UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: James J. Hoecker, Chairman;
Vicky A. Bailey, William L. Massey,
Linda Breathitt, and Curt Hébert, Jr.

Explorer Pipeline Company) Docket Nos. OR99-1-000 and OR99-1-001

ORDER ON APPLICATION FOR MARKET POWER DETERMINATION AND ON RELATED WAIVER REQUEST

(Issued June 30, 1999)

On October 15, 1998, Explorer Pipeline Company (Explorer) filed an application for a market power determination pursuant to 18 C.F.R. § 348.1. Explorer seeks permission to file market-based rates for deliveries of petroleum products from all origins on its system to all of its destinations in Houston and Dallas, Texas; Tulsa, Oklahoma; St. Louis, Missouri; and Chicago, Illinois. The Commission finds that Explorer origin markets Houston, Tulsa, and St. Louis, are not at issue in this proceeding. The Commission also finds that Explorer lacks significant market power in the destination markets of Dallas, Tulsa, Houston, St. Louis, and Chicago. Therefore Explorer may implement market-based rates in those markets. Since the Commission has made this determination before July 1, 1999, there is no need to address Explorer's related request that it be granted a waiver of the Commission's oil pipeline indexing regulations.

Background

Explorer is a joint interest pipeline owned in varying percentages by Chevron Pipe Line Company, CITGO Pipeline Investment Company, Conoco Pipe Line Company, Equilon Pipeline Company LLC, Marathon Oil Company, Phillips Investment Company, and Texaco Trading and Transportation Inc. It owns and operates a 1,400 mile petroleum products pipeline system that transports primarily gasoline, fuel oil, and jet fuel from the Gulf Coast refineries and import facilities in Texas and Louisiana into the mid-western United States. Explorer serves the major urban markets of Houston, Dallas, Fort Worth, Tulsa, St. Louis, and Chicago and more than 70 population centers by its connections.

Explorer has major tank and terminal facilities at Port Arthur, Greenville, and Grapeville, Texas; Glenpool, Oklahoma 1/; Wood River, Illinois 2/; and Hammond, Indiana. Its mainline pipe size is twenty-eight inches in diameter from Port Arthur to Tulsa and twenty-four inches from Tulsa to Hammond with some twenty pumping stations located on its system. Throughput capacity is over 500,000 barrels per day on the twenty-eight inch portion of the system and 317,000 barrels per day on the twenty-four inch portion of the system. 3/

The Instant Filing

Explorer seeks a declaration pursuant to Part 348 of the Commission's regulations 4/ that it lacks significant market power in all of it BEA origin and destination markets and that therefore Explorer should be permitted to charge market-based rates. Section 348.1 of the Commission's regulations requires the pipeline to: (1) define the relevant geographic and product markets (including both destination and origin markets); (2) identify the competitive alternatives for shippers, including potential competition and other competition constraining the pipeline's ability to exercise market power; and (3) compute the market concentration and other market power measures based on the information provided about competitive alternatives. Explorer defines the relevant product market as refined petroleum products that consist of motor gasoline, distillates, and jet fuel. Explorer states that its relevant destination markets are comprised of five BEAs: 5/ Houston, TX, Dallas, TX, Tulsa, OK, St. Louis, MO, and Chicago, IL. Explorer defined three relevant origin markets comprised of nine BEAs: Houston, TX (7 BEAs), Tulsa, OK (1 BEA), and St. Louis, MO (1 BEA). Each of these BEAs contains several refineries and/or water based petroleum terminals.

1/ Glenpool is located within the Tulsa, Oklahoma BEA.

2/ Wood River is a major barge transfer and pipeline interconnect, storage, and marketing hub located just north of East St. Louis on the Mississippi River.

3/ See Application, Vol. 1, Statement C at 2 of 4; Statement F, Maps.

4/ 18 C.F.R. Part 348 (1998).

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

In establishing BEAs as the definition of its destination markets, Explorer states it followed the destination market definitions used in the Buckeye, 6/ Williams, 7/ Longhorn, 8/ and Kaneb proceedings. 9/ Explorer claims the BEAs it proposes are of similar size to the BEAs adopted by Kaneb. The BEAs served by Explorer, as in the case of Kaneb, are centered on major cities, and include the areas in the immediate vicinity of these major cities. Explorer also cites the Commission's statement in Kaneb that external supply sources that were within 75 miles of the BEA border were appropriate to be included in the market share and market concentration analyses along with the supply sources that were located within the BEA's borders. 10/ Explorer asserts that the Commission has found instances 11/ where supply sources of 100 miles or more from a BEA were competitors within the BEA, and thus included in its filing information showing certain supply sources within 100 miles of a BEA as external suppliers to it.

Explorer defines origin market BEAs by identifying refineries that do or could use it as the outbound pipeline. The location of the refineries, the related port facilities and the local areas served by these facilities define the areas to be included in the origin market. Explorer claims the close proximity of refineries and pipeline interconnections in the area from the Texas Gulf Coast through Lake Charles, Louisiana, indicates that Explorer's Houston Origin Market should include all the refiners in this area as well as all the refined

---

6/ Buckeye Pipe Line Company, (Buckeye) Opinion No. 360, 53 FERC ¶ 61,473 (1990); Order on Rehearing, Opinion No. 360-A, 55 FERC ¶ 61,084 (1991).

7/ Williams Pipe Line Company, (Williams) Opinion No. 391, 68 FERC ¶ 61,136 (1994); Order on Rehearing, Opinion No. 391-A, 71 FERC ¶ 61,291 (1995).

8/ Longhorn Partners Pipeline, L.P., 83 FERC ¶ 61,345 (1998).

9/ Kaneb Pipeline Company, 83 FERC ¶ 61,183 (1998).

10/ Id. at p. 61,761. The competitive impact of sources outside the BEA is limited to the counties in the BEA that the source can actually reach on the transportation assumptions involved. Thus, the weight accorded an external source in the calculation of an HHI and any excess capacity ratio will vary depending on the portion of the BEA that can actually be reached by the source. The greater the area reached, the greater weight will be accorded the external source in the calculation of the HHI.

11/ Williams, 68 FERC ¶ 61,136 (1994) and 71 FERC ¶ 61,291 (1995).

petroleum products delivered into ports in this area by water. Explorer states it can receive petroleum product along the Gulf Coast at Lake Charles, Beaumont-Port Arthur, and Houston. At its Houston receipt point (at Pasadena, TX), Explorer asserts it can receive products from refineries in the Corpus Christi, TX BEA that can ship to Pasadena via pipeline. Thus, the seven BEAs proposed by Explorer as making up its Houston origin market are: Corpus Christi, Houston-Galveston-Brazoria, Beaumont-Port Arthur, McAllen-Edinburg-Mission, San Antonio, Austin-San Marcos, TX, and Lake Charles, LA. Explorer states that its Tulsa origin market is defined by the single Tulsa BEA area and, similarly, its St. Louis origin market by the single St. Louis BEA area.

Explorer contends that its market power measures indicate that it has no market power in any of the relevant origin or destination markets. Because the protests do not contest Explorer's assertions that it lacks significant market power in its origin markets, the discussion here only addresses the destination markets. For the five destination markets it serves, Explorer has calculated a delivery-based Herfindahl-Hirschman Index (HHI) measurement, its estimated market share, and an excess capacity ratio. 12/ Its estimated HHI, market share, and excess capacity ratio for all five destination markets are reflected in Appendix A. The HHI is subdivided to reflect the potential impact of external suppliers as well as the suppliers internal to the market. Based on these calculations Explorer concludes its five destination markets are sufficiently competitive to justify authorizing it to utilize market based rates in all markets.

Protests and Interventions

As noted, Explorer filed its application on October 15, 1999. On December 9 and 11, 1998, United Airlines and the Air Transport Association filed motions requesting an extension of time to file comments on December 9 and 11, 1999, respectively. Explorer opposed the motions, which were granted by the Commission. On January 29, 1999, G.P. & W., Inc., d.b.a. Center Oil Company, (Center Oil) and CITGO Petroleum Corporation (CITGO) filed on January 29, 1999, to intervene and to protest the application. On February 3, 1999, Explorer filed a notice of

---

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

intent to file a motion for summary disposition, which CITGO filed to oppose on February 11, 1999. Explorer filed its motion for summary disposition on February 19, 1998. The Association of Oil Pipe Lines (AOPL) filed a motion for leave to intervene out-of-time and filed an answer in support of Explorer on February 24, 1999. CITGO and Center Oil filed replies on March 22, 1999.

Center Oil asserts that there is limited competition to Explorer in the Chicago and St. Louis destination markets, and that Explorer has not adequately demonstrated that both destination markers are sufficiently competitive for it to be permitted to charge market based rates. Center Oil argues that Statement E 13/ of Explorer's application for market-based rates is silent regarding new entry into the St. Louis and Chicago destination markets. While Explorer identifies six other pipelines that currently transport product to the St. Louis destination market, Center Oil states that only the Clark and Shell refineries have competitive relevance for Center Oil, because the other pipelines are not always realistic alternatives. Center Oil therefore believes that Explorer has not established that its HHI analysis and market share calculations are valid because of an absence of data from Explorer on important competitive alternatives. Center Oil says that its business would be jeopardized if Explorer were authorized to file market based rates. This is because Center Oil would not be able to foresee when capacity would be available to it at rates it could afford as the level of Explorer's rates could be unpredictably high due to its market power.

CITGO also challenges Explorer's explanation of its competitiveness in the Chicago destination market, arguing that it is captive to Explorer's system in the Chicago destination market during the peak shipping season. CITGO asserts the peak lasts about six months of the year and that there are no shipping alternatives at that time. While conceding that Explorer has excess capacity during the off-peak period, CITGO asserts that more than half of CITGO's shipments through Explorer's pipeline go to the Chicago consuming market and the rationale for constructing the Explorer pipeline was to take advantage of seasonal price differentials that exist between petroleum prices on the Gulf Coast and in the Mid-west.

CITGO states that the highest seasonal demand and peak market exists from May through October of each year, and that during this period Gulf Coast refiners such as CITGO can sell as much product as they can ship on Explorer. Conversely, when

---

13/ Pursuant to the Commission's regulations this Statement must describe potential competition in relevant markets. 18 C.F.R. § 348.1(c)(5).

demand is reduced during the non-peak months of the year, the price differential does not justify shipping through Explorer. However, in order to retain their privilege to ship during the prorated and capacity-constrained peak season, the shipper must move product during the non-peak season. 14/ It claims that during the peak season Explorer lacks the capacity to transport all the products its shippers want to ship, and that there are no other alternatives during this period.

For example, CITGO states that Explorer lists the TE Products Pipeline Company, L.P. (TEPPCO) pipeline as one alternative CITGO could utilize, but does not take into account that TEPPCO is a smaller diameter pipeline able to offer less capacity and is not easily accessible from CITGO's Lake Charles pipeline. TEPPCO, like Explorer, prorates its shipments, so CITGO would have to put a percentage of its capacity during the off-peak season on its pipeline during this non-profitable time. CITGO claims it would be forced to choose between Explorer and the smaller diameter TEPPCO line, which would lead to the loss of its peak shipping capacity. CITGO also asserts that water transportation is not a viable alternative because costs and transit times are higher. It also states that exchanges are not a realistic alternative because during the peak season there are no products in the destination market available for exchange. It argues that Explorer could therefore raise its rates by as much as 50 percent during the peak period, or about 1.00 a barrel.

Explorer argues that neither Center Oil nor CITGO explicitly opposed Explorer's request for market-based rate authority in each of the following markets: Houston, Dallas, and Tulsa destinations; and the Houston, Tulsa, and St. Louis origin markets. According to Explorer, the only controversy concerns the Chicago and St. Louis destination markets and the questions raised by the protestants can easily be answered on the basis of law and policy. It argues that even if the HHIs and market share figures are adjusted to reflect the protesting parties assertions, the results still demonstrate that the Chicago and St. Louis markets are competitive. It further claims that the increase in seasonal demand for petroleum products in the Chicago area is about 2.6 percent and that existing pipeline and refinery capacity in both the Chicago and St. Louis destination markets can easily handle this increase in demand. Explorer further states that seasonal price swings for petroleum products in Chicago greatly exceed any of its past rate increases and demonstrate that transportation costs are not the principal

---

14/ Explorer uses an historical-based proration methodology, under which access to the pipeline falls to shippers with movements made over the entire year period versus shippers that choose to ship only during peak periods.

factor influencing the price of gasoline and other petroleum products in its destination markets.

AOPL intervened to support Explorer, stating that Explorer has shown sufficient competition in all of its origin and destination markets to support a finding that those markets are competitive. AOPL notes the Commission has previously found the St. Louis and Chicago destination markets to be competitive. 15/ AOPL argues that the protestors did not raise issues of material fact, nor did they dispute the evidence filed by Explorer. AOPL asserts that simply because Explorer serves a low-cost origin, and that there are seasonal differences in demand does not require the Commission to hold a hearing.

Discussion

The instant case centers on whether there is sufficient capacity in Explorer's destination markets to assure that Explorer will not be able to exercise significant market power during peak periods in the St. Louis and Chicago destination markets. 16/ The Commission has not directly addressed seasonal issues in its previous determinations of oil pipeline market power. Addressing this point, CITGO argues that the low HHIs and market shares Explorer presents are not relevant because they are based on annualized market shares that do not reflect the market power it believes Explorer has during the summer peak period. CITGO therefore asserts that the instant filing should be evaluated on a corridor basis, by examining origin-destination pairs, rather than by reviewing the origin and destination markets separately.

The Commission, however, has consistently rejected the use of corridor-based market analyses in oil pipeline cases to date. The reason for this was most clearly stated in Williams: 17/

> We affirm the ALJ's use of destination markets. We agree that the real economic concern of shippers is the delivered product and its price rather than whether the product travels between specific locations via pipeline. Limiting geographic markets to

---

15/ Williams Pipeline Company, 68 FERC ¶ 61,136 (1994).

16/ SFPP, L.P., 84 FERC ¶ 61,338 (1998) at 62,495-96, and 86 FERC ¶ 61,262 (1998). In this proceeding the Commission concluded that origin markets are less likely to be of import because producers frequently have a large number of outlets in an area with a high level of petroleum consumption.

17/ Williams, 68 FERC at 61,660-61.

> specific/origin destination pairs would fail to recognize this factor and also would eliminate from consideration competitive suppliers who bring product to markets without utilizing the specific corridors.

Williams reflects a standing Commission premise in oil pipeline rate proceedings that if there are sufficient alternative sources of supply, these will act to constrain a pipeline's ability to exercise significant market power in a destination market because shippers will shift their business away from the pipeline to other sources of supply, thus reducing the pipeline's throughput, revenues, and profits. The Commission has since adopted a parallel analysis of origin markets based on its current regulations governing determinations of pipeline market power, most recently applied in Longhorn, supra. 18/ In this vein, the Commission's oil pipeline regulations only require that the pipeline show "that it lacks significant market power in the market in which it proposes to charge market-based rates." 19/ (Emphasis added). While regulations do require that "the applicant include the origin market and the destination market related to the service for which it proposes to charge market based rates," the regulations do not require that the applicant show that there is competition for the transportation of the commodity between the specific origin and destination market pair. 20/ The Commission's explanation of its regulations is explicit:

> The Commission also is requiring the oil pipelines to include both relevant origin and destination markets in its evidentiary presentation. This will provide interested parties with complete information about competition at the supply and delivery ends of the pipeline system. The Commission is not requiring the oil pipeline to file a market analysis of each point-to-point corridor. The Commission concludes that, in light of the significant point-to-point traffic in the oil industry, this would be too onerous a requirement at the filing stage, that a point-to-point analysis may exclude competitive alternatives to the relevant service and, in some cases, it could provide an inaccurate picture of market concentration. However, a protestant may, as part of its response to the oil pipeline's application, seek to prove that in the particular circumstances that a point-to-point corridor

---

18/ See Longhorn, 83 FERC at 62,379.

19/ See 49 C.F.R. § 324.4(b).

20/ See 49 C.F.R. § 348(c)(1).

> approach should be used to determine the appropriate geographic market. 21/

The Commission then continued:

> The Commission agrees with the Farmers that the ultimate burden of proof is on the pipeline to establish the relevant geographic market. However, a proponent of corridor markets must come forward with an adequate presentation to warrant rebuttal by the pipeline. 22/

The Commission's current regulations thus permit, but do not require, a corridor-based analysis of an application for market-based rates. However, the administrative history of the regulations clearly places the burden on the protesting parties to provide sufficient grounds to justify such an analysis. In the instant case, the protesting parties attack the adequacy of Explorer's market analysis using two principal arguments. First they assert that there is insufficient transportation capacity in the peak period to constrain Explorer's rates, that some pipeline routes are inefficient or inconvenient, and that barge competition is more costly, provides a lesser quality of service, and that the capacity at barge terminals is insufficient for barges to be effective. 23/ These assertions regarding Explorer's ability to increase its prices during peak periods are relatively general and are based on an assumption, not particularly well documented in the record, that Explorer will be able to capture all or most of the differential between the price of petroleum products on the Gulf Coast and Chicago during the peak period. 24/ Given the burden placed on the protesting parties by the Commission's regulations, in future cases if the pipeline demonstrates that its origin and destination markets are within the limits of market evaluations previously accepted by

---

21/ Market-Based Ratemaking for Oil Pipelines, Order No. 572, FERC Stats. and Regs., Regulations Preambles, 1991-1996, ¶ 31,007 at 31,188.

22/ Id. at 31,189.

23/ Protest and Request for Hearing of CITGO Petroleum Corporation and Motion to Intervene (CITGO Protest), Tab A at 10-12.

24/ Id; Reply of CITGO Petroleum Corporation to Motion for Summary Disposition (CITGO Reply), Tab 1 at 7 and Tab 2 at 13-14.

the Commission, such general assertions may not be sufficient to warrant consideration of a corridor-based analysis. 25/

Turning to the merits, the Commission has examined that portion of Explorer's filing addressing its origin markets and concludes that the definition and import of those markets are not material issues in this proceeding. The Commission therefore concludes that Explorer can be authorized to utilize market-based rates originating from those markets.

The destination markets are contested and require a more detailed analysis. The Commission will begin with its traditional analysis based on HHIs, the delivered market shares, the effective capacity market share, and the excess capacity ratios for the destination markets involved here. While the Commission has not imposed stringent screening guidelines regarding HHI figures or market shares, 26/ they are nonetheless often utilized as competitive market indicators. The market share tests reflect different methods of measuring a firm's actual participation in a market and the total capacity that is available to meet demand. The delivery-based market share is the applicant's estimated percentage of actual deliveries to the market. As such, it does not address whether there is additional capacity to serve the market in the event of a price increase by the applicant. The capacity-based market share measures the effective capacity available after allowing for pipeline, refinery, truck, and barge capacity that may be committed to serving other markets and is therefore not available to serve the market at issue. This measure also specifically allows for the

---

25/ Cf. SFPP., L.P, 86 FERC ¶ 61,262 (1998). The burden of protestors to justify a corridor analysis is a matter that interested parties should keep in mind in reading the balance of this order.

26/ Buckeye, Williams, Kaneb, and Longhorn used an HHI range of 1800 to 2500 as an initial screen, and then reviewed the pipeline's market share and other factors in order to determine whether the pipeline possessed significant market power. Buckeye, 53 FERC at 62,666-68, 55 FERC at 61,254; Williams, 68 FERC at 61,670-72, 71 FERC at 62,127; Kaneb, 83 FERC at 61,761; and Longhorn, 83 FERC at 62,381. The HHI figures of 1800 and 2500 are indicators typically used by pipelines applying for market based rates to reflect what they feel is an accurate depiction of tolerable levels of concentration based on DOJ's Oil Pipeline Deregulation study and DOJ's/FTC's 1992 Merger Guidelines. A threshold of 1,800 would be met if a market was served by between five and six equally sized competitors. The 2,500 threshold is met by a market served by four equally sized competitors.

additional capacity that shippers could turn to if the pipeline were to attempt to raise its rates above competitive levels. The excess capacity ratio is the ratio of the total capacity for all sources available to satisfy demand to the demand for petroleum products in the given market.

The market share and the HHI levels using the delivery-based model in all of the destination markets, as stated in Explorer's application, are illustrated below.

Delivery Based Results for the Destination Markets

Destination Market	HHI	Explorer Market Share
Houston	1165	8.9%
Dallas	1608	20.4%
Tulsa	1823	6.0%
St. Louis	1936	30.2%
Chicago	1551	30.2%

The display is based on the estimated 1999 delivery of petroleum products into the Houston, Dallas, Tulsa, Chicago, and St. Louis destination markets. It is a conservative measure of competition because, as has been discussed, it does not measure the total capacity that is available to meet demand if the pipeline should raise prices or if total demand were to increase in the market under analysis. Appendix A contains a table that provides a fuller display of the capacity-based HHIs, the capacity-based market shares, and the excess capacity ratios stated in the application. 27/ This method results in somewhat lower HHIs and considerably lower market shares because more capacity is deemed to be competing in the market being analyzed.

Using the Commission's Delivery Based Method, the Commission's Effective Capacity Method and the Department of Justice (DOJ) Adjusted Capacity Method, 28/ the Chicago destination market analysis results in HHI measurements of 1551, 1390, and 946, respectively; the St. Louis destination market

---

27/ Subsequent discussion in the text will state whether delivery-based or capacity-based measurements are the basis for some of the numbers presented in the text. Appendix A was too extensive to be readily accommodated in the text.

28/ The DOJ adjusted capacity measure is similar in concept to the Commission's effective capacity measure but is not as refined as that used by the Commission.

results in measurements of 1936, 1500, and 877, respectively. In the Dallas destination market, the measurements in these three categories are 1608, 1579, and 1045 respectively; in the Houston destination market, the measurements are 1165, 1028, and 558, respectively; and in the Tulsa destination market, the measurements are 1823, 1154, and 1111, respectively.

The Commission concludes that Explorer's HHI calculations, delivery-based market shares, capacity-based market shares, and excess capacity ratios are well within Commission precedent for all of its destination markets. This is true even if Explorer's capacity is allocated to its owners for purposes of the analysis and without the adjustments that Explorer included in its Motion for Summary Disposition. 29/ The most relevant comparison is with the Williams case, a fully litigated proceeding in which the Commission accepted HHIs as high as 2600 or market shares as high as 39 percent and concluded that Williams lacked significant market power in the relevant markets. 30/ For all five destination markets, each of the three HHI methods and the market share information compare favorably with HHI initial screening figures found in the Buckeye, Williams, and Kaneb proceedings, supra. 31/ In the three destination markets that are unchallenged here, its delivery-based market share only slightly exceeds 20 percent at most and in Chicago and St. Louis it does not exceed 30 percent. None of these figures rise to the level of combination of a 2500 HHI and a 46 percent market share that the Commission found unacceptable in Williams. 32/ As is

29/ See Application at 23.

30/ For example, in Williams, the Commission accepted an HHI of 2606 and a delivery based market share of 35 percent for the Minneapolis/St. Paul market (68 FERC at 61,682), an HHI of 1801 and a market share of 37 percent for Wausam, Wisconsin (68 FERC at 61,677),an HHI of 2381 and a market share of 39 percent for Dubuque, Iowa (Id.), an HHI of 2048 and a market share of 34 percent for Davenport, Iowa (68 FERC at 61,678).

31/ See Williams, id.; Buckeye, 53 FERC at 62,669-671; and Kaneb, 83 FERC at 61,762.

32/ For example, Topeka, Kansas (HHI 3333, market share 46 percent), Duluth, Minn. (HHI exceeds 2500, 60 percent market share), Rochester, Wis. (HHI exceeds 2500, 60 percent market share), Sioux City, Iowa (HHI exceeds 2500, market share 51 percent), Omaha, Neb. (HHI 2786, market share 46 percent), Grand Island (HHI exceeds 2500, market share 62 percent), Sioux Falls (HHI exceeds 2500, market share 49 percent), Aberdeen (HHI exceeds 2500, market share 49 percent. See 68 FERC at 61,682-85. See also Quincy (HHI 2026, but market
(continued...)

explained further below, this is true even if the HHIs and delivery market shares contained in the application are adjusted to reflect the intervener's criticisms of the application.

Moreover, the most conservative excess capacity ratio for the Chicago market is 3.6 times the peak demand for petroleum products in that market, an excess capacity of some 1,079 MBD after allowing for a peak increase of some 2.6 percent or 420 MBD. 33/ These calculations do not include the possible re-entry of Williams to the central Chicago market and the expansion of water-based deliveries in that market. 34/ The minimum excess capacity ratio in ~~the St. Louis~~ market is approximately 3.4 with potential competition, again without inclusion of the possible re-entry the Williams system and the presence of extensive barge petroleum port facilities. 35/ These conclusions are consistent with the evidence supporting the Commission's prior conclusions in Williams addressing that Williams lacked significant market power in the Chicago and St. Louis markets. 36/

Based on this record and a review of Commission precedent, the protesting parties' general assertions that competitive forces are inadequate to constrain Explorer's rates during peak periods do not compel a further examination based on a corridor argument. 37/ However, in light of the seasonal argument that

---

32/ (...continued)
share 70 percent), and Cedar Rapids, Waterloo, and Ft. Dodge (HHI between 1800 and 2500, but market shares 81 percent, 99 percent, and 98 percent respectively) Id., 61685-86.

33/ See Explorer's Motion for Summary Disposition, Tab C at 48-49.

34/ Id. at 19, 32.

35/ See Williams, 68 FERC at 61,675-78; 61,682; and 71 FERC at 62,121. The HHIs are based on actual deliveries or effective capacity, so only that portion of market that is actually served by water is included in the HHIs. The potential for barge delivery is reflected in the maximum throughput in MBD at the relevant docks.

36/ For example, in Williams the Staff calculation of Explorer's market share was 22.0 percent, an HHI of 1,410, and an excess capacity ratio of 3.8 percent using the effective capacity based market share, HHIs, and excess capacity ratios. See Motion for Summary Disposition, Tab C at 33.

37/ It is not sufficient, for example, to simply challenge the technical calculations of the HHIs for the origin and
(continued...)

has been presented here and the implications the instant application has for the transportation of petroleum products between the Texas and Gulf producing areas and the Central and Midwest, 38/ in this instance the Commission will address the corridor arguments raised by the protesting parties.

The Commission will first analyze the capacity available to the St. Louis destination market since Chicago is downstream of St. Louis. This will assure that capacity that may be used to determine the competitiveness of the St. Louis destination market is not also used to determine whether market-based rates are appropriate for the Chicago destination market. Examining first the various pipeline alternatives, Explorer serves St. Louis directly, as does Phillips, which reaches Houston through its newly constructed affiliate, the Seaway Pipeline. Phillips also connects with the new Equilon system, providing an alternative connection to the Houston area. The Williams system reaches St. Charles, which is just outside of St. Louis proper, but is within the St. Louis BEA, and has a connection directly into St. Louis via the Conoco system. 39/ Therefore protestants are incorrect that Williams does not effectively serve the St. Louis BEA. Conoco also has connections to the Seaway-Phillips and Equilon system which enable it to obtain petroleum products for the Houston area and provides it with an alternative route to its joint route with Williams. Contrary to Center Oil's assertions, Conoco has a published tariff and functions as a common carrier pipeline. In addition, TEPPCO serves St. Girardeau, a point some 75 miles from the St. Louis BEA, within the range normally

37/ (...continued)
destination markets without presenting specific evidence on the capacity needed, specific volumes involved, the operating constraints, if any, and barriers to entry that would support a request for a corridor-based analysis.

38/ For example, the TE Products Pipeline Company, L.P., one of Explorer's principal competitors has also applied for market based rates for origin and destination markets located between Texas and Louisiana in the south and Illinois and western Ohio in the north. See Docket No. OR99-6-000, Volume 1, at 1.

39/ Williams also recently constructed an upgraded joint link with Amoco as an alternative means of reaching St. Louis. There are published tariffs for this line but it has been inactive due to a lack of demand. This is a further indication of competition and that excess capacity is available in the St. Louis market. See Explorer's Motion for Summary Disposition, Tab B at 4-5. Williams also has an idle line of its own into St. Louis that it could reactivate. Id at 6.

accepted by the Commission for the delivery of gasoline and other petroleum products to a BEA. 40/ Thus, on this record, there are at least five effective pipeline routes linking Texas and the Gulf Coast area with St. Louis: Seaway - Phillips, Seaway - Conoco, Seaway-Williams, TEPPCO, and Explorer. Alternatives to these routes include Equilon - Williams, Equilon - Conoco, and Equilon - Phillips. These pipeline combinations assure routing flexibility and four competitive alternatives at each end of the Houston - St. Louis corridor. 41/

Moreover, barges are used to deliver petroleum products to St. Louis and the capacity for these terminals far exceeds the needs of the St. Louis area. CITGO and Center Oil claim that barges are not as efficient as pipelines, but the Commission has consistently concluded that barges are effective competition for petroleum product pipelines. For example, the Commission has previously determined that barge traffic is an effective competitor to pipelines for the delivery of petroleum products as far north as Bettendorf, Iowa, near Davenport, Iowa on the Mississippi River. 42/ In contrast to the area around St Louis, Bettendorf is considerably further north on the Mississippi with many more intervening locks and dams, which reduce the efficiency of barge movements. Nonetheless, the Commission found that barges were an effective form of competition to Williams. Explorer's detailed analysis of the barge petroleum facilities contrasted sharply with the general assertions by the protestants and is convincing evidence that there is sufficient port capacity for barges to compete in the St. Louis area. 43/

40/ Marathon pipeline also serves the St. Louis BEA and can be reversed to bring in petroleum products to the St. Louis BEA. However, since the Commission is accepting Marathon as competitor in the St. Louis - Chicago corridor in the next portion of this analysis, it will exclude Marathon as a possible pipeline competitor in the St. Louis area.

41/ The alternatives are reflected at several points in the record as well as in the pipeline's respective tariffs. For example, See Motion for Summary Disposition, Tab B at 3-6, Tab C at 8-10, 18, and Exhs. 2- 4, 7-8, 25-27, and 34.

42/ Williams, 68 FERC at 61,688. In fact, the Commission accepted an HHI of 3100 at Quincy due to the presence of strong barge competition and a barge market share greater than 10 percent. The Commission took pains to eliminate any double counts that could occur from the presence of barges in this and a number of adjoining markets. Williams, 71 FERC at 62,136-38.

43/ Id. at 18; Tab B at 3, 7-8; Tab C at 3, 5-6, 10, and 40-41.

In addition, Explorer recalculated the HHIs and market shares to reflect some of the criticisms of its initial calculations for this market. These include the fact that Amoco withdrew from the St. Louis market after the current application was filed, 44/ and that Marathon moves product in a northerly rather than a southerly direction. Excluding the former Amoco line and Marathon, the St. Louis BEA shows a capacity-based HHI of 1,723, a capacity-based market share of 21.5 percent, and an excess capacity ratio is 4.3 times the total area consumption. Even if TEPPCO is eliminated as an effective competitor in the St. Louis market, as CITGO urges but which the Commission has declined to do here, the capacity based HHI is 2045, Explorer's capacity-based market share is 27.4 percent, and the excess capacity ratio is 3.4 percent. 45/ Given the pipeline and barge transportation alternatives available, the large excess delivery capacity present in the St. Louis area, and the dynamic nature of entry and exit by petroleum product pipelines serving that BEA, the Commission concludes that Explorer will not be able to exercise significant market power in the St. Louis destination market if it is authorized to file market-based rates.

The Commission also concludes that since there are sufficient good alternatives to Explorer's service in the St. Louis market, the Commission need not consider further Center Oil's protestations that it will be unable to conduct its business if Explorer is authorized to use market based rates. Center Oil may not consider the competitive alternatives available in the St. Louis destination market to be directly equivalent to the current service it receives from Explorer, but the routes need not all be equivalent as long as sufficient competitive alternatives exist to prevent Explorer from exercising significant market power. Center Oil is also concerned that Explorer may be able to raise prices during the peak period. However, the ability to raise prices does not mean that Explorer has significant market power; it may simply mean that the current rates for peak period service are below the competitive market price. Explorer publishes rates to the entire St. Louis BEA, not necessarily a point-to-point rate that serves only one customer. 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

---

44/ Amoco's motives for canceling its petroleum product tariffs into St. Louis are unclear; however, the capacity, while not properly included in an HHI since the firm is not active, remains available for entry if demand should justify it.

45/ Motion for Summary Disposition, Tab C at 15-16, 18.

and a consequent reduction in Explorer's revenues. 46/ This potential loss of revenue serves to constrain Explorer's rates to all of the shippers in the St. Louis destination market, not just the ones that may have direct access to transportation alternatives they deem comparable to Explorer's service.

CITGO's and Center Oil's arguments regarding the Chicago market are equally unconvincing. The record establishes that the common carrier pipeline routes from the Gulf Coast and Houston to Chicago include Explorer, TEPPCO, Seaway-Phillips, Seaway-Williams, Equilon-Phillips, Equilon-Williams, and a market-based route involving CITGO's own pipeline subsidiary, CITGO Products Pipeline and Williams. 47/ CITGO asserts that Williams does not serve Chicago directly but neglects to note that Williams serves Chicago from a point outside the City but within the BEA (at Amboy, Illinois), and that Williams previously served downtown Chicago but withdrew due to a lack of demand. 48/ This is not an indication of an under-served market, even on a seasonal basis. In addition, Explorer recalculated the HHIs and market shares on the assumption that neither Williams nor NORCO (a pipeline with the capacity to flow petroleum from Chicago to Detroit or vice versa) were participating in the market. The resulting HHI was 1620 rather than 1410, Explorer's market share was 24.4 percent rather than 23.3 percent, and the excess capacity ratio was 3.5 rather that 3.8. 49/ Even these reduced capacity margins and HHI factors are within the bounds required to show effective competition for Explorer's services in the Chicago destination market. Moreover, the Marathon and Phillips Pipeline systems have the ability to receive large amounts of refined petroleum from barges in the East St. Louis area and to ship it to Chicago. The record indicates that both pipelines have excess capacity of at least 50 percent on the St. Louis to Chicago route. 50/

CITGO's argument that refinery capacity in Chicago is insufficient is also unpersuasive. CITGO asserts that there has

---

46/ See Williams, 71 FERC at 62,132-33 for a further discussion of this point. See also Motion for Summary Disposition, Tab B at 15-17.

47/ The range of pipeline alternatives for routes from the Houston/Gulf Port areas to Chicago is reflected on the Motion for Summary Disposition, Tab B at 8-9, Tab C at 27-28, 31, 33, 36, 46-47, and Exhs. 2, 3, 7, and 15-17. The barge alternatives are reflected in Tab C at 3, 19-20.

48/ Motion for Summary Disposition, Tab C at 28.

49/ Id., Tab C at 33.

50/ Application, Vol. 1, Tab D, Table D.7 at 7-8 of 13.

been no refinery expansion in Chicago in recent years. Explorer rebuts this argument by pointing out that while CITGO has not expanded its Chicago-based refinery in recent years, other refiners have. 51/ On this record CITGO admits that it is considering selling its refinery in Chicago and redeploying its capital elsewhere even as it argues here that storage expansion, refinery expansion, and off-season shipments place too much risk on the shipper and therefore the current regulated common carrier rate should be retained. 52/ Thus, at a time other refineries are expanding, CITGO is seeking to reduce its own alternatives in the Chicago area by disposing of a refinery that provides 73 percent of its Chicago area needs. By increasing its dependence on other sources rather than protecting itself through capacity it controls, 53/ CITGO lends credence to the Commission's initial conclusion that the low HHIs and high excess capacity ratios evidence a lack of significant market power by Explorer in the Chicago destination market, and supports Explorer's argument that CITGO prefers that Explorer bear the costs and risks of the capacity required to meet seasonal demand.

The Commission also finds CITGO's seasonal argument unpersuasive for other reasons. 54/ First, on balance, the record is inconsistent with CITGO's assertions. The excess capacity ratios that underlie the HHIs discussed earlier strongly suggest that the additional capacity exists in the Chicago and St. Louis destination markets to constrain Explorer's rates. As stated in Explorer's Application, that excess capacity is 3.7 to 3.5 times the total demand for refined petroleum products for the Chicago destination market and 4.9 to 4.3 times the demand for petroleum products in the St. Louis destination. These calculations are based only on the internal suppliers for those markets, i.e., those actually located within the relevant

---

51/ Motion to Dismiss, Tab C at 46-47.

52/ CITGO's Reply, Tab 1 at 2-3 and Exh. HNW-2/

53/ CITGO has stated that storage, increased refinery capacity, and other means of peak shaving impose undue risk on the shipper. The risk of the capacity needed to meet peak demand is therefore shifted to the pipeline.

54/ CITGO's reference to gas cases as controlling the determination on seasonal rates is misplaced. The Commission has previously concluded that oil pipelines transport commodities that are much more susceptible to transportation by other means when compared to natural gas. It specifically concluded that it was inappropriate to analogize the oil and gas pipelines in this regard. See Williams, 68 FERC at 61,660.

BEA. 55/ These excess capacity ratios should be compared to a total estimated increase in the peak demand for refined petroleum products of 2.6 percent for the entire Chicago BEA. 56/ In 1998, Explorer's throughput increased an average of 10 percent from the off-peak months to the peak season of May through October with an average of 206 MBD for those six peak months. In the months of June through August deliveries increased to an average of 219 MBD with an average of 233 MBD in July. 57/ The critical importance of this latter fact is that Explorer's throughput capacity at Hammond, Indiana, outside of Chicago is 317,000 barrels per day , or 64,000 barrels per day more than Explorer actually succeeded in delivering in the peak period. Thus, even Explorer has excess capacity in the Chicago market during the peak period, even if lower portions of its system, for example, Tulsa to St. Louis, are constrained. 58/ If Explorer could exercise significant market power in the Chicago destination market, Explorer would be able to fill this additional capacity, for example, by accepting additional petroleum products at Wood River, Illinois from other pipelines or barges and transporting the commodity to its Hammond, Indiana terminal. 59/ The fact that demand will not support Explorer's or other pipelines abilities to fill portions of their systems to Chicago from St. Louis during the peak period is a telling comment on the inability of Explorer to exercise significant market power in Chicago during the peak demand for petroleum products.

The Commission has previously concluded that pipeline and barge capacity are so extensive at St. Louis that Explorer will not be able to exercise significant market power in the St. Louis destination market. Given that there are two additional routes from St. Louis to Chicago, including Phillips and Marathon, the latter oriented to barges and the local refineries, it is

---

55/ See Volume 2 of Explorer's Application, Statement G at 33-34.

56/ Motion for Summary Disposition, Tab C at 48.

57/ Id., Exh. 49.

58/ The protesting parties do not contest that the Tulsa destination market is sufficiently competitive for Explorer to utilize market-based rates in that market. This implies that the capacity constraint on the Explorer system is between Tulsa and St. Louis.

59/ Explorer could achieve this by entering into through-rate arrangements with barges at Wood River that would cover the higher costs of a joint service based on demand in the Chicago market and its ability to capture some of the related value. On this record it has been unable to do so.

unlikely that Explorer will be able exercise significant market power in the Chicago market as well. Explorer might be able to raise prices in the St. Louis destination market and thereby price its capacity to assure that additional volumes flow over the St. Louis - Chicago portion of its line if the Chicago destination market warranted; however, whatever limited ability Explorer may have to influence prices in the St. Louis market (and the Commission concludes that it is limited) given the large amount of pipeline and barge capacity available to shippers, Explorer will not be able to exercise market power in the Chicago destination market. The fact that capacity is available on Explorer at Chicago indicates that shippers do not deem it worthwhile to pay to access that capacity based on the differentials available, and that therefore there is no rent for Explorer to capture at Chicago.

Explorer convincingly argues that there has never been a shortage of petroleum product in Chicago even at peak periods, and the record indicates a conservative excess capacity of some 1,018 MBD even during peak periods. 60/ Moreover, the Equilon and Seaway systems have added approximately 290,000 barrels per day of capacity for movement of petroleum products from the Gulf and Texas areas to the Midwestern consuming markets. This increased the pipeline capacity to supply petroleum products to the Midwestern market by some 22 to 24 percent. 61/ Since these markets are also served by products flowing out of refineries at Chicago, the increased delivery capacity serves to compress the competitive reach of the Chicago refining hub, particularly if, as CITGO asserts, the Chicago refineries are not as efficient as those located in the Gulf Coast area. Thus any increase in capacity serves to increase the excess capacity ratios in the Chicago area and increase the competitive pressures on all suppliers that are participating in that market. 62/ Given the aggressive nature of entry in the Houston to Midwest

---

60/ Motion for Summary Disposition, Tab C at 49.

61/ Id. at 43-44.

62/ The Chicago BEA is a major petroleum refining and distribution center for the Midwest and products flow out of the area to serve adjoining areas. However, when additional product flows into those areas from the Houston and Gulf Coast refineries, this increases the total supply and serves to reduce the market reach of the Chicago area, particularly if, as CITGO claims, it is true that the Gulf Coast refineries are more efficient. Thus, unless capacity is reduced in the Chicago market, competition in the market increases. CITGO's intention to sell its own refinery may be one indication of the increasing pressure from increased pipeline capacity in the Midwestern market.

corridor, 63/ the willingness of CITGO's pipeline to enter into a joint market-based rate with Williams, and the presence of expandable refinery capacity in Chicago, including CITGO's, the Commission concludes that CITGO has ample opportunity to protect itself from the exercise of significant market power by Explorer in the Chicago destination market.

The Commission recognizes that there may be some increase in some of Explorer's rates if it is authorized to utilize market-based rates. However, the protesting parties' arguments that there should not be an increase in rates to reflect the tightening of capacity in peak periods is inconsistent with the Commission's recent recognition that at least some differential pricing, i.e. pricing based on demand, is lawful and appropriate in the oil pipeline industry. 64/ Differential pricing, when constrained by effective competition, can materially improve the efficiency of transportation markets by allocating capacity to those shippers who value it the most, particularly in markets involving different degrees of geographic or seasonal variation. CITGO's statement that it must reserve off-peak capacity to obtain peak capacity reflects the use of pro-rationing rather than pricing to allocate capacity in periods of relative shortage. This is a reflection of the current inefficient pricing that is occurring on the constrained sections of Explorer's system.

Moreover, it is clear that the use of discounting during the off-period has not succeeded in flattening demand over a twelve-month period. Both parties agree that when Explorer attempted to reduce its volume discounts, thereby increasing the rate on large volume contracts, CITGO canceled its related volume contract. 65/ CITGO argues that it offered to increase the annual rates by 10 percent if Explorer would not file for market-based rates. However, the increase in the volume discounted rates was in the nature of 5 to 7 cents per barrel on a base tariff of $2.00, a minimum increase. This demonstrates that the 10 percent increase offered by CITGO could not be collected by Explorer since the

---

63/ The Commission has recognized that the evaluation of potential competition is inexact, but that it is clearly relevant to determining the competitiveness of a particular market. See Williams, 68 FERC at 61,667.

64/ See Williams Pipe Line Company, 84 FERC ¶ 61,022 (Opinion No. 391-B)(1998). The Commission has previously recognized that the fact a price increase results (or may result) from the use of market-based rates does not necessarily mean that the pipeline possess significant market power. Williams, 71 FERC at 62,145).

65/ Motion for Summary Disposition, Tab A at 9.

increased revenues could be collected only during a relatively short peak period and would go begging during the balance. This shows that the 10 percent increase in the maximum annual tariff rate offered Explorer by CITGO had only modest prospects of increasing Explorer's revenues. 66/ Explorer asserts that it is unlikely to generate sufficient revenue to warrant expansion because of the seasonal risk involved as long as the current rate structure is in effect. 67/ This is because the relatively low volumes Explorer transports in the off-peak periods, in conjunction with the discounts required to move those volumes, would not generate revenues that appear to be implied by a 10 percent increase in an under-utilized annual rate. While CITGO disagrees, the fact that additional capacity is deterred at the same time a major shipper believes that it should be constructed is another sign that the current pricing structure is inefficient.

At bottom, CITGO and Center Oil are arguing that they should have the right to ship products in a specific corridor at a regulated rate without the risk that an additional portion of the peak period value of the petroleum products will be shifted to the pipeline. The Commission recognizes that if there is a lack of effective competition in a market and the Commission concludes that the pipeline has the ability to exercise significant market power, then the Commission will assert its jurisdiction to assure an equitable allocation of risk and return among shippers and a pipeline. 68/ Thus, in the absence of effective competition, the Commission does not leave the power to determine how rents should be allocated solely to the pipeline. However, if sufficient competition exists to prevent the exercise of significant market power, the allocation of rents and risk should be left to market forces since markets are more efficient than regulation in such circumstances. 69/ The fact that the pipeline may be able to increase rates during a period of tight demand and allocate to itself a greater portion of the rents than would be the case under a cost-of-service rate does not preclude authorizing the pipeline to implement a market-based rate regime. Given the degree of competition present in the Chicago and St. Louis destination markets, the Commission concludes the use of seasonally-based differential pricing that underpins Explorer's application is appropriate here.

66/ Id.

67/ Id. at 4.

68/ SFPP. L.P., Opinion No. 435, 86 FERC ¶ 61,022 (1999); Williams Pipeline Company, Opinion No. 391-B, 84 FERC ¶ 61,022 (1998) at 61,106.

69/ Order No. 572, FERC Regulations and Preambles, at 31,180.

The Commission finds that Explorer's origin markets are not at issue here and that market-based rates are acceptable from those markets. The Commission also finds that Explorer has adequately demonstrated that it lacks significant market power in all of its destination markets. Therefore Explorer may file tariffs that apply market-based rates in all of its markets.

On May 26, 1999, Explorer filed in Docket No. OR99-1-001 a petition for waiver of the Commission's index regulations. Section 342.3(e) would require Explorer to reduce its rates by about two percent on July 1, 1999, in the absence of a waiver or authorization to utilize market-based rates. Since the Commission is authorizing Explorer to utilize market-based rates, the waiver is unnecessary and the request is dismissed as moot.

The Commission orders:

(A) Explorer's application for a market power determination is granted for all of its origin markets and destination markets.

(B) Explorer's request for a waiver of the Commission's indexing regulations is dismissed as moot.

By the Commission.

(S E A L)

David P. Boergers

David P. Boergers,
Secretary.

Docket Nos. OR99-1-000 and 001

Appendix A

Effective Capacity-Based Statistical Results
For the Destination Markets

Market	HHI	Market Share %	Excess Capacity Ratio
Houston			
Internal Suppliers Only	1028	7.9	5.8
With 75 mile external suppliers	943	7.5	6.1
With 100 mile external suppliers	697	5.3	8.6
Dallas			
Internal Suppliers Only	1579	23.2	1.8
With 75 mile external suppliers	1499	22.4	1.9
With 100 mile external suppliers	1372	20.9	2.0
Tulsa			
Internal Suppliers Only	1154	12.8	7.8
With 75 mile external suppliers	1131	12.6	7.9
With 100 mile external suppliers	1039	12.1	8.3
St. Louis			
Internal Suppliers Only	1390	18.7	4.9
With 75 mile external suppliers	1387	18.6	5.0
With 100 mile external suppliers	1377	18.5	5.0
Chicago			
Internal Suppliers Only	1500	23.4	3.7
With 75 mile external suppliers	1493	23.3	3.7
With 100 mile external suppliers	1484	23.3	3.7