonable charge for such service or any part thereof is prohibited and declared to be unlawful. The provisions of this subdivision shall not apply to common carriers by railroad subject to this chapter.

(b) Each rate for any service rendered or to be rendered in the transportation of persons or property by any common carrier by railroad subject to this chapter shall be just and reasonable. A rate that is unjust or unreasonable is prohibited and unlawful. No rate which contributes or which would contribute to the going concern value of such a carrier shall be found to be unjust or unreasonable, or not shown to be just and reasonable, on the ground that such rate is below a just or reasonable minimum for the service rendered or to be rendered. A rate which equals or exceeds the variable costs (as determined through formulas prescribed by the Commission) of providing a service shall be presumed, unless such presumption is rebutted by clear and convincing evidence, to contribute to the going concern value of the carrier or carriers proposing such rate (hereafter in this paragraph referred to as the "proponent carrier"). In determining variable costs, the Commission shall, at the request of the carrier proposing the rate, determine only those costs of the carrier proposing the rate and only those costs of the specific service in question, except where such specific data and cost information is not available. The Commission shall not include in variable cost any expenses which do not vary directly with the level of service provided under the rate in question. Notwithstanding any other provision of this chapter, no rate shall be found to be unjust or unreasonable, or not shown to be just and reasonable, on the ground that such rate exceeds a just or reasonable maximum for the service rendered or to be rendered, unless the Commission has first found that the proponent carrier has market dominance over such service. A finding that a carrier has market dominance over a service shall not create a presumption that the rate or rates for such service exceed a just and reasonable maximum. Nothing in this paragraph shall prohibit a rate increase from a level which reduces the going concern value of the proponent carrier to a level which contributes to such going concern value and is otherwise just and reasonable. For the purposes of the preceding sentence, a rate increase which does not raise a rate above the incremental costs (as determined through formulas prescribed by the Commission) of rendering the service to which such rate applies shall be presumed to be just and reasonable.

indirectly to the Trans-Alaska Pipeline.

§ 342.1 General rule.

Each carrier subject to the jurisdiction of the Commission under the Interstate Commerce Act:

(a) Must establish its initial rates subject to such Act pursuant to § 342.2; and

(b) Must make any change in existing rates pursuant to § 342.3 or § 342.4, whichever is applicable, unless directed otherwise by the Commission.

§ 342.2 Establishing initial rates.

A carrier must justify an initial rate for new service by:

(a) Filing cost, revenue, and throughput data supporting such rate as required by part 346 of this chapter; or

(b) Filing a sworn affidavit that the rate is agreed to by at least one non-affiliated person who intends to use the service in question, *provided* that if a protest to the initial rate is filed, the carrier must comply with paragraph (a) of this section.

[Order 561, 58 FR 58779, Nov. 4, 1993, as amended at 59 FR 59146, Nov. 16, 1994]

§ 342.3 Indexing.

(a) *Rate changes.* A rate charged by a carrier may be changed, at any time, to a level which does not exceed the ceiling level established by paragraph (d) of this section, upon compliance with the applicable filing and notice requirements and with paragraph (b) of this section. A filing under this section proposing to change a rate that is under investigation and subject to refund, must take effect subject to refund.

(b) *Information required to be filed with rate changes.* The carrier must comply with Part 341 of this title. Carriers must specify in their letters of transmittal required in § 341.2(c) of this chapter the rate schedule to be changed, the proposed new rate, the prior rate, the prior ceiling level, and the applicable ceiling level for the movement. No other rate information is required to accompany the proposed rate change.

(c) *Index year.* The index year is the period from July 1 to June 30.

(d) *Derivation of the ceiling level.* (1) A carrier must compute the ceiling level for each index year by multiplying the previous index year's ceiling level by the most recent index published by the Commission. The index will be published by the Commission prior to June 1 of each year.

(2) The index published by the Commission will be based on the change in the final Producer Price Index for Finished Goods (PPI-FG), seasonally adjusted, as published by the U.S. Department of Labor, Bureau of Labor Statistics, for the two calendar years immediately preceding the index year. The index will be calculated by dividing the PPI-FG for the calendar year immediately preceding the index year, by the previous calendar year's PPI-FG.

(3) A carrier must compute the ceiling level each index year without regard to the actual rates filed pursuant to this section. All carriers must round their ceiling levels each index year to the nearest hundredth of a cent.

(4) For purposes of computing the ceiling level for the period January 1, 1995 through June 30, 1995, a carrier must use the rate in effect on December 31, 1994 as the previous index year's ceiling level in the computation in paragraph (d)(1) of this section. If the rate in effect on December 31, 1994 is subsequently lowered by Commission order pursuant to the Interstate Commerce Act, the ceiling level based on such rate must be recomputed, in accordance with paragraph (d)(1) of this section, using the rate established by such Commission order in lieu of the rate in effect on December 31, 1994.

(5) When an initial rate, or rate changed by a method other than indexing, takes effect during the index year, such rate will constitute the applicable ceiling level for that index year. If such rate is subsequently lowered by Commission order pursuant to the Interstate Commerce Act, the ceiling level based on such rate must be recomputed, in accordance with paragraph (d)(1) of this section, using the rate established by such Commission order as the ceiling level for the index year which includes the effective date of the rate established by such Commission order.

(e) *Rate decreases.* If the ceiling level computed pursuant to § 342.3(d) is below the filed rate of a carrier, that rate must be reduced to bring it into compliance with the new ceiling level; provided, however, that a carrier is not required to reduce a rate below the level deemed just and reasonable under section 1803(a) of the Energy Policy Act of 1992, if such section applies to such rate or to any prior rate. The rate decrease must be accomplished by filing a revised tariff publication with the Commission to be effective July 1 of the index year to which the reduced ceiling level applies.

[Order 561, 58 FR 58779, Nov. 4, 1993, as amended by Order 561–A, 59 FR 40256, Aug. 8, 1994; 59 FR 59146, Nov. 16, 1994; Order 606, 64 FR 44405, Aug. 16, 1999; Order 650, 69 FR 53801, Sept. 3, 2004]

§ 342.4 Other rate changing methodologies.

(a) *Cost-of-service rates.* A carrier may change a rate pursuant to this section if it shows that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate within the meaning of the Interstate Commerce Act. A carrier must substantiate the costs incurred by filing the data required by part 346 of this chapter. A carrier that makes such a showing may change the rate in question, based upon the cost of providing the service covered by the rate, without regard to the applicable ceiling level under § 342.3.

(b) *Market-based rates.* A carrier may attempt to show that it lacks significant market power in the market in which it proposes to charge market-based rates. Until the carrier establishes that it lacks market power, these rates will be subject to the applicable ceiling level under § 342.3.

(c) *Settlement rates.* A carrier may change a rate without regard to the ceiling level under § 342.3 if the proposed change has been agreed to, in writing, by each person who, on the day of the filing of the proposed rate change, is using the service covered by the rate. A filing pursuant to this section must contain a verified statement by the carrier that the proposed rate change has been agreed to by all current shippers.

[Order 561, 58 FR 58779, Nov. 4, 1993, as amended at 59 FR 59146, Nov. 16, 1994]

PART 343—PROCEDURAL RULES APPLICABLE TO OIL PIPELINE PROCEEDINGS

Sec.
343.0 Applicability.
343.1 Definitions.
343.2 Requirements for filing interventions, protests and complaints.
343.3 Filing of protests and responses.
343.4 Procedure on complaints.
343.5 Required negotiations.

AUTHORITY: 5 U.S.C. 571–583; 42 U.S.C. 7101–7352; 49 U.S.C. 60502; 49 App. U.S.C. 1-85.

SOURCE: Order 561, 58 FR 58780, Nov. 4, 1993, unless otherwise noted.

§ 343.0 Applicability.

(a) *General rule.* The Commission's Rules of Practice and Procedure in part 385 of this chapter will govern procedural matters in oil pipeline proceedings under part 342 of this chapter and under the Interstate Commerce Act, except to the extent specified in this part.

§ 343.1 Definitions.

For purposes of this part, the following definitions apply:

(a) *Complaint* means a filing challenging an existing rate or practice under section 13(1) of the Interstate Commerce Act.

(b) *Protest* means a filing, under section 15(7) of the Interstate Commerce Act, challenging a tariff publication.

[Order 561, 58 FR 58780, Nov. 4, 1993, as amended by Order 578, 60 FR 19505, Apr. 19, 1995]

§ 343.2 Requirements for filing interventions, protests and complaints.

(a) *Interventions.* Section 385.214 of this chapter applies to oil pipeline proceedings.

(b) *Standing to file protest.* Only persons with a substantial economic interest in the tariff filing may file a protest to a tariff filing pursuant to the Interstate Commerce Act. Along with

PART 348—OIL PIPELINE APPLICATIONS FOR MARKET POWER DETERMINATIONS

Sec.
348.1 Content of application for a market power determination.
348.2 Procedures.

AUTHORITY: 42 U.S.C. 7101–7352; 49 U.S.C. 60502; 49 App. U.S.C. 1–85.

§ 348.1 Content of application for a market power determination.

(a) If, under § 342.4(b) of this chapter, a carrier seeks to establish that it lacks significant market power in the market in which it proposes to charge market-based rates, it must file and provide an application for such a determination. An application must include a statement of position and the information required by paragraph (c) of this section.

(b) The carrier's statement of position required by paragraph (a) of this section must include an executive summary of its statement of position and a statement of material facts in addition to its complete statement of position. The statement of material facts must include citation to the supporting statements, exhibits, affidavits, and prepared testimony.

(c) The carrier must include with its application the following information:

(1) *Statement A—geographic market.* This statement must describe the geographic markets in which the carrier seeks to establish that it lacks significant market power. The carrier must include the origin market and the destination market related to the service for which it proposes to charge market-based rates. The statement must explain why the carrier's method for selecting the geographic markets is appropriate.

(2) *Statement B—product market.* This statement must identify the product market or markets for which the carrier seeks to establish that it lacks significant market power. The statement must explain why the particular product definition is appropriate.

(3) *Statement C—the carrier's facilities and services.* This statement must describe the carrier's own facilities and services in the relevant markets identified in statements A and B in paragraphs (c) (1) and (2) of this section. The statement must include all pertinent data about the pipeline's facilities and services.

(4) *Statement D—competitive alternatives.* This statement must describe available transportation alternatives in competition with the carrier in the relevant markets and other competition constraining the carrier's rates in those markets. To the extent available, the statement must include all pertinent data about transportation alternatives and other constraining competition.

(5) *Statement E—potential competition.* This statement must describe potential competition in the relevant markets. To the extent available, the statement must include data about the potential competitors, including their costs, and their distance in miles from the carrier's terminals and major consuming markets.

(6) *Statement F—maps.* This statement must consist of maps showing the carrier's principal transportation facilities, the points at which service is rendered under its tariff, the direction of flow of each line, the location of each of its terminals, the location of each of its major consuming markets, and the location of the alternatives to the carrier, including their distance in miles from the carrier's terminals and major consuming markets. The statement must include a general system map and maps by geographic markets. The information required by this statement may be on separate pages.

(7) *Statement G—market power measures.* This statement must set forth the calculation of the market concentration of the relevant markets using the Herfindahl-Hirschman Index. The statement must also set forth the carrier's market share based on receipts in its origin markets and deliveries in its destination markets, if the Herfindahl-Hirschman Index is not based on those factors. The statement must also set forth the calculation of other market power measures relied on by the carrier. The statement must include complete particulars about the carrier's calculations.

(8) *Statement H—other factors.* This statement must describe any other factors that bear on the issue of whether

the carrier lacks significant market power in the relevant markets. The description must explain why those other factors are pertinent.

(9) *Statement I—prepared testimony*. This statement must include the proposed testimony in support of the application and will serve as the carrier's case-in-chief, if the Commission sets the application for hearing. The proposed witness must subscribe to the testimony and swear that all statements of fact contained in the proposed testimony are true and correct to the best of his or her knowledge, information, and belief.

[59 FR 59160, Nov. 16, 1994]

§ 348.2 Procedures.

(a) All filings under this Part must be made electronically pursuant to the requirements of §§ 341.1 and 341.2 of this chapter. A carrier must submit with its application any request for privileged treatment of documents and information under § 388.112 of this chapter and a proposed form of protective agreement.

(b) A carrier must provide a copy of its letter of transmittal and its proposed form of protective agreement to each shipper and subscriber on or before the day the material is transmitted to the Commission for filing.

(c) A letter of transmittal must describe the market-based rate filing, including an identification of each rate that would be market-based, and the pertinent tariffs, state if a waiver is being requested and specify the statute, section, subsection, regulation, policy or order requested to be waived. Letters of transmittal must be certified pursuant to § 341.1(b) of this chapter.

(d) An interested person must make a written request to the carrier for a copy of the carrier's complete application within 20 days after the filing of the application. The request must include an executed copy of the protective agreement. Any objection to the proposed form of protective agreement must be filed under § 385.212 of this chapter.

(e) A carrier must provide a copy of the complete application to the requesting person within seven days after receipt of the written request and an executed copy of the protective agreement.

(f) A carrier must provide copies as required by paragraphs (b) and (e) of this section by first-class mail or by other means of transmission agreed upon in writing.

(g) Any intervention or protest to the application must be filed within 60 days after the filing of the application and must be filed pursuant to §§ 343.2 (a) and (b) of this chapter. A protest must also be telefaxed if required by § 343.3(a) of this chapter.

(h) A protest filed against an application for a market power determination must set forth in detail the grounds for opposing the carrier's application, including responding to its position and information and, if desired, presenting information pursuant to § 348.1(c).

(i) After expiration of the date for filing protests, the Commission will issue an order in which it will summarily rule on the application or, if appropriate, establish additional procedures and the scope of the investigation.

[59 FR 59160, Nov. 16, 1994, as amended by Order 714, 73 FR 57537, Oct. 3, 2008]

PART 349—DISPOSITION OF CONTESTED AUDIT FINDINGS AND PROPOSED REMEDIES

Sec.

349.1 Notice to audited person.
349.2 Response to notification.
349.3 Shortened procedure.
349.4 Form and style.
349.5 Verification.
349.6 Determination.
349.7 Assignment for oral hearing.

AUTHORITY: 42 U.S.C. 7101–7352; 49 U.S.C. 1, *et seq.*

SOURCE: Order 675, 71 FR 9708, Feb. 27, 2006, unless otherwise noted.

§ 349.1 Notice to audited person.

An audit conducted by the Commission or its staff under authority of the Interstate Commerce Act may result in a notice of deficiency or audit report or similar document containing a finding or findings that the audited person has not complied with a requirement of the Commission with respect to, but not limited to, the following: A filed tariff

Mobil Pipe Line Company v. FERC
D.C. Cir. No. 11-1021

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P.25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 4th day of October 2011, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or via U.S. Mail, as indicated below:

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