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Buckeye Pipeline Company, L.P.
Opinion No. 360
53 FERC ¶ 61,473 (1990)

On February 12, 1990, the Presiding Administrative Law Judge (ALJ) rendered an Initial Decision in Phase I (50 FERC ¶ 63,011 (1990)) finding that Buckeye Pipeline Company, L.P. (Buckeye) lacked significant market power in all of its relevant markets. (Id. at 65,064). Exceptions to the Initial Decision were filed by the Air Transport Association (ATA) and the Commission's Trial Staff (Staff).

Opinion No. 360 (53 FERC § 61,473 (1990)) dealt with the scope of Buckeye's market power in and between seven northern and northeastern states. It also addressed Buckeye's proposed experimental program for rate regulation in its competitive markets. This was commonly referred to as "light-handed regulation."

Opinion No. 360 affirmed the Initial Decision with respect to fifteen markets. It found that Buckeye had significant market power in five markets, while in the two remaining markets the Commission found that Buckeye had no tariffs on file to serve these markets. Therefore, it was unnecessary to analyze them and made no finding with respect to these two markets. (Id. at 62,662-63).

Opinion No. 360 affirmed: (1) the ALJ's definition of the relevant product market as the transportation by pipeline of refined petroleum products. (Id. at 62,663); (2) the ALJ's use of Bureau of Economic Analysis markets - the so-called BEA's - to determine each relevant geographic market (Id. at 62,663); (3) that the primary statistical tool used to measure market concentration was the Herfindahl - Hirschman Index (HHI) (Id. at 62,666-67); and (4) that the use of delivery data, e.g., deliveries into each BEA, was the best method to calculate an HHI for each Buckeye market. (Id. at 62,667).

The Commission further stated that other factors, such as transportation alternatives available to shippers, were significant elements, along with market concentration and the potential entry into the market of nearby suppliers. They all were useful in evaluating whether Buckeye exercised significant market power in each of its markets. (Id. at 62,667).

Having found that Buckeye did not have significant market power over a large portion of its markets, the Commission stated that light-handed regulation was appropriate in those markets. (Id. at 62,680). It further stated, "The broad outline of Buckeye's proposal - to use price changes in markets where it lacks significant market power to set caps for price changes in its markets where it does have market power - is a regulatory approach we generally support, especially on a limited experimental basis." (Id. at 62,680).

The Commission accepted Buckeye's experimental proposal but only for a three-year period. It also required Buckeye to file annual reports detailing price and revenue changes in each of its markets. These modifications were due to the Commission's concerns with Buckeye's proposal for capping rate increases in markets in which it did not exercise significant market power. (Id. at 62,680).

OPINION NO. 360

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Buckeye Pipeline Company, L.P.,
Opinion No. 360,
Opinion and Order On Initial Decision
53 FERC ¶ 61,473 (1990).

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[¶ 61,473]

Buckeye Pipe Line Company, L.P., Docket No. IS87-14-000, et al. and *OR88-3-000*

Opinion No. 360; Opinion and Order on Initial Decision

(Issued December 31, 1990)

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, and Jerry J. Langdon.

[Note: The Initial Decision of the presiding administrative law judge issued February 12, 1990, appears at 50 FERC ¶ 63,011.]

Appearances

Christropher J. Barr and *David B. MacGregor* for Buckeye Pipe Line Company, L.P.

Roger B. Coven, Richard T. Williams, and *David A. Berg* for Air Transport Association of America

Lisa J. Gefen and *Kevin Hawley* for the Association of Oil Pipe Lines

Sherman S. Poland and *John Ladner* for Sun Pipe Line Company

Edward I. LeDuc for Texas Eastern Transmission Corporation

Michael D. Cotleur, Anja M. Clark, Kenneth M. Ende, Arnold H. Meltz, William Collins, and *Robin Nuschler* for the Staff of the Federal Energy Regulatory Commission

[Opinion No. 360 Text]

This is a bifurcated proceeding. In Phase I the Commission directed the presiding administrative law judge (ALJ) to make findings whether Buckeye Pipe Line Company, L.P. (Buckeye) has significant market power in the markets to which it transports or whether it is subject to effective competition in those markets. Phase II was intended to address how Buckeye's rates would be regulated, particularly in the markets, if any, in which Buckeye lacks significant market power. On February 12, 1990, the ALJ issued an Initial Decision in Phase I[1] finding that Buckeye lacks significant market power in all of its relevant markets.[2] The Air Transport Association

[1] 50 FERC ¶ 63,011 (1990).

[2] *Id.* at p. 65,064.

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(ATA) and the Commission's staff filed briefs on exceptions to the ALJ's Initial Decision.

The Commission affirms the conclusions of the ALJ with respect to 15 of Buckeye's markets, reverses the ALJ with respect to five markets, and finds that in two markets analyzed by the parties Buckeye has no tariff on file to serve the market. For Phase II of this proceeding, Buckeye has proposed a five-year experimental program by which its rates (including those for markets where Buckeye does not exercise significant market power) will be controlled by certain rate caps. The Commission has decided to allow Buckeye to implement its proposal with some modifications. However, with respect to the five markets in which the Commission finds that Buckeye exercises significant market power, the Commission will remand the case to the ALJ to determine the appropriate base rates to which the rate caps will apply and to resolve the amount of reparations, if any, to which ATA may be entitled in its pending complaint against Buckeye's rates.

I. Background

A. *Buckeye's System*

Buckeye is one of the largest independent oil pipelines, with over 3,400 miles of pipeline serving 10 states.[3] It is an operating partnership of a master limited partnership, Buckeye Partners, L.P. The Penn Central Corporation is the general partner of Buckeye Partners, L.P. Over 97 percent of Buckeye's service is interstate and thus subject to the jurisdiction of the Commission. Buckeye is solely a common carrier that neither owns nor controls the petroleum products that it transports. Buckeye's transportation rates are based on a volumetric, perbarrel basis. The Company receives no demand charges from its customers.

Buckeye transports petroleum products from refineries, connecting pipelines, and marine terminals owned by others to terminals. Each shipment moves through Buckeye's system as a separate and identifiable batch to the destination indicated by the shipper.[4]

Buckeye's markets span the northern part of the United States from Illinois to New York City with a spur line in the State of Washington. Most customers are either major integrated oil companies, major United States air carriers, or smaller marketing companies.[5] In the New York City area, Buckeye transports primarily jet fuel; however, outside of this area most of Buckeye's shipments are gasoline and distillate.[6]

B. *Procedural History*

This proceeding arises from a Buckeye filing on February 13, 1987, that proposed a six percent general rate increase and requested relief from section 4 of the Interstate Commerce Act (ICA) in order that Buckeye could charge lower rates for a longer haul than for a shorter haul to meet competition.[7] Buckeye's rate proposal would cover the transportation of petroleum products in and between the States of Illinois, Indiana,

[3] Buckeye Br. at 17

[4] *Id.*

[5] Buckeye owns a short pipeline segment in Washington State, which connects a marine terminal near the port of Tacoma with McChord Air Force Base. (Buckeye Br. at 19).

[6] Approximately 25 percent of Buckeye's total volumes transported are jet fuel; most of this jet fuel is transported within the New York City area.

[7] Under section 4, 49 U.S.C. § 4 (1979), a pipeline may not charge a higher rate for transporting products to a nearer destination than it charges for a farther destination, without obtaining FERC approval.

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Michigan, Ohio, Pennsylvania, New Jersey and New York. On March 3, 1987, USAir, Inc. (USAir) filed a protest and petition for investigation and suspension of the general rate increase. On March 10, 1987, Buckeye filed revised tariff sheets to withdraw the increases on jet fuel shipments ultimately received by USAir. Simultaneously, USAir withdrew its protest. On March 13, 1987, the Commission's Oil Pipeline Board issued an order that accepted Buckeye's revised filing subject to refund, suspended it for one day, temporarily approved the requested section 4 relief, and set the matter for hearing. Subsequently, ATA filed a petition to intervene out-of-time, which was granted by the Chief Administrative Law Judge on May 1, 1987.

On October 29, 1987, ATA filed a "Motion For Summary, Disposition" alleging that Buckeye had failed to establish that its rates, as increased, are just and reasonable. Following oral argument, the presiding ALJ issued an order denying the motion, but he required Buckeye to file supplemental direct testimony containing its rate design justification, cost-based or otherwise, pursuant to Buckeye's understanding of *Farmers Union Central Exchange v. FERC*. 734 F.2d 1486 (D.C. Cir. 1984), *cert. denied*. 469 U.S. 1034 (1984).[8] In that same order, the ALJ approved a late filed intervention of the Association of Oil Pipelines (AOPL).

On April 29, 1988, ATA filed a complaint against Buckeye's rates for the transportation of jet fuel and requesting the establishment of just and reasonable rates and the ordering of reparations back to January 1, 1987. The Complaint has been pending since it was filed.

Subsequently, Buckeye filed an interlocutory appeal to protect the confidentiality of requested data. On July 15, 1988, the Commission granted the interlocutory appeal. 44 FERC ¶ 61,006 (1988) (*Buckeye I*). *Buckeye I* found that while Buckeye's appeal was primarily directed to the narrow issue of whether certain cost-of-service data should be required, Buckeye had raised the issue of whether its proposal should be evaluated under some less strict standard than Opinion No. 154-B[9] that would not require production of the involved cost data. *Buckeye I* also noted that *Farmers Union II* would permit some form of lighter regulation where clearly identified non-cost factors such as competition or lack of market power may warrant departure from strict rate review.[10] The Commission then concluded that the proceeding should be bifurcated stating that:

> [T]o give Buckeye an opportunity to demonstrate that strict ratemaking scrutiny is not warranted in this proceeding, we will direct the ALJ to conduct the

[8] Hereafter cited as "Farmers Union II". This case vacated in part and remanded in part Opinion No 154, *Williams Pipe Line Co.*, 21 FERC ¶ 61,260 (1982), the Commission's first pronouncement on oil pipeline rate methodology after jurisdiction over oil pipelines was transferred to it from the Interstate Commerce Commission (ICC) by the Department of Energy Organization Act; Pub. L. No. 95-91, 91 Stat 565 (1977), codified at 42 U.S.C. §§ 7101-75 (1982) Opinion No. 154 was issued after the Court of Appeals remanded, at the request of the Commission, a pending appeal from an ICC decision rejecting a protest by shippers to the rate charged by the *William Brothers Pipe Line Company* (Williams), 351 I.C.C. 102 (Div. 2 1975), aff'd. on reconsideration, 355 I.C.C. 479 (1976).

[9] Subsequent to Farmers Union II, the Commission issued Opinion No. 154-B, which established a revised set of ratemaking principles and guidelines for oil pipelines, and identified a number of other issues for case-by-case determination. *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985); *see also* Opinion No. 154-C, 33 FERC ¶ 61,327 (1985). The Commission declared that Opinion No. 154-B was "a statement in compliance with the court's mandate that it fashion a 'proper ratemaking method for oil pipelines';" 31 FERC ¶ 61,377, at p. 61,838 (1985) (footnote omitted). Because the Commission approved a complete settlement of the underlying Williams case, 30 FERC ¶ 61,262, Opinion 154-B has not been reviewed by the court of appeals, but it remains as the Commission's standard for regulating oil pipelines.

[10] *Id.* at p. 61,185.

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proceeding in stages. In the first stage, the ALJ should evaluate evidence ... to determine whether Buckeye has market power in relevant markets and whether it is subject to effective competition in those markets. Buckeye should submit evidence in this proceeding that demonstrates its lack of significant market power in those markets in which it desires light-handed regulation. Once the ALJ makes a determination with respect to Buckeye's market position, we will direct him to forward his findings to the Commission so that we can determine whether Buckeye's proposed rates should be evaluated under the Opinion No. 154-B methodology or under a less strict standard.[11]

Subsequently, *Buckeye I* was clarified in certain respects by the Commission's October 7, 1988 Order Denying Rehearing and Clarifying Prior Order, 45 FERC ¶ 61,046 (1988) (*Buckeye II*). In *Buckeye II* the Commission determined, among other things, that the ALJ should allow the submission of cost based evidence with respect to the issue of Buckeye's market power.

Hearings began on April 4, 1989, and concluded on April 19, 1989. Testimony was submitted by Buckeye, the Commission's staff, ATA, and AOPL. One issue was litigated: whether Buckeye has significant market power in any of its relevant markets. On February 12, 1990, the ALJ issued an Initial Decision that found "that Buckeye has shown it lacks significant market power in each of its relevant markets at the present time."[12] On March 14, 1990, ATA and staff filed Briefs on Exceptions to the Initial Decision. On April 3, 1990, Buckeye filed a Brief Opposing Exceptions.

C. *Initial Decision*

As noted, the ALJ found that Buckeye lacks significant market power in all of its relevant markets. For the purpose of making these findings, the ALJ determined that the relevant product market was the transportation of refined petroleum products. In so doing, the ALJ rejected the position advanced by ATA that the product market should be markets in which Buckeye transports only jet fuel. He concluded that the relevant geographic markets were the areas that include all supplies of transportation from all origins to United States Department of Commerce, Bureau of Economic Analysis Economic Areas (BEAs).[13]

The ALJ stated that the concept of market power as developed in antitrust law refers to the ability to raise price above the competitive level without losing sales so rapidly that the price increase is unprofitable and must be rescinded.[14] The ALJ, relying on the consensus of the parties, determined for the purposes of this case, that significant market power is the ability to control market price by sustaining at least a 15-percent real price increase, without losing sales, for a period of at least two years. The ALJ noted that the Herfindahl-Hirschman Index (HHI), which calculates market concentration by summing the squares of the individual market shares of all the firms included in the market, is often used as a preliminary indicator in determining whether the Department of Justice (DOJ) will begin to challenge a merger under section 7 of the Clayton Act. The Commission has used an HHI of 1800 in evaluating market concentration in natural gas proceedings.[15] The DOJ Report *Oil Pipeline Deregulation* (DOJ Report) used an HHI of 2500 in a petroleum products transportation market as a

[11] *Id.* at p. 61,186.

[12] 50 FERC ¶ 63,011, at p. 65,064 (1990).

[13] BEAs are geographic regions surrounding major cities that are intended to represent areas of actual economic activity.

[14] 50 FERC ¶ 63,011, at p. 65,048 (1990), quoting Landes and Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937 (1981).

[15] *See El Paso Natural Gas Co.*, Opinion No. 336, 49 FERC ¶ 61,262 (1989).

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threshold below which a market was presumed competitive.[16] The ALJ concluded that he would examine several discretionary factors in each of Buckeye's markets rather than automatically apply some threshold HHI.

In his analysis the ALJ examined Buckeye's competition in each of the relevant BEAs, as well as system-wide, to determine whether Buckeye has significant market power in any of these regions. The key factors he evaluated were: (1) the number and type of true economic transportation alternatives available to Buckeye's customers; (2) market concentration; (3) availability of excess capacity; and (4) the extensive vertical integration of large buyers, and patterns of joint, collaborative ventures that discourage competition in setting pipeline rates due to the monopsonistic power[17] of the pipeline's shippers. Other factors he considered on a system-wide basis included: (1) natural barriers to entry due to the fixed and costly nature of pipelines themselves; (2) advance posting of oil pipeline rates, which allows competitors quickly to match rate cuts, and thereby limits any increase in sales and profits that might result from the lower tariffs; and (3) the elasticity of demand for the products Buckeye transports.

The ALJ concluded that Buckeye had shown that it lacks significant market power in each of its relevant markets. The ALJ also concluded that given the presence of numerous competitors and the possibility of new entrants, Buckeye appeared incapable of sustaining at least a 15-percent real price increase for a period of at least two years without losing substantial sales.[18] Although ATA argued that Buckeye exercised significant market power in all of its markets, the ALJ did not agree, concluding that even in the more concentrated BEAs such as Pittsburgh, Buckeye has acquired its market share by providing quality service at competitive rates. The ALJ also noted that factors such as the presence of excess capacity and the widespread use of product exchanges that allow a shipper to bypass Buckeye's system, prevented Buckeye from exercising significant market power.

II. Discussion

Under section (5) of the Interstate Commerce Act, 49 U.S.C. §(5) (1976), the Commission has discretion in fulfilling its responsibilities under the just and reasonable rate standard. With respect to the Commission's responsibilities under *Farmers Union II*, the Commission noted in *Buckeye I* that clearly identified non-cost factors such as competition or lack of market power may warrant departure from strict rate review. The Commission went on to note that if a pipeline were to receive the benefit of such light-handed regulation, it must demonstrate that it lacks significant market power in the relevant markets.[19] It was with this in mind that the Commission ordered this proceeding to be bifurcated, and directed the ALJ to conduct a full evidentiary hearing on the market power issue to determine whether Buckeye has market power in relevant markets or whether it is subject to effective competition in those markets.[20]

Of the 22 markets examined in Phase I, the Commission affirms the ALJ's finding that Buckeye lacks significant market power in the following 15 markets: Scranton-Wilkes Barre; Pittsburgh; Harrisburg-York-Lancaster; Philadelphia; Columbus; Lima; Toledo; Detroit; Saginaw-Bay City; Fort Wayne; Kokomo-Marion; Indianapolis; Hart-

[16] Staff asserts that 17 of 18 Buckeye markets evaluated by it have an HHI not only above 1800, but are also above 2500.

[17] Monopsony is a situation where there is only one buyer or predominant buyer for the product or services of sellers that can control how much will be paid for the product.

[18] As noted, there was a general agreement among the parties to this proceeding that a sustained 15-percent price increase would be the minimum requirement for a finding of significant market power.

[19] 44 FERC ¶ 61,066, at pp. 61,185-186 (1988).

[20] *Id.* at p. 61,186.

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ford-New Haven-Springfield; Seattle and Terre Haute. Because Buckeye has no tariffs on file to serve the Youngstown-Warren and Buffalo markets, the Commission makes no findings with respect to those two markets. The Commission finds that the New York City Market should continue to be regulated because the record is insufficient to make a finding of Buckeye's market power in that market. The remaining four markets, Syracuse-Utica, Rochester, Binghampton-Elmira, and Cleveland, are found to be markets in which Buckeye has significant market power.

In conducting our analysis of Buckeye's market power, as described below, we have first defined the product and geographic markets. We have then evaluated whether Buckeye has significant market power in those markets by first doing an initial screen for market concentration in each market (using the Herfindahl-Hirschman Index) and then considering, weighing and balancing a number of factors. The HHI used for each market as an initial screen was the initial HHI calculated by the staff witness based on actual deliveries into the market. Unless the market had a particularly low HHI, as in the case of the Philadelphia market, the Commission has further analyzed the market, weighing evidence of such factors as the potential entry of competitors into the market, available transportation alternatives, market share, availability of excess capacity, and the presence of large buyers able to exert downward monopsonistic pressure on transportation rates. The Commission has concluded whether, on balance, these factors establish that Buckeye has significant market power in any particular market that necessitates continued close regulatory oversight of its rates.

A. *Relevant Markets*

The ALJ appropriately found that before market power may be assessed, the relevant product and geographic markets must be defined.[21] The ALJ then determined that the relevant product market is the transportation of refined pipeline petroleum products and, as noted, the relevant geographic markets are BEAs.[22] He concluded that his proposed market definition was consistent with: (1) an extensive body of antitrust laws developed over 100 years by the courts and the Federal Trade Commission;[23] (2) the DOJ Merger Guidelines;[24] and (3) expert testimony from economists and professionals experienced in the oil pipeline industry.[25]

Staff and Buckeye agree with the findings of the ALJ. However, ATA avers that a properly defined relevant market will include all of the alternative transportation services that compete with the transportation service offered by the subject firm (the relevant product market) and the area in which such services are provided (the relevant geographic market). ATA believes that the relevant product market should be jet fuel, while the relevant geographic market should be the individual airports to which Buckeye transports jet fuel. ATA contends that its witnesses applied a systematic analysis based on sound economic principles to define the relevant product and geographic markets in which Buckeye operates.[26]

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[21] 50 FERC ¶ 63,011, at p. 65,046 (1990).

[22] *Id.*

[23] *Id.* at pp. 65,043-44, 65,046-47, fn.13.

[24] In an attempt to establish uniformity in analyzing mergers, the Antitrust Division of DOJ issued a set of merger guidelines in 1984 that include a proposed framework for identifying relevant and geographic markets. 50 FERC ¶ 63,011, at p. 65,047, fn.18.

[25] *Id.* at p. 65,046.

[26] The ATA witnesses addressed only those markets in which Buckeye transports significant amounts of jet fuel.

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While ATA asserts that the ALJ should have adopted a product market definition limited to the transportation of jet fuel,[27] the ALJ correctly pointed out that accepting ATA's position would overlook the fact that Buckeye's rate increase affects all its customers and not just jet fuel customers (except USAir and those customers at the New York City and Newark Airports) The ALJ stated that other refined petroleum products are transported in greater quantity on the Buckeye system. The ALJ also pointed out that the acceptance of ATA's contention would mandate separate consideration of each product carried by Buckeye and each use to which each product could be put.[28]

As staff witness Dr. Ogur explained in his testimony, if a threshold increase in the product price encourages enough consumers to switch to substitute products, then the group of products are all included in the product market.[29] ATA's approach fails to take into consideration that the substitution of the transportation of one petroleum product for the transportation of another petroleum product is nearly universal among pipelines.[30] Although petroleum products are not generally substitutes in use, oil pipelines such as Buckeye can easily substitute the transportation of one petroleum product for another.[31] The obvious advantage to such substitution is that shippers, who are wholesale distributors, can earn higher profits by selling more of the product for which the price has risen. This same analogy applies to substitution in production. As Dr. Ogur noted, if producers of a substitute product can switch production within one year and supply the product that increased in price, then both the product and the substitute product can be classified in the same product market based on their substitution in production if there is evidence that their prices move together.[32] The reasoning is that if producers can switch production from a substitute product to the product whose price was increased, that higher price will not be able to be maintained.[33]

Dr. Ogur used jet fuel as an example of how substitution on the production side can change one's assessment of the relevant product market. He pointed out that viewed only from the consumption side, one may conclude that buyers are unable to substitute any other fuel for jet fuel. On the production side, however, refiners who produce jet fuel and gasoline may be able to switch their production mix in response to an increase in the price of jet fuel. If a threshold increase in the price of jet fuel causes refiners to produce more jet fuel and less gasoline, and if the price of gasoline also increases, jet fuel and gasoline are in the same product market. The ease of product substitution among pipelines is an important reason why the relevant product market should be the transportation of refined petroleum products rather than the transportation of a specific petroleum product, such as gasoline, fuel oil or jet fuel. Thus, the record shows that the relevant product market is the transportation of refined petroleum products from all origins to a particular destination. Plus, the rates at issue here are for the movement of refined products by shippers, generally refiners, not for just the movement of jet fuel. Accordingly, we affirm the ALJ's definition of the relevant product market.

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[27] ATA Reply Br. at 85.

[28] 50 FERC ¶ 63,011, at p. 65,046 (1991).

[29] Exh. S-3 at S-1.

[30] See 49 FERC ¶ 61,262, at pp. 61,905-06 (1989).

[31] In some cases, petroleum products do substitute in use. For example, jet fuel is blended with some heating oils. The extent of such blending can vary with the price of jet fuel relative to the price of heating oil. (See, e.g., Exh. B-93 at 13-17).

[32] Exh. S-1 at 12-13; Exh. S-19 at 10-11.

[33] Exh. S-19 at 10-11.

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As to ATA's argument that the relevant geographic markets are the individual airports to which Buckeye transports jet fuel,[34] the record supports the ALJ with respect to his finding on geographic markets. ATA has not supported its position that the geographic markets should be individual airports. The primary purpose of the geographic market definition is to identify an area in which the price of the relevant product is largely determined by the buyers and sellers within the area. Thus, as the ALJ noted, expert economic witnesses for Buckeye, staff, and AOPL each testified that the relevant geographic market is an area at least as large as a BEA.[35] Those expert witnesses based their conclusions on the suitability of BEAs, traditional economic theory, Supreme Court precedent and the DOJ Merger Guidelines. The ALJ also indicated that the DOJ Report used 181 BEAs as a basis for organizing data on the geographic scope of markets for oil pipelines and other competing facilities. Both the NERA Report and the DOT/DOE Report use BEAs as the appropriate measure for the geographic market of oil pipelines.

The analytical process in determining a geographic market is similar to that used in defining the relevant product market. The goal is to identify an area in which a hypothetical monopolist can profitably impose a small but significant and nontransitory increase in price.[36] Given the prevailing price of the relevant product, the threshold price increase is used to estimate the ability of buyers to avoid the price increase by purchasing the same product from sellers in other areas. In his analysis Dr. Ogur assumed a threshold price increase in the initial geographic area. He then looked for evidence that buyers could travel to sellers in other areas and for evidence that sellers in other areas could ship into the area in question. If buyers can avoid a price increase in either manner, then the geographic market must be expanded to include the other area of competing sellers.[37] The process is repeated until a geographic market is defined within which the price increase can be profitably imposed on buyers.

Based upon such an evaluation, Dr. Ogur concluded that a BEA was a reasonable approximation of the relevant geographic market for the delivered product.[38] In effect what Dr. Ogur did was to consider the smallest geographic area that seemed reasonable. Given the presence of competitive trucking for final distribution within a BEA, Dr. Ogur determined that a threshold price increase by a pipeline to one point would not be profitable and thus concluded that an area smaller than a BEA did not appear to be a reasonable geographic market.[39]

Dr. Ogur again used jet fuel as an example and concluded that a single airport is not a relevant geographic market.[40] Dr. Ogur noted that a customer airline could avoid a price increase at one airport by reducing its fuel purchases at that airport and substituting increased purchases from other airports.[41] Thus, we conclude that the evidence of record supports the findings of the ALJ. BEAs are shown to be appropriate geographic markets since they are convenient, easily identified and have been used in past studies of the oil pipeline industry. The ALJ's geographic and product market definitions are consistent with the definition adopted by many studies of market power in this industry.[42]

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[34] Exh. ATA-22 at 6.

[35] 50 FERC ¶ 63,011, at p. 65,047 (1990)

[36] See Exh. S-3 at 5-3

[37] Exh. S-19 at 14

[38] See Exh. S-1 at 13

[39] Tr. at 2491.

[40] Exh. 19 at 15

[41] See Exh. 18 at 10, where Dr. Ogur noted the suggestion by ATA witness Mr. Watson (Exh. ATA-8 at 18) that a typical airline buys 50 percent or more of its fuel at four or five airports.

[42] See the DOJ Report; National Economic Research Associates, Inc., Competition in Oil Pipeline

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B. *Measuring Market Power*

The ALJ, as well as the parties generally, agreed that market power is the ability to profitably raise price above the competitive level for a significant time period. The ALJ then went on to define significant market power as the ability to control market price by sustaining at least a 15-percent real price increase, without losing sales, for a period of at least two years. He stated that the parties were generally in agreement that this standard was acceptable as a minimum requirement for finding significant market power. However, while staff agreed with the 15 percent figure as a minimum, it believes that the adoption of the 15 percent standard would narrow both product and geographic market definitions and increase the likelihood of erroneously finding market power. Staff argues that this definition is inadequate because it fails to consider whether the exercise of market power results in a reduction in output, thereby causing a misallocation of society's resources. The Commission finds that the ALJ's definition of significant market power is adequate in this proceeding. This is especially so, since Buckeye has never tried to raise its rates by more than 15 percent over a two year period.

The ALJ did not make a product price analysis in determining that Buckeye lacks significant market power. Staff argues that the ALJ's failure to take delivered product prices into account makes his market power findings unreliable. Staff argues further that the key to competitive delivery of petroleum products into a market from different supply sources is the delivered price of the product, including all transportation costs and the product price from the source. ATA makes a similar argument, noting that unless the product prices can be shown to be the same, the only real competition that Buckeye faces in each market is from the transportation alternatives from Buckeye's origin.

We conclude that the relevant price for the purposes of making a determination of whether Buckeye can profitably increase its transportation prices above the competitive level is the delivered product price. Because shippers or customers in the destination market often have the option of switching away from purchasing transportation into the market, and, instead, purchasing the delivered product itself, suppliers of transportation must compete with suppliers of the delivered product.[43] For example, a fuel oil distributor that purchases transportation for its product on a common carrier pipeline such as Buckeye may have the option of purchasing delivered fuel oil from a proprietary pipeline. In addition, if a nearby refinery can profitably deliver product by truck into a destination market, the final consumer can avoid an increased pipeline tariff by purchasing the refinery's delivered product. Therefore, any market power that might be exercised by transportation suppliers can be limited by delivered product suppliers who provide both product and transportation. The competition between transportation suppliers can only be evaluated in the destination market where the ultimate consumer can choose among these alternatives.

1. Market Concentration

The ALJ identified market concentration as one of the factors to be considered in determining market power. He acknowledged that HHIs as applied under the DOJ Merger Guidelines serve as preliminary threshold measures of market concentration,

(Footnote Continued)

Markets: A Structural Analysis (April 1983) ("NERA REPORT"); the Secretaries of the Departments of Transportation and Energy, National Energy Transportation Study, A Preliminary Report to the President (July 1980) (DOT/DOE Report).

[43] Exh. S-1 at 8.

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but he then concluded that the identification of the number and type of true economic alternatives available to buyers of petroleum transportation services should have paramount importance. Accordingly, the ALJ conducted an analysis of each market on the basis of several qualitative factors that he concluded were pertinent to the question of market power, and determined that Buckeye did not exercise significant market power in any market. His analysis specifically addressed the 11 Buckeye markets that were contested.[44]

ATA argues that market concentration is the primary indicator of how competitive a market is likely to behave. ATA further contends that the ALJ virtually ignored the high concentration of Buckeye's markets in his analysis. Staff also argues that the ALJ's analysis skips any meaningful evaluation of market concentration. Staff contends that the ALJ should have established an HHI in each market served by Buckeye, and that his failure to establish an HHI threshold makes his analysis unnecessarily susceptible to erroneous findings.

We conclude that an analysis of market concentration using HHIs should be the first step in evaluating the likelihood of market power being exercised in a given market. Knowing the degree of concentration in a market provides useful information about where on the competitive spectrum that market likely lies and what other factors will have to be weighed to enable a finding as to the existence or absence of significant market power.[45] For measuring market concentration, we conclude that a proper screening device is an HHI.[46] We also conclude that the use of delivery data, *e.g.*, deliveries into each BEA, is the best method for calculating HHIs here.

2. Other Factors

The ALJ identified the number and type of true economic transportation alternatives available to buyers of petroleum transportation service in each relevant BEA as the most important factor to consider in evaluating Buckeye's market power.[47] However, both ATA and staff argue that much of the evidence that the ALJ relied on in finding that Buckeye lacks significant market power in all of its relevant markets consists of a mere listing or identification of supply alternatives.

Consideration of transportation alternatives is significant in any market power analysis, and we agree that it is not the only factor that should be looked at in evaluating market power. However, the ALJ did not rely exclusively on transportation alternatives as establishing whether a market is competitive. Instead, he included a number of other indicia of market power, as discussed above, in his evaluation. We consider each of those factors to be significant elements, along with market concentration and potential entry,[48] to be weighed and balanced for each market in evaluating

[44] The 11 BEAs that the ALJ addressed were: New York City (including JFK, La Guardia and Newark airports, specifically), Pittsburgh, Detroit, Cleveland, Columbus Rochester, Buffalo, Hartford-New Haven-Springfield, Syracuse, Binghampton-Elmira and Indianapolis.

[45] Market concentration is a function of the number of firms in a market and their respective market shares, and HHIs are an appropriate and widely used measure of market concentration. However, a high HHI does not necessarily establish that an individual firm has significant market power. The HHI serves merely as an initial screen, or threshold, to indicate the degree of concentration in a market.

[46] Under the DOJ Merger Guidelines, if an HHI is less than 1000, the market is viewed as competitive. If the HHI exceeds 1800, significant market power may be exercised, and the DOJ will examine entry conditions and other factors to determine whether a proposed merger is likely to increase market power. Staff recommended the use of an 1800 threshold, consistent with the approach suggested in the DOJ Merger Guidelines and the approach taken by the Commission in the natural gas area.

[47] 50 FERC ¶ 63,011, at p. 65,049 (1990).

[48] Potential entry is the ability of nearby suppliers to serve a market if current suppliers attempt to increase profits by raising the market price. Nearby

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whether Buckeye exercises significant market power in that market. In the Commission's specific analyses of the contested markets set forth below, we have considered each of these various factors and weighed each of them to determine whether, on balance, each market is one in which Buckeye can exercise significant market power.

3. Interdependent Pricing

The ALJ concluded that interdependent pricing, or collusion, had little relevance to this proceeding. He found that to the extent collusion was a relevant issue, there is simply very little likelihood of collusion in this case because of unregulated intermodal competition, excess capacity, shipper/competitors, large buyers, lack of meaningful posted prices and quality of service considerations.

ATA argues that without a thorough evaluation of whether dominant firms in highly concentrated markets are likely to be able to exercise significant market power jointly, the ALJ's analyses of the BEA-markets in which Buckeye operates are simply inadequate to support any conclusions in this proceeding. However, ATA did not present any evaluation of interdependent pricing in order to support its position or show that collusion, or the possibility of collusion, is present in any of Buckeye's contested markets.

Staff argues that the characteristics of Buckeye's high HHI markets make it unreasonable to assume that Buckeye and all other suppliers in the markets served by Buckeye are acting independently of each other. To support its argument, staff did evaluate the potential for collusion. Staff's analysis concluded that three factors (product homogeneity, large buyers, and excess capacity) tended to discourage collusive behavior, one factor (public announcement of prices) tended to facilitate collusive behavior, and one factor (small, frequent purchases) was inconclusive due to lack of information.[49] However, the analysis was only able to determine whether each factor tended to increase or decrease the likelihood of collusive behavior. Moreover, the five factors did not all support the same finding. Staff, therefore, was unable to determine the net impact of these other factors on the likelihood of collusive behavior. As a result, staff's consideration of the potential for collusive behavior proved to be indeterminate.[50]

The ALJ is correct that there is no record evidence of overt collusion and that, absent evidence, overt collusion has no relevance to this proceeding. The concept of interdependent pricing, however, is broader than overt collusion; it includes "tacit collusion" and other forms of cooperative, as compared to competitive, behavior. The Commission recognizes that collusion and interdependent pricing are not synonomous. We agree with the ALJ that opportunities for collusion are insignificant and have no relevance in this case. However, we disagree with the ALJ about the unimportance of interdependent pricing. In highly concentrated markets, pricing behavior of one firm will likely have a direct impact on the market position of its competitors, and firms are likely to weigh the market ramifications of pricing decisions and likely actions of rivals

(Footnote Continued)

suppliers need not actually enter the market. All that is required is that they have the capability or potential to enter the market. Since potential entry can limit the market power of current suppliers, the ability of a firm or group of firms to exercise significant market power over a substantial period of time will depend, to a large extent, on the strength of potential entry.

[49] The ALJ rejected the significance of public announcement of prices because trucks and proprietary pipelines do not post prices. However, Buckeye's public announcement of prices can serve as a focal point for others attempting to match Buckeye at a price above the competitive level.

[50] See staff's Brief on Exceptions at 51.

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before changing their prices. In less concentrated markets, firms behave more as "price-takers" and make pricing decisions based only on the particular circumstances of their firm and do not account for any anticipated market response. As the Commission stated with respect to El Paso Natural Gas Company, the HHI is an "indicator of the likelihood that El Paso together with other suppliers can jointly exercise market power in a given market."[51] A high HHI indicates that cooperative behavior may be a concern and that other factors, such as those considered by staff and the ALJ affecting the potential for cooperative behavior, should be considered. Accordingly, the Commission does consider and weigh factors that might affect cooperative behavior in markets where the HHI indicates that such behavior may be of concern.

C. *Analysis of Buckeye's Markets*

1. The Markets In Which Buckeye Does Not Have Significant Market Power

The ALJ did not specifically discuss the Scranton-Wilkes Barre, Harrisburg-York-Lancaster, Philadelphia, Lima, Toledo, Saginaw-Bay City, Fort Wayne, and Kokomo-Marion markets because they were uncontested. Accordingly, after conducting an independent evaluation of these markets, we affirm the ALJ's findings as to these markets and discuss below only the contested markets.

a. *Pittsburgh BEA*. The Pittsburgh BEA was found by staff to have an initial HHI of 2561. ATA, however, argues that this is a highly concentrated market with an HHI of 3531. The ALJ noted that high market share in a concentrated market will not, by itself demonstrate that Buckeye possesses significant market power.[52] The ALJ then went on to find that Buckeye lacks significant market power in this market. In reaching this conclusion, the ALJ first found that Buckeye faces potential competition from barges.[53] The ALJ then found that shippers could switch volumes on Buckeye from a long-haul to a short-haul route to save on transportation costs.[54] The ALJ also relied on the presence of USAir, a purchaser of 65 percent of the product transported to the Pittsburgh Airport, to constrain Buckeye's prices.[55]

We affirm the ALJ's finding with respect to the Pittsburgh BEA and conclude that Buckeye lacks significant market power in the Pittsburgh market. The evidence supports the ALJ's conclusions regarding competitive transportation, alternate routes, and the presence of a large shipper in the market that can exert downward pressure on Buckeye's rates. The record also shows that there is considerable excess capacity in the market.[56] In addition, in Dr. Ogur's evaluation of the extent to which potential entrant trucking firms could profitably serve the Pittsburgh BEA, he calculated an HHI of 2102 for Pittsburgh. This HHI suggests a degree of market concentration that, when considered with Buckeye's 43.7 percent market share, makes the decision with respect to this market a close call. However, after considering the nature and quality of the transportation alternatives relied on by the ALJ and the amount of excess capacity in the market, we conclude that Buckeye does not have significant market power in the Pittsburgh BEA.

b. *Indianapolis BEA*. The ALJ concluded that Buckeye lacks significant market power in this BEA because Buckeye's market share is only two percent and because

[51] Opinion No. 336, *supra*, 49 FERC at p. 61,919.

[52] 50 FERC ¶ 63,011, at p. 65,055 (1990).

[53] The ALJ found staff's arguments that Buckeye faced potential competition from trucks to be unconvincing. *Id.*

[54] *Id.* at p. 65,056.

[55] *Id.*

[56] *See* Exh. B-69, at 4-5; Exh. B-23 at 20.

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there are six pipelines that compete with each other as well as with trucks. ATA claims that its estimated HHI of 4687 shows that this is a highly concentrated market. We agree with the findings of the ALJ.

As the ALJ pointed out, Marathon acquired Rock Island Refining Company in February 1987, and since then has had, by ATA's own estimate, over 64 percent of the market, with the rest of the deliveries into the market being made by other pipelines and trucks. This fact alone belies ATA's claims of Buckeye's market power. The record also shows that Buckeye not only lacks market share, but that there is substantial excess capacity in this market, since total deliveries amount to 114,400 bbl per day, while total pipeline capacity amounts to 368,000 bbl per day. Finally, the DOJ report calculated the HHI for this BEA to be 1400. After weighing all of these factors, we find, on balance that Buckeye does not have significant market power in the Indianapolis BEA.

c. *Detroit BEA.* The ALJ concluded that Buckeye lacks significant market power in the Detroit BEA. He based his conclusions primarily on the availability of substantial excess capacity on the four pipelines serving the market that act as a strong disincentive to raising rates. He also concluded that exchanges affect Buckeye's competitive posture since its two biggest shippers are major oil refiners with the ability to exchange barrels, shift sources, and bargain with Buckeye to satisfy their transportation needs at the lowest possible costs. The ALJ found further that Buckeye's ability to increase prices is constrained by the presence of Northwest Airlines, which has its own fuel terminals and feeder pipelines at the airport and accounts for 61 percent of the jet fuel transported to the airport. The ALJ also noted that Marathon's refinery in Detroit could produce jet fuel and that trucking from Toledo refineries provide some competitive restraint.

ATA argues that the record does not indicate that Buckeye faces effective competition for deliveries to the Detroit BEA, and that the delivery based HHI for Detroit is 2252. Staff, on the other hand, supports the findings of the ALJ and calculates an HHI adjusted to account for potential entry at 1600.

We agree with the findings of the ALJ. As established in the record, there is significant competition both from other pipelines and from trucks, plus significant downward pressure on Buckeye's rates from large shippers. Buckeye's share of this market amounts to 38.5 percent, but there is substantial excess capacity in the BEA — total deliveries amount to 190,900 bbl per day, while total capacity on the four pipelines serving the market amounts to 434,000 bbl per day. After weighing all of these factors, we conclude, on balance, that Buckeye does not have significant market power in the Detroit market.

d. *Columbus BEA.* The ALJ concluded that Buckeye lacks significant market power in the Columbus BEA. He found that almost 95 percent of the deliveries into this market are made by the three pipelines serving the BEA, but that trucking and barging, which are used to some degree, and considered to be a viable alternative to Buckeye at current rates, would become even more attractive should Buckeye raise its rates. The ALJ also found that Inland, which accounts for the greatest portion of the pipeline transportation into the Columbus BEA, is a significant competitor of Buckeye, even though it is a proprietary pipeline that serves only its partners. ATA had argued otherwise, but the ALJ concluded that since the Inland partners own the refineries at Toledo and Lima that supply much of the jet fuel to Columbus' airport, in the event of a Buckeye price increase, nothing would prevent airlines from buying products directly

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from the refineries and then having the refineries use Inland to transport directly to airports. Additionally, the ALJ pointed out that TransWorld Oil not only purchases 72 percent of the services to this market, so that it would seem to have monopsony power over Buckeye's pricing, but also is the principal interest partner in Buckeye's chief competitor Inland.

ATA claims that based on an HHI of 3048 for Columbus, there is no reasonable basis for concluding that Buckeye lacks significant market power or faces effective competition in the Columbus market. Staff, while unable to conclude if Buckeye lacks significant market power in this BEA because of an absence of pricing data, also found Buckeye to have an actual HHI of 3051, and concluded that the ALJ erred in finding that Buckeye lacked significant market power in the Columbus BEA. We do not agree. Buckeye's market share in this market is only 28.5 percent. In addition to the competitive factors considered by the ALJ, the record establishes that there is significant excess capacity in this market, with total deliveries amounting to 93,300 bbl per day and total pipeline capacity amounting to 142,000 bbl per day. After weighing all of these factors, we find, on balance, that Buckeye does not have significant market power in the Columbus market.

2. The Markets In Which Buckeye Has Significant Market Power

a. *Cleveland BEA.* The ALJ concluded that Buckeye lacks significant market power in the Cleveland BEA, based entirely on his finding that three other pipelines serve the market, that the private Inland pipeline is a serious competitor for Buckeye, and that long-haul trucking from Toledo refineries and barging might become viable alternatives should Buckeye increase its rates. We conclude otherwise.

The ALJ determined that Inland offered serious competition to Buckeye because between Toledo and Bradley Road, Buckeye and Inland own parallel pipelines, Buckeye's only business is in carrying Inland's overflow volumes at a substantial discount, and recently Inland had expanded capacity to displace 11 percent of Buckeye's Bradley Road volumes and might displace more in the future. This overstates the case for finding this market to be competitive.

First, though it is not the only factor to be considered, the very high HHI of 5976 for Cleveland does indicate a highly concentrated market. Even staff's revised HHI, which took into account the potential for entry into the market leaves Cleveland with an HHI of over 2400.[57] Second, as the ALJ himself noted, the three other pipelines, including Inland, account for only about a quarter of the deliveries into the market. In fact, the record shows that Buckeye's market share amounts to 75.7 percent, which lessens significantly any competitive impact that Inland could exert over Buckeye throughout this market. The ALJ also indicated that an increase in Buckeye's rates would create an opportunity for the Sun Pipeline to increase its business. However, the ALJ's conclusion does not address ATA's contention that Sun runs only to Akron and the cost of transportation on Sun to Cleveland is substantially higher than the cost on Buckeye.[58] This would seem to belie any finding that Sun offers any real competition to Buckeye in this market. The ALJ also concluded, without explanation, that Buckeye faces competition from ARCO Pipeline. However, there seems to be no basis for this conclusion since this segment of ARCO is being operated under a proprietary lease and

[57] *See* Exh. S-12 Revised.

[58] Exh. ATA-15, Schedule 3; Exh. B-64, Table B-64-1.

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therefore is not considered to be a common carrier pipeline able to hold itself out to transport for the shipping public.[59] Accordingly, we conclude that Buckeye can exercise significant market power in the Cleveland market.

b. *Rochester BEA.* The ALJ concluded that Buckeye lacks significant market power in the Rochester BEA. He based this conclusion primarily on his finding that Buckeye faces significant competition from the Atlantic Pipeline. The ALJ did not rely on any analysis in reaching this conclusion, but instead merely assumed that shippers would change their shipping arrangements and have their products delivered to Philadelphia, rather than Linden, to use the Atlantic pipeline rather than Buckeye. Such a change, however, would likely involve some additional expense to the shipper which the ALJ failed to take into consideration in reaching his conclusion that Atlantic presented a viable option to Buckeye.

The ALJ also found that Mobil pipeline could become an effective competitor if Buckeye were to increase its rates. The record shows, however, that Mobil does not deliver directly to the Rochester market and that its 18 MBD operating capacity is 90 percent utilized.[60] Thus, Mobil has little ability to compete effectively with Buckeye. Instead it provides indirect service through deliveries to its terminal in Buffalo, which are then trucked to Rochester, resulting in a cost of transportation on Mobil Pipeline that is between 13 and 14 cents a barrel higher than the cost of transportation on Buckeye.[61] The ALJ also noted that trucks, which currently deliver some volumes to the Rochester market from United Refining's refinery in Warren, Pennsylvania, could provide competition, and that potential competition exists from two Canadian refineries' entering the market by trucking their products. Finally, the ALJ concluded that Buckeye is constrained in its pricing by the monopsony power of USAir at the Rochester Airport.

First, the HHI for the Rochester market was calculated by staff to be 5378, indicating a very highly concentrated market.[62] The record also shows that an evaluation by staff of potential entry by competing firms could not reduce the HHI since no potential entrants could be found to come into the market at a reasonable cost.[63] In addition, the record shows that Buckeye has a 71.3-percent share of the Rochester market. While we agree that USAir may have some ability to exert downward pressure on Buckeye's pricing, we cannot, however, assume that USAir's position will allow it to control prices. Since this is the only factor that weighs in favor of finding a competitive market, we disagree with the findings of the ALJ. Accordingly, we find that Buckeye has significant market power in the Rochester BEA.

c. *Syracuse-Utica BEA.* The ALJ concluded that Buckeye lacks significant market power in the Syracuse-Utica BEA. He found that an increase in Buckeye's tariff rates from Linden could encourage shippers to use Atlantic through Philadelphia as a source for shipping their product. He also found that Buckeye could face competition from the Sun and Mobil pipelines if it increased its rates. Finally, the ALJ found that Buckeye's market power was limited by the monopsony power of USAir. We do not agree with the findings of the ALJ.

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[59] *See* Exh. ATA-15, Schedule 3; Exh. B-64, Table B-64-1.

[60] *See* Exh. S-9 at 188.

[61] *See* Exh. S-9 at 187.

[62] *See* Exh. S-8 Revised.

[63] *See* Exh. S-8 Revised.

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First, the HHI for this market as calculated by staff is 4783,[64] thus indicating a highly concentrated market. As with Rochester, no potential entrants could be identified by staff, thus the HHI remained at 4783. Second, as discussed previously with regard to the Rochester market, there is no basis in the record to support the assumption that shippers would be likely to change their distribution patterns from Linden to Philadelphia in order to avoid a rate increase by Buckeye. The record also shows that the Sun and Mobil pipelines are designed primarily to serve the needs of their affiliated refiners.[65] In addition, they originate in Philadelphia and thus, as is the case with Atlantic, cannot offer any competitive restraint on Buckeye's pricing from Linden. We also conclude that USAir cannot influence Buckeye's rates throughout this market, and we question whether it can even exert any meaningful monopsonistic pressure as to airport traffic. USAir does receive 57 percent of the product delivered to the airport. However, Buckeye handles 100 percent of the airport deliveries and has no competitors for this traffic, which tips the balance in favor of Buckeye's being able to resist any attempts by USAir to keep Buckeye from raising prices. Finally, the record shows that Buckeye has a 68.4-percent share of the Syracuse-Utica market. Accordingly, after weighing all of these factors, we conclude that Buckeye can exercise significant market power in the Syracuse-Utica market.

d. *Binghampton-Elmira BEA.* The ALJ concluded that Buckeye lacks significant market power in the Binghampton-Elmira BEA. His findings were based mainly on his observation that Buckeye lost 18 percent of its market share in this BEA between 1982 and 1988, despite having 73 percent of the available pipeline capacity, and that Mobil and the recently merged Atlantic and Sun lines, which have the remaining pipeline capacity, could continue to take away Buckeye's business through the use of drag reducing additives. The ALJ also stated that trucking accounts for about 10 percent of this market and would increase in response to a Buckeye price increase. We disagree with the ALJ's conclusions.

First, staff determined that the HHI for this market is 3401 and that Buckeye's share of this market is 50.2 percent. As in the Rochester and Syracuse markets, staff found that there were no potential entrants that could be identified.[66] Second, there is no sound basis for finding that other pipelines will, as a matter of course, take away Buckeye's business. The only reason for the ALJ's so concluding was that those pipelines could use drag reducing additives to make petroleum products flow more freely through the pipeline and thereby increase the volume of the pipeline itself. This may be true, but it overlooks the fact that Buckeye can use the same methods itself, to its own benefit. Thus, we cannot conclude that the availability of drag reducing additives alone gives other pipelines a competitive advantage over Buckeye. Accordingly, after weighing all of these factors, we find, on balance, that Buckeye can exercise significant market power in the Binghampton-Elmira market.

3. The Markets In Which Buckeye Only Makes Intra-BEA Deliveries

In some markets Buckeye only makes intra-BEA deliveries of products transported into the BEA by other pipelines or water carriers, or Buckeye receives but does not deliver products. For example, in the New York City BEA, Buckeye receives gasoline, jet fuel, and distillate fuel oil in Linden, N.J. and transports it to Long Island City, N.Y., Inwood, N.Y. and to La Guardia, JFK, and Newark airports. These are "intra-BEA" shipments. The markets in which Buckeye makes only intra-BEA deliv-

[64] *See* Exh. S-8 Revised.

[65] Exh. ATA-26 at 174-76.

[66] *See* Exh. S-1 at 27.

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eries are the Hartford-New Haven-Springfield, New York, Terre Haute, and Seattle BEAs. Staff did not analyze these markets because staff presumed that Buckeye would be unable to affect the price of delivered product in these markets since it has no control over the amount of product flowing into them and because numerous studies have shown trucking to be a cost-effective alternative to pipeline transportation over the relatively short distances such as those that exist within a BEA.[67] Of the four intra-BEA markets, this presumption was only contested with respect to the New York City market.

ATA disputed this assumption as applied to the transportation of jet fuel to the airports in the New York BEA. However, the ALJ concluded that Buckeye's rates to these airports were constrained by the potential for competition from barges and trucks. For example, the ALJ pointed out that cost estimates of barging jet fuel to JFK made by both Buckeye and ATA are not significantly different and support the feasibility of barging. With regard to La Guardia, he noted that rates to Long Island, a clearly competitive market with much barge traffic, are comparable to those to La Guardia. At Newark, trucking costs are less than one cent per barrel above Buckeye's rates.

The Commission agrees with staff that it is reasonable to presume that Buckeye cannot affect the delivered price in a BEA if it makes only intra-BEA deliveries, and this presumption is uncontested as applied to three of these markets. Therefore, we conclude that Buckeye does not have significant market power in the three uncontested markets: Hartford-New Haven-Springfield, Terre Haute, and Seattle.

In the case of New York City, however, the presumption, especially as applied to jet fuel delivered to three airports, is contested and the Commission is concerned that the record is not sufficient to confidently support a finding that the presumption is justified for this particular market. Because of extreme traffic congestion, safety consideration, and quality inspections, trucking may not be a cost-effective alternative for transporting jet fuel to JFK and La Guardia airports. Although the ALJ concluded that barging was an effective alternative for these airports, we think the record is too weak to draw any firm conclusions. Accordingly, because we cannot find that Buckeye does not exercise significant market power in this market, Buckeye's rates in New York City will continue to be regulated. Buckeye may, in a future case, attempt to show that it does not exercise significant market power in this market.

4. Markets For Which The Commission Makes No Findings

The Buffalo and Youngstown-Warren BEAs were analyzed by the parties and the ALJ found that Buckeye does not have significant market power in those markets. However, Buckeye has no tariffs on file to serve those markets. Therefore, it is unnecessary to analyze those markets and the Commission makes no finding with respect to Buckeye's market power in those two markets.

III. Phase II: The Rate Methodology to be Used by Buckeye for the Future

In light of our findings as to Buckeye's market power in each of its relevant markets, we next consider a ratemaking methodology proposed by Buckeye for application in each of Buckeye's relevant markets.

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[67] See Exh. S-4 (Charles Untiet, "The Economics of Oil Pipeline Deregulation: A Review and Extension of the DOJ Report," U.S. Department of Justice, Economic Analysis Group Discussion Paper, May 22, 1987); and George S. Wolbert, Jr., U.S. Oil Pipe Lines, Washington, D.C.: American Petroleum Institute (1979).

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A. *Buckeye's Proposed Experimental Program*

On May 1, 1990, Buckeye filed a Motion for Expedited Adoption of an Experimental Program for Rate Regulation in Competitive Markets. The motion asks that the Commission establish on an experimental basis the proposal set forth below for the regulation of Buckeye's rates in competitive markets.

Buckeye's proposal for rate regulation in competitive markets has the following key elements: The Commission will continue to regulate Buckeye's rates to ensure compliance with the requirements of the Interstate Commerce Act. In markets where Buckeye does not have significant market power: (a) individual rate increases will not exceed a "cap" of 15 percent (real) over any two-year period; and (b) individual rate increases will be allowed to become effective without suspension or investigation if they do not exceed the change in the GNP deflator since the rate was last increased, plus 2 percent. Rate increases exceeding this "trigger" would have to be justified as being consistent with competitive pricing or other appropriate factors and would be subject to suspension and investigation. Rate decreases would be presumptively valid and complainants would bear the burden of demonstrating any alleged unlawfulness. If Buckeye is found to have significant market power in one or more of its markets, Buckeye proposes that rates in such markets would be required to track rate changes in competitive markets. This proposal is explained in more detail below.

1. Rate Cap

Buckeye notes that the Initial Decision defined significant market power as the ability to raise rates more than 15 percent in real (noninflated) terms over a two-year period without losing substantial business.[68] Thus, under the proposal any individual rate increase of less than 15 percent (real)[69] over two years should be presumptively valid since by definition it does not constitute significant market power.

Buckeye proposes that this test of significant market power 15 percent (real) over two years — be employed as a cap on individual rate increases. Thus, Buckeye contends that this cap guarantees that it cannot exercise significant market power as to any shipper under the minimum standards agreed to by all parties to this case.

2. Rate Trigger

Buckeye's proposal states that to ensure close Commission oversight, to protect shippers and to allay any concerns that substantial price increases are likely to occur, the Commission should establish a threshold even below the cap. The threshold would be set at 2 percent above the change in the GNP deflator since the prior rate change.[70] Under the proposal rate increases which do not exceed the change in GNP deflator plus 2 percent would be permitted without suspension or investigation. Any individual rate increase exceeding the threshold would have to be justified by Buckeye through a demonstration that the rate increase is consistent with competitive pricing, or other appropriate factors, and would be subject to possible suspension and investigation were Buckeye's justification found to be inadequate.

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[68] 50 FERC ¶ 63 011, at p. 65,049.

[69] A real rate increase would be one that has been adjusted for inflation.

[70] The GNP deflator is published quarterly by the United States Department of Commerce The change in GNP deflator would also be used to calculate the 15% (real) price cap

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According to Buckeye, its proposed threshold "trigger" will assure shippers and the Commission that Buckeye's rates cannot increase substantially more than the general rate of inflation without justification. At the same time, Buckeye believes this would eliminate the need for costly rate investigations and regulatory intervention over *de minimis* rate changes. The "plus 2 percent" feature of the threshold preserves some degree of pricing flexibility which Buckeye claims that it needs to react to differing competitive conditions in its various markets.

3. Presumptively Valid Rate Decreases

Under Buckeye's proposal rate decreases would be presumptively valid and free from regulatory investigation. Buckeye argues that the Commission should not independently investigate price reductions, and any competitor or shipper complaining of rate decreases should bear the burden of proving them unlawful. In support of this position Buckeye cites *Texas Eastern Products Pipeline Company*.[71]

4. Continued Application of the ICA

Sections 2, 3, 4 and 6 of the ICA would continue to apply to Buckeye.[72] Under section 2, pipelines cannot charge different rates for the same transportation service between the same origin and destination points. Section 3 prohibits undue discrimination. As indicated above, under section 4, a pipeline may not charge a higher rate for transporting products to a nearer destination than it charges for a further destination, without obtaining Commission approval. Section 6 of the ICA requires a pipeline to provide a tariff filing of all rates and 30 days' notice of all rate increases to the Commission and shippers.

5. Commission Oversight of Competitive Circumstances

To satisfy the Commission that competition continues, and to assure that Buckeye's rates are just and reasonable, Buckeye proposes to file a report with the Commission every five years describing any material changes in the competitive status of its markets. This report would permit the Commission to monitor the level of competition to determine whether competitive circumstances have changed such that Buckeye has acquired significant market power in any of its markets.

Buckeye contends that because full-blown hearings on competition are extremely costly, to prevent wasteful relitigation, the Commission's finding that Buckeye lacks significant market power in any market would be controlling for future rate filings unless shippers make a *prima facie* showing that competitive circumstances have changed. Complainants would carry the ultimate burden of proof that the market has ceased to be competitive.

6. Less Competitive Markets

Buckeye acknowledges that a prospective regulatory methodology should address the possibility that it could acquire substantial market power in one or more of its markets in the future. If this were to occur, Buckeye proposes that rates, for what Buckeye terms less competitive markets, would be tied to a price change index derived from rate changes in Buckeye's competitive markets. Buckeye maintains that competitive market pricing reflects cost changes and market conditions, therefore, a competitive, market-based price should be an efficient proxy for cost-based regulation.

[71] 50 FERC ¶ 61,218, at pp. 61,703-704 (1990).

[72] 49 U.S.C. § § 2, 3, 4, and 6 (1976).

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7. Shipper Complaints

Shippers would retain the right to file complaints or protests following notice of a rate increase. Shippers, however, would be required to show either: (a) that a rate increase exceeds the cap (15 percent real over two years); (b) that a rate increase exceeds the change in GNP deflator plus 2 percent and has not been adequately justified by Buckeye; (c) that the rate is unlawfully discriminatory under ICA sections 2 or 3; or (d) that as the result of substantially changed circumstances, Buckeye has acquired significant market power in the relevant market and that the proposed rate increase exceeds the standards for markets in which Buckeye exercises significant market power. If a shipper presents a factual, *prima facie* case supporting any of these contentions, Buckeye would then be obligated to provide responsive evidence.[73] Buckeye proposes that Commission staff would be allowed to participate by order of the Commission in any complaint proceeding.

8. Experimental Nature of the Proposal

Buckeye states that it recognizes that its proposal, while firmly grounded in law and economics, is novel. Buckeye, therefore, proposes that this rate regulation proposal be adopted on an experimental basis for five years, at which time it can be reviewed by the Commission. Buckeye contends that this will allow the Commission further oversight and control over Buckeye's rates and the experiment will provide valuable information as to the strengths and weaknesses of competitive rate regulation.

Buckeye's proposal is not, however, intended to be generically applicable to other oil pipelines. Buckeye argues that interstate oil pipeline industry, consisting of over 130 different pipeline companies, is enormously varied as to organizational structure, rate structures and market conditions. The industry includes integrated pipelines and independent pipelines, crude oil pipelines and products pipelines, gathering pipelines, distribution pipelines and long-haul pipelines. Buckeye notes that its proposal may well not fit other pipelines' circumstances.

B. *Comments on Buckeye's Proposal*

ATA argues that Buckeye's motion must be rejected as being seriously flawed and unlawfully generous in many respects, and that Buckeye's current rates cannot be found to be just and reasonable at this stage of these proceedings. ATA also notes that Buckeye's motion is premised on the assumption that the Initial Decision in this proceeding will be affirmed without substantial modification. ATA further maintains that the justness and reasonableness of Buckeye's rates was not at issue in Phase I and cannot be determined at this time. ATA contends that without a finding that Buckeye's current rates are just and reasonable, the Commission would have no basis to assume that the rates increased from current levels would be just and reasonable.[74]

ATA asserts that under this proposal Buckeye could impose enormous rate increases costing its shippers millions of dollars without any justification, and its shippers would be powerless to complain. ATA, as well as staff, question the use of the GNP deflator as a component in either the rate cap or rate trigger because the GNP deflator may not mirror Buckeye's costs.

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[73] Any party submitting a complaint would bear the ultimate burden of proof.

[74] The justness and reasonableness of Buckeye's rates are addressed below in the discussion of the complaint filed by ATA on April 29, 1988.

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ATA argues that Buckeye's proposal to preclude suspension and investigation by the Commission would violate section 15(7) of the ICA. ATA argues further that Buckeye's proposal would strip the Commission of all authority to carry out its statutory responsibilities under section 15(7) for any rate increase that did not exceed the change in the GNP deflator since the applicable rate was last increased plus two percent. ATA further argues that Buckeye's proposed limitation on customers' complaints would violate section 13 of the ICA. ATA contends that under Buckeye's proposal, shippers and other affected parties would lose all of their rights under section 13 unless they could present a *prima facie* case: (a) that a rate increase exceeds the cap; (b) that a rate increase exceeds the change in GNP deflator plus 2 percent and has not been adequately justified by Buckeye; (c) that the rate is unlawfully discriminatory under ICA sections 2 or 3; or (d) that as the result of substantially changed circumstances, Buckeye has acquired significant market power in the relevant market and that the proposed rate increase exceeds the standards for less competitive markets. ATA contends that the Commission has no authority to impose a higher standard on potential complainants.

ATA argues that under the guise of requiring flexibility, Buckeye is proposing to allow its rates in less competitive markets to increase at a rate above the average increase allowed in allegedly competitive markets. ATA states that Buckeye has failed to address the likelihood that existing rates in less competitive markets would already be above competitive, or just and reasonable levels.

Staff, while not opposing Buckeye's proposal, urges that a number of issues should be addressed before the Commission decides on any particular form of light-handed regulation.

With respect to Buckeye's proposal that its rate increases be subject to a cap of 15 percent (above the inflation rate) over a two-year period, staff argues that there should be an analysis of the likely effects of such a proposal on economic efficiency. Staff notes, for example, that from an economic standpoint, price increases in competitive markets do not need to be capped to achieve economic efficiency. Staff contends that if the market-clearing price in a competitive market increases by more than 15 percent, then a 15-percent cap will preclude some economic transactions from taking place that would increase economic efficiency. Staff notes that it is not proposing that the 15-percent cap be eschewed in favor of some higher cap. Staff does, however, recommend that the Commission carefully weigh the potential costs of a cap in competitive markets against any benefits that may result.

With respect to Buckeye's proposal that rate increases which do not exceed the change in the GNP deflator plus 2 percent be permitted without suspension or investigation, staff notes that the use of such a broad-based index of inflation as the GNP deflator for tracking costs in the oil pipeline industry is questionable. Staff contends that in a competitive market, prices track industry-specific and, in some cases, region-specific marginal costs, not the average rate of increase of prices for economy as a whole. Staff maintains that although it may be efficient for the Commission not to suspend and investigate small rate increases, there was not an adequate basis provided for the particular rate trigger proposed by Buckeye, i.e., 2 percent above the inflation index. Staff argues that the proposal should specify the time period over which the trigger increase would be calculated. Staff also notes that the proposal should make it clear that the trigger would apply in addition to the cap.

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With respect to Buckeye's proposal that rate decreases be considered presumptively valid, the staff believes that any such decreases should not result in a rate below marginal costs. Otherwise, the rate would be inefficient. Moreover, staff argues that given that Buckeye is in the best position to know its own costs, it should carry the burden of demonstrating that any proposed rate is not below marginal cost.

With respect to Buckeye's proposal that rate increases in less competitive markets be limited by the average rate increase in competitive markets, staff also has several concerns. Staff contends that the flexibility given to rate changes in noncompetitive markets by the use of the "inner-quartile range" of rate changes in the competitive markets again may not be enough to allow all efficiency-promoting economic transactions to occur.

Staff noted that if rates decline in the competitive markets, the 75th-percentile cap could prevent efficient differential pricing by requiring all rates in the noncompetitive markets to decrease. This, according to staff, could prevent a pipeline from earning its revenue requirement. Staff maintains that a better alternative for providing pricing flexibility may be the use of a weighted-average cap which could allow efficient differential pricing when rates decline in the competitive markets. Staff suggests that the use of a weighted-average cap (weighted by volumes) may be an alternative to Buckeye's use of a minimum-quantity threshold for calculating the average rate increase in competitive markets. In other words, if a particular rate increase only related to minimal volumes, that rate increase would not have much of an impact in the calculation of the weighted-average rate increase.

Finally, the staff is concerned that the use of either a minimum-quantity threshold or a weighted-average cap that is calculated solely by reference to Buckeye's rate increases may provide Buckeye with an opportunity to manipulate the average rate increase in competitive markets in its favor. Staff argues that a better alternative may be to use an average that would include rate increases instituted by Buckeye's competitors, such as other pipelines and possibly, barges and trucks.

Buckeye argues that ATA and staff have offered no basis for modifying its proposal and therefore the Commission should promptly approve the proposal. Buckeye contends that neither staff nor ATA challenges the Commission's authority to rely upon market forces to establish rates in competitive markets. Buckeye also argues that ATA's insistence upon the need for a Phase II hearing to determine the reasonableness of Buckeye's rates simply ignores the Commission's clear policy that rates in competitive markets are just and reasonable. Buckeye declares that ATA's unsupported assertion that the Commission must investigate and suspend all rate changes that are subject to protest and complaint is contrary to all relevant and controlling precedent.

Buckeye notes that ATA and staff suggest that Buckeye's proposed "rate trigger" and "rate cap" may not adequately track Buckeye's cost changes. Buckeye contends that this argument reflects a fundamental misunderstanding of its proposal. According to Buckeye, both Commission staff and ATA ignore the fact that Buckeye's proposal relies primarily on competitive forces to keep rates within the zone of reasonableness. Buckeye states that the additional protection of the rate trigger and rate cap are not intended to establish cost-based rates. Buckeye contends that such a result would be inconsistent with the reliance on competitive markets to ensure just and reasonable rates, and would require expensive and complex rate cases to establish cost-based rates in a competitive setting. Buckeye argues that the rate cap and rate trigger are designed

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to balance appropriately Buckeye's need for rate flexibility and the need to protect shippers during the establishment of an experimental rate program.

Buckeye maintains that its proposal is a fair and balanced experimental program for competitive regulation of its rates which affords reasonable pricing flexibility, full protection of shippers and continued close monitoring by the Commission to ensure that Buckeye's rates remain just and reasonable.

C. *Discussion of Buckeye's Proposal*

Having found that Buckeye does not possess significant market power in a large portion of its markets, and that these markets account for a sizeable portion of Buckeye's total deliveries, we believe that light-handed regulation is appropriate. The broad outline of Buckeye's proposal—to use price changes in markets where it lacks significant market power to set caps for price changes in its markets where it does have market power—is a regulatory approach we generally support, especially on a limited experimental basis. Significantly, Buckeye also has proposed to cap price increases in markets where it lacks significant market power. Although there is no efficiency basis for a price cap in a truly competitive market, we accept that aspect of Buckeye's proposal. We recognize that judgment plays an important role in determining whether markets are competitive, and a cap on rates in markets where Buckeye does not exercise significant market power will serve as an added safeguard against any unanticipated opportunity Buckeye may have to exercise market power.

Nonetheless the Commission has two primary concerns with Buckeye's proposal for capping rate increases in markets in which it does not exercise significant market power. First, Buckeye's calculation of average price in the markets in which it does not exercise significant market power could give undue weight to small volume markets and give Buckeye an incentive to manipulate price in those markets for gain in its larger volume markets in which it exercises significant market power. And second, the price flexibility Buckeye advocates in markets in which it does not exercise significant market power would not be an effective protection against its potential to use its monopoly to price discriminate. To address these concerns, we will authorize a modified version of Buckeye's proposal for a three-year period only, and we will require that Buckeye file annual reports detailing price and revenue changes in each of its markets. The Commission will use information in Buckeye's reports to judge whether light-handed regulation was successful in protecting shippers against monopoly abuses.

ATA argues that the Commission cannot find Buckeye's current rates just and reasonable without conducting a full Phase II hearing. As discussed later in section IV of this opinion, in connection with ATA's pending complaint against Buckeye's rates, the Commission will establish just and reasonable rates for the markets in which the Commission has found that Buckeye exercises significant market power. The just and reasonable rate so established will then serve as the base rate to which Buckeye's proposed rate caps will apply to govern rate increases during thee experimental period. With respect to the markets in which Buckeye does not exercise significant market power, there is no need for further investigation because competition can be relied upon to restrain Buckeye's rates in these markets.

The Commission will permit Buckeye to implement its proposed experiment, as modified by this order. In order to implement this experiment Buckeye must make a tariff filing in which it sets out all of the terms of the experiment that will govern its

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rates and rate increases during the experimental period. The experimental period will begin after the Commission accepts the tariff sheets for filing.

We now respond to specific concerns raised by ATA and the Commission staff.

1. Rate Caps in Markets Where Buckeye Lacks Significant Market Power

ATA argues that Buckeye's proposal could impose enormous rate increases costing its shippers millions of dollars (up to $32 million according to ATA) without any justification, and its shippers would be powerless to complain. This argument is not persuasive. Buckeye's proposal contains both a rate cap and a rate trigger. Thus any individual rate increase exceeding the rate trigger would be subject to full suspension and investigation by the Commission, thereby creating an avenue of redress for those affected by excessive rate increases. In markets where Buckeye lacks significant market power, it is appropriate to permit Buckeye to maintain its real rate without refund obligation. It should be noted that a rate increase exceeding the GNP deflator, as proposed by Buckeye, is equivalent to an increase in Buckeye's real rate.

Staff argues that Buckeye's proposal, that its rate increase be subject to a cap of 15 percent over a two year period, should be carefully reviewed by the Commission. Staff argues that in competitive markets, price caps are not needed to achieve economic efficiency, and in some instances, could preclude some efficient transactions from taking place. As a general proposition we agree with staff. However, as we explained earlier, we accept the added protection against market power this aspect of Buckeye's proposal offers. Thus, we agree with Buckeye that the better course would be to monitor this issue during the experimental period and to adjust the rate cap if necessary.

2. Rate Triggers

Staff expressed several concerns with respect to the operation of the rate trigger. Staff questions Buckeye's use of such a broad based index of inflation as the GNP deflator for tracking costs in the oil pipeline industry. Staff contends that in a competitive market, prices track industry-specific and in some cases, region specific marginal costs, not the average rate of increase of prices for the economy as a whole. ATA expressed similar concerns. Buckeye argues that the approach recommended by staff would require substantial regulatory proceedings to identify precisely what "market-basket" of goods and services should be used to establish a cost-based index.

The Commission agrees with Staff that the GNP inflation measure will not precisely track cost changes in the oil pipeline industry. However, the GNP deflator is a widely used and well-understood broad-based index which we believe is a reasonable index for price changes in a competitive market, especially for the limited term of the Buckeye experiment. We see no compelling reason to mandate an alternative in this context, and we will accept this aspect of Buckeye's proposal.

Staff also requests clarification on two issues. First, staff questions whether the rate trigger will be applied in addition to the cap. Buckeye confirms that each rate would be subject to both the rate cap and rate trigger.[75] Accordingly, Buckeye must make this clear in the tariff sheets it will file to implement the experiment. Second, staff maintains that the proposal should specify the time period over which the trigger increase would be calculated. We agree, the tariff must clearly specify the time period. Staff also suggests that the 2 percent addition to the GNP deflator needs further

[75] See Buckeye's Reply at p. 18.

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justification. We think it is appropriate for Buckeye to have the flexibility it proposes, to increase its rates in the markets in which it does not have market power without justifying the increase as necessitated by competitive circumstances, since this trigger, as with the rate cap, simply provides added protection against the exercise of market power.

3. Sections 13 and 15(7) of the ICA

ATA argues that Buckeye's proposal violates section 13 of the ICA. The Commission does not agree. As Buckeye noted, section 13(1) imposes a duty to investigate a complaint only if there is a reasonable ground for investigation. Under the proposal as adopted here, a shipper can establish reasonable grounds for a complaint by showing either: (1) that a rate increase exceeds the rate cap; (2) that the rate increase exceeds the change in the GNP deflator and has not been justified by Buckeye; (3) that the rate is unlawfully discriminatory under sections 2 or 3 of the ICA; or (4) that as a result of substantially changed circumstances, Buckeye has acquired significant market power in a relevant market and the proposed rate increase exceeds the standards for markets in which Buckeye exercises significant market power. Thus, in adopting Buckeye's proposal, the Commission is setting general parameters for a finding of reasonable grounds under section 13(1) of the ICA.

ATA also argues that Buckeye's proposal to preclude suspension and investigation by the Commission would violate section 15(7) of the ICA. ATA argues further that the proposal would strip the Commission of all authority to carry out its statutory responsibilities for any rate increase that did not exceed the change in the GNP deflator since the applicable rate was last increased by two percent. Buckeye, on the other hand, argues that the Commission has broad authority in determining whether or not to investigate and suspend rate changes. As Buckeye contends, ICA section 15(7) authorizes the Commission to investigate rate changes, it does not require the Commission to investigate and suspend all rate changes. The decision by the Commission to investigate or suspend is a discretionary one. Therefore, in accepting Buckeye's proposal, we are setting forth in advance how the Commission will exercise its discretion to investigate or suspend Buckeye's rate changes during the period of the experiment.

4. Rate Caps for Markets Where Buckeye Has Significant Market Power

ATA and staff expressed concerns with respect to Buckeye's proposal regarding markets where Buckeye has significant market power. The concerns raised by ATA were similar to the arguments it made regarding Buckeye's proposal for markets in which Buckeye does not have significant market power which were addressed above. Staff, however, expressed certain other misgivings with regards to this issue. First, Commission staff found that restricting individual rate changes to the "inner-quartile range" of rate changes in markets where Buckeye does not have significant market power may not provide sufficient flexibility. Buckeye notes that staff appears to suggest a broader range for individual rate increases based upon a weighted average cap for all rate increases in a less competitive market. Citing staff's Answer at 4-5.

Buckeye argues that the inner quartile range restriction was designed to protect individual shippers in markets where Buckeye has significant market power, while still allowing some pricing flexibility.[76] Buckeye submits that the "inner-quartile" range,

[76] That is, Buckeye would restrict its pricing flexibility in markets where it has significant market power so that the maximum rate increase allowed would not exceed the 75th percentile of the entire range of price increases in markets where it has no significant market power.

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which it claims strikes a balance between pricing freedom and shipper protection is an appropriate part of an experimental program. Buckeye contends that staff's proposal may have merit, but argues it would be best addressed after the Commission gains some experience under the Buckeye proposal.

The Commission's chief concern with Buckeye's proposal for price flexibility in its markets where it does have significant market power is that it would potentially allow Buckeye to act as a discriminating monopolist. Thus, we are not willing to grant Buckeye this pricing flexibility. Instead, we will require that any average decrease in rates in Buckeye's markets where it does not have significant market power must be accompanied by a corresponding decrease in all of Buckeye's rates in markets where it does have significant market power. For example, if Buckeye's rates in markets in which it does not have significant market power decline by an average of 5 percent, then each of Buckeye's rates in markets where it does have significant market power must also decrease by 5 percent. However, if Buckeye's rates in markets where it does not have significant market power increase on average by 5 percent, Buckeye may increase any rate in markets where it does have significant market power by no more than 5 percent.

Staff also proposes to calculate the average rate increase on a volume weighted basis, instead of Buckeye's proposal to exclude small volume movements from the calculation. Buckeye notes that it also seeks to eliminate the possible distortions caused by rate increases on small volume movements. Buckeye argues that for purposes of this experimental program, the use of a minimum volume standard is simpler to administer than Staff's proposal and effectively eliminates the influence of small-volume movements.

As we stated previously, the Commission is concerned that Buckeye's calculation of average price could give undue weight to small volume markets and give Buckeye an incentive to manipulate price in those markets for gain in its larger volume, markets where it does have significant market power. Thus, we agree with staff that the use of a weighted-average cap is a viable alternative to Buckeye's use of a minimum quantity threshold for calculating the average rate increase. Accordingly, Buckeye must modify its proposal to use a weighted-average cap.

Staff is also concerned that Buckeye's proposal, even using staff's suggested volume weighted approach, "may provide Buckeye with an opportunity to manipulate the average rate increase in competitive markets in its favor." Instead, staff suggests an alternative index of rate increases by Buckeye's competitors such as pipelines, barges and trucks. Buckeye objects to this proposal on both theoretical and practical grounds. Buckeye argues that staff fails to consider that Buckeye's proposed index is derived from Buckeye's rate changes in competitive markets. Buckeye argues further that in competitive markets, the "manipulation" feared by staff simply cannot occur, the only possible means of manipulation according to Buckeye, would be for Buckeye to substantially increase very low-volume rates to drive up the average rate of increase in the markets where it does not have significant market power. Buckeye submits that this scenario is inherently unlikely. Buckeye contends that any possibility of this "manipulation" has already been eliminated by Buckeye's proposal to exclude small volume movements from the calculation. While staff's concerns with respect to this issue may have considerable merit, indices based upon competitor's prices would not appear to be feasible, since there is no way to ensure that Buckeye would have access to current and accurate prices charged by its competitors. Furthermore, our requirement

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that Buckeye modify its proposal to calculate weighted-average price caps and to eliminate pricing flexibility in markets in which it exercises significant market power should offer adequate protection against any market manipulation. Thus, we will monitor Buckeye's price changes as a part of the experimental program and rely on the changes in markets in which it does not have significant market power during this period.

During the experimental period, the Commission will require Buckeye to submit annual reports, on January 20 of each year, detailing price and revenue changes under each of its tariffs in all its markets and relevant GNP inflation calculations. Specifically, for each tariff in each market, Buckeye must give the initial rate ($/Bbl), volume (MBD), and revenue ($/yr). Then, Buckeye must give any percentage change in each rate during each 12-month experimental period and corresponding changes in revenue. Buckeye must also show how it calculated applicable price caps for its markets in which it does have significant market power for each experimental period.

The Commission will carefully evaluate any revenue losses in Buckeye's markets in which it does not have significant market power that are accompanied by substantial revenue gains in Buckeye's monopoly markets. Higher competitive rates and lower competitive revenues, along with higher rates and revenues in markets in which Buckeye does not have significant market power, would strongly suggest market manipulation and the need for a return to traditional regulation.

5. Rate Decreases

Staff argues that rates should not be allowed to fall below marginal costs and further suggests that the burden of demonstrating that any proposed rate is not below marginal costs should be on the pipeline. Buckeye argues that staff's proposal is unnecessary and inappropriate. Although Buckeye agrees that rates below marginal costs would be inefficient, Buckeye contends that it has no incentive to charge such rates, nor has any party alleged that any of its rates are below marginal costs. The Commission is not persuaded by Buckeye's arguments. The primary concern with placing the burden of demonstrating any alleged unlawfulness on complainants is that this might effectively exclude any small complainant from being heard because the process would be too costly. The ICA places the burden of showing justness and reasonableness of filed tariffs on the company filing the tariffs and we see no need to deviate from that standard. Thus, Buckeye's proposal is modified accordingly.

IV. ATA's Complaint as to Buckeye's Rates

On April 29, 1988, ATA filed a complaint requesting the establishment of just and reasonable rates for the transportation of aviation jet fuel by Buckeye and the ordering of reparations back to January 1, 1987. ATA's complaint was filed under sections 13(1), 15(1), 16(1) of the Interstate Commerce Act and Rule 206 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 385.206 (1990).

In its complaint ATA argues that the record developed in this proceeding (which is now referred to as Phase I) demonstrates that the revenues Buckeye is recovering under its current rates far exceed its cost of service. ATA asserts that Buckeye is currently receiving revenues far in excess of its costs and that most, if not all, of Buckeye's current rates for the transportation of aviation jet fuel are excessive, unjust and unreasonable. ATA further contends that even complete denial of the rate increases proposed by Buckeye in this proceeding would fail to provide adequate relief to ATA's member air carriers. ATA argues that all shippers have a right to transporta-

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tion under just and reasonable rates, and that its member air carriers would be denied this right unless the Commission prescribes just and reasonable rates and orders reparations for excessive charges made on or after January 1, 1987.

ATA requested that the Commission address the complaint along with the issues in Phase I of this proceeding to resolve: (1) the justness and reasonableness of all of Buckeye's tariff rates for the transportation of aviation jet fuel, whether or not an increase to any such rate has been proposed; (2) the just and reasonable rate to be thereafter observed to the extent that any of Buckeye's tariff rates for the transportation of aviation jet fuel are found to be unjust and unreasonable; and (3) the appropriate measure of reparations (with interest) to be made to ATA's member air carriers as relief from unjust and unreasonable tariff rates charged for the transportation of aviation jet fuel for the period from January 1, 1987 to the date that the prescribed just and reasonable rates become effective.

ATA's complaint raises issues that require investigation with respect to Buckeye's rates in the markets in which the Commission has found that Buckeye exercises significant market power. As a first step, however, the Commission must determine in which of Buckeye's relevant markets, as defined in Phase I of this proceeding, ATA has standing to challenge Buckeye's rates. That is, since ATA's complaint is limited to the rates for the transportation of aviation jet fuel, the Commission must determine which rates are at issue, and further determine whether the rates are for transportation to or in markets which the Commission has found that Buckeye exercises significant market power. Therefore, the Commission will require Buckeye to identify which of its rates apply to the transportation of jet fuel. ATA will then have an opportunity to respond.

Once the Commission knows the precise rates at issue the Commission will be able to determine the markets at issue. The complaint will be dismissed as to those markets that have been found in Phase I of this proceeding to be markets in which Buckeye does not have significant market power. The rates in those markets are deemed to be just and reasonable. The Commission will then be able to proceed with consideration of the merits of the complaint as to the rest of the markets in which ATA has standing, and to a determination as to the justness and reasonableness of Buckeye's rates in those markets and whether reparations are appropriate. Once a final determination is made as to just and reasonable rates, the methodology adopted in Phase II of this proceeding for setting Buckeye's rates will be applied to those rates in each market in which Buckeye can exercise significant market power. Until that time, the Phase II methodology will be applied to the rates currently in effect, subject to refund.

The Commission orders:

(A) The Initial Decision is affirmed in part and reversed in part consistent with the discussion contained in the body of this order.

(B) Buckeye's proposed experimental program is accepted for a three-year period consistent with the discussion contained in the body of this order, and Buckeye must make a tariff filing that sets out the proposal in detail.

(C) Within 21 days of the date of this order, Buckeye must identify its rates that apply to the transportation of jet fuel. ATA may respond to the identification filed by Buckeye within 10 days thereafter.

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Elizabeth Anne MOLER, Commissioner, *dissenting in part*:

I agree with the Commission's decision and findings in Phase I of these proceedings analyzing Buckeye's market power in its various markets and the end result of the Commission's decision in Phase II of these proceedings fixing the rate methodology for Buckeye to use in the future. I am convinced that the requisite showing has been made that, under the conditions imposed by the Commission taken as a whole, the end result reached here is just and reasonable. I dissent from those parts of the Commission's order which suggest that even less regulation may be appropriate in this case.

Section 1(5) of the Interstate Commerce Act (ICA) requires that all rates charged for oil pipeline transportation "shall be just and reasonable." Under section 13(1) of the ICA, any person may complain of a pipeline's action or rate and "[if] there shall appear to be any reasonable ground for investigating said complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall deem proper." Under section 15(1) of the ICA, the Commission is authorized "to determine and prescribe what will be the just and reasonable" rate for such transportation services.

There can be no question that the Commission may discharge its statutory obligations without resort to the traditional rate review process. However, in doing so, the Commission must show, "that under current circumstances the goals and purposes of the statute will be accomplished through substantially less regulatory oversight." *Farmers Union II*, 734 F.2d at 1510.

In *Buckeye I*, citing *Farmers Union II*, the Commission described the parameters for the approach it could use to regulate oil pipeline rates:

> [T]he Commission clearly could, if competitive circumstances warrant, require only generalized cost data for oil pipeline ratemaking if it can be demonstrated that the resulting rates from such an approach would satisfy the just and reasonable standard. . . . The competitive forces warranting such light-handed regulation would have to be clearly identified and must be shown to keep prices at a just and reasonable level to ensure that the Commission can protect shippers from unreasonable rates under the ICA.

44 FERC ¶ 61,066, at p. 61,185 (1988). Fundamentally, there must be "a substantial evidentiary predicate on which to determine that competition in relevant markets will operate as a meaningful constraint on the involved pipeline." *Id.* at p. 61,186.

In this case we find there are two different types of markets: those in which Buckeye lacks significant market power, and those in which Buckeye has significant market power. Nonetheless, for both, we provide the same answer and adopt the general outlines of Buckeye's proposal:[1] (i) over the next three years individual rate increases will not exceed a "cap" of 15 percent over any two-year period; and (ii) individual rate increases will be allowed to become effective without suspension or investigation if they do not exceed a "trigger" which is the change in the GNP deflator since the rate was last increased plus 2 percent. Additionally, as to those markets where

[1] The Commission, quite properly, requires certain adjustments to Buckeye's plan to blunt the possibility of cross-market subsidization. Additionally, and correctly in my view, the Commission allows the revised plan to proceed, subject to annual reporting requirements, for only three years and only after the filing of detailed tariffs which we will examine.

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Buckeye lacks significant market power, we find the current rates to be just and reasonable.[2]

As a result, with this order we find that Buckeye may impose rate increases in all of its markets without refund obligation up to the "trigger" point. We also describe the general parameters for a finding of "reasonable grounds" under section 13(1) to investigate complaints for rate increases in both types of markets. If a rate increase is below the trigger point, there will be no investigation; if above the trigger point but below the cap, there may be an investigation if Buckeye has not "justified" the increase. (Slip Op. at 35-36.)[3]

I would not support this order without the rate cap and the trigger. These provisions — the rate cap and the trigger — are not, as the majority states, merely an "added safeguard" (Slip Op. at 33, describing the cap) or "added protection" (Slip Op. at 35, describing the trigger and the cap). They are, for me, necessary to ensure that we provide for just and reasonable rates.

At bottom, I disagree with the fundamental assumption made by the majority that, on this record, competition alone can be relied upon to restrain Buckeye's rates where it lacks significant market power. (Slip Op. at 33 and 34.) As the order correctly notes, "judgment plays an important role in determining whether markets are competitive" (Slip Op. at 33). More importantly, however, judgment determines whether markets are competitive *enough* to warrant the sort of rate flexibility we allow Buckeye. That judgment may prove wrong. The markets we deem competitive enough today may not be tomorrow. The rate cap and trigger thus work to provide a necessary backstop.

I also disagree with the majority's endorsement, even as an "experiment", of regulating markets where Buckeye has significant market power by referencing markets where it lacks that power. (Slip Op. at 33.) This is a serious step which cuts new, untried ground and has no factual support on the record before us.[4] First, there is no factual basis for assuming that any rate increase Buckeye can impose in markets where it lacks significant market power translates into allowable costs for all of its markets. Nor can this approach be justified by assuming that, because "a sizeable portion of Buckeye's total deliveries" are in markets where it lacks significant market power (Slip Op. at 33), these then become the appropriate yardsticks for ensuring just and reasonable rates for all markets.[5]

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[2] As to those markets where Buckeye does exercise significant market power (Cleveland, Rochester, Syracuse-Utica, Binghampton-Elmira) or might exercise such power (New York), the matter of the current rates — as opposed to future rate increases — might be set for hearing depending upon whether the customer/parties have standing to raise the issue. (Slip Op. at 40.) This leaves open the prospect that, as to some of these markets, future rate increases will be allowed as if the underlying rates are just and reasonable. I have serious reservations about such ratemaking by default. However, my reservations are tempered by the fact that customers remain free to litigate these underlying rates in future cases.

[3] Additionally, one may complain and have set for investigation whether the rate is unlawfully discriminatory or whether the competitive situation has changed significantly (Slip Op. at 35-36.)

[4] A similar approach was a key element in recent legislation introduced in the Congress to deregulate the oil pipeline industry. The legislation was not enacted. Congress alone has the authority to deregulate the industry. Unless and until it does so, this Commission is obligated to ensure that rates charged are just and reasonable as required by the regulatory regime of the ICA.

[5] The idea appears to be that, because a large portion of Buckeye's business is subject to competition, there is (proportionally) less likelihood that Buckeye will successfully subsidize losses in those markets with price increases in markets where it does not face significant competition. However, such a criterion cannot, alone, provide adequate protection. As the order properly recognizes (Slip Op. at 33 and 36-39) additional safeguards are required to ensure there is no market cross-subsidization.

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When we find that Buckeye can, in certain markets, "exercise significant market power" we find that, as to those markets, Buckeye has monopoly power. The rate cap and trigger thus are necessary to impose a proper discipline in those markets. They ensure that, even if Buckeye has significant market power, it cannot exercise that power. This is precisely the sort of monitoring mechanism necessary to ensure that rates remain within a zone of reasonableness.

In summary, when we rely on competitive markets to ensure just and reasonable rates we must act to ensure that, as to all of its markets, Buckeye cannot enjoy the force of its market power and that its rates are just and reasonable. The regulatory scheme the Commission develops must "act[] as a monitor to see if this occurs or to check rates if it does not." *Farmers Union II*, 734 F.2d at 1509. On the record we have here, the rate cap and trigger are necessary to do precisely that.

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Buckeye Pipe Line Company, L.P.)	Docket No. IS87-14-000, et al.
)	and OR88-3-000

ERRATA NOTICE

(January 23, 1991)

OPINION NO. 360

OPINION AND ORDER ON INITIAL DECISION

(Issued December 31, 1990)

Page One, Second Paragraph, Line 12, should read: "market power, the Commission will, in those markets in which ATA is found to have standing, remand the case to the ALJ, if necessary, to determine the appropriate base rates to which the rate caps will apply and to resolve the amount of reparations, if any, to which ATA may be entitled in its pending complaint against Buckeye's rates."

Lois D. Cashell
Secretary