

# ANTITRUST AND THE NATURAL GAS INDUSTRY

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Because of deregulation, the 1980s have seen an increased amount of anti-trust litigation in the natural gas industry. The first wave of cases coincided with the sudden availability of cheap spot market gas that purchasers wished the pipelines to transport. This gas became available as a result of the significant deregulation of well head prices effected by the Natural Gas Policy Act of 1978.<sup>1</sup> If there is a second wave of cases, it will result from further steps which have been taken to deregulate the industry. These steps have broadened the pipelines' antitrust exposure by subjecting more of their activities to business judgment rather than regulatory edict. The electrical industry is on the threshold of deregulation and may well experience a similar increase in anti-trust litigation.

The natural gas antitrust litigation has been brought by State Attorneys General in *parens patriae* and class actions on behalf of gas consumers, cities owning gas utilities, local distribution companies (LDCs), and end-users. In contrast, except for merger cases, the federal antitrust agencies have been essentially inactive with respect to the industry. However, the new Administration's antitrust chief, James F. Rill, has promised vigorous antitrust enforcement.<sup>2</sup> An ABA task force has "recommend[ed] that the new Administration be particularly sensitive to competitive conditions in newly deregulated industries."<sup>3</sup>

## I. RELEVANT FEDERAL ANTITRUST STATUTES

Section 1 of the Sherman Act<sup>4</sup> prohibits contracts, combinations, or conspiracies in restraint of trade. It applies to such concerted actions as agreements to fix prices, divide territories, or restrict production. In the natural gas industry, it has also been invoked in refusal-to-transport cases on a *tying theory*<sup>5</sup> that the pipeline is conditioning the sale of transportation services upon

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The author was lead counsel for the defendant in *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 730 F. Supp. 826 (C.D. Ill. 1990) (ruling that defendant Panhandle's conduct in the sale and transportation of natural gas in central Illinois did not violate the antitrust laws).

1. Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 (1988).

2. 56 Antitrust & Trade Reg. Rep. (BNA) No. 1421, at 883 (June 22, 1989).

3. American Bar Association Section of Antitrust Law Task Force on the Antitrust Division of the U.S. Dep't of Justice, Report (July 19, 1989), reprinted in 57 Antitrust & Trade Reg. Rep. (BNA) No. 1425, at S-13 (Special Supplement July 20, 1989).

4. Sherman Act, 15 U.S.C. § 1 (1988).

5. "A pipeline/supplier that controlled customers' access to natural gas through its pipeline system, controlled the cost of natural gas . . . [and] possessed monopoly power over natural gas sales to 'captive' local distribution companies. *Illinois ex rel. Hartigan v. Panhandle E.*, 730 F. Supp. 826 (C.D. Ill. 1990).

the purchase of its own gas.<sup>6</sup>

Section 2 of the Sherman Act<sup>7</sup> prohibits monopolization as well as attempts and conspiracies to monopolize. In the natural gas industry, the prohibition applies to single firm conduct such as pipeline refusals to transport, refusals to take, predatory pricing, and abuses of the regulatory process.

Acquisitions, mergers and joint ventures are covered by section 7 of the Clayton Act.<sup>8</sup> Joint ventures can additionally or independently be challenged under section 1 of the Sherman Act.

A pipeline's sales of system supply gas at discriminatory rates conceivably could be attacked under the Robinson-Patman Act,<sup>9</sup> which prohibits price discrimination in sales of commodities where the effect may be to lessen competition or create a monopoly.

## II. THE INDUSTRY'S TRANSITION FROM REGULATION TO COMPETITION

The industry's transition from regulation to competition resulted from a number of ground-breaking Congressional acts, Federal Energy Regulatory Commission (FERC) orders, and court decisions. Most important were the Natural Gas Policy Act of 1978 (NGPA),<sup>10</sup> the District of Columbia Circuit's decision in *Maryland People's Counsel v. FERC* case,<sup>11</sup> and Order No. 436.<sup>12</sup>

Until recently, interstate natural gas pipelines operated primarily as gas merchants who purchased gas from producers, transported it over their pipelines, and resold it primarily to LDCs. The Federal Power Commission (FPC) and its successor, the FERC, regulated the pipelines' entry into and exit from markets, their terms and conditions of transportation, and the prices at which they purchased and resold gas.

The NGPA provided for a phased deregulation of gas prices at the well-head. The impetus for this legislation was the gas shortage of the 1970s, which many thought had been caused by industry regulation. The NGPA produced the desired result, an increase in the production of gas. Unfortunately, because of a decline in demand owing to conservation, increased prices, and other factors, a gas surplus developed which has been labeled the "gas bubble." This surplus gas, also called off-system gas, was offered by producers on a spot market directly to end-users at prices below pipeline LDC rates. Because pipelines were purchasing their gas at high prices under long-term contracts entered into during the gas shortage period, pipeline gas was highly priced by comparison.

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6. *See id.*, (applying rule of reason analysis, the court found for defendant on the State's tying claim); *Reynolds Metals Co. v. Commonwealth Gas Servs. Inc.*, 682 F. Supp. 291 (E.D. Va. 1988) (denying defendant's motion for summary judgment on tying and essential facilities claims with proceedings subsequently stayed).

7. 15 U.S.C. § 2 (1988).

8. Clayton Act, 15 U.S.C. § 18 (1988).

9. Robinson-Patman Act, 15 U.S.C. §§ 13-136,21a (1988).

10. 15 U.S.C. §§ 3301-3432 (1982).

11. *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) [hereinafter *MPC II*].

12. Order No. 436, 50 Fed. Reg. 42,408 (1985) (codified at scattered sections of 18 C.F.R.), *vacated and remanded*, *Associated Gas Distrib. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988) [hereinafter Order No. 436].

The high price of pipeline gas sold to LDCs caused a growing number of fuel switchable customers of the LDCs to leave the system in favor of alternative fuels, principally fuel oil. To check this trend, the FERC in 1983 issued Order Nos. 319<sup>13</sup> and 234-B,<sup>14</sup> under which pipelines could obtain “blanket certificates” to transport the cheaper off-system gas to fuel switchable customers. A blanket certificate provided transportation authority without the need for a hearing as to each transaction.

In *MPC II*, the D.C. Circuit vacated and remanded Order Nos. 319 and 238-B. The Commission was directed to consider the antitrust implications of the orders’ failure to require that pipelines which obtained blanket certificates must also transport for LDCs and their customers who did not have fuel switching capabilities.

In response to *MPC II*, the FERC issued Order No. 436<sup>15</sup> which provided that if a pipeline chose to obtain a blanket certificate to transport off-system gas, it had to transport on a non-discriminatory basis. The effect of Order No. 436 was to unbundle pipeline transportation services from gas sales and to make pipelines open-access transporters. Order No. 436 also authorized pipelines to engage in selective discounting within approved ceiling and floor rates and made it possible for them to initiate new services more quickly through optional expedited certificates.

Most of Order No. 436 was upheld by the D.C. Circuit in *Associated Gas Distributors v. FERC*,<sup>16</sup> but the court remanded the order because of the Commission’s failure to deal with the pipelines’ serious take-or-pay problem. The Commission later attempted to address that problem in Order No. 500.<sup>17</sup>

Today, virtually all major interstate pipelines have become certificated as open-access transporters under Order Nos. 436 and 500. While transportation of off-system gas previously constituted a small percentage of pipeline throughput, it now constitutes over 70%. Moreover, pipelines have become

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13. Order No. 319, *Interstate Pipeline Blanket Certificates for Routine Transactions and Sales and Transportation by Interstate Pipelines and Distributors*, [1982-1987 Proposed Regs.] F.E.R.C. Stats. & Regs. ¶ 30,477, 48 Fed. Reg. 34,875 (1983) (codified at 18 C.F.R. § 157.209(e) (1984)), *vacated*, Maryland People’s Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985).

14. Order No. 234-B, *Sales and Transportation by Interstate Pipelines and Distributors; Expansion of Categories of Activities Authorized Under Blanket Certificate*, [1982-1985 Regs. Preambles] F.E.R.C. Stats. & Regs. ¶ 30,476, 48 Fed. Reg. 34,875 (1983) (codified in relevant part at 18 C.F.R. §§ 157.202, 157.209 (1984)), *vacated*, Maryland People’s Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985).

15. See Order No. 436, *supra* note 12.

16. *Associated Gas Distrib. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

17. The interim order was issued in 1987. Order No. 500, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, III F.E.R.C. Stats. & Regs. ¶ 30,761, 52 Fed. Reg. 30,334 (1987). The FERC subsequently modified Order No. 500 in Order No. 500-B, III F.E.R.C. Stats. & Regs. ¶ 30,772, 52 Fed. Reg. 39,630; Order No. 500-C, III F.E.R.C. Stats. & Regs. ¶ 30,786, 52 Fed. Reg. 48,986 (1987); and Order No. 500-D, III F.E.R.C. Stats. & Regs. ¶ 30,800, 53 Fed. Reg. 8439 (1988). After the D.C. Circuit’s opinion in *American Gas Ass’n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989), the Commission issued a final rule, Order No. 500-H, III F.E.R.C. Stats. & Regs. ¶ 30,867, on December 21, 1989, 54 Fed. Reg. 52,344 (1989), a rehearing order, Order No. 500-I, III F.E.R.C. Stats. & Regs. ¶ 30,880, on February 12, 1990 [hereinafter Order No. 500].

more competitive with each other and with providers of alternative fuels by offering special seasonal rates and discounts.

### III. INDUSTRY PRACTICES LIKELY TO RECEIVE ANTITRUST SCRUTINY

The FERC has a limited but important role in applying antitrust policy in the natural gas industry. It lacks power to directly enforce the antitrust laws.<sup>18</sup> In some circumstances, the FERC's approval of a practice will not bar a subsequent antitrust suit.<sup>19</sup> However, a long line of cases holds that the FERC must consider antitrust policy in making its public interest determinations.<sup>20</sup> As the Supreme Court said in *Gulf States Utilities Co. v. FPC*,<sup>21</sup> the Commission's consideration of antitrust issues serves as a first line of defense against anticompetitive practices in the industry.

The Commission has considered antitrust issues in formulating its existing transportation orders and its recently issued orders and policy statements relating to marketing affiliates,<sup>22</sup> rate design,<sup>23</sup> gas inventory charges (GICs)<sup>24</sup> and capacity brokering.<sup>25</sup> However, it has been careful to note that it is not granting any antitrust immunity.<sup>26</sup> Some of the practices addressed by these FERC orders and policy statements are new to the industry. If employed for anticompetitive purposes, they will invite antitrust attack in the courts. Therefore, some industry practices are more likely to be subject to antitrust scrutiny than others. Five of these practices are discussed below.

#### A. Mergers, Acquisitions and Joint Ventures

Although the federal antitrust agencies have been largely inactive with respect to the natural gas industry, they have challenged pipeline mergers and acquisitions they perceived to be anticompetitive. The industry's new competitive climate may result in additional consolidations as pipelines seek new markets, greater access to supply, and cost reduction. It may also result in more pipeline joint ventures. Should these results come about, increased federal antitrust enforcement in the natural gas industry can be expected at least in the mergers and acquisitions area.

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18. *City of Pittsburgh v. FPC*, 237 F.2d 741, 754 (D.C. Cir. 1956).

19. *California v. FPC*, 369 U.S. 482 (1962).

20. See, e.g., *Pennsylvania Water & Power Co. v. FPC*, 343 U.S. 414 (1952); *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156 (D.C. Cir. 1979); *Central Power & Light Co. v. FERC*, 575 F.2d 937 (D.C. Cir. 1978).

21. *Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 760 (1973).

22. Final Rule, *Inquiry into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, III F.E.R.C. Stats. & Regs. ¶ 30,820, 53 Fed. Reg. 22,139 (1988) (codified at 18 C.F.R. pts. 161, 250, 284), *modified in part*, III F.E.R.C. Stats. & Regs. ¶ 30,868, 54 Fed. Reg. 52,781 (1989) (codified at 18 C.F.R. pts. 161, 250).

23. Notice of Policy, *Providing Guidance with Respect to the Designing of Rates*, 47 F.E.R.C. ¶ 61,295, 54 Fed. Reg. 24,382 (1989) (concurring opinion at 49 F.E.R.C. ¶ 61,171 (1989)).

24. Notice of Proposed Policy, *Interim Gas Supply Charges; and Interim Gas Inventory Charges*, 47 F.E.R.C. ¶ 61,294, 54 Fed. Reg. 24,400 (1989) (concurring opinion at 49 F.E.R.C. ¶ 61,170 (1989)).

25. Notice of Proposed Rulemaking, *Brokering of Interstate Natural Gas Pipeline Capacity*, IV F.E.R.C. Stats. & Regs. ¶ 32,460, 53 Fed. Reg. 15,061 (1988).

26. Order No. 436, *supra* note 12, at 42,453.

Although the Department of Justice and the Federal Trade Commission (FTC) jointly enforce section 7 of the Clayton Act, under the informal division of responsibilities between them, suits against mergers of natural gas companies generally have been brought by the FTC.<sup>27</sup> The enforcement effort has concentrated on horizontal mergers between competitors, because these are the mergers most likely to be anticompetitive. Few of the government's merger cases are litigated. Most are settled by an entry of consent orders requiring curative divestiture. The merger is allowed to proceed, but divestiture of certain assets is required to eliminate the merger's anticompetitive effects.

In a recent complaint, the FTC challenged Panhandle Eastern Corporation's acquisition of Texas Eastern Transmission Corporation.<sup>28</sup> The complaint alleged that the acquisition might substantially lessen competition in the pipeline transportation of natural gas out of portions of the Gulf of Mexico. A consent order which accompanied the complaint allowed the acquisition to proceed, but required Panhandle to divest itself of its interest in a pipeline gathering system which competed with a Texas Eastern subsidiary.

Private parties may also sue to enjoin mergers,<sup>29</sup> but they can do so only if they have suffered "antitrust injury." That is, they must have been injured by competition factors resulting from the merger.<sup>30</sup> In a recent private suit of this kind in the natural gas industry, *MidCon Corp. v. Freeport-McMoran, Inc.*,<sup>31</sup> a preliminary injunction was sought by MidCon to prevent the owners of some natural gas producing properties from acquiring it. An injunction was denied because of a failure to show a likelihood of success on the merits, owing to a lack of proof that the acquisition would injure either MidCon or competition.

Joint ventures of competitors can be reached under section 7 of the Clayton Act or section 1 of the Sherman Act. As indicated by the *GM-Toyota* consent decree,<sup>32</sup> joint ventures should be structured to preserve competition between the parties. Joint ventures which are shams, and have no purpose other than to fix prices, divide territories, or restrict production, are held unlawful. The FPC's approval of a joint venture between a Canadian and an American pipeline to construct and operate a pipeline was remanded by the D.C. Circuit in *Northern Natural Gas Co. v. FPC*<sup>33</sup> because the joint venture

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27. See Axinn, Fogg, Stoll & Prager, *Acquisitions Under the Hart-Scott-Rodino Antitrust Improvements Act*, L.J. SEMINARS-PRESS § 9.03[3] (N.Y. 1988), (stating that under the arrangement "between two agencies the FTC has focused on acquisitions involving the . . . oil . . . [industry], among others." Apparently, natural gas companies are deemed to be within the oil industry (there is no reference to the natural gas industry as such) and thus within the FTC's area of responsibilities, for during the period from 1985 through 1989, five pipeline acquisitions were challenged by the FTC, while none were challenged by the Department of Justice).

28. Panhandle Eastern Corp., 5 Trade Reg. Rep. (CCH) ¶ 22,680 (July 17, 1989).

29. *Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104 (1986).

30. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977).

31. *MidCon Corp. v. Freeport-McMoran, Inc.*, 625 F. Supp. 1475 (N.D. Ill. 1986).

32. *General Motors Corp.*, 103 F.T.C. 374 (1984).

33. *Northern Natural Gas Co. v. FPC*, 399 F.2d 953 (D.C. Cir. 1968).

had serious anticompetitive restraint and the Commission's order was based on an inadequate consideration of antitrust policies.

*B. Refusals to Transport or to Take*

Since the appearance of the gas bubble and the availability of cheap off-system gas, many pipelines have been hit by antitrust suits alleging they refused to transport off-system gas which the plaintiffs had purchased. Most of the recent antitrust litigation in the industry has been of this type. As mentioned earlier, some of the suits have been brought by State Attorneys General in *parens patriae* and class actions on behalf of gas consumers.

A first line defense against such suits is lack of standing under the *Illinois Brick* decision<sup>34</sup> which allows only direct purchasers from the defendant to sue for damages. A conflict exists between the Seventh and Tenth Circuits on the applicability of the *Illinois Brick* rule to such suits.<sup>35</sup> The Supreme Court has granted certiorari as to the Tenth Circuit's decision and, hence, will soon address the matter.<sup>36</sup> The issue has been further complicated by the Supreme Court's recent decision in *California v. ARC America Corp.*<sup>37</sup> holding that provisions of *state* antitrust laws allowing damage suits by indirect purchasers are not pre-empted by *Illinois Brick*.

Other refusal to transport suits have been brought by cities owning gas utilities, by LDC's, and by end-users. Typically, the complaints have alleged that the pipelines' refusals to transport the off-system gas were for the purpose of acquiring or maintaining a monopoly in sales of their own gas in violation of section 2 of the Sherman Act. Some of the complaints have also alleged that the refusals amounted to tying the sale of transportation services to the purchase of pipeline gas in violation of section 1 of the Sherman Act.

To establish monopolization under section 2 of the Sherman Act, the plaintiff must prove "(1) the [defendant's] possession of monopoly power in the relevant market and (2) [its] willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."<sup>38</sup> Because a pipeline is regulated, monopoly power cannot be inferred from the fact of a predominant market share.<sup>39</sup> Instead, the regulatory scheme must be examined to determine whether the pipeline has the power to control prices or restrict entry into the market.<sup>40</sup> Also, because the pipeline is regulated, it must be shown that each of its allegedly anticompetitive acts was done with the specific

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34. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

35. *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 852 F.2d 891 (7th Cir. 1988), *cert. denied*, 109 S. Ct. 543 (1988); *In re Wyoming Tight Sands Antitrust Cases*, 866 F.2d 1286 (10th Cir. 1989), *cert. granted*, 58 U.S.L.W. 3443 (U.S. Jan. 16, 1990) (No. 88-2109) [hereinafter *Tight Sands*].

36. *See Tight Sands*, *supra* note 35.

37. *California v. ARC America Corp.*, 109 S. Ct. 1661 (1989).

38. *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

39. *See Consolidated Gas Co. of Fla. v. City Gas Co. of Fla.*, 880 F.2d 297, 300 (11th Cir. 1989), *reh'g granted en banc*, 889 F.2d 264 (11th Cir. 1989).

40. *Id.*

intent to monopolize.<sup>41</sup>

To establish attempted monopolization under section 2, the plaintiff must show (1) that the defendant had a specific intent to monopolize, and (2) that there was a dangerous probability it would succeed.<sup>42</sup>

In support of their monopolization and attempted monopolization claims, plaintiffs in the pipeline cases have also invoked two other theories: the essential facilities doctrine and the monopoly leveraging concept. The elements of the essential facilities doctrine are delineated in *MCI Communications Corp. v. AT&T*.<sup>43</sup> There, the Seventh Circuit stated that “the antitrust laws have imposed on firms controlling an essential facility the obligation to make the facility available on non-discriminatory terms.”<sup>44</sup> It added that four elements are required to establish liability under the doctrine: (1) control of the facility by a monopolist, (2) a competitor’s practical inability to duplicate it, (3) denial of its use to a competitor, and (4) the feasibility of providing such use.<sup>45</sup> It should be noted that some courts have held that the essential facilities doctrine can be invoked only by a competitor and not by a customer or an entity representing customers.<sup>46</sup>

Depending upon the facts, a pipeline alleged to have denied access to an essential facility can raise in its defense that duplication was practical because it was necessary only to build a short interconnect to gain access to another pipeline,<sup>47</sup> or that granting access was not feasible because that would have interfered with the pipeline’s ability to serve its existing customers adequately.<sup>48</sup>

A pipeline could also assert as a defense that good faith adherence to regulatory obligations required that access be denied or restricted. This is known as the “regulatory justification” defense. The defense is defined in *MCI Communications Corp. v. AT&T*;<sup>49</sup> it has been successfully invoked in several telecommunications cases. In a recent case, *Phonetele, Inc. v. AT&T*,<sup>50</sup> AT&T had filed a tariff with the Federal Communications Commission (FCC) that permitted the attachment of plaintiff’s “call restrictor” to AT&T’s lines provided a protective device supplied by AT&T was also attached. AT&T enforced this tariff for a number of years, until the FCC and California Public Utilities Commission (CPUC) determined that use of the protective device was unnecessary. Plaintiff challenged AT&T’s conduct in requiring use of the

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41. *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1108 (7th Cir. 1983), *cert. denied*, 464 U.S. 891 (1983).

42. *Swift & Co. v. United States*, 196 U.S. 375 (1905).

43. *MCI*, 708 F.2d 1081.

44. *Id.* at 1132.

45. *Id.* at 1132-33.

46. *See, e.g., Reynolds Metals Co. v. Columbia Gas Sys., Inc.*, 694 F. Supp. 1248 (E.D. Va. 1988).

47. *See Panhandle Eastern*, 730 F. Supp. 826 (essential facilities claim denied because duplication of benefits of defendant’s pipeline system in relevant market was practical, as evidenced by competitors’ construction of short interconnecting lines in the market).

48. *See Hecht v. Pro-Football, Inc.*, 570 F.2d 982, 992-93 (D.C. Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) (“[t]he antitrust laws do not require that an essential facility be shared if such sharing would be impractical or would inhibit the defendant’s ability to serve its customers adequately”).

49. *MCI*, 708 F.2d at 1138.

50. *Phonetele, Inc. v. AT&T*, 889 F.2d 224 (9th Cir. 1989).

protective device during the period from AT&T's filing of its tariff until the determinations of the FCC and CPUC, contending that such conduct was intended to prevent plaintiff from entering or succeeding in the market. The district court upheld AT&T's "regulatory justification" defense and dismissed the complaint.<sup>51</sup> The Ninth Circuit affirmed.<sup>52</sup>

Monopoly leveraging was described by the Second Circuit in *Berkey Photo, Inc. v. Eastman Kodak Co.*<sup>53</sup> as a firm's use of "its monopoly power in one market to gain a competitive advantage in another, albeit without an attempt to monopolize the second market."<sup>54</sup> In the pipeline cases, it has been asserted that the pipeline used its alleged monopoly power in transportation to gain an unwarranted competitive advantage in gas sales. Monopoly leveraging is not universally regarded as a separate offense under section 2 of the Sherman Act; some circuits regard it as merely one way of proving monopolization.<sup>55</sup>

It is difficult to assess the results in the refusal-to-transport cases. Some of the cases, such as *City of Chanute v. Williams Natural Gas Co.*,<sup>56</sup> where a preliminary injunction was entered against the pipeline, have been settled before the courts addressed the merits of the claims.

One of the few decisions on the merits to reach the appellate level is *Consolidated Gas Co. of Florida v. City Gas Co. of Florida*.<sup>57</sup> The Eleventh Circuit affirmed a verdict against an LDC which, among other things, had refused to transport and sell natural gas to a small potential competitor except on one occasion at an unreasonably high price. It was clear from the totality of the LDC's actions that it was seeking to maintain a monopoly of the south Florida natural gas market. The Eleventh Circuit decided to rehear the case *en banc*.<sup>58</sup>

Most of the issues that have been raised in pipeline refusal-to-transport cases were present in *Illinois ex rel. Hartigan v. Panhandle Eastern Pipe Line Company*.<sup>59</sup> The complaint alleged monopolization, attempted monopolization, denial of access to an essential facility, monopoly leveraging, and tying in violation of the Sherman Act and the Illinois Antitrust Act. The action was brought by the State in its proprietary and *parens patriae* capacity and as a class action on behalf of 300,000 consumers of natural gas in central Illinois.

The State's case focused on two aspects of Panhandle's conduct in the sale and transportation of natural gas in central Illinois: (1) Panhandle's subjecting the transportation of off-system gas to industrial end-users to the terms

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51. The defense was also successfully raised in *Southern Pacific Communications Co. v. AT&T*, 740 F.2d 980 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985).

52. *Phonetele*, 889 F.2d 224.

53. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

54. *Id.* at 275.

55. *See, e.g.*, *Catlin v. Washington Energy Co.*, 791 F.2d 1343 (9th Cir. 1986).

56. *City of Chanute v. Williams Natural Gas Co.*, 678 F. Supp. 1517 (D. Kan. 1988).

57. *Consolidated Gas Co. of Fla., Inc. v. City Gas Co. of Fla.*, 880 F.2d 297 (11th Cir. 1989), *reh'g granted en banc*, 889 F.2d 264 (11th Cir. 1989).

58. *Consolidated*, 889 F.2d 264.

59. *Illinois ex rel. Hartigan v. Panhandle Eastern Pipe Line Co.*, 730 F. Supp. 826 (C.D. Ill. 1990).



of its transportation guidelines, and (2) its refusal to transport off-system gas for Central Illinois Light Company (CILCO), a G-tariff LDC customer. Panhandle argued, *inter alia*, that the transportation guidelines were reasonable and justified by Panhandle's take-or-pay situation and that G-tariff customers were precluded from purchasing natural gas from other suppliers by the terms of the tariff itself.

The court found that the relevant product market was the sale of natural gas to G and SG LDCs, because these customers were obligated by their tariffs to purchase all their gas supplies from Panhandle. The court then divided this market into relevant submarkets because different types of end-users had differing abilities to use alternative fuels and, thus, different demand elasticities. One submarket included residential and commercial end-users; the other included industrial end-users. The court also found that in certain areas of central Illinois, customers could not turn to a pipeline other than Panhandle for natural gas and, thus, that these areas constituted the relevant geographic market.

Because Panhandle was subject to pervasive federal regulation, the court concluded that an inference of monopoly power could not be based solely on market share. Therefore, the court examined the record for direct evidence of Panhandle's monopoly power. The court relied on the facts that for most of the time period involved, Panhandle controlled the only pipeline physically connected to the relevant market; controlled the terms and conditions by which third parties could transport natural gas over the pipeline; and controlled the price of the gas it sold to LDCs. These facts persuaded the court that, as to residential and commercial end-users, Panhandle did possess monopoly power.

However, with respect to industrial end-users, the court found that these customers had ready access to alternative fuels, thereby preventing Panhandle from charging higher prices without losing significant sales. Finding that the state institutions involved in the proprietary claim fell within this latter submarket, the court held that the State's proprietary claim failed.

The court rejected Panhandle's argument that, even if it did possess monopoly power, the FERC regulation effectively prevented Panhandle from exercising that power. It held that the FERC's "prudence" review of interstate pipeline's gas costs did not constrain Panhandle. The court also found that the FERC regulation had no effect on several aspects of Panhandle's challenged conduct.

The court ruled that Panhandle's G and SG tariffs required LDC's purchasing under those tariffs to purchase all their supplies from Panhandle. Thus, Panhandle's refusal to transport off-system gas to such LDCs could not constitute unlawful conduct. The State argued that Panhandle's refusal to negotiate a new tariff also constituted the willful maintenance of monopoly power. However, the court found that such a refusal was justified by Panhandle's take-or-pay situation. Therefore, as to Panhandle's conduct towards the G and SG LDCs, the court held that the pipeline's actions did not constitute the unlawful maintenance or acquisition of monopoly power.

Under Panhandle's transportation guidelines, an end-user who wanted to

transport off-system gas had to allow Panhandle system supply producers the opportunity to “match” the price and other terms of the end-user’s contract with an off-system producer. If an on-system producer matched the contract, then Panhandle would transport the gas and receive take-or-pay credit from the producer. If the contract was not matched, Panhandle transported the off-system gas to the end-user. The transportation guidelines also required that all contracts be rebid every six months.

The court found that the transportation guidelines were anticompetitive. The court was persuaded that the procedures had the effect of discouraging off-system producers from competing with Panhandle in the relevant market. However, the court found that no person whose claims were raised in the action could benefit from this finding. G and SG LDC customers could not utilize the guidelines because their tariffs prohibited such transportation, and there were no LS customers, whose tariffs did allow transportation, in central Illinois. As to industrial end-users, including the state institutions who could use the guidelines, the court had previously found that Panhandle did not have monopoly power over those customers.

On the State’s monopoly leveraging claim, the court found that the transportation of natural gas constituted a distinct product from the sale of natural gas. As the owner of the only pipeline into the relevant geographic market, Panhandle had monopoly power over the transportation into that market. The State argued that the transportation guidelines constituted an attempt by Panhandle to use this monopoly power to gain an advantage in the sale of natural gas market. While the court suggested that the transportation guidelines did give Panhandle a competitive advantage, it found that the State had not established a violation. As discussed above, Panhandle did not have the requisite monopoly power over industrial end-users and no other person or group involved in the action could challenge the guidelines because of the terms of the tariffs.

On the State’s tying claim, the court again found the existence of two separate products: natural gas transportation and natural gas sales. The court believed that the guidelines restrained competition and might constitute an unlawful tying arrangement. However, residential and commercial customers of G and SG LDCs could not challenge the guidelines. As to these persons, there was no forcing because the terms of the tariffs, and not Panhandle’s conduct, effectively bundled the two products. Further, there was no danger that the tying arrangement would give Panhandle market power in the gas sales market to industrial end-users because such end-users had the ability to switch to alternate fuels. Therefore, the court found for Panhandle on the State’s tying claim.

On the essential facility claim, the court found that the State had not established the impracticality of duplicating Panhandle’s facilities, which is a necessary element of such a claim. The court agreed with Panhandle that the pertinent question was not whether Panhandle’s entire gas pipeline could be duplicated. Rather, the question was whether the benefits of Panhandle’s system to central Illinois could be obtained otherwise. Since other pipelines had already constructed short interconnecting lines into the central Illinois mar-

ket, such duplication of benefits was possible and the court dismissed plaintiff's essential facility claim.

The court briefly addressed Panhandle's defenses, in *dictum*, since it had not found a violation of the antitrust laws. Of note, however, was the court's recognition that Panhandle had a regulatory justification defense as to conduct, based on regulation, that was "concrete, articulable, and recognized as legitimate," but not as to some of Panhandle's discretionary conduct.

*Panhandle Eastern* suggests that the pipelines have suffered unnecessarily from the refusal-to-transport complaints filed up to now. The complaints cover a period when regulation did not contemplate open-access transportation or provide for take-or-pay relief. The complaints charged pipelines with monopolistic conduct even though transportation of off-system gas during this period would have resulted in violations of tariff restrictions or aggravated the pipelines' soaring take-or-pay liabilities. Pipelines which refused to transport during this period were not seeking to maintain a monopoly but to avoid self-destructing. These cases should have been brought before the FERC as regulatory proceedings to revise tariff provisions and provide take-or-pay relief, rather than before the courts as antitrust suits.

There have been fewer antitrust cases based on alleged refusals to take. One recent case of this kind is *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of America*.<sup>60</sup> This was an unusual case in that the defendant, Natural Gas Pipeline Company of America (NGPL), was accused of having attempted to secure a monopoly for another pipeline. NGPL allegedly did this by manipulating its gas purchases under its service agreement with Colorado Interstate to tie up capacity on the latter's pipeline. This allegedly caused potential new customers of Colorado Interstate to obtain transportation services from the third pipeline. The court noted that by exercising all of its rights under the service agreement, NGPL was able to raise the third pipeline's market share by only 13%. Because the service agreement was the only means by which NGPL could increase the third pipeline's market share, and the agreement was due to expire shortly, the court held that there was no dangerous probability of successful monopolization.

Virtually all major interstate pipelines have become certificated open access carriers under Order Nos. 436 and 500. It is therefore doubtful that antitrust claims in the future will be based on absolute refusals to transport. Order No. 436 indicates that more subtle forms of exclusion and discrimination may be practiced. Industry members should be aware that such practices not only may violate Order Nos. 436 and 500, but may well invite antitrust suits.

### C. Marketing Affiliates

The competitive issues raised by marketing affiliates have been comprehensively addressed by the FERC. In 1986, the FERC issued a Notice of

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60. *Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of Am.*, 1989-2 Trade Cas. (CCH) ¶ 68,751 (10th Cir. 1989).

Inquiry concerning pipeline marketing affiliates<sup>61</sup> which sought industry comments on the following practices:

1. Discriminatory transportation rates and conditions;
2. Capacity preferences;
3. Release preferences;
4. Cross-subsidization;
5. Insider information; and
6. Marketing affiliate assumption of pipeline merchant role.

The Department of Justice submitted a response in which it stated that such practices are "typical of anti-competitive conduct that might be undertaken by a regulated firm with market power that injures a related competitive market."<sup>62</sup>

The FERC issued its Final Rule in 1988.<sup>63</sup> Among other things, the rule provides that a pipeline "may not . . . give its . . . affiliate preference over non-affiliated customers in scheduling, transportation, storage, or curtailment priority" and "must process all similar requests for transportation in the same manner and within the same period of time."<sup>64</sup>

Undoubtedly, marketing affiliates present opportunities for engaging in anticompetitive practices. Again, while some of these practices are addressed by the FERC's Final Rule, they may also violate the antitrust laws. Because of *Copperweld Corp. v. Independence Tube Corp.*,<sup>65</sup> a pipeline cannot be guilty of conspiring with a wholly-owned marketing affiliate. In many cases, this would rule out the use of section 1 of the Sherman Act. Thus, antitrust suits challenging pipeline-marketing affiliate relationships most likely will have to be brought under the monopoly provisions of section 2.

An energy marketing consultant recently predicted that unless small marketing companies find a particular niche, affiliated marketers will squeeze them out due to the advantages they possess.<sup>66</sup> These advantages include financial backing from the parent, intimate knowledge of how the particular pipeline works, and the pipeline infrastructure.

However, this scenario does not appear to pose an antitrust problem. A number of federal appellate courts have recognized an "integrated business" exception, which would seem to apply in such situations. The Second Circuit articulated the exception in *Berkey Photo, Inc. v. Eastman Kodak Co.*<sup>67</sup> There, the court stated that ". . . an integrated business [does not] offend the Sherman Act whenever one of its departments benefits from an association with a divi-

61. Notice of Inquiry, *Alleged Anticompetitive Practices, Related to Marketing Affiliates of Interstate Pipelines*, IV F.E.R.C. Stats. & Regs. ¶ 35,520 (1986), 51 Fed. Reg. 41,982 (1986) (codified at 18 C.F.R. pts. 154, 271)

62. Response to Notice of Inquiry, *Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, at 3 (No. RM87-5-000) (filed Dec. 29, 1986).

63. See *supra* note 22.

64. Order No. 497 *Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, III F.E.R.C. Stats. & Regs. ¶ 30,820, 53 Fed. Reg. at 22,139, 22,161 (1988).

65. *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

66. *Bumpy Road Seen for Some Gas Marketers*, Houston Post, Aug. 20, 1989, at 6D.

67. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

sion possessing a monopoly in its own market."<sup>68</sup> *Berkey Photo* was cited by the Ninth Circuit in *Catlin v. Washington Energy Co.*,<sup>69</sup> where that court dismissed an independent retailer's complaint that a gas utility violated the antitrust laws by retailing equipment through a marketing division and distributing advertisements in bills to its gas customers.

#### D. Regulatory Interventions and Oppositions

When a pipeline seeks an authorization or approval of some kind from the FERC, suppliers, competitors, and customers commonly intervene and present positions, which frequently oppose the pipeline's position.

In most cases such interventions and oppositions enjoy antitrust immunity under cases such as *United Mine Workers of America v. Pennington*.<sup>70</sup> Cases such as *United Mine Workers* hold that group or individual solicitation of government action at the executive, administrative, legislative or judicial levels, even if for an anticompetitive purpose, is protected by the United States Constitution under the first amendment.<sup>71</sup> The first amendment guarantees the right to petition the government.<sup>72</sup> However, baseless actions made in bad faith, and done solely to harass competitors, to delay proceedings, or to deny competitors access to government agencies, lack immunity because they come within the sham exception to the *Noerr-Pennington* doctrine.<sup>73</sup> These actions may also constitute an abuse of the regulatory process.<sup>74</sup>

Such conduct, even if pursued by a single company, has been characterized as "non-price predation." As such, it can constitute an antitrust violation by itself or be, at the least, evidence of an anticompetitive intent. FTC Commissioner Calvani has provided an example for the natural gas industry with the following hypothetical: A pipeline opposes a potential competitor's application for a certificate from the FERC, arguing there is no need for additional capacity. After the competitor's application has been denied, the pipeline then petitions for certification of additional capacity for itself, arguing that it is needed.<sup>75</sup>

An opposition in a regulatory proceeding was deemed indicative of an anticompetitive intent because it was part of a pattern of anticompetitive conduct in *Consolidated Gas Co. of Florida, Inc. v. City Gas Co. of Florida*.<sup>76</sup> The Eleventh Circuit upheld a \$4.76 million judgment against City Gas based

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68. *Id.* at 276.

69. *Catlin v. Washington Energy Co.*, 791 F.2d 1343 (9th Cir. 1986).

70. *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965); *see also* *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *California Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972).

71. U.S. CONST. amend. I.

72. *Id.*

73. *California Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508 (1972).

74. *Litton Systems, Inc. v. AT&T Co.*, 700 F.2d 785 (2d Cir. 1983), *cert. denied*, 464 U.S. 1073 (1984).

75. *The Federal Trade Commission's Agenda in the Energy Industry* (remarks of FTC Commissioner Terry Calvani before the ABA Section of Natural Resources Law, New Orleans, June 2, 1987).

76. *Consolidated Gas Co. of Fla. Inc. v. City Gas Co. of Fla.*, 880 F.2d 297 (11th Cir.), *reh'g granted en banc*, 889 F.2d 264 (1989).

upon findings that it had monopolized and attempted to monopolize the natural gas market in south Florida. Among other anticompetitive acts, City Gas had intervened in a FERC proceeding to oppose plaintiff's application seeking permission to sell natural gas. The court noted with approval the district court's finding that this act, when viewed with the principal acts, further evidenced City Gas' intent to monopolize.<sup>77</sup>

As noted, most interventions in FERC proceedings are protected activity under the *Noerr-Pennington* doctrine. However, such interventions can have antitrust consequences if they are a sham, as in Commissioner Calvani's example, or if they are part of a pattern of anticompetitive conduct, as in *Consolidated Gas*.

### E. Selective Discounting and Rate Design

Order No. 436<sup>78</sup> authorizes pipelines to engage in selective discounting within a range of maximum and minimum rates. Maximum rates are to be based on "fully allocated cost," minimum rates on "average variable cost." Selective discounting is intended to permit pipelines to make competitive responses to unregulated commodity traders and to competing pipelines in transportation services. Pipelines are required to report to the FERC any discounts they grant.

The FERC, in authorizing selective discounting in Order No. 436, is careful to note that it is not granting pipelines any immunity from the antitrust laws. Although it states that the minimum rate serves as a check on anticompetitive behavior, the FERC adds that charging the minimum rate "may not necessarily constitute a defense to a predatory pricing charge under the antitrust laws."<sup>79</sup> Further, it expressly recognizes that selective discounting could be used for predatory purposes, to prevent market entry, to effect a price squeeze on an LDC by giving a discounted rate to an end-user, or to favor a marketing affiliate.

In May 1989, the FERC issued a Policy Statement Providing Guidance with Respect to the Designing of Rates.<sup>80</sup> This policy statement was intended to be used as a guideline by Administrative Law Judges hearing testimony in thirty-nine pipeline rate cases. In the statement the Commission recognized the need to use seasonal rates for peak and off-peak periods. Shortly after issuance of the policy statement, the Commission approved the Seasonal Sales Program of Panhandle Eastern Pipe Line Company.<sup>81</sup> The program results in a price for Panhandle's sales gas that will be competitive with, albeit above, the price of spot market gas with interruptible transportation.

It is difficult to imagine how such seasonal rates, which receive specific FERC approval, can raise antitrust risks. The *Keogh*,<sup>82</sup> or "filed rate" doc-

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77. *Id.* at 304.

78. *See* Order No. 436, *supra* note 12.

79. *See* Order No. 436, *supra* note 12.

80. *See supra* note 23.

81. *Panhandle Eastern Pipe Co. Proposed Changes in FERC Gas Tariff*, 54 Fed. Reg. 31,237 (1989).

82. *Keogh v. Chicago & Northwestern Ry.*, 260 U.S. 156 (1922). There, the Supreme Court held that an antitrust action could not be based on rate structures approved by the Interstate Commerce Commission.

trine would appear to give antitrust immunity to such rates. However, prudence would suggest that even seasonal rates be subjected to an antitrust review before implementation.

As the FERC and pipelines come to grips with current issues concerning capacity brokering and gas inventory charges, other market participants are sure to scrutinize the antitrust implications of these new programs and tariffs as well. For example, several producers have filed challenges with the FERC to Panhandle's seasonal program, alleging that the program is anticompetitive.

#### CONCLUSION

In conclusion, the federal antitrust agencies can be expected to broaden their focus beyond mergers to include any industry practices which are incompatible with the new competitive environment. The FERC has issued orders and policy statements relating to such matters as transportation, marketing affiliates, GICs, selective discounting, and rate design, but has been careful to note that it is not conferring any antitrust immunity. Thus, conduct pursuant to these orders and policy statements that is anticompetitive may invite antitrust attack from federal or state authorities or from injured private parties. Pipeline sales and transportation programs likely to have competitive impact should therefore be subjected to antitrust review before implementation.

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*Keogh* was recently reaffirmed by the Supreme Court in *Square D Co. v. Niagara Frontier Tariff Bureau*, 476 U.S. 409 (1986).