

b. These other factors might include ease of entry, excess capacity held by competing sellers, and buyer power.

Each of these steps is discussed further below. In section B of this part is an example showing the application of this analysis to a hypothetical interstate pipeline in a market supplied by a number of pipelines.

There are some services that are more likely to pass these criteria than others. These are discussed more fully in section IV.C. below.⁴⁶ For example, IT and hub services have different characteristics than firm transportation and might more easily satisfy these criteria. If the capacity release program is functioning well, IT service may compete with capacity release offered by all of the pipeline's customers in the relevant zones. Capacity release may be a good alternative for IT service. There are, by definition, several pipelines at each market hub.⁴⁷ Each of the pipelines at the hub may be able to offer the same hub services as good alternatives to each other.

As a practical matter, it may well be difficult for long-term firm transportation to qualify under this framework. The nature of the transportation grid ensures that pipelines typically face few direct competitors in delivering gas from one point to another. In addition, given the long-term contracting for firm transportation service that exists, staff believes it may be difficult for pipelines to show that customers have the ability to freely move to alternative long-term transportation. For example, if a pipeline that proposes market-based rates for firm transportation has existing long-term contracts for that service, the pipeline would need to allow its customers to terminate their contracts to freely move to alternative services.

1. Market Definition

Market definition identifies the specific products or services and the suppliers of those products or services that provide good alternatives to the applicant's product or service. In this market staff would test the applicant's ability to exercise market power. Naturally, the more narrowly the market is defined, the harder it is to show a lack of market power.

The Commission's order approving market-based storage rates for Koch

⁴⁶ This paper does not attempt to analyze the capacity release market or IT service in any detail but the same general framework would apply to these.

⁴⁷ See "Importance of Market Centers," Office of Economic Policy, FERC (Washington, D.C.), August 21, 1992. Some pipelines have defined market hubs differently.

Gateway, defined good alternatives as follows:

A good alternative is an alternative that is available soon enough, has a price that is low enough, and has a quality high enough to permit customers to substitute the alternative for Koch Gateway's service.⁴⁸

a. The Product Market

The applicant's service together with other services that are good alternatives constitute the relevant product market. The applicant must fully, and specifically, define the product market. For example, the applicant must be specific in defining whether the product market consists of firm transportation only, or if the product market consists of off-peak interruptible transportation service only, etc. The applicant must also be responsible for developing and justifying any substitutes for the relevant product that can be considered competitive alternatives, e.g., storage delivery services, gathering services, etc. For example, pipelines might suggest numerous alternatives to FT in their applications: IT, storage services, residual fuel oil, etc.

It is likely that applicants will argue that the market should be defined broadly. Given the natural monopoly features of many transportation services, staff suggests that the Commission take a more conservative approach and define the product market narrowly as only firm transportation. For purposes of defining relevant gas transportation markets, staff focuses here on the pipeline customers' peak.⁴⁹

i. Timeliness

Generally, antitrust authorities have used one year as the time period in which to test whether a product can become a substitute. This is probably not appropriate for long-term firm transportation because capacity on competitors would typically need to be available simultaneously to offer a viable alternative to customers. If the pipeline applicant relies on the existence of capacity that will not be available immediately, it would also need to show that its customers would not be committed to long term contracts on its system under the operation of the right of first refusal rules, so that the alternative would not be available.

ii. Price

Along with showing that alternative capacity will be available in a reasonable time frame, the applicant

⁴⁸ *Koch Gateway*, 66 FERC at 62,299.

⁴⁹ During the winter peak period we would expect that excess capacity would be at a minimum and that customers' alternatives would be fewer than in off-peak periods.

must demonstrate that the price for the available capacity is low enough to effectively restrain the applicant from increasing prices. In prior cases, the Commission has defined such a threshold price level as being at or below the applicant's *approved* maximum cost-based rate plus 15%.⁵⁰

The regulated price has been used as the prevailing price—a proxy for the competitive price. This is necessary because almost all prices for transportation are regulated and a competitive price level would be at best a guess. However, the use of prevailing prices presents analytic problems. For example, three pipelines that follow parallel courses may have radically different rates because of different historical costs, despite the fact that in a competitive market they would offer almost identical services at almost identical prices. Which of the alternative pipelines' prices should be used as the "prevailing" price? This question would have to be addressed in deciding whether the prices of alternatives are appropriate references.

iii. Quality

A good alternative must provide service in which the quality is at least as high as that of the service provided by the applicant. In order to make this showing the applicant must first be required to describe its own services. Then, the applicant must demonstrate that any available third party capacity must be comparable in service to the transportation service provided by the applicant.

Staff believes that with Order Nos. 436 and 636, all interstate pipelines currently provide operationally comparable firm transportation (FT) service.

However, even if a customer can find available capacity on an alternative pipeline, the overall package of services available may not be comparable to that it currently receives from the applicant. For instance, no-notice service may not be available from other pipelines (though a similar service might be available from third parties). Under Order No. 636 interstate pipelines

⁵⁰ In *Buckeye Pipe Line Company, L.P.*, Opinion No. 360, the Commission held that a 15 percent increase was an appropriate level to measure market power. 53 FERC 61,473 at 62,681 (1990), *order on reh'g*, Opinion No. 360-A, 55 FERC ¶ 61,084 (1991). However, in *Williams Pipe Line Co.*, Opinion No. 391, the Commission declined to adopt a specific rate increase as a litmus test for market power. 68 FERC ¶ 61,136 at 61,657. In *Koch Gateway Pipeline Company*, the Commission suggested that potential alternatives would include services that though presently not used, would be economic if prevailing prices were to rise by a modest amount, e.g., five to 15 percent. 66 FERC ¶ 61,385.