# THE REGULATION OF GATHERING IN A FEDERAL SYSTEM

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## I. INTRODUCTION

Regulation of the gathering of natural gas production has gone almost unnoticed among the revolutionary changes that have overtaken the natural gas industry. Now attention has been focused on gathering. The Federal Energy Regulatory Commission (FERC or Commission) has recently issued what it regards as a series of definitive rulings on its jurisdiction over gatherers and the rates they charge.[1] While the rulings appear to concede more of the regulatory field to the states, they leave many questions in their wake. Has the Commission correctly gauged the proper role for the state agencies? Is it attempting to arrogate too much power to itself? Is the new dispensation in the public interest, or is it merely a lawyer's effort to cut the jurisdictional line in a way that dissipates controversy without coming to grips with the problems generated by the pre-existing rules? These are some of the topics explored in this article.

Congress and the FERC have decided that the natural gas industry must move towards an open market model. Order 436[2] provided open access transportation; the Natural Gas Wellhead Decontrol Act of 1989[3] deregulated wellhead sales; and Order 636[4] restructured the industry, unbundling the pipeline sales function from its transportation function, expanding open access to pipelines' other services and creating a secondary capacity market. The new open market has left those within the industry with many questions. Will the market perform? Will there be barriers to entry in the future? Could abuse of market power still occur under this new regime? From our present perspective, the answers to those questions

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1. *Mid Louisiana Gas Co.*, 67 F.E.R.C. ¶ 61,255 (1994); *Eastern Am. Energy Corp.*, 67 F.E.R.C. ¶ 61,258 (1994); *Arkla Gathering Serv. Co.*, 67 F.E.R.C. ¶ 61,257 (1994); *Amerada Hess Corp.*, 67 F.E.R.C. ¶ 61,254 (1994); *Williams Natural Gas Co.*, 67 F.E.R.C. ¶ 61,252 (1994); *Superior Offshore Pipeline Co.*, 67 F.E.R.C. ¶ 61,253 (1994); *Field Gas Gathering Co.*, 67 F.E.R.C. ¶ 61,259 (1994).

2. *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol*, [1982-1985 Preambles] F.E.R.C. STATS. & REGS. ¶ 30,665, 50 Fed. Reg. 42,408 (1985) (codified as amended in scattered sections of 18 C.F.R. pts. 2, 157, 282, 375, 381).

3. Pub. L. No. 101-60, 103 Stat. 157 (codified at 15 U.S.C. §§ 3311-3432 (Supp. V 1993)).

4. *Pipeline Service Obligations & Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, III F.E.R.C. STATS. & REGS. Preambles ¶ 30,939, 57 Fed. Reg. 13,267 (1992), *order on reh'g*, Order No. 636-A, III F.E.R.C. STATS. & REGS. Preambles ¶ 30,950, 57 Fed. Reg. 36,128 (1992), *order on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, 57 Fed. Reg. 57,911 (1992).

are obvious. The competitive market will perform, but only if barriers to entry and abuses of market power are forestalled.

It is never easy to change years of policy and practice. The FERC has done its best to prod and push the industry towards an open market environment. The early returns indicate that the Commission did its work well. Events of the winter of 1993-1994 have shown that, in the post-Order 636 environment, there are likely to be many more winners than losers. Free markets, if truly open to all market participants, producers and consumers alike, appear to be the best regulators. Where, however, there exists a potential for barriers to entry, there remains a need for regulatory oversight to prevent such barriers from developing.

An area where there is a potential for market barriers is in the gathering of natural gas. The Commission's unbundling efforts under Order 636 have caused a number of pipelines to re-evaluate the locus of gathering in their corporate structures. This has led to the decision by many pipeline companies to sell their gathering assets to unaffiliated purchasers or to transfer or spin-down these facilities to a non-regulated affiliated gathering company. In response, many producers are raising concerns both at the federal and state level that, absent adequate regulation, such spin-offs or spin-downs would result in increased gathering rates and impeded access to gathering facilities. On the other hand, pipelines and pipeline-affiliated gatherers argue for regulatory parity among providers of gathering services, pointing to the lack of regulation of non-affiliated gatherers. This attempt to achieve parity has caused both the FERC and state agencies to struggle with the jurisdictional implications of spin-downs and spin-offs of gathering facilities.

Therefore, the questions that arise are: (1) Is there a need for continued regulation, of either category?; (2) If so, then should this oversight function occur in Washington or at the state level?; and (3) If, on a policy basis, this authority should be exercised on the state level, can the FERC delegate its authority to the states?

This article will demonstrate that FERC's traditional oversight of gathering arose from the need to determine gathering costs' impact on the ultimate delivered cost of gas in order to assure that the consumer is protected from excessive rates. That regulatory oversight was not intended to interfere with the states' broad regulatory authority over gathering through their responsibility over natural gas conservation and correlative rights.[5] To carry out their responsibilities, states have had and continue to have jurisdiction over gathering, irrespective of ownership. However, there is authority for the argument that the federal regulatory authorities have at least some jurisdiction over gathering, even in a post-Order 636 world. Thus, if regulators determine that there is a need for continued regulation of gathering, they must further decide, in determining at which level of government—state or federal—jurisdiction should reside, whether the problems to be resolved through regulation are more substantially of local

5. *See* Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kan., 489 U.S. 493 (1989).

interest or so significantly affect the consumers' right under the Natural Gas Act (NGA) to reasonably priced natural gas that FERC oversight is required.

## II. BACKGROUND

Congress and the FERC have found that there exists a nationally available competitive supply of gas that makes continued regulation of pricing of gas unnecessary. Congress, on the basis of that finding, enacted the Natural Gas Wellhead Decontrol Act of 1989 and the FERC revised its regulation of natural gas under Order No. 636.[6] In light of that finding, the FERC issued a Notice of Public Conference on October 28, 1993,[7] in which it requested comments on, and set a public conference in February 1994, to explore "the extent to which the Commission should exercise its [NGA] rate and tariff jurisdiction, pursuant to sections four and five of the NGA, over the rates, terms and conditions for gathering services performed by interstate pipelines and their affiliates."[8] Public comments filed indicated that, on a local or regional level, some non-affiliated intrastate gatherers do have market power with the potential to deny producers access to the marketplace.[9]

A balancing of the states' interest with the NGA's objective leads to the conclusion that regulatory oversight of gathering can and must occur on the state level. Regulation of the "production and gathering" of hydrocarbons is a well established and historic function of state authority.[10] In this respect, it does not conflict with the goal of the NGA to protect the ultimate consumer. To the extent that there is also a federal interest in regulating gathering to ensure the existence of an open nationwide marketplace for natural gas supplies, we believe that considerations of sound public policy warrant a delegation of this responsibility to the state regulatory authorities, either by FERC administrative action or by statute. Such a step would not represent an abdication of FERC's responsibilities under the NGA. Instead, it would be the most efficient means of achieving the primary objective of the federal regulatory program: open access to markets by producers and consumers.

The jurisdictional status of gathering, particularly in light of the spindown and spin-off of gathering facilities, is ultimately a legal question.[11] However, members of the natural gas industry are primarily concerned, not with legal constructs, but with the answer's political and economic impact

6. Pub. L. No. 101-60, 103 Stat. 157 (codified at 15 U.S.C. §§ 3311-3432 (Supp. V 1993)).

7. 65 F.E.R.C. ¶ 61,136 (1994).

8. 65 F.E.R.C. at 61,688-89.

9. 65 F.E.R.C. ¶ 61,136; OKLAHOMA CORPORATION COMMISSION, COMMENTS, at 2-3 (Jan. 21, 1994); KANSAS CORPORATION COMMISSION, COMMENTS, at 9-10 (Jan. 14, 1994).

10. *See* sources cited *supra* note 4.

11. For a particularly good analysis of recent case law, see Angela S. Chitwood-Beehler, Comment, *A Conflict in the Circuits: The FERC's Jurisdiction Over Gathering Rates*, 13 ENERGY L.J. 375 (1992). For an overview and legal analysis of gathering issues, see Patricia Fry Eldridge, *Natural Gas Gathering Systems*, *in* 3 DAVID J. MUCHOW AND WILLIAM A. MOGEL, ENERGY LAW AND TRANSACTIONS §§ 84.01 to .07 (1994).

on the industry. To the extent that in the first fifty years after enactment of the NGA there was a clear line of demarcation between "production and gathering" on the one hand, and "interstate transportation" on the other, the line has been obscured by FERC's restructuring of the industry. The solution to gathering's jurisdictional quandary in the post-Order 636 environment lies in reconciling the law with the practical realities of the unbundled, restructured industry and that reconciliation begins with a reassessment of the law, particularly cases addressing the issue of preemption under the NGA and application of the NGA's exemption of production and gathering under section 1(b).

## III. THE GATHERING EXEMPTION AND THE STATES' AUTHORITY OVER CONSERVATION AND CORRELATIVE RIGHTS

Section 1(b) of the NGA provides that, "the provisions of this chapter shall apply to the transportation of natural gas in interstate commerce . . . but shall not apply . . . to the production or gathering of natural gas."[12] The NGA does not define "production" or "gathering," even though it excludes those two activities from its coverage. Neither does it define "transportation," the shibboleth for the extent of its reach. Assuming that Congress intended to place some of those activities on one side of the jurisdictional line and the remaining activities on the other side of that line, "production or gathering" could be defined, at least in theory, in terms of what "transportation" is not.

The NGA's legislative history also does not include any clear statement of how its authors defined "production or gathering." The legislative history merely demonstrates Congress' intent that production and gathering (whatever they might be) should be exempt from regulation under the NGA.[13] It is appropriate, therefore, to consider the production and gathering exemption in the context of industry usage and understanding at the time. Congress' rationale for exempting production and gathering from federal regulation is equally important to the definitional question.

Although the *Public Utilities Commission v. Attleboro Steam & Electric Co.* (*Attleboro*)[14] decision had left a large area exempt from regulation by the States, there nevertheless remained many important activities still subject to state jurisdiction. The legislative history of the NGA clearly demonstrates Congress' determination that enactment of the Natural Gas

12. 15 U.S.C. § 717(b) (1988).

13. *See* 81 CONG. REC. 6721 (1937) (containing Committee on Interstate and Foreign Commerce Chairman Lea's statement in which she states, "The bill does not apply to the production and gathering of gas."). Chairman Lea was also the sponsor of the bill in the House of Representatives. Note also Senator Wheeler's response to Senator Austin's questions during the debate on the Senate floor:

> Does the bill undertake to regulate the production of natural gas, or does it undertake to regulate the producers of natural gas?
>
> Senator Wheeler: It does not attempt to regulate the producers of natural gas or the distributors of natural gas; only those who sell it wholesale in interstate commerce.

81 CONG. REC. 9313 (1937).

14. 273 U.S. 83 (1927).

Act would not interfere with then-existing state authority to regulate the natural gas industry.[15] In the debate in the Senate, Chairman Wheeler of the Committee on Interstate Commerce affirmed that "as a matter of fact, the bill does not interfere with the state regulation in any way, shape, or form .... There is no attempt and can be no attempt under the provisions of the bill to regulate anything in the field except where it is not regulated at the present time."[16]

Congress' intent was to preserve the *status quo* with respect to states' jurisdictional authority in 1938, when the NGA was passed. Any powers over gathering the states did not possess in 1938 were to be conferred on federal regulatory authorities by the statute.

States had traditionally regulated gathering relative to production in furtherance of their clear and uncontroverted authority over conservation and correlative rights. For regulatory purposes, gathering was perceived to be an extension of production in the preparation and aggregation of volumes, first from the leasehold, and then the field for sale in the market.[17] Since gathering was deemed incidental to producing the oil and gas field, the state's interest in gathering was the same as its interest in production: conservation and the protection of correlative rights.

The interrelationship between production and gathering, as they relate to conservation and correlative rights, can best be illustrated in connection with the history of legal authority to regulate the production and gathering of oil. Because gas production was traditionally a secondary industry to oil production, the oil analogy also illustrates how the industry regarded gas production and gathering. *Champlin Refining Co. v. Corporation Commission of Oklahoma* (*Champlin*),[18] decided before the NGA's enactment, provides an instructive perspective.

In *Champlin*, an oil and gas production company challenged the validity of an Oklahoma statute that prohibited production of either oil or gas that constituted waste, which was defined to include "economic, underground and surface waste and waste incident to production in excess of transportation or marketing facilities or reasonable market demands."[19] Under the statute, the Oklahoma Corporation Commission was authorized to regulate the taking of oil or gas from common sources to prevent unrea-

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15. Note the following excerpts:

> The bill takes no authority from State commissions, and is so drawn *as to complement* and in no manner usurp State regulatory authority, and *contains provision for cooperative action with State regulatory bodies*. . . . The primary purpose of the pending bill is to provide Federal regulation, in those cases where the State commissions lack authority, under the interstate-commerce law. This bill takes nothing from the State commissions; they retain all the State power they have *at the present time*.

HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, H.R. REP. No. 709, 75th Cong., 1st Sess. (1937) (emphasis added).

16. 81 CONG. REC. 9313 (1937).

17. *See* Champlin Ref. Co. v. Corporation Comm'n. of Okla., 286 U.S. 210 (1932).

18. 286 U.S. 210 (1932).

19. *Id.* at 226.

sonable discrimination in favor of one source against others.[20] The Supreme Court described the problem of waste as it existed prior to enactment of the statute:

> If some of the wells are permitted to produce a greater proportion of their capacity than others, drainage occurs from the less active to the more active .... Where proportional taking from the wells in flush pools is not enforced, operators who do not have physical or market outlets are forced to produce to capacity in order to prevent drainage to others having adequate outlets.[21]

Oil was being produced in quantities that exceeded market demand and consequently was being *gathered* and *stored* on the lease in a manner in which the Court found to result in "enormous waste." Regulation of such gathering and storage was required to control the waste and to prevent drainage. It is noteworthy that the Oklahoma statute conferred regulatory jurisdiction not only over production *per se*, but also over gathering of oil and gas. In upholding the Oklahoma regulatory program, *Champlin* demonstrates the early perception that gathering was only another step in the production process, whether the production was oil or gas, and that regulation of the production process was thought necessary to protect the correlative rights of others, thus avoiding the migration of gas and promoting its conservation.

Also, the states' powers over gathering and storage is reflected in the way in which royalty payments, clearly a subject solely within the jurisdiction of the states, were to be calculated. The calculation was based on the perception that gathering was simply an extension of production in preparing the gas production for market. As a general rule, the lessee is obligated to pay all costs of production, but the lessor is obligated to pay a proportionate share of costs incurred subsequent to production that increase the value of production. In some instances, gathering is considered necessary to make the gas a "marketable product," and its cost is borne solely by the lessee. In other instances, however, gathering is regarded as enhancing the value of the production, and, therefore, its costs are shared by the lessor.[22]

In either case, gathering impacts the calculation of the royalty based on the netback value of the gas at the wellhead. The rules governing these and other relationships between gathering and production have traditionally been established under state, not federal, law. No one has ever sug-

20. *Id.*

21. *Id.* at 228.

22. *See* 3 EUGENE O. KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 40.5, at 356 n.38 (1989). "The royalty should be paid uniformly on the basis of the sale of gas at the well and that costs of gathering and transporting gas to a distant market should be deducted if the sale occurred at a place other than at the well." *Id. See also* W.L. SUMMERS, THE LAW OF OIL AND GAS § 589, at 116-17 (2d ed. 1958). Mr. Kuntz also discussed that royalty owners do not share production costs, stating that "acts which constitute production have not ceased until a marketable product has been obtained." KUNTZ, *supra*, at 351. However, he further comments that determining when gas becomes marketable is not easy when considering costs of gathering. *See also* Wegman v. Central Transmission, Inc., 499 So. 2d 436, 448 (La.Ct.App. 1986). "[B]y industry customs, lessors are not charged for the transportation of gas through small gathering lines. This is usually considered part of the cost of operating the well and therefore not charged against the lessor." *Id.*

gested that state law should give way to federal rules on these subjects. Why has this been the case? We suggest that the dominance of state law in this area has resulted from a common understanding that the generic subject of gathering is a matter of local concern and should, therefore, be left to local ordering by state legislatures and regulatory agencies.

United States Supreme Court decisions on jurisdictional issues relating to the production and gathering exemption, found in section 1(b) of the NGA, have viewed the legitimacy of the states' authority over gathering and production in the context of the states' interest in conservation and protection of correlative rights. The Court stated, in *Colorado Interstate Gas Co. v. FPC*,[23] that "the [production and gathering exemption] precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over *the drilling and spacing of wells and the like*."[24] Then, in *FPC v. Panhandle Eastern Pipe Line Co.* the Court stated:[25]

> The legislative history of this Act is replete with evidence of the care taken by Congress to keep the power over the production and gathering of gas within the states. This probably occurred because the state legislatures, *in the interests of conservation*, had delegated broad and elaborate power to their regulatory bodies over all aspects of producing gas.[26]

Later, in *United Gas Improvement Co. v. Continental Oil Co.*,[27] the Court upheld the regulatory jurisdiction of the federal government under the NGA, even though the transaction occurred during the production process, but reiterated the states' continuing authority over production and gathering:

> We conclude that even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to [federal] regulation. In the context of such a sale . . . the "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This accommodation of the two relevant clauses of Section 1(b) gives content to the national objectives of the Natural Gas Act as expounded in *Phillips*, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of *production or gathering in furtherance of conservation or other legitimate state concerns*.[28]

## IV. The Historical Relationship Between FERC's Jurisdiction over Gathering Costs and the NGA's Objective to Protect Consumers from Excessive Rates

From the time of the enactment of the NGA until the issuance of FERC Order 436, there was no significant litigation about the jurisdictional

23. 324 U.S. 581 (1945).
24. *Id.* at 603 (emphasis added).
25. 337 U.S. 498 (1949).
26. *Id.* at 509-12 (emphasis added) (footnote omitted).
27. 381 U.S. 392 (1965).
28. *Id.* at 402-03 (emphasis added).

status of gathering performed by an interstate pipeline otherwise subject to federal regulatory jurisdiction. Gathering tended to occur after the purchase of the production by the interstate pipeline. Except for those few pipelines that owned substantial amounts of production, gathering facilities of the interstate pipeline were not used for the purpose of aggregating production from a field to prepare it for market. Instead, they were used for the purpose of aggregating the pipeline's system supply from multiple fields.

The distinction between gathering production to prepare it for sale and gathering interstate system supply already purchased is important in determining whether the local interest or the purposes of the federal regulatory program are paramount in the public interest. Normally, the exercise of the state's predominant interest in production and gathering, to the extent it relates to the state's concern for conservation and correlative rights, would have been resolved prior to or at the time of purchase, so that state authority would not extend to gathering by the interstate pipeline. Moreover, because pipeline gathering costs were generally included in pipeline transmission costs and bundled into the sales rate charged to the local distribution company, it was arguable that the predominant interest in those costs, as they related to an interstate pipeline's gathering facilities, was at the federal level, in the regulation of the pipeline's overall business by the Federal Power Commission and, later, the FERC. The states' interest in pipeline gathering costs was legitimate, but it was analytically no different from any other cost that might be passed through a local distribution company and show up in the latter's rates for gas delivered to the consumer.

In *Colorado Interstate Gas Co. v. FPC (CIG)*,[29] the pipeline (Colorado Interstate Gas Company or CIG) had proposed in a section four rate filing to include in its operating expenses a bundled purchased gas cost that was equivalent to a commodity price for the gas plus the costs of gathering the gas. The proposed gathering costs included recovery of capital costs related to pipeline-owned gathering facilities. The Federal Power Commission ordered that the cost of the production and gathering facilities must be included in the rate base of the pipeline, to be recovered through its depreciation expense charge, while the production and gathering expenses could be included separately in operating expenses. CIG argued that by requiring it to include the capital costs of the gathering facilities in its rate base, the Commission was regulating "the production and gathering of natural gas contrary to the provisions of Section 1(b) of the Act."[30]

This argument was unsuccessful in the Supreme Court. In rejecting the pipeline's argument, the Court held:

> [Section 1(b) of the NGA] precludes the Commission from any control over the activity of producing or gathering natural gas. . . . [It] does not preclude the Commission from reflecting the production and gathering facilities of a natural gas company in the rate base and determining the expenses incident

29. 324 U.S. 581 (1945).
30. *Id.* at 600.

> thereto *for the purposes of determining the reasonableness of rates subject to its jurisdiction.*[31]

The Court also noted that regardless of the methodology used by the FPC to allow the pipeline to recover its gathering costs:

> [T]he effect on the producing properties and gathering facilities would be precisely the same as in the present case. Since there is no provision in the Act which would require the Commission to value the gas at the price urged by [the pipeline], the problem on review would be whether the *end result was unjust and unreasonable.*[32]

To that end, the Supreme Court has allowed, not mandated, the Commission to examine production and gathering costs when reviewing the ultimate rates of a pipeline's sales service. The Court has given the Commission discretion as to the methodology by which the Commission regulates pipeline rates. It is the end result that counts, as the Court has said in many cases, including *FPC v. Panhandle Eastern Pipe Line Co.*[33] "The primary duty of the Commission is to fix just and reasonable rates for the transportation and sale of natural gas in interstate commerce for resale. For this purpose the Court permitted the Commission to examine and consider the cost of production and gathering."[34]

## V. Gathering in Pre-Order 636 Environment

The natural gas industry has been transformed by open-access transportation and restructured purchase contracts between pipelines and producers, and between pipelines and local distribution companies. It no longer resembles the industry envisioned by Congress in 1938, when the NGA was originally enacted. Gathering costs are no longer rolled into the interstate pipeline sales rate. The cost of gas as a commodity is unbundled from all transmission costs, including gathering, incurred to move the gas from the wellhead. The FERC is relying on competition to ensure the just and reasonable unbundled purchase price of gas sold in interstate commerce for resale.

FERC's general policy is to place responsibility for costs of a particular service on customers that utilize that service. Since pipelines could no longer spread their gathering costs over all their gas, but could charge those costs only to customers moving gas through their gathering facility, pipelines began to establish gathering rates separate from their transportation rates. FERC's Order 636 now requires jurisdictional pipelines to file separately stated gathering rates.[35] FERC's ability to require separately-stated

31. *Id.* at 603 (emphasis added).

32. *Id.* at 603-04 (emphasis added).

33. 337 U.S. 498 (1949).

34. *Id.* at 506 (citing Colorado Interstate Gas Co. v. FERC, 324 U.S. 581 (1945)).

35. Final Rule, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; Regulation of Natural Gas Pipelines after Wellhead Decontrol,* III F.E.R.C. Stats. & Regs. ¶ 30,939, 52 Fed. Reg. 13,267 (1992).

gathering rates was reviewed in *Northern Natural Gas Co. v. FERC* (*Northern*).[36]

In *Northern*, Northern Natural Gas Company (Northern), a FERC-jurisdictional pipeline, sought judicial review of a FERC order requiring it to include in its tariff separately stated gathering rates. Northern had not filed rates for the services of the gathering systems it owned, contending that the facilities and the rates and services were exempt under section 1(b) of the NGA. When Northern refiled its tariff as ordered by the FERC, it noted that the gathering rates were stated for informational purposes only. The FERC rejected the filing, holding that the pipeline's gathering services were rendered "in connection with" interstate transportation and therefore the rates for those services were subject to FERC's jurisdiction under sections four and five of the NGA.

Northern sought judicial review, and the United States Court of Appeals for the Eighth Circuit, in affirming the Commission's jurisdiction, focused its attention on the fact that the total bundled costs of the interstate transportation of gas included both gathering and transmission main-line costs. If the FERC lacked power to regulate gathering costs, said the reviewing court, an interstate pipeline could, by merely separating out the gathering function and manipulating the unregulated rate, effectively establish rates for interstate transportation in a discriminatory manner:

> By setting transportation rates at levels which give an advantage to the pipeline's own gas, while making the total transportation charges incurred by third-party shippers so high as to render their cost sales prices non-competitive, the pipeline can also create an "undue preference or advantage" for its own jurisdictional interstate gas sales to the "undue prejudice or disadvantage" of the interstate gas sales of third-party shippers.[37]

Further, the court found that the potential for discrimination reached beyond third-party shippers: "The public, the ultimate consumer, suffers from the reduced competition in the interstate sale of natural gas."[38] The court held that the detrimental effect of such discriminatory practices would be contrary to the purposes and explicit provisions of the NGA and would frustrate the pro-competitive goals of the Natural Gas Policy Act (NGPA).

For these reasons, the court rejected Northern's argument that pipelines received discriminatory regulatory treatment under FERC's analysis, because the Commission did not regulate rates for gathering by producers or independent gatherers. The court ruled that the difference in treatment was justified, because the need to protect access to and prices for interstate transportation did not exist in the case of independently-performed gathering. Independently-performed gathering, the court said, does not present

36. 929 F.2d 1261 (8th Cir. 1991).

37. *Id.* at 1270.

38. *Id.*

the opportunity to manipulate interstate transportation rates and access through control of the gathering rate.[39]

In *Northwest Pipeline Corp.* (*Northwest*),[40] Northwest Pipeline Corporation (Northwest) proposed to transfer its pipeline-owned gathering facilities to an affiliate, Williams Gas Processing Company (Williams). The FERC applied the court's ruling in *Northern* to the gathering services that would be rendered by Williams and held that it retained sections four and five jurisdiction over the rates to be charged by the latter for gathering services.

An effort was made by the appellant to distinguish the *Northern* precedent based on the fact of the transfer of ownership of the gathering facilities to a non-jurisdictional, though affiliated, company. The FERC did not embrace this distinction. FERC's rejection of the effort to distinguish *Northern* relied on dictum contained in a footnote in that case:

> However, in *Northern Natural*, the Court stated that its use of "the expression 'gathering facilities owned by the pipeline' and all substantially similar expressions are intended to include such facilities owned or operated directly or indirectly by a pipeline or its parent, affiliate, subsidiary or lessors." In other words, the Commission's authority to exert NGA section 4 and section 5 jurisdiction over gathering facilities operated by an interstate pipeline, as explained by the Court, would extend in like manner to an interstate pipeline's parent, affiliate, subsidiary, or lessor.[41]

The FERC stressed that its regulation of gathering was restricted to circumstances in which such regulation is "necessary to make effective the Commission's primary jurisdiction over interstate transportation."[42]

In *Northern*, the court had found that federal regulation was necessary to protect the "ultimate consumer" from the "ultimate disadvantage," in light of the "obvious opportunity" of the interstate pipeline to discriminate against third-party gas and to provide an unduly preferential advantage for its own gas supplies.[43] Claims of potential discrimination were also raised in *Northwest*.[44] In contrast to its ruling in *Northern*, however, the FERC in *Northwest* made no specific finding as to the opportunity for Williams to

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39. *Id.* at 1274. The Court also noted that gathering by producers was subject to some regulatory oversight by the FERC under section 110 of the NGPA. *Id.* NGPA's section 110 provides that the price for the first sale of natural gas shall not be considered to exceed the maximum lawful price to the extent that the price recovers any post-production costs, such as compressing, gathering, processing, treating, liquefying, or transporting such gas. The FERC implemented section 110 in Order No. 94, *Order Amending Interim Regulations Under the Natural Gas Policy Act of 1978 and Establishing Policy Under the Natural Gas Act*, F.E.R.C. STATS. & REGS. Preambles ¶ 30,178, 45 Fed. Reg. 53,099 (1980), and Order No. 94-A, *Regulations Implementing Section 110 of the Natural Gas Policy Act of 1978 and Establishing Policy Under the Natural Gas Act*, F.E.R.C. STATS. & REGS. Preambles ¶ 30,419, 48 Fed. Reg. 5,152 (1983). Order 94-A provided that the first seller could recover the lesser of (1) the contract price for the gathering; or (2) an amount computed under methods established by the Commission.

40. 59 F.E.R.C. ¶ 61,115, at 61,426 (1992).

41. 59 F.E.R.C. ¶ 61,115, at 61,435 (1992) (quoting Northern Natural Gas Co. v. FERC, 929 F.2d 1261, 1263 n.2 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 169 (1991)).

42. 59 F.E.R.C. ¶ 61,115, at 61,436.

43. 929 F.2d. at 1274.

44. 59 F.E.R.C. ¶ 61,115, at 61,436.

discriminate.[45] Rather, the FERC stated that the open-access warranty provision in the Transfer and Assignment Agreement between Northwest and Williams "should alleviate" concerns about discrimination.[46] On this basis, the FERC concluded that it was not *then* necessary to regulate Williams' gathering services or gathering rates. However, in the event "circumstances develop that would allow Williams to exploit its position as a pipeline affiliate to engage in anti-competitive activity," or if "Williams is not operating in accordance with the open access policies of this Commission," then, said the FERC, regulation of the company's gathering activities will become necessary to carry out the objectives of the NGA.[47]

In spite of expansive claims to the contrary, *CIG* and its progeny do not support unlimited FERC jurisdiction over gathering. They can, and they should, be read more narrowly to suggest that the FERC has jurisdiction over gathering only when, and to the extent, it determines that ancillary federal regulation is necessary to vindicate its primary jurisdiction over rates for interstate transportation. On the other hand, there is no sound basis for extending the hand of federal regulation over gathering rates and the terms and conditions upon which gathering services are performed to cases in which those activities do not impinge on interstate gas transportation rates.

As the market-based gas-pricing regime of Order 636 takes effect and pipeline-owned gathering operations are spun-off and sold, there appears to be much less justification for federal regulation of gathering. There is a correspondingly greater validity to state claims for jurisdiction over those services to protect the local interests in how gathering affects the correlative rights of mineral owners and the conservation of the states' natural resources.

Chair Elizabeth Anne Moler dissented from FERC's May 1, 1992, Order in *Northwest*. She argued that FERC's ability to regulate rates and services "cannot depend upon who owns the facilities. It must stem instead from the nature of the facilities and the function those facilities serve."[48] Her concern was the inability of the Commission under the reasoning of the order to remedy discriminatory practices when gathering facilities are transferred or spun-off to an unaffiliated party, instead of being transferred or spun-down to an affiliate of the pipeline. Chair Moler preferred to address the problem of potential discrimination by refusing to determine that gathering facilities are non-jurisdictional in the first place:

> I can see no justification for saying facilities are nonjurisdictional under the NGA, but then threatening to regulate the rates and impose access conditions

45. In *Northern*, the Court found that jurisdiction over costs was necessary to ensure that the interstate pipeline did not manipulate the interstate transportation rates to the unlawful advantage of its own system supply. However, although the FERC relied on *Northern* to find jurisdiction in the *Northwest* proceeding, the concerns facing the *Northern* Court regarding a pipeline's preferential treatment of its own supply were not present there. The FERC found that Northwest no longer provided a sales service and had become primarily a transporter of gas. *Id.* at 61,433.

46. *Id.*

47. *Id.*

48. 59 F.E.R.C. ¶ 61,115, at 61,439.

> if discriminatory practices develop. I would prefer to address the basic test, rather than depend upon the recent *Northern Natural Gas Co.* case for "in connection with" rate jurisdiction over gathering facilities.[49]

Williams requested rehearing of FERC's May 1, 1992, Order, arguing that "by asserting rate jurisdiction over Williams while not asserting such jurisdiction over nonaffiliated gatherers, the Commission has made an arbitrary and unjustified distinction and discriminates against Williams in violation of the Equal Protection Clause."[50] The Commission rejected Williams' rehearing request. It stated that the Equal Protection argument had been disposed of by the court's opinion in the *Northern* case.

FERC's rehearing order also rejected intervenors' arguments that once the Commission determines it has jurisdiction over gathering, it must, under *Northern*, exercise all of the jurisdiction conferred by sections four and five of the NGA.[51] The FERC reiterated that it can "only regulate ... aspects of the natural gas industry to the extent that it is necessary to make effective the Commission's primary jurisdiction over interstate commerce", and that, "at this time there is no indication that regulation of Williams' rates and services is needed."[52]

The intervenors sought Tenth Circuit judicial review of FERC's refusal to exercise jurisdiction over Williams' gathering operations and to require filing of a tariff under section 4(c). Williams appealed FERC's finding that it had jurisdiction over Williams as a pipeline-affiliated gatherer under sections four and five. In an opinion issued on February 28, 1994, the United States Court of Appeals for the Tenth Circuit dismissed the appeal, finding that because the FERC had not yet exercised jurisdiction over Williams, Williams had not been "aggrieved" within the meaning of section 19(b) of the NGA.[53] Consequently, the court concluded, there was no justiciable case or controversy.[54] The court's dismissal left the FERC and the natural gas industry without judicial direction as to FERC's powers with respect to pipeline-affiliated gathering.

## VI. Gathering after Order 636: The Demise of the Captive Customer

Since it issued the *Northern* and *Northwest* Orders, the FERC has issued and implemented Order 636, restructuring the functions and rela-

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49. *Id.*

50. 60 F.E.R.C. ¶ 61,213, at 61,732 (1992).

51. *Id.* at 61,730. The issue of whether a tariff and rates for pipeline-related gathering must be filed under section 4(c), in turn, raises the question why section 4(c) does not include the "in connection with" language so important to finding that jurisdiction attaches under section 4(a). Section 4(c) requires that a natural gas company file a tariff and rates for its jurisdictional services. Gathering is not a jurisdictional service. In addition, the holdings in *CIG* and *Northern* were limited to a review of gathering costs related to interstate transportation. FERC's regulation of services under Section 4(c), or more narrowly, its oversight of access to gathering capacity, would be an expansion of those holdings.

52. *Id.*

53. 15 U.S.C. § 717r(b) (1988).

54. Williams Gas Processing Co. v. FERC, 17 F.3d 1320 (10th Cir. 1994).

tionships of jurisdictional pipelines in the natural gas marketplace.[55] Consequently, many of the concerns that were the bases for the *Northern* and *Northwest* orders are no longer relevant.

The *Northern* case held that regulation of the gathering rate was necessary, so that the pipeline could not manipulate its gathering rates and its rates for main line transmission so as to give the pipeline's own gas "forbidden preferences."[56] The court further stated that the mere existence of a separately stated separate gathering rate does not "magically 'unbundle' " gathering activity performed with the pipeline's own facilities.[57] Order 636, by prohibiting pipelines from transporting their own supplies in interstate commerce on different terms than those offered to competitors, eliminates their ability to confer upon their own gas any preference.

In addition, the court in *Northern* relied, *inter alia*, on the fact that gathering by producers was subject to some regulatory oversight by the FERC under section 110 of the NGPA when it rejected Northern's claim of selective regulation by the FERC.[58] The Commission's later rejection of Williams' Equal Protection claim in the *Northwest* orders relied upon that passage from the *Northern* holding.[59] Since those decisions were rendered, Congress has enacted the Wellhead Decontrol Act of 1989, eliminating any FERC regulatory oversight of gathering under section 110 of the NGPA.[60]

In Order 636, the Commission found that adequate divertible gas supplies exist in all pipeline sales markets. The Commission held that its finding was consistent with the Wellhead Decontrol Act: "Congress, therefore, has determined that gas sales at the wellhead, or in the field, are sufficiently competitive to justify decontrol of all first sales of gas supplies."[61] The Commission went on to state that:

> [T]he Congressional finding of a competitive wellhead or field market applies to all sellers in that market, and that it is reasonable to infer that Congress believed that the production area market for natural gas is competitive on a national level without regard to the status of a particular gas merchant as first seller or non-first seller.[62]

The Commission has yet to deal expressly with these later findings in gauging the necessity of regulating gathering to make effective its primary jurisdiction over interstate transportation. But their implications are clear. If wellhead sales markets are competitive, the consumer's protection is found in the law of supply and demand, and there is no valid consumer-protection purpose served by continued federal regulation of gathering rates.

55. III F.E.R.C. STATS & REGS. ¶ 30,939 (1992).

56. Northern Natural Gas Co. v. FERC, 924 F.2d 1261, 1270 (8th Cir. 1991).

57. *Id.* at 1273.

58. *Id.* at 1274.

59. 59 F.E.R.C. ¶ 61,115, at 61,435 (1992).

60. Pub. L. No. 101-60, 103 Stat. 157 (codified at 15 U.S.C. §§ 3311-3432 (Supp. V 1993)).

61. III F.E.R.C. STATS. & REGS. ¶ 30,939, at 30,439 (1992).

62. *Id.*

As a result of Orders 436 and 636, consumers are no longer captives of the pipeline when it performs a merchant function. The local distribution companies that serve consumers at retail can bargain for their own supplies and related gathering services with producers and gatherers in many competing supply areas. From the perspective of the gas sales market, gathering is competitive. The price paid by the end-user is, more and more frequently, a delivered "market price." It is this market price to which the Commission's interest has been limited in carrying out its NGA responsibility to protect the ultimate consumer from excessive rates.[63]

## VII. Coordinating Federal and State Regulation

There is a natural tension between federal and state regulatory programs covering the same industry. The Supreme Court recognized this tension in *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas*: "[I]t is inevitable that 'jurisdictional tensions [will] arise as a result of the fact that [state and federally regulated elements coexist with] a single integrated system.' "[64] Disagreements between state and federal regulatory regimes are usually disposed of under a cluster of doctrines that have become known as the law of federal preemption. Two themes dominate this rich vein of constitutional law. First, states' rules are preempted when the two regulatory programs cannot coexist. Second, federal preemption of state authority occurs when Congress has expressed a clear intent that federal law is to completely occupy the field, i.e, the scheme of federal regulation is so pervasive as to permit the inference Congress left no room for the states to supplement it.[65]

If Congress did not provide for a pervasive regulatory scheme, dual regulation is permissible, and states will be preempted only when their concurrent authority would cause a conflict that is contradictory and repugnant to the federal scheme.[66] In *Goldstein v. California*,[67] the Supreme Court distinguished between those "situations where concurrent exercise of a power by the Federal Government and the states or by the states alone may possibly lead to conflicts and those situations where conflicts will necessarily arise."[68] Citing the Federalist Papers, the Court continued, "[I]t is not . . . a mere possibility of inconvenience in the exercise of powers, but an immediate constitutional repugnancy that can by implication alienate and extinguish a pre-existing right of [state] sovereignty."[69]

63. FPC v. Hope Natural Gas Co., 320 U.S. 591 (1943); Colorado Interstate Gas Co. v. FPC, 324 U.S. 581 (1945); Northern Natural Gas Co. v. State Corp. Comm'n. of Kan., 372 U.S. 84 (1963).

64. 489 U.S. 493, 515 (1989) (citing Louisiana Pub. Serv. Comm'n. v. FCC, 476 U.S. 355, 375 (1986)).

65. *See* Goldstein v. California, 412 U.S. 546 (1973); Silkwood v. Kerr-McGee Corp., 464 U.S. 238 (1984).

66. *Silkwood*, 464 U.S. 238.

67. 412 U.S. 546 (1973).

68. *Id.* at 554.

69. *Id.* at 554-55 (citing The Federalist No. 32, at 243 (B. Wright ed., 1961)).

From a constitutional standpoint, nothing in the NGA preempts the states from regulating rates for gathering of natural gas, as well as the terms and conditions imposed by firms that engage in the gathering business. It is well established that the principle purpose of the NGA is to protect the consumer from excessive rates.[70] The Supreme Court has consistently decided cases involving the issue of whether the Federal Power Commission's or FERC's regulatory programs preempt state regulation of the natural gas industry by weighing the local concerns, such as the state's interest in conservation and correlative rights against the regulation's impact on the federal regulatory scheme's objective of protecting gas consumers from excessive prices.

In *Northern Natural Gas Co. v. State Corporation Commission of Kansas*,[71] the Kansas Corporation Commission had ordered purchasers of natural gas to take ratably from common sources of supply in order to prevent unreasonable discrimination in favor of or against any producer from the common source. The Court acknowledged that the state's purpose for issuing the ratable take order was the exercise of its legitimate interest in conserving natural resources. Nevertheless, the Court struck down the Kansas Commission's order because it directly interfered with federal policy:

> [O]ur cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producers and production. The former cannot be sustained when they threaten, as here, the achievement of the comprehensive scheme of federal regulation.[72]

In another notable ratable take case, *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas* (*Northwest Central*),[73] the Kansas Corporation Commission had adopted regulations providing for permanent cancellation of a producer's underproduced entitlement if the producer did not timely produce the underage. The Supreme Court held that the state's regulatory program could withstand an attack on its validity on federal preemption grounds.

In *Northwest Central*, no threat to the federal scheme of regulation was found. The Court recognized that the regulation could "result in pipelines making purchasing decisions that have an effect on their cost structures and hence on interstate rates."[74] The Court declined to treat this possibility as triggering federal preemption, however, it explained that decision as follows:

> By paying due attention to Congress' intent that the States might continue to regulate rates of production in aid of conservation goals and the protection of

70. *See* FPC v. Hope Natural Gas Co., 320 U.S. 591 (1943).

71. 372 U.S. 84 (1963).

72. *Id.* at 94.

73. 489 U.S. 493 (1989).

74. 489 U.S. at 512. It is interesting to note, however, that the Court did not resolve in *Northern* specifically whether conservation measures aimed at purchasers would or would not be sustained where those measures were consistent with and did not "threaten" the federal comprehensive regulatory scheme.

producers' correlative rights, we may readily distinguish [*Northern*] and [*Transcontinental Gas Pipe Line Corp v. States Oil and Gas Board of Mississippi*[75]], upon which appellant mainly relies. In both of those cases we held state regulations requiring gas purchasers to take gas ratably from producers were pre-empted, because they impinged on the comprehensive federal scheme regulating interstate transportation and rates.[76]

The Court, in its preemption analysis, held that the Kansas regulation, without something more than an indirect impact on pipelines' costs, did not conflict with the federal regulatory scheme. Significantly, the Court noted the assurance in the *amicus curiae* brief for the United States that the FERC would recognize the Kansas order as part of the environment in which pipelines would conduct their business and would make its decision accordingly.[77] The Solicitor General, who would normally file an *amicus* brief in such a case only after consultation with the FERC, took the position that the state regulations did not significantly interfere with the federal regulatory scheme.

In the preemption cases discussed above, the Court looked for direct conflicts between state regulation and the federal regulatory scheme. As demonstrated above,[78] however, section 1(b) of the NGA stands as conclusive evidence that Congress did not intend that federal regulation of gathering occupy the field to the exclusion of state regulation. As the *Northwest Central* case demonstrates, moreover, the states' interest in conservation and correlative rights does not necessarily conflict with FERC's implementation of the NGA's comprehensive scheme of federal regulation; rather, this interest is consistent with FERC's regulatory program of providing consumers with a competitively priced and readily available supply of natural gas. These two objectives are complementary, not competitive.

In situations such as this, where state and federal laws have the same or similar purposes, courts have held that state law is not preempted by federal law. They have, instead, determined that both sets of law, and the programs undertaken to carry them out, can stand together as complementary to one another.[79] As a general rule, "where the Government has provided for collaboration, the courts should not find conflict."[80]

At one time, there was a "bright line" of demarcation between the states' interest in regulating production related to gathering activities and facilities in the interest of conservation and the federal interest in regulating gathering by interstate pipelines (or gathering paid for by interstate pipelines), when that was necessary to carry out the NGA's mandate to protect consumers from excessive rates and charges. The *locus* of that line was readily ascertainable; it was delineated by pipeline purchases. Now, it

75. 474 U.S. 409 (1986).

76. 489 U.S. at 513.

77. *Id.*

78. *See supra* text accompanying notes 14-16.

79. *See, e.g.*, Exxon Corp. v. Governor of Md., 437 U.S. 117 (1978); Ray v. Atlantic Richfield Co., 435 U.S. 151 (1977); Kelly v. Washington, 302 U.S. 1 (1937).

80. Union Brokerage v. Jensen, 322 U.S. 202, 209 (1944); *See also* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117 (1973); Kelly, 302 U.S. at 10; Savage v. Jones, 225 U.S. 501 (1911).

has been obscured by the unbundling of gas transmission and related services and by deregulation of the sale of natural gas as a stand-alone commodity.

Unbundled pipeline-related gathering gives rise to issues of local interest subject to state jurisdiction, just as the federal interest in gathering rates diminishes. When a FERC-jurisdictional pipeline spins-off or sells its gathering system to a non-jurisdictional entity, there is no longer any valid reason for preempting state regulation of the gathering system's new owner. The contract rates, terms, and conditions under which the newly independent gatherer does business remain of vital interest to the states. The same is true with pipeline affiliated gatherers. Producers look to the state regulatory authorities to protect them from the monopsony power of the gatherer. In addition, the activities of the gatherer have a powerful impact on the states' ability to perform effectively their traditional role of promoting conservation and the protection of correlative rights. The gas consumer's interest in reasonable rates is now protected by the existence of an open and competitive marketplace for natural gas supply, and the ancillary services, such as transmission, storage, and gathering, necessary to bring the supply to the city gate.

To the extent that both the FERC and state commissions both have interests in gathering services, there is, as there has always been, a real issue of the practicality of dual regulation of such the facilities and services.

Congress foresaw the possibility that there would be a need for coordination in order to foster the harmonious and comprehensive regulation of the industry when it included in section 17(a) of the NGA provisions that would allow the federal regulatory authority to work in harmony with the states. In theory, these so-called "joint board" proceedings could be forums for the FERC and one or more interested state regulatory commissions to conduct proceedings that could result in either an adjudication or a rulemaking that would resolve both state and federal interests in gathering in a coordinated manner. Section 17(a) of the NGA provides "the Commission may refer any matter arising in the administration of this Act to a board to be composed of a number of members, as determined by the Commission, from the State or each of the States affected or to be affected by such matter."[81]

The prospects for using section 17(a) as the vehicle for dealing with the disparate interests of the federal and state regulatory programs in a coordinated manner is, however, more theoretical than real. The FERC has exercised its section 17(a) authority on only one occasion, and then over the opposition of its own staff.[82] That was in 1978, the first year of the Commission's existence. Commission regulations implementing section 17(a) restrict its use to "unusual cases, and as a means of relief to the Commission when it might find itself unable to hear and determine cases before it in the usual course, without undue delay."[83] Relying on this language,

81. 15 U.S.C. § 717p(a) (1988).

82. *See* Lehigh Portland Cement Co. v. Florida Gas Transmission Co., 3 F.E.R.C. ¶ 61,005 (1978).

83. COMM'N R. PRACTICE & P. 1304(a) (codified at 18 C.F.R. § 385.1304 (1994)).

the Commission has twice rejected requests by state regulatory agencies for joint board proceedings.[84]

Given this history, it is improbable that section 17(a) of the NGA could be the vehicle for allowing the states to exercise their regulatory oversight responsibilities in connection with gathering of natural gas. However, expanding the applicability of 17(a) would be consistent with the expansive restructuring of the natural gas industry the FERC has implemented over the last decade. This restructuring merits a rethinking of the uses to which section 17(a) might be put, particularly in leaving to the states the regulation of gathering.

But if the FERC will not use its statutory tools to that end, it would be appropriate for Congress to enact legislation making it clear that state jurisdiction of gathering is exclusive and plenary, regardless of whether the entity performing that service is a FERC-jurisdictional pipeline or an affiliate of such a pipeline.

## VIII. THE STATES SHOULD REGULATE GATHERING

As noted, gatherers tend to have monopsony market power. This power, like all others, is subject to abuse. Abuse of market power by gatherers affects a significant state interest; its impact is felt primarily at a state and local level. A producer bringing a new well on line may have several gatherers offer to connect their facilities to his well. Once an election is made, the producer loses any additional negotiating power. He is compelled to do business with one gathering firm, on that firm's terms. That firm's gathering system is the only avenue available to a producer to move his gas to market.

Consider the plight of a producer who began to develop a lease five years ago. He entered into an agreement with XYZ Interstate Pipeline to transport his gas, with ten cents per Mcf of cost attributed to gathering. Five years later, XYZ spins-down its gathering facilities to a new affiliated entity, ABC Gathering Corporation. Our producer, who now has eight gas wells producing, gets a letter from ABC saying it is no longer interested in transporting his gas, but it is interested in buying his gas. What options does the producer have? Very few. He can sell to ABC at its price, or he can spend thousands of dollars to lay his own pipe so he can move his gas to market. Either way the producer is not benefitting from any "market price" for his natural gas, and that clearly is not what the FERC intended when it began moving the industry towards an open access-open market.

The FERC recently addressed this problem, stating:

> If the existing customers and the pipeline's successor in interest cannot negotiate mutually agreeable terms and conditions, the pipeline must submit with

84. *Florida Gas Transmission Co.*, 45 F.E.R.C. ¶ 61,114 (1988); *Kansas State Corp. Comm'n.*, 25 F.E.R.C. ¶ 61,400 (1983). In the *Kansas State* order, the Commission ruled that it would be improper to allow the State regulatory commission to assume an adjudicatory role when it had previously intervened as a party to the proceeding. The FERC did not explain how this situation differs from the normal state of affairs in its own proceedings, i.e., with the Commission sitting in judgment of the litigation position taken by its own staff.

> its abandonment application a "default contract" or pro forma agreement which has been offered to existing customers. The terms for service under the default contract should not be inconsistent with the terms, conditions and rates for various services currently offered by independent gatherers in the particular region. If the Commission concludes that the default contract meets this standard, it will act to authorize a spin-down or spin-off. Existing customers who choose not to take service under these terms, conditions and rates will not be guaranteed continuation of service.[85]

But the FERC cannot assure producers reliable service at reasonable rates. The Commission has leverage to regulate these matters only by conditioning its ruling that an independent gathering firm is non-jurisdictional upon offering producers in its existing clientele a standard contract containing FERC-specified terms. But once the FERC acts to approve the arrangement, the gatherer becomes instantly non-jurisdictional by virtue of that very action. The FERC is no longer available to protect the producer against oppression by the gatherer who finds himself in the unique position of operating an unregulated monopoly, thanks to an agency of the federal government. In addition, FERC's approval of the gatherer's initial contracts offers no protection or solace to future producers or existing producers with new wells. The only institution available to protect against invidious conduct by gatherers is the state regulatory agency.

Some will argue that gathering costs are not important because the price paid by the end-user consumer is now a "market" price. Consumers do have options and can choose between many sources of supply. It may also be argued, with considerable justification, that excessive gathering costs, artificially low purchase prices, or both are at least as undesirable as mulcted customers at the burner tip. They result in below-market returns to producers. That, in turn, will eliminate any incentive for producers to continue to develop additional reserves.[86] In the end, consumers will pay higher prices for gas supplies if gathering is unregulated because fewer reserves will ultimately be developed.

This Article's central premise is this: state regulation of gathering will maximize producers' access to the marketplace. Such access is absolutely necessary if the market-based goals of federal policy are to be achieved. If state regulation is to be struck down when it threatens "the achievement of the comprehensive scheme of federal regulation,"[87] then state regulation must be upheld when it clearly furthers the overall goals of federal regulation.

The drafters of the NGA recognized the states' right to regulate production and gathering. The courts have long recognized these two areas as

85. *Mid Louisiana Gas Co.*, 67 F.E.R.C. ¶ 61,255, at 61,852 (1994). *See also Eastern Am. Energy Corp.*, 67 F.E.R.C. ¶ 61,258, at 61,887 (1994); *Arkla Gathering Serv. Co.*, 67 F.E.R.C. ¶ 61,257, at 61,872 (1994).

86. This assumes that a true market price will in fact allow a producer to finance internally the drilling of additional wells. Experience in Oklahoma indicates that current prices do not provide a sufficient price signal to encourage significant new drilling.

87. Northern Natural Gas Co v. State Corp. Comm'n. of Kan., 372 U.S. 84, 94 (1963).

legitimate fields for the operation of state policies.[88] The central tenet of these policies is the need for protection of the correlative rights of mineral owners and their lessees. Failure to regulate gathering adequately could result in gathering systems favoring one producer or group of producers over another, with the end result being denial of correlative rights, producer access to the marketplace, and realization of maximum exploitation of potential natural gas resources.

Consumers have always been concerned with producer control over energy supplies. There is suspicion that somehow producers will conspire to restrict supply to raise prices. Consequently, when states act to implement policies that appear to remove regulatory control from Washington, there is usually great opposition on the part of so-called consumer advocates. One of the most interesting features of the gathering issue is that producers and consumers have exactly the same interests. Each wants free, ready, and complete access to the other. The more natural gas that is produced and sold at a competitive "market price," the lower the real price to consumers and the more gross production tax paid to each producing state's treasury. It can be assured that neither consumers nor producers will benefit in the long-run from the lower "purchase price" of natural gas that appears, at first glance, to result from unregulated or lightly regulated gathering. The appearance of this phenomenon is a chimera.

If gathering presents such a potential for abuse, one may ask, why should FERC's jurisdiction be relinquished and returned to the states? The reason lies in the need for uniform and consistent regulation of all gatherers. FERC's power to regulate gathering touches only interstate pipelines and their affiliates.[89] The FERC cannot regulate producer-owned gathering systems that are unaffiliated with pipelines.[90] The states, however, can regulate *all* gatherers through their respective powers to promote conservation of resources and to protect the correlative rights of mineral owners, if the FERC will only relinquish or delegate its limited authority, or if Congress grants this authority exclusively to the states. From a practical standpoint, it seems very unlikely that the FERC could find the time, the staff, or the inclination to settle the literally hundreds of small gathering disputes that may arise.

A clear delegation of authority to the states (by the FERC or Congress) will allow consistent regulatory policies to develop for natural gas gathering. If it is clear to industry participants what role regulators are going to play and if it is clear to industry participants that there will be no regulatory cracks to fall through, then it is very unlikely that abuses of market power will occur.

88. *See supra* note 15.

89. *See* Northern Natural Gas Co. v. FERC, 929 F.2d 1261 (8th Cir 1991), *cert. denied*, 112 S. Ct. 169 (1991); *Mid Louisiana Gas Co.*, 67 F.E.R.C. ¶ 61,255 (1994).

90. *See* cases cited *supra* note 89.