Pipeline Gathering in an Unbundled World: How FERC's Response to "Spin Down" Threatens Competition in the Natural Gas Industry

David V. Bryce
Note

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Motivated by fears that interstate pipeline companies engaged in profit gouging and other unsavory monopolistic practices, Congress in 1938 passed the Natural Gas Act (NGA) to protect consumers from excessive gas rates.1 The Act mandated "just and reasonable" rates for all jurisdictional gas services, declaring that the natural gas industry was "affected with a public interest."2 To ensure just rates, the NGA empowered the Federal Power Commission (FPC) to regulate the interstate sale and transportation of natural gas and to ensure that companies did not abandon facilities dedicated to interstate gas markets without prior approval from the FPC.3 Significantly, the Act specifically exempted the production and gathering of natural gas from federal regulation.4

Initially, the FPC pursued its statutory ends by enabling pipeline companies to perform all the actions needed to bring gas to market, with purchasers required to pay a single contract price for these "bundled services."5 Minimum competition existed in the interstate gas market, with given markets and pipeline companies mutually bound to one another.6 This regulatory regime of bundled services and minimal interstate com-

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* J.D. Candidate 2005, University of Minnesota Law School; B.A. 1992, University of Michigan.

3. See id. §§ 717(b), 717f(b).
4. Id. § 717(b).
6. See id.
petition remained unchanged until the energy crisis of the 1970s spurred Congress to pass the Natural Gas Policy Act, deregulating many wellhead gas prices, and replacing the FPC with the Federal Energy Regulatory Commission (FERC).  

Since its inception, FERC has attempted to inject competition into the natural gas industry. In pursuit of competition, FERC mandated open access to pipeline transportation facilities and required the unbundling of gas services. Open access forced pipelines to make their transportation services available to any producer of gas, for the first time enabling end users to purchase gas directly from the wellhead. Coming on the heels of open access initiatives, unbundling required pipelines to make each of their gas services available to purchasers at individual prices. Purchasers no longer were required to buy a package of services from the pipelines. Instead, they could match individual services to their specific needs, thus forcing pipelines to compete with independent producers and gatherers of natural gas.

Generally, competition created by unbundling and open access has the effect of lowering prices. Not all of FERC's policies, however, are consistent with its procompetitive agenda. Specifically, FERC's liberal policy toward deregulating pipeline gathering facilities once they are transferred to a wholly owned affiliate presents pipelines with fresh avenues of regulatory arbitrage and new means of reestablishing monopoly power in certain gas markets.

Despite the NGA's exemption of gathering from federal regulation, FERC asserted jurisdiction over many pipeline gathering facilities because the gas they gathered directly entered the flow of interstate commerce. By requiring pipelines

7. See id.
8. Id. at 1344 ("The Federal Energy Regulatory Commission (FERC) which in 1977 succeeded to the jurisdiction of the former Federal Power Commission . . . issued a series of orders designed to . . . stimulate competition.").
10. Id.
11. See id. at 1030.
12. Id.
13. See RICHARD J. PIERCE, JR. & ERNEST GELLHORN, REGULATED INDUSTRIES IN A NUTSHELL 341–46 (3d. ed. 1994) (discussing the desirable and undesirable effects that unbundling and open access have on various regulated markets).
to offer their gathering services on an individual basis, however, unbundling forced pipelines to compete with independent nonregulated gatherers. In response, pipelines began abandoning jurisdictional gathering facilities and transferring them to wholly owned affiliates, simultaneously petitioning FERC to classify the transferred facilities as nonjurisdictional. This process, known as "spin down," has been warmly received by FERC, which asserts that it possesses no authority to assert jurisdiction over a transferred facility that qualifies as gathering, and thus is not required to determine whether or not a proposed abandonment and transfer is in the public interest. Notably, FERC requires no showing that a spin down will promote competition or that competitive conditions exist in a market where spin down is proposed. This lack of interest in an a priori showing of competition threatens to enable pipelines to reassert the precise market dominance FERC's policies of open access and unbundling are intended to prevent.

This Note argues that FERC should reformulate its approach to spin down requests, requiring a showing of competition in markets where spin down is proposed and exercising its regulatory authority to conduct a public interest analysis prior to granting abandonment requests. Part I provides a brief description of the natural gas industry prior to passage of the NGA. Part II discusses specific provisions of the NGA, including the regulation of interstate sales, transportation, and abandonment, as well as regulatory reliance on a system of bundled services. Part III describes the FERC's deregulatory initiatives, focusing on pipeline adoption of spin down in response to unbundling. Part IV discusses and analyzes responses by FERC and the courts to spin down. Part V provides a series of recommendations, including the promotion of informational transparency within the gathering industry and the importance of demonstrating that spin down will encourage, rather than curtail, competition.

(holding that an intrastate gathering facility is subject to federal regulation if the facility sells its gas to companies that will distribute it over interstate pipelines).

15. See id.
16. See, e.g., Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1015 (D.C. Cir. 2003).
17. See id. at 1015, 1021–22.
18. Id. at 1022.
I. THE UNREGULATED ERA

The use of gas as an energy source is deeply rooted in American history. By 1859, manufactured gas illuminated over 9000 public lamps in the cities of New York and Philadelphia. Today, natural gas fuels the production of approximately sixteen percent of the nation's electricity, while some experts anticipate that by the year 2020 natural gas will provide the fuel needed to generate over one-third of all electrical consumption.

State involvement in the American gas industry dates to its inception. When the Gas Light Company of Baltimore became the nation's first gas company in 1816, it possessed an exclusive municipal lighting contract with the city of Baltimore.

Until the 1920s, ill-fated location stunted growth of the natural gas industry. Natural gas reserves were concentrated in the Southwest, particularly Texas and Oklahoma. Large


20. Manufactured gas consists of energy-rich vapors resulting from the thermal decomposition of various hydrocarbon sources including coal and oil. ARLON R. TUSSING & CONNIE C. BARLOW, THE NATURAL GAS INDUSTRY: EVOLUTION, STRUCTURE, AND ECONOMICS 259 (1984). By comparison, natural gas consists of various hydrocarbons including methane, ethane, and propane. DAVIS, supra note 19, at 134–35. Natural gas is generated as a result of decaying animal and plant matter that takes on a gaseous state and seeps under the earth's surface. Id. For use as fuel, natural gas must be extracted from its underground source and shipped by pipeline to its point of consumption. Id. The advantages of natural gas over manufactured gas are significant. In comparison to coal and oil, natural gas emits virtually no pollutants, is odor free, and available at lower prices. See id.

21. CASTANEDA, supra note 19, at 35.


23. See Bradley, supra note 19, at 3. Bradley suggests that the close interrelationship of the state and the incipient gas industry in the United States derives from the "English tradition of government charters and franchises and public ownership of the streets." Id.

24. Id.


26. Id. Since the location of natural gas reserves in the Southwest, dating to the late nineteenth century, additional large scale reserves have been located in Alberta, Canada; Colorado; and New Mexico. Id.
markets for natural gas, however, were situated miles away, primarily on the East and West coasts. For anyone interested in entering the natural gas industry, this presented a significant problem because no reliable means of transporting natural gas such distances existed. Not until the emergence of electric welding and high tensile steel in the 1920s did construction of pipelines suitable for transporting gas great distances become possible.

While developments in pipeline technology facilitated an unprecedented boom in the natural gas industry, they simultaneously introduced the threat of pipeline companies exercising monopoly control over the distribution of natural gas. Cities with high demand for natural gas found themselves with no alternative but to accept the terms of service offered by the pipeline company that supplied gas to their area. Further complicating this situation was the inability of states to regulate the interstate transmission of natural gas. Individual state attempts to regulate pipelines were thwarted by a series of Supreme Court decisions that held that the dormant Commerce Clause barred states from regulating the interstate transportation of natural gas. This created a regulatory void between producers and customers, providing pipeline companies with essentially unrestrained leverage over their clients.

27. Id.

28. Natural gas is notoriously difficult to transport, largely due to its gaseous state. This gaseous state generates two transportation difficulties. First, gases typically yield low amounts of energy. Therefore, it is necessary, absent compression, to transport great quantities in order to meet end user demand. Second, gas, quite obviously, tends to easily escape even from the most minutely porous storage or transportation facilities. Attempts to transport gas through pipes joined by screws typically resulted in up to forty percent loss. See DAVIS, supra note 19, at 133.


30. See id. (describing interstate transportation of natural gas as a natural monopoly “characterized by large economies of scale and high barriers to entry”).

31. Many major cities received natural gas supplies from a single pipeline company. By the mid-1930s, the ten largest pipeline companies controlled eighty-six percent of all interstate natural gas transmission. DAVIS, supra note 19, at 138.

32. See Pierce, supra note 29, at 53.


34. See DAVIS, supra note 19, at 140.
To fully grasp the bargaining advantage pipeline companies possessed, one must consider the three transactional phases that characterized the natural gas industry between the mid-1920s and mid-1980s. In general terms, producers extracted natural gas from the earth, selling it to a pipeline company. The rate charged for this transaction, known as the “field price,” was subject to state regulation since the entire exchange occurred within a single state.\(^\text{35}\) The pipeline company then transported the gas to consumer markets, most often located across multiple state lines.\(^\text{36}\) Once it arrived at its destination, the pipeline sold the gas to a local distribution company (LDC).\(^\text{37}\) States regulated rates, known as the “city gate price,” charged for this transaction.\(^\text{38}\) Finally, in a last transaction also falling under state regulatory jurisdiction, the LDC resold the gas to end users, typically residential or industrial consumers.\(^\text{39}\)

In sum, the series of transactions that occurred as gas moved from wellhead to end user fell under the purview of state regulation. But the critical space in between wellhead extraction and end use consumption—the transportation of gas from the well to market—lacked regulation. This regulatory gap led Congress to pass the NGA.\(^\text{40}\)

II. THE REGULATORY ERA

A desire to protect consumers from excessive gas rates inspired passage of the NGA.\(^\text{41}\) Congress sought to protect consumers by asserting federal jurisdiction over the interstate sale and transportation of gas and by requiring jurisdictional facilities to obtain federal approval prior to discontinuing services.\(^\text{42}\)

\(^{35}\) See id.; MACAVOY, supra note 25, at 4 (defining “field price”).
\(^{36}\) MACAVOY, supra note 25, at 4.
\(^{37}\) Id.
\(^{38}\) See DAVIS, supra note 19, at 140; MACAVOY, supra note 25, at 4 (defining “city gate price”).
\(^{39}\) MACAVOY, supra note 25, at 4.
\(^{40}\) DAVIS, supra note 19, at 140.
\(^{41}\) FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944) (“The primary aim of [the Natural Gas Act] was to protect consumers against exploitation at the hands of natural gas companies.”).
\(^{42}\) See Fagan, supra note 1, at 711–12 (explaining that Congress empowered the FPC to assert jurisdiction over the sale of gas, the transportation of gas, and the abandonment of gas facilities).
The NGA specifically exempted the production and gathering of natural gas from federal regulation.\textsuperscript{43}

A. FEAR OF A NATURAL MONOPOLY

Supporters of the NGA drew heavily from a 1935 Federal Trade Commission study concluding that the natural gas pipeline industry was a natural monopoly.\textsuperscript{44} Natural monopoly theory posits that economies of scale within certain industries enable a single firm to provide service at lower average cost than several competing firms.\textsuperscript{45} Where a natural monopoly exists, failure to regulate the monopolist firm may lead to pricing structures highly detrimental to consumers of the monopolist's services.\textsuperscript{46} Regulation becomes necessary to achieve a balance between the monopolist service provider and consumers that roughly mimics competitive market conditions.\textsuperscript{47}

Critics of basing regulatory policy on concerns of natural monopoly argue that perfectly competitive markets are not needed to prevent firms from achieving monopoly profits.\textsuperscript{48} Instead, the threat of competitors entering a market, coupled with their ability to exit if profits do not materialize, offsets the capacity of a single firm to attain monopoly profits.\textsuperscript{49} Moreover, natural monopolies do not exist in perpetuity.\textsuperscript{50} Technological developments in a given industry or modification of regulatory policy may reduce or eliminate natural monopoly conditions.\textsuperscript{51}

Nevertheless, concern that natural monopoly defined the gas pipeline industry featured prominently in passage of the NGA.\textsuperscript{52} This concern stemmed directly from the Federal Trade Commission's 1935 report concluding that the pipeline industry possessed both monopoly and monopsony characteristics, including inflated prices, restricted availability of services, and

\begin{itemize}
\item \textsuperscript{43} 15 U.S.C. § 717(b) (2000).
\item \textsuperscript{44} See Fagan, \textit{supra} note 1, at 712.
\item \textsuperscript{45} See \textsc{Stephen Breyer}, \textsc{Regulation and Its Reform} 15 (1982).
\item \textsuperscript{46} See \textsc{James C. Bonbright et al.}, \textit{Principles of Public Utility Rates} 33–41 (2d ed. 1988).
\item \textsuperscript{47} See id.
\item \textsuperscript{48} See id. at 42–43 (discussing contestable market theory).
\item \textsuperscript{49} See id.
\item \textsuperscript{50} See \textsc{Charles F. Phillips Jr.}, \textit{The Regulation of Public Utilities} 45–47 (2d ed. 1988).
\item \textsuperscript{51} See id.
\item \textsuperscript{52} See Fagan, \textit{supra} note 1, at 712 (mentioning that Congress was concerned about the monopolistic characteristics of the natural gas industry and the effect a gas monopoly would have on small residential consumers).
\end{itemize}
monopoly profits at the expense of natural gas producers and consumers.\textsuperscript{53} Drafted against this backdrop, the NGA sought to protect consumers from the monopolistic practices of interstate pipelines.\textsuperscript{54}

B. A BUSINESS AFFECTED WITH THE PUBLIC INTEREST

Congress predicated its ability to regulate the natural gas industry upon its belief "that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest."\textsuperscript{55} The concept of regulating business in the public interest dates to the medieval period,\textsuperscript{56} yet precise definition of public interest regulatory standards remains elusive.\textsuperscript{57} American jurisprudence generally holds that the public interest standard "is not a broad license to promote the general public welfare."\textsuperscript{58} Instead, interpretation of the public interest must stem directly from "the purposes of the regulatory legislation."\textsuperscript{59} The NGA seeks to ensure a plentiful supply of natural gas to consumers at "just and reasonable

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\textsuperscript{53} See Fagan, \textit{supra} note 1, at 714 n.14 ("Noting that the [natural gas industry] contained some of the textbook features of a monopoly/monopsony for instance, abnormally high prices, considerable accumulation of wealth at the expense of producers and consumers, and insufficient availability of the pipeline service, the FTC recommended that the industry be regulated."); John Burrit McArthur, \textit{Anti-Trust in the New [De]Regulated Natural Gas Industry}, 18 \textit{Energy L.J.} 1, 7–9 (1997) (mentioning that the FTC study found a high level of power and the potential for market abuse, which in turn led to the regulatory controls on interstate gas transportation in the NGA).

\textsuperscript{54} Fagan, \textit{supra} note 1, at 712.


\textsuperscript{56} See \textit{BARRY M. MITNICK, THE POLITICAL ECONOMY OF REGULATION} 243–44 (1980). Mitnick describes how the concept of "just price" emerged in the medieval period in opposition to Roman law's reliance on "natural price." \textit{Id.} at 243. Contrary to "natural price," which approved any willing exchange, "just price" noted that certain types of exchanges might involve implicit or explicit coercion. \textit{Id.} at 243–44.


\textsuperscript{58} \textit{NAACP v. FPC}, 425 U.S. 662, 669 (1976) (holding that regulation in the public interest, as defined by the NGA, does not provide the FPC with a broad directive to eliminate employment discrimination).

\textsuperscript{59} \textit{Id.}
rates." The public interest as embodied by the NGA, therefore, requires regulatory actions closely linked to the objective of providing access to natural gas at reasonable prices.

**C. REGULATING SALES, TRANSPORTATION, AND ABANDONMENT**

1. Bundled Services and Just and Reasonable Rates

To engage in the interstate sale or transportation of natural gas, the NGA requires pipelines to first obtain a certificate of public convenience and necessity from FERC. Moreover, the NGA directly mandates that rates charged for the interstate sale of natural gas be just and reasonable with services provided in a manner that is not unduly discriminatory. To enforce these provisions, section 4 of the NGA requires jurisdictional firms to file rates and conditions of service with FERC.

The just and reasonable standard of rate making aims to protect both endusers, by assuring that rates charged fall within a "zone of reasonableness," and providers, by assuring that they can recover their investments. From its inception until the mid-1980s, the NGA sought to balance the interests of end users and pipeline companies by instituting a system of bundled services.

Under a system of bundled services, pipelines performed all the actions needed to bring natural gas to market—gathering, processing, storing, transporting, and marketing. Further, pipelines controlled access to transportation, owning virtually all the gas that passed through their facilities. Because of this transportation monopoly, LDCs were required to purchase gas directly from the pipelines, paying a single price...
for bundled services.\textsuperscript{70} The system of bundled services protected the financial interests of pipelines by providing them with captive markets.\textsuperscript{71} In turn, the system protected end users by requiring pipelines to submit to rate regulation in exchange for monopoly control of a given natural gas market.\textsuperscript{72}

2. Regulation of Abandonment

Section 7(b) of the NGA prevents any natural gas company from abandoning “all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission.”\textsuperscript{73} Petitions for abandonment are granted upon a showing that the “present or future public convenience or necessity permit such abandonment.”\textsuperscript{74}

Section 7(b) premises its requirement that a certificate be obtained prior to abandonment on two rationales. The first holds that obtaining a certificate to provide service carries with it “an obligation, deeply embedded in the law, to continue service.”\textsuperscript{75} The second posits that the company seeking abandonment bears the burden of demonstrating that “the public interest will in no way be disserved by abandonment.”\textsuperscript{76} Evaluation of a petition for abandonment requires adequate consideration of “all factors relevant to an intelligent determination of the overall public interest.”\textsuperscript{77}

D. THE PRODUCTION AND GATHERING EXEMPTION

Section 1(b) of the NGA specifically exempted the production and gathering of natural gas from federal regulation.\textsuperscript{78} Production of natural gas involves locating gas sources and extracting gas from the earth.\textsuperscript{79} Gathering “is the process of tak-

\textsuperscript{70} See Fagan, supra note 1, at 713.
\textsuperscript{71} See id.
\textsuperscript{72} See id.
\textsuperscript{73} 15 U.S.C. § 717f(b) (2000).
\textsuperscript{74} Id.
\textsuperscript{76} Transcon. Gas Pipe Line Corp. v. FPC, 488 F.2d 1325, 1328 (D.C. Cir. 1973) (holding that the public interest is the paramount criteria governing abandonment and that the burden of showing that abandonment serves the public interest rests with the petitioner).
\textsuperscript{77} Id. at 1328.
\textsuperscript{78} 15 U.S.C. § 717(b).
\textsuperscript{79} Fagan, supra note 1, at 709.
ing natural gas from the wells and moving it to a collection point for further movement through a pipeline's principal transmission system.”

Two factors led Congress to exempt production and gathering from NGA jurisdiction. First, unlike the interstate sale and transportation of natural gas, no regulatory gap existed for production and gathering. Prior to the NGA, states possessed authority to regulate local production and gathering. Thus, section 1(b)'s exemptions sought to "preserve in the States powers of regulation in areas in which the States are constitutionally competent to act." Second, again unlike the interstate transportation of natural gas, robust competition characterizes the production and gathering industries. With no prospect of natural monopoly, Congress lacked justification to place production and gathering within NGA jurisdiction.

The production and gathering exemption proved easy to theoretically state and difficult to practically apply. The paramount challenge became how to classify whether facilities engaged in jurisdictional transportation or nonjurisdictional production and gathering. The NGA itself provides little guidance, defining neither "transportation" nor "production and gathering."

Attempting to fill this definitional gap, the Supreme Court held that "'production' and 'gathering' are terms narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution." Additionally, the Court held that "[e]xceptions to the primary grant of jurisdiction in [section 1(b)] are to be strictly construed."

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80. N.W. Pipeline Corp. v. FERC, 905 F.2d 1403, 1404 n.1 (10th Cir. 1990).
81. Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690 (1947).
82. Id.
83. Id.
84. See Phillips, supra note 50, at 633.
85. See Fagan, supra note 1, at 711–13 (explaining the integral role of a natural monopoly in the NGA's grant of jurisdiction over the transportation and sale of natural gas to the FPC).
86. See ExxonMobil Gas Mktg. Co. v. FERC, 297 F.3d 1071, 1076–77 (D.C. Cir. 2002) (discussing varied constructions of the gathering exemption and the resultant variance in its application).
87. Id. at 1076.
89. Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690–91 (1947).
Two points pertaining to these holdings bear consideration. First, while production is easy to categorize based on purely physical acts, this is less true where gathering is concerned. Production involves extracting gas from the earth, a single physical act. Gathering, however, requires use of a network of small pipelines to transport gas to a collection point for further delivery over a single line. Because multiple pipelines are used in the gathering process "[t]he line between jurisdictional transportation and nonjurisdictional gathering is not always clear." 

Second, limiting section 1(b) exemptions to physical acts extended NGA jurisdiction to rates charged for the production and gathering of gas subsequently entering the flow of interstate commerce. Production and gathering done by a company wholly independent of an interstate pipeline and occurring on a purely intrastate basis fell under NGA authority if the company sold its gas to a pipeline for interstate transmission. By the Court's logic, by the time a producer sold its gas to a pipeline, the physical acts associated with production and gathering were long since over. The Court considered the gathering exemption to apply only to purely local concerns such as conservation and the drilling of wells.

The bundled services system of gas delivery greatly accelerated expansion of NGA authority over production and gathering. Since pipelines provided production and gathering services as constituent elements of their interstate sale and transportation operations, NGA jurisdiction often perfunctorily extended to a pipeline's entire package of bundled services. Indeed "when a pipeline applied for a certificate to construct facilities, the [FPC] did not inquire into the pipeline's prospective

90. See Fagan, supra note 1, at 711–13 (categorizing steps of production according to the physical act required).
93. See Phillips Petroleum Co. v. FERC, 347 U.S. 672, 677–78, 685 (1954) (holding that the NGA applies to wellhead prices of gas entering the flow of interstate commerce).
94. Id. at 685.
95. Id. at 678.
98. See id.
use of the facilities before issuing the certificate." Instead, the certificate simply placed all facilities within NGA jurisdiction since the pipeline was providing a multifunctional service in which production and gathering were integrally linked to interstate sales and transportation.

III. THE DEREGLATORY ERA

Reliance on bundled services and broad extension of NGA jurisdiction to production and gathering characterized regulation of the natural gas industry until the 1970s energy crisis. When the crisis struck, the price of unregulated intrastate natural gas rose dramatically. Conversely, the FPC was slow to adjust the price of interstate gas upward in response to increased demand. Producers began to dedicate their sales of gas to higher priced intrastate markets, leading to a severe shortage of natural gas on the interstate market, and prompting Congress to pass the National Gas Policy Act of 1978 (NPGA).

The NGPA greatly curtailed NGA jurisdiction over production activities, deregulating many wellhead gas prices in an effort to bring intrastate and interstate gas prices into balance. The NGPA signaled the beginning of a deregulatory era witnessing the end of bundled services and significant deregulation of gathering facilities. This section discusses these changes in regulatory policy and their effects.

99. Id.
100. Conoco Inc. v. FERC, 90 F.3d 536, 545 (D.C. Cir. 1996).
102. Fagan, supra note 1, at 716.
103. See id.
104. Id.
105. See Kearney & Merrill, supra note 5, at 1343–46.
A. THE FEDERAL ENERGY REGULATORY COMMISSION AS A Deregulatory Force: The Unbundling of Natural Gas Services

Though FERC is a "creature of statute," it possesses great latitude in determining how best to pursue its statutory ends as long as it does not depart from the Supreme Court's interpretation of statutory terms. Reviewing courts will overturn FERC's administrative orders only if they are arbitrary or capricious due to a lack of reasoned decision making. Reasoned decision making by an administrative agency includes demonstrating a rational relationship between chosen policies and their supporting facts.

The NGPA did not alter the NGA's statutory goals. Hence FERC remains charged with regulating the natural gas industry in the public interest to ensure the availability of gas at just and reasonable rates. Toward this end, subsequent to passage of the NGPA, FERC adopted a formal policy to promote competition. The policy of promoting competition, in the belief that this best serves end users, remains in place today. To date, FERC's efforts to generate competition include policies

108. Atlantic City Elec. Co. v. FERC, 295 F.3d 1, 8 (D.C. Cir. 2002) (stating that FERC is a "creature of statute" with "no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress").
109. In re Permian Basin Area Rate Cases, 390 U.S. 747, 784 (1968) ("[A]dministrative authorities must be permitted, consistently with the obligations of due process, to adapt their rules and policies to the demands of changing circumstances.").
110. Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 131 (1990) (holding that an administrative agency does not have the power to adopt a policy conflicting with its governing statute and that an agency's interpretation of a statute will be judged against the Court's interpretation).
113. See McArthur, supra note 53, at 12.
114. See supra notes 62–65 and accompanying text.
promoting open access to pipeline transportation facilities, and more recently, the unbundling of gas services.

1. The Unbundling of Natural Gas Services

FERC Order 636 condemned the traditional bundled service system of gas delivery to the historical scrap heap. The order—which specifically stated that bundled services unduly advantaged pipelines—required pipelines to “unbundle” production, gathering, sales, and transportation services and to offer them as individual products available at separate prices to any purchaser. By unbundling gas services, FERC intended to promote competition by allowing sellers independent of pipelines to contract directly with LDCs and end users. Moreover, FERC believed pricing services individually would yield more accurate price signals than bundled pricing.

Unbundling profoundly affected FERC's prior classification of gas facilities as jurisdictional or nonjurisdictional, particularly in regards to gathering facilities. Before unbundling, FERC classified many pipeline-owned gathering facilities as jurisdictional because the facilities were bundled with the pipe-

117. FERC Order 436 initiated the process of opening access to pipeline facilities. See Order 436, Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol, 50 Fed. Reg. 42,408, 42,420–21 (Oct. 18, 1985). Order 436, in essence, required pipelines to make any of their spare transportation capacity available to any bidder on a first come first serve basis. See id. This enabled LDCs to purchase gas directly from an independent producer, transforming the pipeline into a merchant of common carriage transportation services. See McArthur, supra note 53, at 18–19. Allowing LDCs to bypass pipelines and contract directly with producers injected competition into the commodity supply market for natural gas, reducing overall gas prices. See Pierce, supra note 29, at 53.


119. Id.

120. Id. at 20 (citing Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 57 Fed. Reg. 13,267 (Apr. 16, 1992)).

121. Id.

122. See id. (explaining that “FERC intended this ‘unbundling’ to stimulate competition ... [finding] that bundled services gave pipelines an ‘undue’ advantage over other sellers and prevented customers from switching from firm sales to firm transportation”).

123. Id.

lines' sales and transportation services.\textsuperscript{125} Few reasons existed for pipelines to challenge these classifications since bundling blocked independent gatherers from directly offering their services to end users. Unbundling, however, allowed customers to satisfy their gathering needs either by hiring a pipeline for gathering or an independent service provider.\textsuperscript{126} This disadvantaged pipelines since their gathering services, previously classified as jurisdictional, remained regulated.\textsuperscript{127} To prevent unregulated gatherers from undercutting them on price, pipelines began to pursue strategies for deregulating their own gathering facilities.\textsuperscript{128}

2. Spinning Down: Pipelines Respond to Unbundling

"Spin downs" became the main strategy employed by pipelines to deregulate their previously jurisdictional gathering facilities.\textsuperscript{129} A spin down occurs when a pipeline transfers its gathering facilities to a wholly owned affiliate.\textsuperscript{130} Spinning down is a two-step process. First, the pipeline petitions FERC to abandon its gathering facilities by transferring them to an affiliate.\textsuperscript{131} Second, the affiliate petitions FERC to reclassify the transferred facilities as nonjurisdictional gathering facilities.\textsuperscript{132}

Independent producers and gatherers argue that allowing pipelines to deregulate gathering facilities by transferring them to affiliates potentially enables pipelines to reassert a modicum of monopolist control.\textsuperscript{133} Specifically, they claim that a spin down allows pipelines to control access to the main interstate transportation pipeline, since to reach the mainline, gas must

\begin{itemize}
  \item \textsuperscript{125} See supra notes 97–100 and accompanying text.
  \item \textsuperscript{126} See McArthur, supra note 53, at 20–21.
  \item \textsuperscript{127} See id.
  \item \textsuperscript{128} See Conoco Inc. v. FERC, 90 F.3d 536, 541 (D.C. Cir. 1996) (illustrating that pipelines wish to deregulate their gathering facilities to fairly compete with independent gatherers).
  \item \textsuperscript{129} See, e.g., Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1015 (D.C. Cir. 2003) (discussing procedural aspects of a spin down in determining whether an affiliate's pipelines were subject to FERC's jurisdiction).
  \item \textsuperscript{130} Id.
  \item \textsuperscript{131} See Pacific Gas & Electric Co. v. FERC, 106 F.3d 1190, 1193 (5th Cir. 1997) (discussing pipeline's abandonment of gathering facilities to a wholly-owned subsidiary and subsidiary's corresponding petition to reclassify facilities as exempt from FERC regulation.).
  \item \textsuperscript{132} See id.
  \item \textsuperscript{133} See Transcon. Gas Pipe Line Co., Williams Gas Processing—Gulf Coast Co., 96 F.E.R.C. ¶ 61,396, at 61,452 (July 25, 2001).
\end{itemize}
often pass through a network of gathering lines, which following spin down, are exclusively owned and operated by the pipeline's own affiliate. 134

Pipeline gathering affiliates can potentially control access to the mainline either by setting discriminatory gathering rates or by giving their parent company's gas preferential treatment in terms of the order it passes through the gathering lines to the mainline. 135 FERC's ability to prevent such behavior is constrained because once a gathering facility is spun down, it is no longer required to file rates with FERC, thus increasing the prospects of concealing rate discrimination. 136 Such control arguably frustrates FERC's goal of fostering competition by providing open access to interstate pipelines and making unbundled gas services available. 137 FERC and the courts, however, are generally receptive to spinning down.

IV. FERC AND JUDICIAL RESPONSES TO SPINNING DOWN

FERC principally cites three rationales as support for spinning down. First, FERC asserts that the test it uses to determine whether a facility is used for gathering or transportation comports with Supreme Court precedent when the effects of unbundling and developments in the industry are taken into account. Second, if the applicable test indicates that a transferred facility engages in gathering, FERC maintains that it possesses no authority to determine if the pipeline's abandonment of the facility is in the public convenience and necessity. Third, FERC states that discriminatory acts by pipelines and their affiliates are adequately restrained by the inclusion of equal access provisions in spin down approvals and by the threat of FERC intervention in the event collusive behavior appears. This section describes and analyzes the rationales used by FERC to support spin down.

134. Id.
136. See id. at 22.
A. Determining Whether a Facility Engages in Gathering or Transportation

When FERC receives a petition to classify a facility as engaged in nonjurisdictional gathering, it first considers whether the facility is owned by an interstate pipeline company. If the facility is owned by a pipeline, it is with rare exception that FERC finds it falls within NGA jurisdiction. If, however, the facility is transferred to a wholly owned pipeline affiliate, FERC generally holds that the facility is nonjurisdictional.

FERC's policy of placing pipeline-owned gathering operations within its jurisdiction, while excluding transferred gathering facilities, stems from changes brought by Order 636. Once unbundling occurred, FERC recognized that for pipelines to offer competitive gathering services they needed "to operate on a level playing field with... independent gatherers unregulated by [FERC]." FERC did not simply deregulate all gathering because, pursuant to NGA section 4(b), gathering "in connection with" transportation is jurisdictional. Instead, FERC argued that once transferred to an affiliate, gathering no longer occurred "in connection with" transportation, and thus

138. See N. Natural Gas Co. v. FERC, 929 F.2d 1261, 1269 (8th Cir. 1991) (holding that a gathering facility owned by an interstate pipeline was properly classified as jurisdictional).

139. Id. ("It would be inconsistent to hold that [FERC] may not regulate rates for transportation over a pipeline's own gathering facilities performed in connection with admittedly jurisdictional interstate transportation.").


142. Id.

143. Pac. Gas & Elec. Co., 106 F.3d at 1196–97. Section 4(b) states that "All rates and charges made, demanded, or received by any natural gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of [FERC]... shall be just and reasonable...." 15 U.S.C. § 717c(a) (2000) (emphasis added). The Eighth Circuit has held that FERC may regulate gathering facilities owned by pipelines to perform its role of preventing monopolistic trade practices. N. Natural Gas Co., 929 F.2d at 1272–73.
the danger of collusion became minimal.\textsuperscript{144} Courts warmly support this distinction\textsuperscript{145} despite the fact that by their very nature, affiliates are intended to serve the interests of their parent company.\textsuperscript{146}

FERC does not automatically exempt a transferred gathering facility from its jurisdiction.\textsuperscript{147} Prior to issuing a classification, FERC applies what is known as its "primary function test" to determine whether the facility fits its definition of gathering.\textsuperscript{148} The primary function test predominantly relies on a series of physical criteria.\textsuperscript{149} FERC also considers a number of nonphysical factors, including: (1) a facility's location and purpose, (2) the type of business conducted by the facility owner, and (3) whether meeting the objectives of the NGA requires classifying the facility as jurisdictional.\textsuperscript{150}

Two trends regarding FERC's application of the primary function test are particularly notable. First, a 1989 court holding rejected FERC's emphasis on a facility's overall size—specifically the length of the pipeline—in assessing jurisdiction.\textsuperscript{151} FERC's subsequent application of the primary function test resulted in approval of virtually all petitions for reclassification.\textsuperscript{152} This is particularly true of facilities on the Outer


\textsuperscript{145} See, e.g., id. (noting that whether an affiliate is involved "makes all the difference"); Conoco Inc., 90 F.3d. at 547 (explaining that FERC does not have jurisdiction over independent affiliates which do not themselves transport gas in interstate commerce).

\textsuperscript{146} See STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 338–42 (2002).

\textsuperscript{147} See, e.g., Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1014 (D.C. Cir. 2003) (applying primary function test).

\textsuperscript{148} Id.

\textsuperscript{149} ExxonMobil Gas Mktg. Co. v. FERC, 297 F.3d 1071, 1077 (D.C. Cir. 2002) (describing the primary function test).

The "primary function" test generally employs the following six physical criteria: (1) the length and diameters of the lines; (2) the extension of the facility beyond the central point in the field; (3) the geographic configuration of the facility; (4) the location of compressors and processing plants; (5) the location of wells along all or part of the line facility; and (6) the operating pressure of the lines.

\textsuperscript{150} Id.

\textsuperscript{151} EP Operating Co. v. FERC, 876 F.2d 46, 48–50 (5th Cir. 1989) (holding that FERC's refusal to classify a facility as gathering was unreasonable because of over reliance on the length of the facility's pipeline).

\textsuperscript{152} See McArthur, supra note 53, at 22–23.
Continental Shelf (OCS).153 Reasoning that the physical realities of gas gathering offshore require larger gathering facilities, FERC began distinguishing gathering from transportation based in part on “the centralized aggregation point.”154 Under this standard, the line between gathering and transmission lies at the point where two or more segments of an OCS pipeline join for the last time, and a single line moves natural gas toward shore.155 The centralized aggregation point standard arguably expands gathering well beyond “the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution.”156 Nevertheless, the standard received court approval on the grounds that it fell within a “zone of reasonableness” in light of physical realities on the OCS and FERC’s policy of unbundling.157

Second, though nonphysical factors have always received secondary consideration in assessing facilities for jurisdiction, FERC has lately afforded them less weight in its analysis.158 FERC’s reluctance to consider nonphysical factors draws support from a Fifth Circuit decision reprimanding FERC for over-relying on factors such as the ownership status of a gathering facility applying for reclassification.159 At least in cases where a pipeline owns the gathering facility seeking reclassification, however, courts have held that nonphysical factors can be central to a decision of whether to exempt a pipeline from jurisdiction.160

153. See, e.g., Williams Gas Processing—Gulf Coast Co., 331 F.3d at 1013-16 (upholding FERC’s approval of transfer of gathering facility from jurisdictional pipeline to nonjurisdictional wholly owned affiliate).

154. See ExxonMobil Gas Mktg. Co., 297 F.3d at 1080-81 (discussing the centralized aggregation point test).


157. See ExxonMobil Gas Mktg. Co., 297 F.3d at 1084-87 (affirming FERC’s use of the central aggregation point test for offshore facilities).

158. See id. (affirming FERC’s decision to allot nonphysical factors only secondary importance in assessing whether to approve a spin down proposal).

159. Sea Robin Pipeline Co. v. FERC, 127 F.3d 365, 371 (5th Cir. 1997) (faulting FERC for over-relying on nonphysical considerations).

160. See generally Okla. Natural Gas Co. v. FERC, 28 F.3d 1281 (D.C. Cir. 1994) (upholding FERC’s refusal to exempt gathering facility largely on the grounds that it was owned by an interstate pipeline company).
1. FERC's Method of Classifying Facilities as Gathering or Transportation Conflicts with Supreme Court Precedent and Undervalues Nonphysical Factors

To date, evidence suggests that unbundling has led to an overall reduction in gas rates.\textsuperscript{161} Not all consumers or markets, however, have benefited.\textsuperscript{162} The lack of reduced rates within certain markets may, in part, stem from FERC's response to spin downs.\textsuperscript{163} By liberalizing its primary function test, FERC created a broad gathering classification, ensuring the success of the vast majority of spin down plans.\textsuperscript{164} While FERC may believe this policy promotes competition, and is thus consistent with its unbundling objectives, it nevertheless conflicts with the Supreme Court's narrow definition of gathering.\textsuperscript{165} Moreover, FERC's winsome views concerning the prospect for abuse between pipelines and their gathering affiliates—characterized by its lack of emphasis on nonphysical factors when applying the primary function test—potentially enable pipelines to reassert a semblance of monopoly control within given markets, specifically those where limited competitive alternatives are available to purchasers.\textsuperscript{166}

\textit{Northern Natural Gas Co. v. State Corp. Commission} specifically holds that NGA section 1(b)'s production and gathering exemptions are "narrowly confined to the physical acts of drawing the gas from the earth and preparing it for the first stages of distribution."\textsuperscript{167} While Congress has ended the extension of section 1(b) authority to wellhead prices,\textsuperscript{168} no Supreme Court decision or congressional act directly modifies the Court's holding in \textit{Northern Natural Gas Co.}

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\textsuperscript{161.} See GREG PALAST ET AL., DEMOCRACY AND REGULATION: HOW THE PUBLIC CAN GOVERN ESSENTIAL SERVICES 143 (2003).

\textsuperscript{162.} See id. (noting that industrial users have benefited the most from FERC regulatory policy between 1982 and 2000 while residential consumers have seen the fewest cost benefits).

\textsuperscript{163.} See McArthur, supra note 53, at 60–61.

\textsuperscript{164.} See id. at 20, 26.

\textsuperscript{165.} See N. Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 90 (1963) (laying out the Court's narrow definition of gathering).

\textsuperscript{166.} See McArthur, supra note 53, at 60–61 (noting that in an area where there is a single gatherer, spin down is more likely to result in discriminatory rates).

\textsuperscript{167.} N. Natural Gas Co., 372 U.S. at 90.

\textsuperscript{168.} See supra note 106 and accompanying text.
\end{flushleft}
Petitions for spin down since the early 1990s demonstrate FERC's inclination to liberalize the primary function test, thus expanding the definition of acts that constitute gathering. Reliance on the centralized aggregation point for classifying offshore facilities, in particular, pushes the envelope. The aggregation of gas from various wells at a central point where it will enter the mainline bears little relationship to a physical act intended to prepare gas for the first stages of distribution. Almost by definition, once gas arrives at the mainline—a journey often traversing hundreds of miles—its lifecycle has already progressed beyond initial distributive acts.

The absence of a relationship between a centralized aggregation point and Northern Natural Gas Co.'s holding featured prominently in an opinion dissenting from the D.C. Circuit's approval of the centralized aggregation point test:

FERC has thus asked this court to validate a determination that 'gathering' ends where two large lines become one and grow disproportionately wider as a result. This proposition is perplexing on its own terms, and it is unlawful in light of what we have been told by the Supreme Court in Northern Natural Gas Co., namely that production and gathering entail only the 'physical acts of drawing gas from the earth and preparing it for the first stages of distribution.'

In addition to conflicting with the principle that Supreme Court interpretations of statutory terms are controlling, FERC's liberalization of the primary function test potentially allows pipelines to assert excessive control over gathering services and to restrict access to their transportation facilities, in direct contradiction of FERC's own agency objectives. This danger is compounded by FERC's willingness to allow pipelines to avoid regulation by transferring their gathering facilities to wholly owned affiliates.

FERC maintains a somewhat curious policy regarding affiliate transfers. While it insists that it can assert jurisdiction over gathering facilities directly owned by pipelines, FERC rather quickly washes its hands of regulatory responsibility

169. See supra notes 151–60 and accompanying text.


171. See supra notes 154–57 and accompanying text.


173. See supra notes 115–17 and accompanying text.

174. See, e.g., Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1015 (D.C. Cir. 2003) (demonstrating FERC's amenability to approving pipelines' transference of their gathering facilities to their affiliates).
once a pipeline transfers gathering facilities to a wholly owned affiliate.\textsuperscript{175} FERC maintains a hands-off approach to affiliates despite the fact that they exist primarily to benefit their parent company's bottom line.\textsuperscript{176}

FERC further compounds this danger by according nonphysical factors only secondary consideration when reviewing a petition for transfer.\textsuperscript{177} Since courts generally hold that nonphysical factors are less significant than physical ones, FERC runs no risk of contradicting judicial precedent.\textsuperscript{178} Yet by providing nonphysical factors significantly less weight than physical ones, FERC creates a regulatory climate potentially more conducive to promoting, rather than curtailing, discriminatory behavior.

Two of the most important nonphysical factors in terms of potentially controlling pipeline-affiliate abuses are: (1) the purpose, location, and operation of a facility; and (2) the general business activity of the transferor.\textsuperscript{179} If a pipeline is the sole transporter of gas to a particular market and concurrently the sole gatherer of gas in a particular field, the dangers of monopoly abuse increase.\textsuperscript{180} If such a pipeline petitioned to spin down its gathering facilities, under FERC's current standards the physical characteristics of the gathering facilities would receive primary consideration in the evaluative process.\textsuperscript{181} FERC would de-emphasize nonphysical evidence pointing to monopoly potential in the absence of regulation.

It is reasonable for pipelines to seek a level playing field and for FERC to address their concerns. A regulatory scheme favoring one competitor over another would arguably defeat FERC's goal of injecting robust competition into the natural gas industry. Yet the danger also exists of tilting the scales too favorably toward pipelines in FERC's efforts to balance competitive reforms with pipeline interests. FERC's liberalization of its primary function test, lack of attention to potential parent-

\textsuperscript{175} See supra notes 138–40 and accompanying text.
\textsuperscript{176} See supra note 146 and accompanying text.
\textsuperscript{177} See supra notes 158–60 and accompanying text.
\textsuperscript{178} See ExxonMobil Gas Mktg. Co. v. FERC, 297 F.3d 1071, 1080 (D.C. Cir. 2002).
\textsuperscript{179} See supra note 150 and accompanying text.
\textsuperscript{180} See McArthur, supra note 53, at 60–61 (noting that in an area where there is a single gatherer, spin down is more likely to result in discriminatory rates).
\textsuperscript{181} Sea Robin Pipeline Co. v. FERC, 127 F.3d 365, 371 (5th Cir. 1997).
affiliate abuses, and de-emphasis of nonphysical factors may combine to place pipelines in the precise position of advantage the NGA was designed to prevent.

B. FERC AND THE REQUIREMENT THAT ABANDONMENT SERVE THE PUBLIC INTEREST

Prior to any abandonment of a jurisdictional facility, the NGA requires a petitioner to obtain a certificate from FERC stating that abandonment is consistent with the public convenience and necessity. The burden of demonstrating that abandonment serves the public interest rests with the petitioner. In a public interest analysis relative to abandonment, FERC chiefly considers whether or not cessation of a jurisdictional activity will result in anticompetitive practices that adversely affect the public.

In seeming contradiction of the NGA, FERC does not conduct public interest analysis prior to approving transfers from a parent company to an affiliate. FERC argues that a public interest analysis need not occur in such cases for two related reasons. First, FERC states that it lacks jurisdiction to conduct a public interest analysis if the transferred facility qualifies as gathering under the primary function test. Second, FERC argues that transferred facilities are not being abandoned within the meaning of section 7(b) of the NGA. Instead, the facilities are simply being transferred to another entity who will continue operations as before.

Interestingly, in light of its recent emphasis on promoting competition, FERC suggests that even if a public interest

182. See supra notes 74–77 and accompanying text.
183. See supra notes 74–77 and accompanying text.
184. See supra notes 74–77 and accompanying text.
185. See, e.g., Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1021–22 (D.C. Cir. 2003) (affirming FERC's policy of not conducting a public interest analysis when it finds that the facilities a pipeline is seeking to transfer are engaged in gathering).
186. Id. at 1022 ("[O]nce FERC determines that a facility is not dedicated to a jurisdictional function, it has no authority to exercise jurisdiction over that facility by denying the certificate of abandonment for that facility.").
188. Id. (holding that section 7(b) cannot be used to "bootstrap" FERC jurisdiction over gathering facilities the petitioner sought to transfer and reclassify).
189. See supra notes 115–18 and accompanying text.
analysis were necessary, no specific showing that competition would flow from reclassification is required. FERC believes that "the existence of competition is not particularly relevant to a decision to allow a pipeline to abandon gathering facilities. To the extent competition is relevant, the excessive effort required to assess it would be unwarranted ...." Instead, FERC relies on its belief that reclassification, combined with unbundling, "should, in the long run, promote competition within the gathering industry." 

A circuit court split exists as to whether or not FERC must conduct a public interest analysis prior to reclassifying a transferred facility. The D.C. Circuit backs FERC, holding that FERC possesses no NGA authority "to deny abandonment of . . . facilities that it found were primarily functioning as gathering." In support of its position, the D.C. Circuit holds that the NGA's section 1(b) exemption for gathering subsumes language in section 4—suggesting that gathering in connection with transportation is jurisdictional—and section 7—suggesting that a jurisdictional facility cannot be reclassified as gathering without a public interest analysis.

Conversely, the Fifth Circuit holds that the NGA requires a public interest analysis prior to approval of any abandonment "that permanently reduces a significant portion of a particular service dedicated to interstate markets." The Fifth Circuit

190. See Williams Gas Processing—Gulf Coast Co., 331 F.3d at 1022.
192. Williams Gas Processing—Gulf Coast Co., 331 F.3d at 1022 (quoting N. Natural Gas Co., 93 F.E.R.C. ¶ 61,101, at 61,273 (Oct. 27, 2000)). FERC's position is supported by the D.C. Circuit. Id.
193. Id.
194. See Conoco, Inc. v. FERC, 90 F.3d 536, 551 (D.C. Cir. 1996).

Sections 4, 5 and 7 do not concern the producing or gathering of natural gas; rather, they have reference to the interstate sale and transportation of gas and are so limited by their express terms. Thus §§ 4(a), (b), (c), 5(a) and 7(c) speak of "transportation or sale of natural gas subject to the jurisdiction of [FERC]" while § 7(a) and (b) refer respectively to "transportation facilities" and "facilities subject to the jurisdiction of [FERC]." Nothing in the sections indicates that the power given to [FERC] over natural-gas companies by § 1(b) could have been intended to swallow all the exceptions of the same section and thus extend the power of [FERC] to the constitutional limit of congressional authority over commerce.

Id. at 552 (quoting FPC v. Panhandle E. Pipe Line Co., 337 U.S. 498, 508–09 (1949)).
specifically holds that a public interest analysis must be conducted regardless of whether or not a facility is being transferred to a nonjurisdictional entity.\(^{196}\) This strict reading of the statute, allowing very limited exceptions, draws support from a Supreme Court holding that section 7(b) allows no exceptions to statutory procedure.\(^{197}\)

1. **FERC Should Conduct a Public Interest Analysis Prior to Approving Proposed Spin Downs**

To meet its statutory goals of providing just and reasonable rates and reliable service, the NGA requires that any gas company seeking to abandon any jurisdictional facility must first obtain a certificate of public convenience and necessity from FERC.\(^{198}\) FERC's current approach to spin down sidesteps the NGA's public interest requirements by means of semantic hair-splitting, thus ignoring valid legal and policy arguments supporting use of public interest analysis. Ironically, FERC's reluctance to conduct a public interest analysis prior to approving a spin down threatens to undermine the Commission's own pro-competitive reforms.

Since unbundling set the need for spin down in motion,\(^{199}\) FERC appears almost averse to conducting public interest analysis of proposed transfers and abandonment.\(^ {200}\) FERC puts the cart before the horse when arguing it lacks jurisdiction to conduct a public interest analysis of transferred facilities independently qualifying as nonjurisdictional.\(^ {201}\) Under FERC's approach, a jurisdictional pipeline-owned gathering facility can become nonjurisdictional immediately upon transfer, entirely sidestepping section 7(b) requirements.\(^ {202}\) Such maneuvers, while perhaps well-intentioned methods of allowing pipelines to compete fairly with independent gatherers, are akin to using procedural devices to defeat the intent of substantive law. While FERC's actions are within legal bounds, one might justifiably hope for more allegiance to public interest analysis from

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503, 511 (5th Cir. 1981)).

196. *Id.* ("As we read the statute, it makes no difference who gets the facilities or, indeed, whether anyone gets them at all . . . ").


198. *See* supra notes 73–77 and accompanying text.

199. *See* supra notes 119–28 and accompanying text.

200. *See* supra notes 185–97 and accompanying text.

201. *See* supra notes 185–97 and accompanying text.

202. *See* supra notes 185–97 and accompanying text.
an agency charged with regulating an industry affected with the public interest. 203

Considering the conflicting circuit court precedents, FERC possesses the latitude, but perhaps not the inclination, to more aggressively apply public interest analysis to transfer requests. 204 Indeed, valid legal and policy arguments suggest transfer petitioners should be required to demonstrate that their request comports with the public interest. Legal support for applying public interest analysis to transfer and abandonment requests flows directly from section 7(b), which states that any abandonment of a jurisdictional facility requires a certificate of public convenience and necessity. 205 Reinforcing the strict application of section 7(b)'s abandonment requirements, the Supreme Court allows for no exceptions to section 7(b)'s prescribed statutory procedures. 206

In response, FERC argues that section 7(b) does not apply to spin down cases since facilities are not being abandoned, but rather transferred to another operator. 207 But this belies the reality that transfer enables a previously jurisdictional facility to gain nonjurisdictional status without first obtaining a certificate, thus procedurally circumventing section 7(b). Moreover, FERC's position is somewhat self-contradictory. FERC essentially states that they will exempt jurisdictional facilities dedicated to serving interstate markets even though those facilities, by FERC's own admission, will continue to perform exactly the same operations for exactly the same markets. Semantic distinction between transfer and abandonment should not suffice to profoundly undercut the intended statutory reach of section 7(b).

From a policy standpoint, FERC undermines its own pro-competition agenda by not requiring a localized showing of competition before permitting transfer. 208 FERC's faith in competition over the long run ignores the reality that monopoly abuses most easily flourish in markets lacking competitive al-

203. See PALAST, supra note 161, at 81–87.
204. See supra notes 186–97 and accompanying text.
205. 15 U.S.C. § 717f(b) (2000) (“No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission... without... a finding by the Commission... that the present or future public convenience or necessity permit[s] such abandonment.”).
208. See supra notes 189–92 and accompanying text.
ternatives.\textsuperscript{209} By not examining the degree of gathering and transportation competition existing in markets where a pipeline spins down, FERC runs the risk of allowing pipelines to assert monopoly control over those markets.\textsuperscript{210} The dangers of pipelines attaining new unregulated monopolies are magnified by the fact that the states impose few, if any, regulations on intrastate gathering. For example, in the four largest natural gas producing states—Texas, New Mexico, Oklahoma, and Kansas—there are no state requirements that gatherers file rates and no regulation of gathering prices.\textsuperscript{211} Moreover, technological developments have not undermined the advantages of large economies of scale within the natural gas industry.\textsuperscript{212} Thus, established companies, if given the opportunity through lack of regulatory oversight, retain the ability to price competitors out of business, consolidating their own power and potentially leading to market abuses.\textsuperscript{213}

C. FERC's Provision of Equal Access and Ability to Reassert Jurisdiction

FERC further supports its position regarding transfers by asserting that when approving spin downs it requires open access provisions and reserves the right to reassert jurisdiction if evidence of collusive behavior appears.\textsuperscript{214} Equal access provisions are generally de rigueur in the granting of a spin down petition. These provisions are intended to ensure that independent producers and gatherers will continue receiving fair treatment by a pipeline's affiliated gatherer following transfer.\textsuperscript{215} By requiring equal access nondiscrimination provisions, FERC argues that the risk of discriminatory behavior is sufficiently mitigated.\textsuperscript{216}

In the event discrimination arises, FERC maintains the ability to reassert jurisdiction over the transferred facility, dis-

\textsuperscript{209} See McArthur, \textit{supra} note 53, at 60–61.
\textsuperscript{210} Id.
\textsuperscript{211} Id.
\textsuperscript{212} See \textit{id.} at 7–9. Because slow technological change characterizes the natural gas industry and the capital costs of entering the business remain high, the danger of natural monopoly remains salient in the gas industry. See \textit{id.} For a brief summary of natural monopoly and countervailing theories, see \textit{supra} notes 44–54 and accompanying text.
\textsuperscript{213} See \textit{supra} notes 209–12 and accompanying text.
\textsuperscript{214} See Conoco, Inc. v. FERC, 90 F.3d 536, 549 (D.C. Cir. 1996).
\textsuperscript{215} See \textit{id}.
\textsuperscript{216} See \textit{id}.
regarding the affiliate's separate corporate structure. In articulating its position on reasserting jurisdiction, FERC acknowledges that potential for abuse exists. Accordingly to FERC, "[w]hereas an affiliated gatherer acting in concert with its affiliated interstate pipeline has an incentive to maximize profits for the corporate parent, an unaffiliated gatherer has no such incentive."

Nevertheless, FERC believes the mere potential for affiliate abuse does not require traditional forms of regulation. Instead, FERC will "only regulate . . . pipeline affiliates if shown [by complaint] that more extensive . . . regulation is necessary to invalidate an unjust and unreasonable rate or to correct an unduly discriminatory practice . . . ." Consequently, absent an a priori showing of undue discrimination, affiliate gatherers are not required to file rates or conditions of service with FERC.

1. Successful and Effective Reassertion of Jurisdiction Requires Access to Information on Rates and Conditions of Service

Open access promotes competition by increasing purchasing options and exerting downward pressure on price. Inclusion of open access provisions in approved spin downs likely reduces the risk of discriminatory actions by pipelines. At the very least, open access requirements provide independents with an actionable claim should they be barred from accessing a pipeline's facilities. Similarly, FERC's assurances that they will reassert jurisdiction where violations occur likely deters some unsavory trade practices. Yet for both open access and the threat of intervention to truly succeed, it is critical that relevant data be available to potentially aggrieved parties.

Knowing when an actionable claim arises, and assembling the data needed to prove it to FERC's satisfaction, depends

217. Id. The D.C. Circuit holds that FERC can reassert jurisdiction where evidence of collusion is shown. Id.


219. Id.


221. Id.

222. Id.

223. See supra note 117 and accompanying text.

224. See supra notes 214–16 and accompanying text.
heavily on access to information. Without informational transparency, it is difficult for an aggrieved party to even know for certain they are being discriminated against. Public access to pricing and service information remains one of the unique features of American public utility regulation. It is arguable that such access rights in and of themselves contribute to the achievement of just and reasonable rates. Though impossible to prevent data concealment, operating in a glass bowl constrains a company's ability to set unreasonable rates.

Section 19 of the NGA allows any aggrieved person to appeal FERC orders. To do so successfully, however, requires access to relevant information. FERC's position that transferred facilities need not file rate or service information impedes the ability of consumers to challenge both FERC orders and pipeline practices. Pipelines possess incentives to conceal financial data regarding rates and profits. Lack of filing requirements impedes the flow of information needed to reveal and curtail abuses. Ironically, free access to information is a hallmark of competitive markets. By allowing pipelines to suspend filings upon transfer, FERC threatens the growth of competition by endangering open access and inhibiting the ability of aggrieved parties to successfully petition FERC for redress.

V. RECOMMENDATIONS

Most commentators view FERC's policies of open access and unbundling favorably. Certainly regulation of the industry required reform following the abysmal performance of the interstate gas market during the mid-1970s. Competition,

225. McArthur, supra note 53, at 86.
226. Id. at 87.
227. See PALAST, supra note 161, at 15–27.
228. See id.
229. Id.
232. See supra notes 220–22 and accompanying text (noting that FERC does not require affiliate gatherers to file rates).
234. See PIERCE & GELLHORN, supra note 13, at 28.
235. See id. at 287; McArthur, supra note 53, at 88.
236. See supra notes 101–05 and accompanying text.
however, must be viewed as a practical task-oriented objective, not a theoretical panacea. Deregulatory policies can lead to new inefficiencies or generate new opportunities for regulatory arbitrage.\textsuperscript{237} For example, even though gas prices have generally fallen since FERC embarked on its deregulatory course, residential users have seen their rates increase.\textsuperscript{238} Similarly, FERC’s policies regarding spin down and the regulation of gathering facilities present pipelines with new opportunities to exert monopoly control of discrete gas markets.\textsuperscript{239} FERC’s proclamation—based on theoretical faith—that gathering competition will flourish in the long run\textsuperscript{240} provides little comfort in light of current realities.

Nevertheless, a legitimate argument exists that pipelines deserve a fair opportunity to compete in the unbundled gathering industry.\textsuperscript{241} A level playing field cannot exist where pipelines must file gathering rates and terms of service while independent gatherers need not.\textsuperscript{242} FERC attempts to counteract this inequity by allowing pipelines to avoid regulation through spin down.\textsuperscript{243} Yet FERC’s liberal acceptance of spin down without a showing that it is in the public interest may give pipelines an unfair advantage rather than simply placing them on equal regulatory footing with their independent counterparts.\textsuperscript{244} Three policy proposals would help to achieve a more proper balance.

First, a public interest analysis should be required prior to approval of any spin down. As a general rule, regulated firms should not be able to unilaterally avoid statutory will by disassembling themselves into smaller entities beyond an agency’s jurisdiction. Because independent gatherers might undercut a pipeline while its petition is pending, a pipeline that makes out an initial prima facie case that their petition is valid should be excused from filing rates while the petition is pending.\textsuperscript{245}

\begin{itemize}
\item \textsuperscript{237} See supra text accompanying note 166.
\item \textsuperscript{238} See supra note 162 and accompanying text.
\item \textsuperscript{239} See supra text accompanying note 166.
\item \textsuperscript{240} Williams Gas Processing—Gulf Coast Co. v. FERC, 331 F.3d 1011, 1022 (D.C. Cir. 2003).
\item \textsuperscript{241} See Conoco, Inc. v. FERC, 90 F.3d 536, 541 (D.C. Cir. 1996).
\item \textsuperscript{242} See id.
\item \textsuperscript{243} See supra notes 140–42 and accompanying text.
\item \textsuperscript{244} See Williams Gas Processing—Gulf Coast Co., 331 F.3d at 1021–22.
\item \textsuperscript{245} Rate information for this period, however, should be maintained so that if the pipeline’s petition is rejected FERC will have access to the withheld data.
\end{itemize}
Second, each public interest analysis should include review of competitive conditions in the market where spin down is proposed. Whether or not gathering and transportation alternatives are available within a given market provides insight into the prospect of pipeline abuses. The burden of showing that local competition will not suffer upon transfer, and that transfer will not create captive customers without regulatory protection, must rest with the petitioner. Competition in a local market—long term or short term—cannot be assumed into existence by fiat.

A proper consideration of competitive conditions must necessarily heighten emphasis on nonphysical factors such as facility purpose and location and the general business activity of the transferor. This is not to say that nonphysical factors should receive more weight than physical ones, but rather to suggest that they bear more consideration when transfer to an affiliate is proposed. If sold to a truly independent entity, the importance of nonphysical factors would correspondingly diminish.

Finally, and most problematically, rates and conditions of service for all gathering activities should be publicly available. This does not necessitate the regulatory setting of rates and terms of service, but merely their public reporting. Transparency of pricing and service conditions fits neatly with FERC's procompetitive agenda. Indeed, "competitive markets thrive on information, which is a necessary ingredient of price competition." Making rates and service conditions publicly known would arm consumers with the information they need to assemble the most cost effective package of unbundled services. Additionally, with pipelines and independent gatherers required to publicize their rates, the dangers of regulatory arbitrage would likely abate.

Realizing publicly available gathering rates, however, is no easy matter. Local gathering lies beyond FERC's jurisdiction.

246. See Sea Robin Pipeline Co. v. FERC, 127 F.3d 365, 377 (5th Cir. 1997).
247. See supra notes 158–60 and accompanying text.
248. See supra notes 223–34 and accompanying text.
249. McArthur, supra note 53, at 88 ("Free markets give consumers alternatives and let them make informed choices. Competitive markets drive out excess profits, but protect producers from illegal undercutting because companies that price below competitive levels will lose money and go out of business.").
250. See id.
251. See supra notes 81–85 and accompanying text.
and states seem little inclined to fill the gap. Thus transparent gathering rates and service conditions are not likely to be achieved, at least in the short term. For now, a robust public interest analysis prior to spin down must suffice. Yet if the move toward increasingly competitive gas markets proceeds, the ideal of transparency must remain in sight.

CONCLUSION

The NGA was passed to protect purchasers of natural gas from monopolist practices by interstate pipeline companies. Providing natural gas at just and reasonable rates remains the paramount goal of the NGA. Until the deregulatory era commenced by the NGPA, regulators sought to achieve just and reasonable rates by permitting pipelines to operate monopolies so long as they submitted to considerable regulatory oversight. The procompetitive era, characterized by open access and unbundling, profoundly altered the existing regulatory landscape. Unbundling forced pipelines to compete with independent operators for business within discrete segments of the gas industry.

When pipelines began to respond to unbundling by spinning down jurisdictional gathering facilities, they received strong support from FERC, which required no showing that spin down benefited consumers by encouraging competition, and conducted no public interest analysis prior to approving spin down petitions. As a result, pipelines, particularly those in areas where little competition exists in the gathering industry, obtained an opportunity to reassert market dominance in certain markets. Such an outcome directly contradicts the objectives of FERC's procompetitive unbundling reforms. To ensure that consumers continue to receive access to natural gas at just and reasonable rates, FERC must reformulate its response to spin down by conducting a public interest analysis and promoting informational transparency in the natural gas industry.

252. See supra note 211 and accompanying text.
253. See supra notes 41–47 and accompanying text.
255. See supra notes 71–72 and accompanying text.
256. See supra notes 117–29 and accompanying text.
257. See supra notes 119–22 and accompanying text.