

NOTE

WILLIAMS GAS PROCESSING—GULF COAST COMPANY, L.P. v. FERC: REMEDIES FOR PRODUCERS IN THE ABSENCE OF FERC REGULATION

I. INTRODUCTION

Williams Gas Processing Company (WGP), a wholly-owned subsidiary of The Williams Companies, petitioned for review of orders entered by the Federal Energy Regulatory Commission (FERC) claiming jurisdiction under the Natural Gas Act (NGA), over the gas gathering activities of Williams Field Services (WFS), a subsidiary of WGP. The FERC reasoned that WFS fell within its jurisdiction under the NGA because WFS and Transcontinental Gas Pipeline Company (Transco), a regulated subsidiary of The Williams Companies subject to the FERC's jurisdiction, acted in concert in a manner frustrating the FERC's ability to regulate Transco.¹ The FERC also asserted jurisdiction over WFS and Transco under the Outer Continental Shelf Lands Act (OCSLA).² The United States Court of Appeals for the District of Columbia Circuit granted WGP's petition for review and determined that the FERC's assertion of jurisdiction over WFS was arbitrary and capricious,³ and the FERC's authority under section 5(f)(1) of the OCSLA does not include the power to enforce the Act's open access terms.⁴

As a result of the court's holding in this case, gas producers will find it difficult to look to the FERC for relief from gas gathering affiliates that charge exorbitantly high prices. Such producers will have to find relief through other legal or economic remedies. Relief for gas producers is more likely to come either through the antitrust law, or (more slowly) through the exercise of natural economic forces associated with competitive markets. Market theorists see merit and shortcomings in either approach.

II. THE FERC'S JURISDICTION OVER "SPUN-DOWN" GATHERING AFFILIATES

A. *Facts of the Case*

Prior to November of 2000, Transco operated gathering facilities off the shores of North Padre Island, Texas in the Gulf of Mexico. These gathering facilities, known as the North Padre Island (NPI) gathering facilities, consist of two small branches of pipeline, which join offshore at a Transco pipeline that transports gas to an onshore gas processing facility. From there, the gas is transported to Transco's main transmission line.⁵ In November of 2000 Transco sought and received approval from the FERC to "spin down" these gathering facilities to WGP, Transco's gathering affiliate.⁶ The spin-down of the NPI

1. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1335 (D.C. Cir. 2004).

2. *Id.* at 1345.

3. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1343.

4. *Id.* at 1345.

5. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1338–39.

6. *See Transcon. Gas Pipeline Corp.*, 96 F.E.R.C. ¶ 61,115 (2001) (approving Transco's spin-down of

facilities was completed in December of 2001 and WGP subsequently delegated the operation of those facilities to WFS.⁷

Shell Offshore, Inc. (Shell) produced gas in the vicinity of the NPI gathering facilities, and used those facilities to transport its gas to Transco's main transmission line. Prior to the spin-down, Shell paid Transco \$0.08/dekatherm to transport Shell's gas 230 miles to Transco's main transmission line (three miles to the interconnection at the main feeder line, and 227 miles to Transco's main line). After the spin-down WFS notified Shell that it would charge \$0.12/dekatherm for the three mile transport to the feeder line, and Transco agreed to maintain its rate of \$0.08/dekatherm for the 227 mile transport of the gas. In essence, before the spin-down Shell was paying \$0.08/dekatherm for 230 miles worth of gas transportation, and after the spin-down it was asked to pay \$0.20/dekatherm to transport its gas over the same distance.⁸

Shell sought relief from the FERC under the NGA. In order to decide the dispute, the FERC assigned the responsibility of making a finding as to the nature of the actions of Transco and WFS to an administrative law judge. However, the FERC retained the right to decide whether or not it should assert jurisdiction over WFS's NPI gathering facilities pursuant to the NGA. The judge found that Transco and WFS had acted in concert, and in a manner frustrating the FERC's effective regulation of Transco.⁹ Subsequently, the FERC affirmed this decision and asserted jurisdiction over the NPI gathering facilities. The FERC explained that the concerted actions of both WFS and Transco effectively allowed the two companies to be treated as one. Under the FERC's reasoning, because the FERC would normally have jurisdiction over Transco, it now had jurisdiction over WFS's NPI gathering facilities. Furthermore, the FERC asserted jurisdiction over the rates and services of both companies pursuant to the OCSLA. The FERC reasoned that because both companies had acted in concert and abused their monopoly powers, both had violated the open-access and non-discrimination provisions of the OCSLA.¹⁰ WGP sought review of these findings by the FERC.

B. Issues

The issues in this case stem from Transco's spin down of its NPI gas gathering facilities to WGP and subsequently to WFS. It is important to note that this case deals with the "spin down" of assets to an affiliate rather than a "spin off" of assets. The difference between these two terms has a substantial impact on the outcome of the case. The term "spin off" is used when a facility or asset is transferred to an unrelated entity.¹¹ The FERC has made it clear that gathering facilities, once owned by a FERC-regulated entity and spun off to an unaffiliated entity, fall outside the FERC's NGA jurisdiction.¹² Consequently, if

NPI gathering facilities to WGP).

7. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1339 (D.C. Cir. 2004).

8. *Id.*

9. *Shell Offshore, Inc.*, 99 F.E.R.C. ¶ 63,034, 65,230 (2002).

10. *Shell Offshore, Inc.*, 100 F.E.R.C. ¶ 61,254, 61,914, 61,915 (2002).

11. *Natural Gas Gathering Servs. Performed by Interstate Pipelines and Interstate Pipeline Affiliates*, 65 F.E.R.C. ¶ 61,136, 61,194 (1993).

12. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1337.

Transco had sold the NPI gathering facilities to a separate, unaffiliated entity, the FERC would not have jurisdiction over that entity. In contrast, the term “spin down” describes a transaction where an interstate pipeline transfers ownership of an asset to a related corporate affiliate.¹³

The FERC’s jurisdiction over a spun-down gathering affiliate had not been addressed prior to this case. As a result of Transco’s spin down of its NPI gathering facilities to WGP, two main issues arose for review. First, WGP challenged whether the FERC could assert jurisdiction under the NGA over WFS as a gatherer affiliated with a FERC-regulated entity such as Transco. Second, the court considered whether section 5(f)(1) of the OCSLA gives the FERC general authority to enforce the OCSLA’s open-access and non-discrimination provisions.

III. THE RELEVANT LAW PRIOR TO THE CASE

Under the NGA, the FERC has “jurisdiction over rates charged by any ‘natural-gas company for or in connection with the transportation or sale of natural gas.’”¹⁴ The Act goes on to define a “natural-gas company” as a company “engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.”¹⁵ The Act explains that natural gas gathering, which encompasses the extraction of natural gas from gas wells and transporting it to a collection point, is not included within the jurisdiction of the Act.¹⁶ However, the FERC has long maintained that it has jurisdiction over gas gathering services provided by jurisdictional interstate pipelines.¹⁷

The FERC illustrated its understanding of the scope of its authority in this area in a decision involving Arkla Gathering Services Company. There, the FERC stated that “companies that perform only a gathering function, whether they are independent or affiliated with an interstate pipeline, are not natural gas companies because they neither transport natural gas in interstate commerce, nor sell such gas in interstate commerce for resale.”¹⁸ Although the FERC conceded that the activities of independent gas gatherers do not fall within its jurisdiction, it asserted its ability to regulate a spun-down gathering affiliate in certain situations. The FERC further cautioned that when a gas gatherer affiliated with an interstate pipeline acted in concert with that pipeline in a manner frustrating the FERC’s ability to effectively regulate the pipeline, it could then disregard the corporate structure, and treat both as one entity.¹⁹ The FERC noted that the following activities between an affiliated gatherer and an interstate pipeline would allow it to assert jurisdiction: (1) tying oil and gas gathering services to the pipeline’s FERC-regulated transportation service, (2) providing transmission rate discounts only to those who used the affiliate’s gathering service, and (3)

13. 65 F.E.R.C. ¶ 61,136, at 61,194.

14. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1335, 1336 (D.C. Cir. 2004) (quoting Natural Gas Act § 4(a), 15 U.S.C. § 717c(a) (2000)).

15. *Id.* (quoting 15 U.S.C. § 717a(6)).

16. 15 U.S.C. § 717(b) (2000) (stating “this chapter . . . shall not apply to . . . the production or gathering of natural gas”).

17. *See N. Natural Gas Co.*, 43 F.E.R.C. ¶ 61,473 (1988).

18. *Arkla Gathering Servs. Co.*, 67 F.E.R.C. ¶ 61,257, 61,871 (1994).

19. This position set forth by the FERC is known as the “*Arkla Gathering* test.”

cross-subsidization of rates charged by the affiliate gatherer and the pipeline.²⁰ Nevertheless, the issue surrounding anti-competitive trade practices between an interstate transportation pipeline and its gathering affiliate had not been litigated until the present case.

The second issue the court reviewed in this case revolved around the FERC's authority to enforce the OCSLA's open-access and non-discrimination provisions. The relevant portion of the statute states "every permit, license, easement, right-of-way, or other grant of authority for the transportation by pipeline on or across the outer Continental Shelf of oil or gas shall require that the . . . pipeline must provide open and nondiscriminatory access to both owner and nonowner shippers."²¹ The FERC maintains responsibility for issuing permits or licenses to those wishing to transport oil and gas over the outer Continental Shelf, and pursuant to that authority, which is provided under the NGA, is required to impose the terms of the OCSLA in its licenses and permits.

In a prior case, *The Williams Companies v. FERC*,²² the D.C. Circuit determined that the FERC had overstepped its authority when it tried to require companies operating on the Outer Continental Shelf (OCS) to file pricing and service information with the agency.²³ The outcome of this case turned on the pertinent language of the OCSLA, which explains that companies holding a license or permit to transport oil and gas across the OCS must provide open and non-discriminatory access to their facilities.²⁴ The court held that the plain language of the statute does not grant the authority that the FERC claims. That is, the text of the OCSLA does not supply the FERC with the general authority to create and impose open-access and non-discrimination rules on those operating on the OCS.²⁵

IV. THE COURT'S DECISION

The D.C. Circuit vacated the FERC's order and remanded the case for further proceedings.²⁶ In doing so, the court analyzed the assertion of NGA jurisdiction over WFS, and rejected the FERC's finding that WFS and Transco had engaged in the kind of concerted action posited by the Arkla Gathering test. The court noted that WFS, being an unregulated entity, would be allowed to charge \$0.12/dekatherm for gathering services regardless of its relationship with Transco. Therefore, because WFS's allegedly anti-competitive behavior did not stem specifically from its relationship with Transco, its activities did not constitute concerted behavior within the meaning of *Arkla Gathering*.²⁷

Second, the court determined that the FERC misapplied the second part of the *Arkla Gathering* test. According to the court, the FERC failed to reach the second part of the test (assessing whether the concerted action of the gatherer and the pipeline frustrates the FERC's ability to regulate the pipeline). Under *Arkla Gathering*, an analysis of *both* parts of the test is required before the FERC

20. 67 F.E.R.C. ¶ 61,257, at 61,871.

21. Outer Continental Shelf Lands Act § 5(f)(1), 43 U.S.C. § 1334(f)(1)(A) (2000).

22. *The Williams Cos. v. FERC*, 345 F.3d 910 (D.C. Cir. 2003).

23. *Id.*

24. 43 U.S.C. § 1334(f)(1)(A).

25. *The Williams Cos.*, 345 F.3d at 916.

26. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1335, 1345 (D.C. Cir. 2004).

27. *Id.* at 1343.

can assert jurisdiction.²⁸ The FERC never determined whether WFS's activities impeded its ability to effectively regulate Transco; it simply determined that it could attribute WFS's anti-competitive pricing activities to Transco and then apply the regulatory authority provided by the NGA to both entities. As the court described the FERC's reasoning, "[i]f WFS is Transco, and Transco is subject to just and reasonable rate regulation, then WFS's (Transco's) price hikes frustrate FERC's ability to maintain just and reasonable rates on Transco (which includes WFS)."²⁹ The court held this misapplication of the *Arkla Gathering* test to be arbitrary and capricious.³⁰ As a result, the court declined to reach the question whether the NGA allows the FERC to assert jurisdiction over spun-down gathering affiliates of jurisdictional pipelines.

In addition to rejecting the FERC's jurisdiction over WFS based upon the application of the *Arkla Gathering* test and the NGA, the court also dismissed the FERC's contention that it had jurisdiction over WFS under the OCSLA.³¹ In reaching this conclusion, the court applied the plain-language interpretation of the OCSLA expressed by the court in *The Williams Companies*. In response to this, the FERC first argued that the holding of that case applies only to FERC rule-makings and not to FERC adjudications. Alternatively, the FERC contended that it had OCSLA jurisdiction over WFS because it was enforcing the Act's open-access and non-discrimination provisions contained within a license or permit that the FERC had granted to Transco.³²

The court rejected both arguments. In response to the first argument, the court explained there was no discussion anywhere in *The Williams Companies* that could be construed as supporting the FERC's contention that the opinion should be limited to FERC rulemakings. The court stated, "[w]hether the Commission acts in a rulemaking or adjudicatory capacity, its authority under OCSLA is limited by the plain language of the statute to that of a licensor."³³

Additionally, the court rejected the FERC's alternative argument—that it was simply enforcing non-discrimination and open-access provisions in an existing OCSLA license—because the FERC had not asserted it as a basis for its resolution of Shell's complaint. According to the court, "post hoc rationalizations by agency counsel will not suffice."³⁴

V. ANALYSIS

After the D.C. Circuit's decision in *Williams Gas Processing—Gulf Coast*, gas producers are more susceptible to the pricing strategies of affiliated, unregulated gas gatherers such as WFS. Nonetheless, gas gatherers have at least two alternative forms of recourse: (1) under federal or state antitrust laws, and (2) possibly from the natural laws of economics in competitive markets.

28. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1343.

29. *Id.*

30. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1343.

31. *Id.* at 1344.

32. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1335, 1344–45 (D.C. Cir. 2004).

33. *Id.* at 1344.

34. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1344 (quoting *W. Union Corp. v. FCC*, 856 F.2d 315, 318 (D.C. Cir. 1988)).

A. Antitrust Law

As a result of the court's decision in this case, except where the FERC determines that the *Arkla Gathering* test applies and a pipeline and gathering affiliate should be considered one entity regulated by the FERC, a producer will have to turn to state or federal antitrust laws when a gathering affiliate appears to act in an anti-competitive manner.³⁵ Generally, if a gas producer wants relief from a gas gathering affiliate's high gathering service prices, it might consider filing suit in federal court alleging illegal monopolization in violation of section 2 of the Sherman Act.³⁶

In addition, customers like Shell may be captive for several legitimate reasons other than anti-competitive pricing strategies by gas gatherers. First, the producers may have simply located their gas wells in areas that, although rich in gas, present difficult conditions of operation. In these cases, few gatherers may have the capability to service such areas.³⁷ Second, customers may be captive to gatherers with high gathering rates because of their own low volume of gas production. This may present a situation where few gatherers would want to service the basin because it may not be as profitable as another basin.³⁸ Third, customers may be tied to a particular gatherer, whether they currently like it or not, due to previous contracts between the customer and the gas gatherer. If the contract itself does not smell of anti-competitive activities on the part of the gatherer, then this would appear to be a legitimate transaction.³⁹ Fourth, and last, a gatherer may have achieved a market advantage, with respect to particular producer or group of producers, due to its effective deterrence of competitors.⁴⁰ The gatherer may operate more efficiently, it may be larger and can leverage economies of scale, or it may just have more industry experience and savvy. Whatever the case, it is important to remember that just because a gas gatherer, which is either affiliated with an interstate pipeline or independent, dominates a basin does not mean it has engaged in illegal anti-competitive activities.

B. Economics and Competitive Markets

In addition to antitrust law, simple economic concepts relating to the stimulation of market activity may substitute as a form of relief for producers like Shell in areas once regulated by a government agency such as the FERC. Per the instruction of the NGA, companies that conduct only gas gathering activities, whether independent or affiliated with an interstate pipeline, are not

35. *Arkla Gathering Servs. Co.*, 69 F.E.R.C. ¶ 61,280, 62,088 (1994).

36. The Sherman Act states, in pertinent part, the following:

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding \$100,000,000 if a corporation, or, if any other person, \$1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 2 (2000). The Act goes on to define the term "person" to include "corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country." 15 U.S.C. § 7 (2000).

37. John Burrit McArthur, *Anti-trust in the New Deregulated Natural Gas Industry*, 18 ENERGY L.J. 1, 62 (1997) [hereinafter McArthur].

38. *Id.* at 62.

39. McArthur, *supra* note 37, at 62.

40. *Id.*

“natural gas companies.” The reason for this categorization, or better yet—exclusion, is that these types of companies do not transport or sell for resale natural gas in interstate commerce.⁴¹ Such an extension of authority over these kinds of firms would exceed any commerce clause powers afforded an agency by the U.S. Constitution. Thus, because of their exclusion from the FERC’s jurisdiction via the NGA, these entities must be governed under some other set of laws. Some believe the natural laws of economics will suffice; others believe to the contrary. The rest of this subsection is devoted to this discussion.

The basic premise subscribed to by those advocating free competition, as opposed to government regulation or regulation through antitrust laws, is that the interests of buyers and sellers in a market will counter-balance each other to the point where the seller maximizes profits and the buyer minimizes costs.⁴² Market theorists subscribing to this philosophy posit that it is irrational for a seller to set prices above a competitive level. As soon as this occurs, companies not currently participating in the market will enter the market and prices will retreat to the competitive level.⁴³ In addition, some feel that the threat of entry is enough to keep prices set at a fair rate. According to those supporting this “potential-entrant” or “contested market” theory, monopolists can be deterred purely through the perceived potential of others entering a market.⁴⁴ Based on these theories, it is believed that unrestrained monopolies will not be sustained for long periods. It could be argued that it is just not that simple for a company to enter a market whenever it feels there are excess profits to be reaped. However, those advocating free competition point out that the costs attributed to market entry are not nearly so steep, and these costs can often be recovered because assets required to conduct business in a market can be leased or sold if the endeavor fails.⁴⁵

There are several views in opposition to the theory that no regulation is the best form of regulation and that the natural laws of economics and competitive markets will suffice to regulate an industry. One view opposing this theory adheres to the premise that firms, which somehow achieve substantial cost savings, will eventually morph into monopolists. And, as monopolists, these firms will try to set prices as high as possible, which is not in the best interests of society.⁴⁶ Proponents of this idea state that market regulation solely through the forces that operate within a competitive market depends on certain unrealistic assumptions. For example, those market theorists in favor of deregulation often make assumptions that depend on perfect information, nominal barriers to entry, and other assertions in the way of perfect competition.⁴⁷

Another view adhered to by market theorists posits that blindly allowing all

41. *Arkla Gathering Servs. Co.*, 67 F.E.R.C. 61,257, 61871 (1994).

42. This theory is known to economists as economic or market equilibrium. Equilibrium occurs where each of the players in a market engage in activities that maximize a desired outcome. For a seller the desired outcome is to receive the highest prices the market will bear. Conversely, for a buyer the goal is to pay the lowest price possible. See William R. Parke, *Classic Economic Models*, ECONOMIC TERMS, at <http://www.econmodel.com/classic/terms/equilibrium.htm> (last visited Oct. 7, 2005).

43. McArthur, *supra* note 37, at 52.

44. William Baumol, John Panzar & Robert Willig, *Contestable Markets and the Theory of Industry Structure*, 1 YALE J. ON REG. 111, 120 (1984).

45. McArthur, *supra* note 37, at 52.

46. *Id.* at 49.

47. McArthur, *supra* note 37, at 49.

markets to regulate themselves through natural economic forces will fail because all markets are different. Each market contains different types of players and certain imperfections that must be considered on a case-by-case basis. For each market, certain questions flushing out the market's ability to truly behave in a competitive manner, as well as the existence of any imperfections that might perpetuate abusive pricing, must be addressed before a decision can be made as to how it should be regulated.⁴⁸ If, for example, it is found that a market is truly competitive in nature, then maybe this market is a candidate for the "no regulation is the best regulation" approach. Conversely, if findings illustrate market characteristics opposite this, an interventionist approach might be necessary. Similarly, market imperfections tending to foster price discrimination and other abuses might also warrant agency or judicial intervention. Therefore, according to opponents of regulation through no regulation, the existence of market imperfections and questions around a market's ability to perform competitively must always be scrutinized when determining the form of regulation best suited to maximize social utility.⁴⁹

VI. CONCLUDING WILLIAMS GAS PROCESSING—GULF COAST COMPANY⁵⁰

The FERC first claimed that under certain circumstances it could assert jurisdiction over an oil and gas gatherer per the provisions of the NGA.⁵¹ The court in this case did not deny that there are situations where the FERC can regulate the activities of an oil and gas gatherer. In fact, the court reaffirmed the validity of the *Arkla Gathering* test, which if applied correctly, would allow the FERC to assert jurisdiction over a gatherer. However, when a conclusion is drawn equating a gatherer to an interstate pipeline because it is believed the two entities acted in concert, without actually analyzing whether the actions of the two entities frustrated the FERC's ability to regulate the pipeline, the test has been misapplied and does not justify assertion of the FERC's jurisdiction over the gatherer.⁵²

In addition, the FERC determined it could regulate gathering facilities that violate the open-access and non-discrimination provisions of the OCSLA.⁵³ In addressing this issue the court relied on one of its prior decisions where it determined that nothing in the language of the OCSLA granted the FERC general or broad power to create and enforce open access rules on the OCS. Furthermore, the court noted that the only authority the FERC had in this area was to enforce the OCSLA provisions incorporated into the licenses it issued to operators on the OCS.⁵⁴

The determinations made by the court clarify the permissible actions of a spun-down gathering affiliate, but a question is raised as to the remedies

48. *Id.* at 56.

49. McArthur, *supra* note 37, at 56.

50. On remand, the FERC, in consideration of the decision in *Williams Gas Processing—Gulf Coast Company*, determined "there is not a sufficient basis to reassert NGA jurisdiction or to assert OCSLA jurisdiction over the gathering rates and services of WFS' North Padre Island gathering facilities." *Shell Offshore, Inc.*, 110 F.E.R.C. ¶ 61,162 (2005).

51. *Williams Gas Processing—Gulf Coast Co. v. FERC*, 373 F.3d 1335, 1342 (D.C. Cir. 2004).

52. *Id.* at 1343.

53. *Williams Gas Processing—Gulf Coast Co.*, 373 F.3d at 1343.

54. *Id.* at 1344.

available to those producers like Shell now at the mercy of a spun-down gatherer. Where the oil and gas industry was once heavily regulated and producers could rely on protection from the FERC, this protection is now waning as companies come up with new and innovative ways to operate. However, at least two remedies are still available: (1) regulation via antitrust law and (2) regulation imposed by the natural laws of economics inherent in free markets. The most favorable option depends on one's perspective and maybe one's patience.

Sean Hennessee

