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Regulation of Natural Gas - Federal v. State

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REGULATION OF NATURAL GAS— FEDERAL V. STATE*

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In recent years, along with the tremendous growth of the natural gas industry, far exceeding that of almost all other industries in the post war era, has come a demand for clarification of the original Natural Gas Act of 1938. Decisions of the Supreme Court of the United States since 1938 interpreting the authority of the Federal Power Commission under the Natural Gas Act have confused and clouded the authority of the Federal Power Commission over the natural gas industry. This confusion has resulted in a demand for legislation to clarify the Natural Gas Act. It is important to the natural gas industry, and to the public at large that the jurisdiction of the Federal Power Commission on the one hand and that of the state public utility commissions on the other hand be explicitly defined.

THE CASES PRIOR TO 1938

The natural gas industry as it has developed is unique, the market for natural gas being in one area of the country and the source of supply in another, resulting in the construction of interstate pipe-line transmission facilities to carry the natural gas from the source of supply to the great markets of natural gas consumption, sometimes as many as 2,000 miles away from where the gas was produced and gathered. This unique physical setup of the natural gas industry has complicated the problem of regulation of this industry by proper governmental bodies in the public interest.

Prior to the Natural Gas Act in 1938, many of the states, particularly in the areas of consumption of natural gas, had authorized their respective state utility commissions to regulate the rates and operations of natural gas companies within the particular state jurisdictions. Moreover, prior to 1938 there had been significant decisions of the United States Supreme Court defining to a certain extent the limits of state regulatory authority over the natural gas industry. It was largely on the basis of these decisions that the provisions of the Natural Gas Act in 1938 were drawn, when Congress first entered the field of Federal regulation of the natural gas industry. At least a summary glance at these decisions of the Supreme Court prior to 1938 is indispensable to a complete understanding of the provisions of the Natural Gas Act.

Prior to 1938, the Supreme Court had recognized that Congress

* This is a current revision of a paper written by Mr. Sargent while a student at the University of Denver College of Law.

had not entered the field of regulation of the natural gas industry and that the states had certain well-defined areas of responsibility in which they could act to regulate the industry in the interests of the public. The *Landon* case [1] is good authority that a state could then regulate an independent local distributor of natural gas and could fix its retail rates to ultimate consumers within the state even though the natural gas was received by the local distributor from an interstate carrier. The Court stated that the interstate movement of gas ended when the gas passed into the mains of the local distributor.

In the *Penna. Gas Co.* case,[2] the Court held that a direct (retail) industrial sale made by an interstate carrier was subject to local state regulations even though the sale was made in interstate commerce. The theory behind this decision was that even though the sale was made in interestate commerce, in the absence of a contrary regulation by Congress, a state might within a permissible area pass laws indirectly affecting interstate commerce when such laws were needed to protect matters of local interest.

Whereas the *Penna. Gas Co.* case held that a state could regulate a direct (retail) sale of natural gas in interstate commerce, the Supreme Court determined in the *Kansas Gas Co.* case [3] that a state could not regulate a sale made by a wholesale distributor in interstate commerce to a local distributor for resale, deeming this to be a direct burden on interstate commerce.

Prior to 1938, there were no decisions of the Supreme Court relating specifically to the regulation of production and gathering of natural gas at the source of supply. However, the *Attleboro Co.* case,[4] involving the sale of electric energy, is probably some authority to the effect that prior to 1938 the Supreme Court had determined that a state had no jurisdiction or power to regulate the rate of the *sale* of the producer and gatherer of natural gas to the interstate transporter even though that sale was made at or within the state boundary.[5]

Clearly, at this time there was a recognition by the Supreme Court of effective state regulation of some of the phases of the natural gas industry. In most states, state utility commissions had been given ample authority under state laws to regulate the local utilities, including the natural gas utilities.

THE NATURAL GAS ACT OF 1938

One of the primary objectives of the Natural Gas Act of 1938 was to provide Federal regulation in those cases where the state utility commissions lacked authority under the interstate commerce clause of the United States Constitution. There is no better state-

[1] P.U.C. v. Landon, 249 U. S. 236 (1918).
[2] Penna. Gas Co. v. P.U.C., 252 U. S. 23 (1920).
[3] Missouri v. Kansas Gas Co., 265 U. S. 298 (1924).
[4] P.U.C. v. Attleboro Co., 273 U. S. 83 (1927).
[5] See Jersey Central Power & Light Co., v. F.P.C., 319 U. S. 61 (1943).

ment of the purposes of Congress in passing the Natural Gas Act of 1938 than that of Mr. Justice Rutledge in *Panhandle Eastern Pipeline Co. v. P.S.C.*,[6] wherein he says:

> The act, though extending federal regulations, had no purpose or effect to cut down state power. On the contrary, perhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous regard for the continued exercise of state power, not to handicap or delete it in any way. . . .
>
> The Natural Gas Act created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies. It does not contemplate ineffective regulation at either level. We have emphasized repeatedly that Congress meant to create a comprehensive and effective regulatory scheme, complementary in its operation to those of the States and in no manner usurping their authority. . . . The scheme was one of cooperative action between federal and state agencies.

It is Section 1 (b) of the Natural Gas Act with which this article is particularly concerned. That section provides as follows:[7]

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, *to the sale in interstate commerce of natural gas for resale for ultimate public consumption* for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall *not* apply to any other transportation of natural gas or to the *local distribution of natural gas* or to the facilities used for such distribution or to the *production or gathering of natural gas.*

The Natural Gas Act is aimed at Federal regulation of the transporter and large-scale seller in interstate commerce,[8] and the Federal Power Commission is given authority to fix rates on the sale of gas in interstate commerce for *resale*.[9] The function of regulating the intrastate sale and distribution of gas as well as the production and gathering of gas is left to the states.

Subsequent to the Act, the Supreme Court in the *Panhandle Eastern Pipe-line* case of 1947,[10] consistent with the prior holding of that Court in the *Penna. Gas Co.* case, *supra*, determined that Section 1 (b) of the Act does not prohibit regulation by the states of *direct* sales in interstate commerce to the ultimate consumer. Other subsequent decisions of the Supreme Court, however, have given rise to a demand for clarification of the original Act.

Production and Gathering

Section 1 (b) clearly exempts the "production and gathering of natural gas" from application of the Act. Some confusion, however, has arisen in the interpretation of this provision. The Act at

[6] 332 U. S. 507, 517-520 (1947).
[7] 52 STAT. 821 (1938), 15 U.S.C. § 717 b 1940. Italics supplied.
[8] F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944).
[9] Colorado Interstate Gas Co. v. F.P.C., 324 U. S. 581 (1945).
[10] *Supra*, n. 6.

no point defines what is meant by the term "production and gathering", nor do prior decisions of the Court lend any light in this regard. Thus the problem exists, what did Congress intend to exempt in excluding from application of the Act the "production and gathering" of natural gas?

At the time of the original consideration in Congress of the Act, Senator Wheeler, Chairman of the Committee on Interstate Commerce, gave the following response, on the floor of the Senate, to the question "does this bill undertake to regulate the production of natural gas, or does it undertake to regulate the producers of natural gas?" He said:[11]

> 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.

The problem of what Congress intended in exempting production and gathering of natural gas in Section 1 (b) first came up in the Supreme Court in *Colorado Interstate Gas Co. v. F.P.C.*[12] In that case, the Court concluded that Section 1 (b) did not prevent the Federal Power Commission from taking into account the production properties and gathering facilities of natural gas companies where it fixes their rates subject to its jurisdiction.[13] The Court commented that the exemption of production and gathering of natural gas in Section 1 (b) meant only that the Federal Power Commission has no control over the *drilling* and *spacing* of wells and the like. There was a strong dissent in the *Colorado Interstate Co.* case by Mr. Justices Roberts, Reed, and Frankfurter and Mr. Chief Justice Stone on the ground that the Federal Power Commission exceeded its jurisdiction in including wells and gathering facilities in the rate base of the interstate wholesale sales.

The *Interstate Gas Co.* case[14] in 1947 held that even though Congress has exempted the production and gathering of natural gas from application of the Natural Gas Act, that exemption does not preclude the Federal Power Commission from regulating the rate of the purchase by an interstate transporter from an affiliated intrastate producer and gatherer. This decision was based on the prior decisions of the *Attleboro Co.* case and the *Jersey Power Co.* case involving sale of electrical energy, *supra.*

The most recent case involving an interpretation by the Supreme Court of the exemption of production and gathering of natural gas in Section 1 (b) is *F.P.C. v. Panhandle Eastern Pipe Line Co.*,[15] decided June 20, 1949. Panhandle Eastern Pipe Line Co. transports and markets natural gas in interstate commerce by

[11] 81 Cong. Rec. 9312.
[12] Colorado Interstate Gas Co. v. F.P.C., *supra* note 9.
[13] In accord, Panhandle Eastern Pipeline Co. v. F.P.C., 324 U. S. 635 (1945). In this case, it was held that the F.P.C. could also take into consideration unregulated direct industrial sales in fixing a fair rate of return for regulated wholesale rates.
[14] Interstate Gas Co. v. F.P.C., 331 U. S. 682 (1947).
[15] 337 U. S. 498 (1949).

means of its pipeline system which runs from Texas into Michigan. In addition it owns or controls gas-producing properties in Kansas, Oklahoma, and Texas. The question to be decided by the Court was, may such a natural gas company subject to the Act, sell leases covering an estimated twelve per cent of its total gas reserves without the approval and contrary to an order of the Federal Power Commission. The Commission argued that there was a distinction between the activities of production and gathering, such as drilling, spacing wells, or collecting gas on the one hand, and the facilities, such as reserves and gas bases, used therefor on the other hand. It claimed that only the former were excluded by Section 1 (b) from the coverage of the Act. The Court rejected this argument, viewing leases as an essential part of production. The Court noted that the Commission up to that time had never claimed the right to regulate dealings in gas acreage. It held that Section 1 (b) of the Act excluding the production and gathering of natural gas from application of the Act, left the transfer of gas leases to state regulation and outside the scope of the regulatory powers of the Federal Power Commission.

The *Colorado Interstate Gas Co.* case, the *Interstate Gas Co.* case, and the *Panhandle Eastern Pipeline Co.* case of 1949 point up the difficulty the Court has had in interpreting the intent of Congress in excluding the production and gathering of natural gas from application of the Natural Gas Act. The *Interstate Gas Co.* case in particular has resulted in confusion. The argument is made that the intent of Congress, in excluding production and gathering of natural gas and in defining a "natural-gas company" under the Act as a company "engaged in the transportation of natural gas in interstate commerce," [16] was to exempt *independent* producers or gatherers of natural gas *and their sales thereof* to interstate pipe lines from the provisions of the Act. As a consequence, Congress undertook to re-examine the Natural Gas Act with the idea in mind of giving consideration to this problem and adopting appropriate amendatory legislation.

The Kerr Bill: The Kerr Bill sought to amend Section 1 (b) by adding to the provision that the Act shall not apply to the production or gathering of natural gas, the following:[17]

> Or to any arm's length sale of natural gas made by one producer or gatherer to another producer or gatherer or made at or prior to the point of delivery of such gas into interstate transmission facilities (of a natural-gas company) or to incidental transportation of natural gas necessary for delivery of such gas to such other producer or gatherer or into interstate transmission facilities (of a natural gas company): *Provided*, that such arm's length sale and incidental transportation are by a producer or gatherer not otherwise engaged in and not controlled by or controlling a person otherwise engaged in the transportation or sale of natural gas for resale in interstate commerce.

[16] 52 STAT. 821 (1938), 15 U.S.C. § 717 a (6) (1940).
[17] S. 1498, 81st Cong., 2nd Sess. (1950).

The Kerr Bill was passed by both the House and the Senate, but was vetoed on April 15, 1950 by the President.

Local Distribution

We have already seen that Section 1 (b) of the Natural Gas Act provides that the Act shall apply to the transportation of natural gas in interstate commerce and to the sale thereof in interstate commerce for *resale,* but that it goes on to provide:

> . . . but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution.

Section 2 of the Act gives the following definitions:

> (6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.[18]
>
> (7) "Interstate Commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commence takes place within the United States.[19]

Avowedly, the intent of Congress in enacting Sections 1 (b) and 2 of the Natural Gas Act was to exclude Federal regulation of local distribution and the facilities used for such distribution. This conclusion is borne out from the statement of Senator Wheeler discussed above in connection with the exclusion of production and gathering of natural gas from application of the Act. Reference has previously been made to the *Landon* case, which apparently was a contributing factor to the exclusion of local distribution facilities in Section 1 (b).

Test of wholesale or retail sales: In the *Illinois Gas Co.* case,[20] the Supreme Court in 1942 held that by virtue of the Natural Gas Act, a state had no authority to order an extension of transmission facilities of an *intrastate wholesale* distributor. The basis of this decision was that the intrastate wholesale distributor was a *subsidiary* of the interstate transporter from which it received the gas into its system; therefore, it was a natural gas company transporting gas in interstate commerce and subject to the regulatory authority of the Federal Power Commission.

Relying on the *Illinois Gas Co.* case, the Supreme Court in 1945 determined in *Colorado-Wyoming Gas Co. v. F.P.C.*[21] that the Federal Power Commission had jurisdiction over the wholesale sales made by the Colorado-Wyoming Gas Co. in Colorado. Colorado Interstate Gas Co. transmits gas from Amarillo, Texas fields to

[18] *Supra,* n. 16.

[19] 52 Stat. 821 (1938), 15 U. S. C. § 717a (7) (1940).

[20] Illinois Natural Gas Co. v. Central Illinois P. S. Co., 314 U. S. 498 (1942).

[21] 324 U. S. 626 (1945).

Colorado. Colorado-Wyoming Gas Co. purchases gas from Colorado Interstate Co. at Littleton and sells this gas in both Colorado and Wyoming to local companies and municipalities for resale to the public. The Colorado-Wyoming Gas Co. contended that the wholesale sales made to Colorado towns were made in *intrastate* commerce, and thus those sales were not subject to regulation by the Federal Power Commission. However, the Supreme Court held that Colorado-Wyoming Gas Co. was transporting gas in *interstate* commere to Colorado towns for *resale*, and its sales to Colorado towns were subject to Federal regulation. The Court stated that interstate commerce "does not end until the gas enters the service pipes of the distributing companies" [22] (companies selling *retail* to the public).

Thus, in the *Illinois Gas Co.* case and in the *Colorado-Wyoming Gas Co.* case, the Supreme Court interpreted the scope of Federal regulatory authority under Section 1 (b) of the Act as including not only sales made in *interstate* commerce for resale, but also sales made in *intrastate* commerce for resale.

Test of change in gas pressures: There is another line of cases which raises a somewhat different problem as to the exclusion of local distribution facilities from Federal regulation in Section 1 (b). The first of these is not a decision of the United States Supreme Court, but is a decision of the Federal Power Commission, the significance of which is so important that it must be discussed herein. The case decided in 1949 is *Re Consolidated Co. of N. Y.*[23] The case involved a proposal by Transcontinental Pipe Line Corp. to deliver gas produced in Texas and Louisiana to Consolidated Edison Co., and others in New York for resale to ultimate consumers in the New York metropolitan area. All of the properties presently owned or proposed to be constructed by Consolidated Edison were within the State of New York and the local distributing companies were unaffiliated with the interstate transporter. The Commission held, in spite of the exclusion of local distribution facilities from jurisdiction of the Commission under Section 1 (b) of the Natural Gas Act, that Consolidated Edison was a natural gas company under the Act, engaged in the transportation of natural gas in interstate commerce, and was thus required to obtain a certificate of public convenience and necessity from the Commission upon construction of the transmission facilities to inter-connect with the transmission lines of Transcontinental. To support this conclusion, the Commission stated that the gas would be transported through Transcontinental's pipe lines at a pressure of 200 pounds, which pressure would be continuous and uninterrupted on delivery into the pipe line of Consolidated Edison, and that the pressure would then be reduced in the lines of Consolidated for distribution to the

[22] *Id.* at 629.
[23] 81 P.U.R. (N.S.) 65 (1949).

public. Since the flow of gas was uninterrupted and continuous up to and beyond the point of delivery to Consolidated, the Commission held that Consolidated was engaged in the transportation of natural gas in interstate commerce. The ramifications of this decision are seen in the *East Ohio Gas Co.*[24] case.

The *East Ohio Gas Co.* case, decided January 9, 1950, is the most recent decision of the Supreme Court of the United States relative to the Natural Gas Act, and the significance of this decision is unparalleled by any other decision pertaining to that Act.[25] East Ohio Co. was a company operating solely in Ohio selling natural gas directly to consumers at retail through its local distribution system. Gas was delivered to East Ohio Co. inside Ohio by an interstate transporter, with which East Ohio Co. was not affiliated in any way. The Supreme Court held that East Ohio Co. was subject to the jurisdiction of the Federal Power Commission and was required to keep accounts for and submit reports to the Commission. The basis of this decision was the determination by the Court that the dividing line between federal and state regulation is at that point where gas transmitted under high pressure is converted to low pressure for shipment to the ultimate consumer. Since East Ohio Co. received the gas in its trunk line at high pressure, the Court found that it was a natural gas company engaged in the transportation of natural gas in interstate commerce.

As a matter of fact, prior to the *East Ohio Gas Co.* case in January, 1950, the Court had flatly rejected any such mechanical formula. In the *Interstate Gas Co.* case, *supra,* it was argued that gas moved through petitioner's pipe lines at well-pressure and that interstate commerce did *not* begin until it was subjected to increased pressure in the compressor stations of the purchasing interstate transporter. The Court rejected the argument stating that the increase in pressure "must be regarded as merely an incident in interstate commerce rather than as its origin." In *Panhandle Eastern Pipe Line v. P.S.C., supra,* Mr. Justice Rutledge said,

> Variations in main pressure are not the criterion of the state's regulatory powers, under the commerce clause.

The Bricker Bill: It was largely as a result of the *Illinois Gas Co.* and *Colorado -Wyoming Gas Co.* cases that the so-called Bricker Bill was first introduced in Congress.[26] The importance of the Bricker Bill was given additional significance by the *East Ohio Gas Co.* case. This bill would amend Section 2 (6) of the Natural Gas Act to define a natural gas company so as to *exclude* from federal regulation a company engaged in local distribution within a state which receives natural gas within or at the border of such state in local distribution facilities and sells and delivers such gas to the

[24] 338 U. S. 464 (1950).
[25] 45 Public Utilities Fortnightly 201-208 (Feb. 16, 1950).
[26] S. 1831, 81st Cong., 1st Sess. (1949).

general public for ultimate consumption *or to another company engaged in local distribution* within the same state which sells gas to the general public. The bill would specifically declare such sales and companies subject to regulation by the states. The bill amends the definition of "interstate commerce" in Section 2 (7) of the Act by adding to that section the words:

> . . . but does not mean commerce beyond the point at which natural gas is delivered into local distribution facilities as hereafter defined.

Section 2 of the Act would also be amended to add a new subsection (10) which would define "local distribution" as follows:

> "Local distribution" means the operation of local distribution facilities and includes the delivery or sale of gas therefrom; and "local distribution facilities" means pipe lines and other facilities used for or incident to the distribution of natural gas to the general public, and includes those transmission or transportation facilities of the person engaged in local distribution within a State which extend from the areas of such local distribution to the point or points within or at the border of such State at which natural gas is received from the facilities of a natural gas company.

CONCLUSION

It should be apparent that the cooperative regulation by state and Federal agencies of the natural gas industry is an extremely complicated matter. Herein, consideration has been given only to some of the aspects of jurisdiction of the Federal government in this field. However, the fact that such cooperative regulation by Federal and state bodies is complicated and difficult to administer is no justification for an extension of the authority of the Federal government in this field. Above all, it is imperative in the public interest that Congress enact legislation designed to clarify the limits of jurisdiction of the Federal Government and the states over the natural gas industry.

DENVER BAR OUTING TO BE HELD THIS MONTH

As *Dicta* goes to press, Entertainment Committee Chairman Dick Shaw informs us that the annual Denver Bar outing will be held as usual the last week in June. Special notification of the exact day, place and hour will be made later.

Notices will go out to all members shortly requesting information as to the type of activity in which they wish to indulge and indicating when and where tickets may be purchased. As in previous years, prizes will be awarded in golf, bridge, tennis, horseshoes, and chess. The sports, indoors and otherwise, will be climaxed by a banquet at 6:30, following which alleged entertainment will be provided by The Hiester Hotshots and Shaw's Shaky Shenanigans.