Jurisdiction of the Federal Power Commission Under the Natural Gas Act - Commingled Gas

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COMMENTS

JURISDICTION OF THE FEDERAL POWER COMMISSION UNDER THE NATURAL GAS ACT — COMMINGLED GAS

A new era in which the Federal Power Commission is threatening to increase federal regulation through novel interpretations of its jurisdictional grant ironically was marked by the United States Supreme Court reversal of an FPC declination of jurisdiction in Phillips Petroleum Co. v. Wisconsin (1954). The Natural Gas Act of 1938 was enacted to close a gap created by decisions precluding state regulation of rates of electricity and natural gas that traversed state lines. Among


2. The Federal Power Commission held Phillips was not a “natural-gas company” within the meaning of the Natural Gas Act, therefore not within the Commission’s jurisdiction. 10 F.P.C. 246 (1951).


5. Two United States Supreme Court decisions created the gap that rendered states powerless to regulate rates of natural gas and electricity, while the federal government was lacking congressional authorization and regulatory machinery: Missouri v. Kansas Gas Co., 205 U.S. 208 (1907), holding an interstate pipeline’s wholesale sale of gas produced in another state in interstate commerce, even though mixed with gas produced in state of sale; and Public Utilities Commission v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927), holding a sale in generating state of energy transmitted to and consumed in another state in interstate commerce. State rate regulation of these interstate products was considered a forbidden burden on business essentially national in character. Id. at 90 (controlled by the Missouri case); Missouri v. Kansas Gas Co., supra at 307, relying on Minnesota Rate Cases, 230 U.S. 352, 396 (1913); “If a state enactment imposes a direct burden upon interstate commerce, it must fall regardless of Federal legislation. The point of such an objection is not that Congress has acted, but that the State has directly restrained that which in the absence of Federal
other things the FPC has authority over "the sale in interstate commerce of natural gas for resale.""

"'Interstate commerce' means commerce between any regulation should be free.' The question is so fully discussed in that case, that nothing beyond its citation is required."

Recognition of the existence of this gap and the need for remedial legislation was expressed in H.R. REP. No. 709, 75th Cong., 1st Sess. (1937): "The States have, of course, for many years regulated sales of natural gas to consumers in intrastate transactions. The States have also been able to regulate sales to consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of Congressional prohibition subject to state regulation . . . . There is no intention in enacting the present legislation to disturb the States in their exercise of such jurisdiction. However, in the case of sales for resale, or so-called wholesale sales, in interstate commerce (for example, sales by producing companies to distributing companies) the legal situation is different. Such transactions have been considered to be not local in character even in the absence of Congressional action, not subject to State regulation. (See Missouri v. Kansas Gas Co. (1924), 265 U.S. 298, and Public Service Commission v. Attleboro Steam and Electric Co. (1927), 273 U.S. 83.) The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act."

6. 52 Stat. 821 (1938), 15 U.S.C. § 717(b) (1958): "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 or sale 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." Note that "in interstate commerce" follows both "transportation of natural gas" and "sale" in the provision. The bills reported prior to the one ultimately passed as the Natural Gas Act, H.R. 6586, 75th Cong., 1st Sess. (1937), reported H.R. REP. No. 709, 75th Cong., 1st Sess. (1937), did not include this phrase following "sale." H.R. REP. No. 2651, 74th Cong., 2d Sess. (1936); Hearing Before the House Committee on Interstate and Foreign Commerce on H.R. 4008, 75th Cong., 1st Sess. (1937) (substantially identical with H.R. 2651 that was actually introduced as H.R. 12680, 74th Cong., 2d Sess. (1936), except provision for certification of convenience and necessity was added). The Syracuse Light Company of Syracuse, New York, an intermediate intra-state wholesale sales company, proposed an amendment to the proposed statutory definition of "natural gas company" providing for the insertion of "in interstate commerce" immediately following "sale" to insure the act would not apply to its local operations—wholesale sales in Syracuse and other parts within the state. Before the amendment, section 2 of the proposed act defined a "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, or the sale of such gas for resale to the public, whether or not such gas is mixed with artificial gas." Hearing Before the House Committee on Interstate and Foreign Commerce on H.R. 4008, 75th Cong., 1st Sess. (1937). Syracuse's argument was simply that the bill as worded did not confine jurisdiction to gas sold in interstate commerce. Ibid. The colloquy during this hearing following the proposed amendment shows it was intended to limit the act's application to sales of gas transported across state lines for wholesale sales and to exempt the wholly local intervening companies. Ibid. The amendment was adopted and incorporated into the act. The statutory definition reads: "'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." 52 Stat. 821 (1938), 15 U.S.C. § 717a(6) (1958). Moreover, the Committee inserted the phrase in the jurisdictional provision of the act. It is suggested this was required for consistency in the treatment of a "natural gas company" and the exercise of jurisdiction over its sales. Note, Legislative History of the Natural Gas Act, 44 Geo. L.J. 695, 717 (1956).
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 commerce takes place within the United States."

Before Phillips, the interpretation of "in interstate commerce" raised no appreciable controversy. During this era the most

8. In Kentucky Natural Gas Corp. v. Public Service Commission, 28 F. Supp. 509 (E.D. Ky. 1939), wholesale sales to local public utilities were found to be in interstate commerce, conferring jurisdiction on the Commission notwithstanding 30% to 50% of the sales were of locally produced gas. The vendor was an integrated pipeline whose wholesale sales were intermittently and generally to a larger degree of gas from another state depending upon demand pressures in the pipelines. The court found the wholesale sales an integral part of commerce between the states, saying, "under such circumstances, regulation in the public interest is national rather than local, demanding a standard of uniformity unattainable except through a single paramount authority." Id. at 512. "[T]he mere fact that some gas from the interstate stream is sold and delivered in the state of its origin affords that state no superior power to regulate or control the transaction." Id. at 513.

The United States Supreme Court sustained a Commission finding of jurisdiction over a company that distributed outstate natural gas wholly within its state for local consumption, the gas having been received at the state line. Illinois Gas Co. v. Central Illinois Public Service Co., 314 U.S. 498 (1942). The transportation across the state line and subsequent wholesale sale of the gas was enough to convince the Court jurisdiction was proper.

For Interstate Natural Gas Co. v. FPC (1947), see note 10 infra and accompanying text. Controversy over this case was not provoked by the Court's interpretation of "in interstate commerce." The same may be said for FPC v. East Ohio Gas Co., 338 U.S. 464 (1950), rev'd by Act of March 27, 1954, c. 115, 68 Stat. 36, 15 U.S.C. § 717(c) (1958), in which jurisdiction was exercised. There it was held that outstate gas received by a distributor whose transportation and wholesale sales were local, for local consumption, rendered it a natural gas company, the dissent being of opinion such local facilities were exempted by the local distribution proviso of the act's jurisdictional provision. See § 717(b) note 6 supra. The reversing amendment exempts from the act distributors of interstate gas — having traversed state lines — received at or within the distributor's state, provided all the gas is consumed within that state and the rates, services, and facilities are regulated by the state commission. Up to and including fiscal 1962, 128 exemptions have been issued by the FPC under the amendment. 42 FPC Ann. Rep. 92 (1962).

The wrath incurred by the Phillips decision was not over the Court's determination of interstate commerce. See note 11 infra. Phillips admitted its sales were in interstate commerce. 347 U.S. at 677.

Determination that the transportation or sale of gas was in interstate commerce did not appear to be a difficult one for the court; at least one writer is of the opinion this determination "is usually not a difficult one for the Commission." Legislation, The Proposed Amendment To The Natural Gas Act, 25 Fordham L. Rev. 374, 376 (1956). It seems clear the Commission's jurisdictional grant — "in interstate commerce" — is not as broad or inclusive as the congressional power over interstate commerce as derived from the Commerce Clause. Cf. Wiekard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941). More recently it was said the Commission's jurisdiction was narrower than the scope of federal power under the commerce clause. Lo-Vaca Gathering Co. v. FPC, 323 F.2d 190 (5th Cir. 1963). See Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana, 332 U.S. 507, 516, 517 (1944) (drawing jurisdictional line). Thus, Congress' power in regard to legislation affecting interstate commerce would not seem to supply a criterion by which the FPC or the courts might find FPC jurisdiction over a company predi-
significant decision interpreting this jurisdictional phrase was *Interstate Natural Gas Co. v. FPC (1947)*, creating the destination theory of "in interstate commerce." *Interstate* held sales of gas in the producing state to interstate pipelines, for transportation and resale in other states, "in interstate commerce." *Phillips* then opened the door to expanding federal regulation by subjecting numerous smaller, independent producers, who sold gas at the wellhead, to the provisions of the act. Since

9. 331 U.S. 682.

10. In the *Interstate* case a producer sold locally produced gas from its main field trunk lines to three interstate pipelines, each of which transported the gas to markets in other states. Finding these sales in interstate commerce the Court recognized the Commission's finding that "'said gas is so destined from the moment of its production.'" The Commission further found that "'The gas transported and sold by Interstate to these three pipe line companies continues its flow in interstate commerce and, as an established course of business well known to Interstate, is destined for resale for ultimate public consumption in . . . markets outside Louisiana.'" *Id.* at 687. "All the gas sold in these transactions is destined for consumption in States other than Louisiana." *Id.* at 692. Cf. *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) (vendor's lines crossed state line before reaching points of sale). The Court quoted with approval from *Jersey Central Power & Light Co. v. FPC*, 319 U.S. 61, 69 (1943), to point out the lack of distinction between a sale at or before reaching the state line, saying, "clearly the sales in question were a part of commerce being carried on between points in Louisiana and points in other states." 331 U.S. at 688. Having previously quoted the act's definition of "interstate commerce," see text accompanying note 7 *supra*, the Court continued: "There is nothing in that language to suggest that Congress intended that sales consummated before the gas crosses a state line should not be regarded as being 'in' such commerce." 331 U.S. at 688.

Thus the Court created the destination theory of natural gas in interstate commerce. In regard to electricity, see the *Jersey Central Power & Light Co.* case *supra*.

Huit, *National Regulation of the Natural-Gas Industry*, in *PUBLIC ADMINISTRATION AND POLICY FORMATION* 89-97 (Redford ed. 1956) discusses the *Interstate* case and attempts at congressional remedial legislation that were launched in July 1947, the several proposals becoming known as the Kerr Bill. A detailed account is given, ending with President Truman's veto in 1950. The issue centered over the production and gathering provision that came to a head in the *Phillips* case. The President indicated the FPC had not regulated "arm's length sales of non-transporting companies," but he believed it should be so empowered.

11. Phillips gathered gas for resale to interstate pipeline companies, frequently bringing it across state lines, processing it, and thereafter passing title. After extensive litigation involving a host of intervenors—representatives of ten states, four local units of government and many natural gas industry associations—the United States Supreme Court held that the production and gathering exemption of the act, 52 Stat. 821 (1938), 15 U.S.C. § 717(b) (1958), see note 6 *supra*, did not include wholesale sales to interstate pipeline companies. For an account of the *Phillips* litigation and circumstances surrounding those events see Huit, *National Regulation of the Natural-Gas Industry*, in *PUBLIC ADMINISTRATION AND POLICY FORMATION* 97-103 (Redford ed. 1956); a critical analysis appears in Note, 44 GEO. L.J. 695 (1956) (legislative history of act thoroughly covered).

A number of bills were introduced to alleviate the impact of the *Phillips* decision, H.R. 3703, 84th Cong., 1st Sess. (1955); H.R. 3002, 84th Cong., 1st Sess.
Phillips, the Commission has taken the initiative and continued to broaden the application of its scope of federal regulations by sweeping interpretations of “in interstate commerce,” thereby finding jurisdiction based on factual situations similar to those in which jurisdiction previously had been denied. Principally, these are the commingling situations\(^\text{12}\) in which, for example, gas to be sold in the producing state is mixed and transported in the same pipeline with gas to be sold outside the producing state.\(^\text{13}\)

Preceding the Natural Gas Act the United States Supreme Court did not consider gas produced and consumed in the same state in interstate commerce merely because it was commingled

\(^{12}\) Such cases essentially involve the indistinguishable commingling of natural gas from different sources and destined for dissimilar uses and different areas or markets, and will be discussed in detail.

\(^{13}\) A commingling situation is one in which natural gas having one legal or contractual characteristic is mixed in a pipeline with natural gas having another legal or contractual characteristic.
with outstate gas by the vendor, provided the quantity received and sold as local gas was determinable.\textsuperscript{14} Following the act, the first commingling cases involved situations analogous to the commingling of intrastate and interstate gas. These cases were concerned with the commingling of gas in interstate commerce sold to distributors for resale with gas for direct industrial consumption, the Commission having no jurisdiction over the latter.\textsuperscript{15} It was said, then held, that the existence of a separate transaction identifying the amount to be used for direct consumption precluded federal regulation of that sale; thus commingling of exempted and covered gas did not ipso facto subject the former to jurisdiction.\textsuperscript{16} When the issue was squarely faced whether locally produced gas, sold under contractual provision for metering and sale within the state of production, was in interstate commerce by virtue of being commingled with gas destined for interstate markets, the United States Court of Appeals for the Eighth Circuit affirmed the Commission's refusal to accept jurisdiction.\textsuperscript{17} Identification of an intrastate volume of gas would allow that portion of gas, although indistinguishably commingled with interstate gas, to retain its intrastate character. Then the FPC rendered the \textit{Lo-Vaca Gathering Co.}\textsuperscript{18} and \textit{United Gas Pipe Line Co.}\textsuperscript{19} decisions which apparently

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\textsuperscript{14} People's Natural Gas Co. v. Public Service Commission, 270 U.S. 550 (1926). There was no contractual distinction of the gas produced and consumed in the same state. The Court simply found enough locally produced gas was present in the total commingled flow from which the wholesale sale in question was drawn to account for a sale of intrastate gas. It recognized the wholesale sale involved no greater quantity than the amount of locally produced gas transported in the pipeline.

\textsuperscript{15} 52 Stat. 821 (1938), 15 U.S.C. \textsection 717(b) (1958) : "The provisions of this chapter shall apply . . . to the sale in interstate commerce of natural gas for resale." (Emphasis added.)

\textsuperscript{16} United States v. Public Utilities Commission of California, 345 U.S. 295 (1953) involved a sale of energy that traversed a state line, only a portion thereof to be resold. The Court assumed \textit{arguendo} the energy could be divided for jurisdictional purposes, but then found the absence of a separate transaction by which the power directly consumed by the purchaser could be identified. Two years later it was held that separate transactions distinguished commingled gas for resale from gas for direct industrial consumption. City of Hastings v. FPC, 221 F.2d 31 (D.C. Cir. 1955). The court said: "The entire course of dealings clearly permitted the Commission to find the existence of separate rates, separate billings, separate negotiations, separate contracts, separate allocation of gas and effective separate measurement facilities." Id. at 36.

\textsuperscript{17} North Dakota v. FPC, 247 F.2d 173 (8th Cir. 1957). The contract at issue provided for "firm gas" wholesale sales to an interstate pipeline to be transported therein with other locally produced gas destined for markets outside the producing state as provided for by "dump gas" contract. The "firm gas" was to be separated into laterals for use in four towns of the state of production.

\textsuperscript{18} 40 P.U.R.3d 257 (1961), \textit{rev'd and remanded}, Lo-Vaca Gathering Co. v. FPC, 323 F.2d 190 (5th Cir. 1963).

marked an abandonment of the Commission's former judicially supported position and raised the question whether future commingling situations will lead to federal or state regulatory control.

In *Lo-Vaca*, Houston Pipe Line Company contracted to sell for resale Texas produced natural gas to El Paso Natural Gas Company for consumption wholly within Texas. Through the complexity of El Paso's pipelines in which the gas was to be routed, Houston's gas was to be indistinguishably commingled with gas from other producers destined for consumption outside Texas; then an amount equal to Houston's sales volume was to be metered from the lines in Texas. Upon proceedings by petition for a declaratory order to remove uncertainty as to the Commission's jurisdiction over Houston's proposed sale, the FPC found Houston a natural gas company within the meaning of the act and its proposed sales subject to its jurisdiction. The United States Court of Appeals for the Fifth Circuit reversed, holding physical commingling of gas intended for local consumption with gas destined for outstate markets, the same quantity of the former placed in the mixed stream being metered therefrom in the producing state, does not destroy the status of the former as intrastate, non-jurisdictional gas.

Shortly preceding the *Lo-Vaca* reversal the Commission exercised jurisdiction over wholesale sales of natural gas by United Gas Pipe Line Company to Louisiana distributors for consumption in Louisiana. United purchased gas from onshore Louisiana producers and transported it in an interstate, fully integrated pipeline to customers in Louisiana. United purchased gas from onshore Louisiana producers and transported it in an interstate, fully integrated pipeline to customers in Louisiana.
sales, the remainder of the gas continued its journey in United’s pipeline to markets in other states. The Commission held gas entering an interstate pipeline acquired an interstate character, unalterable even upon separation from the pipeline for consumption in the producing state. Alternatively, the Commission seems to have held gas is “in interstate commerce” when its state-made wholesale rates burden interstate commerce.

An analysis of the Commission’s position reveals the irregularity of its determination that the gas involved was within the ambit of the act’s definition of interstate commerce. In each instance the Commission looked at the “essential character of the commerce” to determine that the sales were “in interstate commerce.” In Lo-Vaca jurisdiction was justified solely by the impossibility of molecular identification of the gas, while in United the unalterable interstate characteristic of the gas was from the Lirette-Mobile line, gas sold from that line coming from onshore Louisiana. The offshore gas is transported through the Kosciusko line.

Although the Commission found that customers receiving gas principally from onshore Louisiana “possibly still receive Mississippi produced gas from the northsouth line extending to Louisiana and Mississippi and gas flowing westerly from Mississippi in United’s Lirette-Mobile line,” this finding will not be discussed; it raised an issue concerning backflow gas that was not essential to the part of the opinion discussed in this Comment.

Alternatively, the Commission held the wholesale sales in question in interstate commerce by application of an “interdependence-substantial impact” test that purportedly showed the impact that the sales in question had upon United’s interstate business in that it was conducted by a wholly integrated, interstate pipeline system. The Commission was of the opinion ‘narrow ‘tests’ should be avoided.’ United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). The Commission’s proof that gas conveyed by the sales in question from the Lirette-Mobile line had traversed a state boundary was less than convincing, the opinion never stating in language stronger than “conceivably” or “possibly” that the gas had crossed the Mississippi-Louisiana boundary. Moreover, on application for rehearing, United filed an application setting forth errors in findings of fact that should eliminate this holding altogether, leaving only the more important ones dealt with in this Comment for consideration.


27. See text accompanying note 7 supra.

28. In Lo-Vaca the Commission said: “It is the ‘nature of the beast’ not the label that is controlling. It has been held that whether a transaction is in interstate commerce is determined by the essential character of the commerce, not necessarily by the contract. Atlantic Coast Line R.R. v. Standard Oil Co. (1927) 275 U.S. 257, 268 . . .” 40 P.U.R.3d at 264. The United case cites the Atlantic Coast Line R.R. case in support of its following statement: “In reaching the conclusion that the gas here in question is ‘in interstate commerce,’ we feel that narrow ‘tests’ should be avoided and instead, that the entire spectrum of pertinent factors should be examined.” Docket No. CP62-161 (Aug. 26, 1963).
buttressed by jurisprudential authorities. The court of appeals brushed aside the physical properties of the gas, making it quite clear the laws of physics do not dictate principles of constitutional law and statutory construction. The authorities that buttressed the United conclusion require examination.

Deep South Oil Co. v. FPC was cited for the proposition that once gas has been sold for resale by a producer to an interstate pipeline it has commenced its journey in interstate commerce, even though some of that gas is to be sold in the producing state. Apparently impressed by the intrastate sales by the pipeline in Deep South, the Commission concluded United’s wholesale sales of gas having an interstate character in the pipeline were in interstate commerce. Deep South involved wholesale sales by a producer to an interstate pipeline, not a subsequent wholesale sale by the pipeline in the state of consumption. It does not follow from that decision that gas commingled in an interstate pipeline cannot reacquire its intrastate character by a subsequent sale for consumption in the state of production. The sale by Deep South to the interstate pipeline imparted an interstate character to the gas by destination as did the producer’s sale to United; but the sales at wholesale by United deprived the gas of opportunity to traverse a state boundary, thereby preventing its fictitious interstate character from maturing. Moreover, the language is simply

29. The court quoted from Judge Brown’s dissenting opinion in Deep South Oil Co. v. FPC, 247 F.2d 882, 891 (5th Cir. 1957): “‘[T]he principles of constitutional law and statutory construction are not equated with laws of physics, so that the inquiry is something more than the schoolboy’s quest for molecular identification.’” Lo-Vaca Gathering Co. v. FPC, 323 F.2d 190, 191 (5th Cir. 1963).

30. Note the Commission merely buttresses its finding that interstate gas has an unalterable characteristic, and cites no direct authority for this proposition. The pertinent language: “Thus, the entire gas stream is, in the most literal sense, ‘in interstate commerce’. The removal of a portion of the gas thus flowing in interstate commerce does not change the gas removed from the stream into intrastate gas. This conclusion is buttressed by the fact that the transactions between United and the producers who sold the gas in question are clearly within our jurisdiction.” United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). The Commission then refers to decisions it found to support its jurisdiction over such sales.

31. 247 F.2d 882 (5th Cir. 1957), noted 18 LA. L. Rev. 578 (1958).

32. The gas was sold for processing after which a portion was resold by the processor for transportation and resale in interstate commerce. The court said: “As to petitioner’s claim that its sales are ‘local’ in character, we think it plain that they are sales ‘in interstate commerce’ for the obvious reason that the sale of gas originating in one state and its transmission and delivery to distributors in any other state constitutes interstate commerce. . . . Cf. Federal Power Commission v. East Ohio Gas Co., 338 U.S. 464, 467 . . . .” Id. at 887.

that the gas sold for resale by Deep South "commenced its journey in interstate commerce."34 Consumption of gas in the producing state simply was not at issue and not discussed. It is submitted *Deep South* is clearly not authority for the conclusion reached in the *United* case.

The FPC buttressed its conclusion further by relying upon the Court's language, in *Phillips Petroleum Corp. v. Wisconsin*,35 that jurisdiction vested over "wholesales" occurring anytime before or after transmission,36 and by relying upon the presence of sales in the purchasing state by the interstate pipelines that bought from Phillips.37 Not only was "in interstate commerce" not at issue in *Phillips*,38 but the language the Commission relied upon suggests no definition of "in interstate commerce."39 Furthermore, it does not appear the Court considered the sale of any gas in the producing state. It is submitted the *Phillips* decision is not authority for the Commission's conclusion.

Lastly, the FPC relied on its *Lo-Vaca* proposition that what the parties actually do with the gas determines its status and not their verbal or written provisions for the transaction.40

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34. See quoted material note 32 *supra*. The court continued: "Petitioner admits . . . 'there is a continuous flow of gas from the Deep South wells into the gathering system of Texas Gas; that the mass of gas of which the Deep South gas becomes a part moves continuously through the gathering system into a processing plant; that the movement through the processing plant is continuous; that there is a continuous movement of natural gas from the outlet of the processing plant to both interstate and intrastate destinations. * * *' Accordingly, and in the light of all the uncontroverted facts, we hold that when the gas was sold by petitioner it had commenced its journey in interstate commerce." 247 F.2d at 887.


37. The Commission seems to have reasoned the wholesale sales by United were in interstate commerce because the wholesale sales by the interstate pipelines in *Phillips* did not render Phillips' sales to the pipelines non-jurisdictional. The Commission said, "the Court was apparently untroubled by the fact that some of the purchasing pipelines resold the gas bought from Phillips within the state in which it was purchased." United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963).

38. Phillips admitted its sales were in interstate commerce, *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 677 (1954) (issue was whether Phillips' sales were part of the production and gathering process).

39. See note 36 *supra*. The quoted language merely defines the breadth of interstate commerce in which sales therein may occur.

40. "[T]he touchstone to the question whether a sale of gas is for resale in interstate commerce is what is done with the gas, not what the parties may say
This case is no authority for the United position notwithstanding its reversal. It is inapposite to United because the possibility at least existed that consumption might occur outside the producing state. It does not stand for the "unalterable interstate character" of natural gas sold under conditions whereby consumption in the producing state is certain.

The alternative holding that gas is "in interstate commerce" when state-made rates of local gas burden interstate commerce is gleaned from the Commission's summary treatment of the Shreveport Rate Case\(^4\) in United. Though the Commission made no effort to develop an analogy to this case, it seems the import was that United's wholesale rates of natural gas produced, transported, and consumed wholly in Louisiana unjustly discriminated against rates of gas similarly transported by United to outstate markets.\(^4\) In Shreveport the United States Supreme Court found no basis for exempting from the Interstate Commerce Commission's jurisdiction\(^4\) interstate carriers that discriminated against interstate traffic by lower intrastate rates; it appears the FPC also found no basis for exempting United's wholesale sales, for it concluded neither the language of the Natural Gas Act alone nor its legislative history was conclusive in determining jurisdiction over these sales.\(^4\) The

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41. Houston, E. & W.T. R.R. v. United States, 234 U.S. 342 (1914). The Commission's summary treatment of this case was as follows: "We do not accept the view that because the gas did not leave the State, it cannot be 'in interstate commerce'. In placing substantial reliance upon this factor, the examiner cited as his authority . . . (the Shreveport Rate Case) . . . and North Carolina v. United States, 325 U.S. 507 (1945)." United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). The Commission did not allude to the Shreveport case again.

42. The FPC did find the rates of United's wholesale sales 9 cents per Mcf lower than it would have prescribed. United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). In Shreveport the United States Supreme Court held rates of freight wholly transported within a state discriminated against freight coming into the state from a comparable distance at higher rates, thus unjustly discriminating against interstate commerce, the two transportation situations being similar. Note the Court found discrimination, not merely the power to discriminate, by state-made intrastate rates. Without discriminating against interstate commerce the states may make intrastate rates. Minnesota Rate Cases, 230 U.S. 352 (1913); see quotation in note 5 supra.

43. After discussing a provision of the Interstate Commerce Act proscribing discrimination by carriers, the Supreme Court said "there is no exception or qualification with respect to an unreasonable discrimination against interstate traffic produced by the relation of intrastate to interstate rates as maintained by the carrier, . . . and there is no basis for the contention that Congress intended to exempt any discriminatory action or practice of interstate carriers affecting interstate commerce which it had authority to reach." Houston, E. & W.T. R.R. v. United States, 234 U.S. 342, 356 (1914).

44. "As noted earlier, whether or not the disputed sales are subject to this
Supreme Court in *Shreveport* reasoned that Congress' power to terminate unjust discrimination against interstate rates was properly executed through its subordinate body, the ICC, notwithstanding a proviso in the Interstate Commerce Act exempting transportation wholly within one state. The controlling provision of the act "sweeping enough to embrace all the discriminations of the sort described," on which the Supreme Court relied was Congress' mandate expressly proscribing discrimination.

The Natural Gas Act may differ significantly from the Interstate Commerce Act in that "interstate commerce" is expressly defined in the former, while not in the latter. Moreover, the Natural Gas Act contains no express mention of discrimination as does the Interstate Commerce Act, although the legislative history of the Natural Gas Act reveals that, at least for some, discrimination among buyers of natural gas was a target of the act. Furthermore, "interstate commerce" does
not appear in the provision proscribing discrimination in the Interstate Commerce Act. In any event, jurisdiction under the Shreveport Rate Case rationale should not lie unless an evil sought to be eliminated by the act is found to exist. The primary target of the act was plugging the gap in regulation of transactions in interstate commerce to check the ultimate fear—exploitation and discrimination by monopoly power. The Commission’s summary treatment of the Shreveport Rate Case and its failure to discuss discrimination or exploitation cause doubt whether either evil was believed to exist in United.

It seems the United case could not have presented a more clearly identifiable situation or event for determining a local quantity of natural gas—locally produced gas being sold for resale in the state of production for consumption therein. Moreover, “interstate commerce” as defined by the act clearly excludes gas produced, sold, and consumed within the same state. Thus, the absence of jurisprudential or statutory support for the affiliated pipelines selling to the latter at higher rates than were charged the affiliated industrial users. 81 Cong. Rec. 9312, 9315 (1937). Mr. Wheeler’s reply was “Yes. At the present time, some of the pipe lines that are selling at wholesale will sell to one community at a certain price, and sell to another community at another price. They are permitted to sell to one industry at one price, and to sell to another industry at another price. In other words, the present state of affairs permits the old racket of rebates and discriminations against cities and against counties and against municipalities, and against particular industries in a community.” Ibid. The gas referred to by Mr. Minton was that which was brought into his state by the discriminating pipelines.

51. See note 47 supra.

52. This is best exemplified by the destination theory of natural gas in interstate commerce as created by the Interstate Natural Gas case. See note 10 supra.

53. The report of the Natural Gas Act recognizes this gap. H.R. Rrr. No. 768, 75th Cong., 1st Sess. 2 (1937). See 2d note 5 supra. The fear of monopoly power appears from Mr. Lea’s remarks, Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 11662, 74th Cong. 2d Sess. 28 (1936) : “I suppose the broad question that Mr. Cooper presents is whether or not it is necessary to have regulation of gas in interstate shipment or transportation. The theory of the bill, I take it, would be that the State regulation is necessary, as on a public-utility basis and without interstate regulation there is a gap in regulation. The consumption in the State is secured largely through interstate transmission and the cost of the interstate production is, of course, a very material element in determining the price the local people must pay for their gas. So that if complete regulation is necessary, it would involve interstate regulation.” Mr. DeVan, Solicitor, Federal Power Commission, replied: “That is correct, Mr. Chairman.” Ibid.

54. See note 41 supra.

55. See note 49 supra. An interesting sidelight upon whether a strict interpretation of “in interstate commerce” precludes jurisdiction over the sales in question herein is raised by Commissioner O’Connor, dissenting in United. He said in the Shreveport Rate Cases the court accepted as “self-evident the principle that railroad traffic between two points in Texas was intrastate, although the trains and railroad lines which carried the intrastate traffic went to and served markets outside the State.” Docket No. CP62-161 (Aug. 26, 1963).
Commission's finding that United's wholesale sales were in interstate commerce and thus within its jurisdiction suggest a strained interpretation of "in interstate commerce" in an attempt to broaden federal jurisdiction to encompass commingling situations.\(^5\)

Though the Commission would have it appear its jurisdiction rested solely on its purported judicially supported interpretation of its statutory grant,\(^5^6\) it seems that additional considerations provoked the extended coverage given "in interstate commerce."\(^5^7\) The Commission considered the threat of buyers' discrimination between suppliers;\(^5^9\) possible cost increases to interstate customers, placing them at competitive disadvantage;\(^6^0\) vulnerability of interstate rates to increments due to irresponsible state ratemaking;\(^6^1\) and maintenance of the federal

\(^{56}\) Moreover, the Commission ignored analogous authority to the contrary. See United States v. Public Utilities of California, 345 U.S. 295 (1953); People's Gas Co. v. Public Service Commission, 270 U.S. 550 (1926) (commingling situation preceding the act); North Dakota v. FPC, 247 F.2d 173 (8th Cir. 1957); City of Hastings v. FPC, 221 F.2d 31 (D.C. Cir. 1954).

\(^{57}\) This follows from the Commission's findings that the gas was "in interstate commerce." In Lo-Vaca the Commission said: "The record makes it clear that because of commingling, the gas from Houston and Lo-Vaca would in part be consumed by El Paso either within or outside Texas and would in part be carried on to El Paso's customers in New Mexico, Arizona and California." 40 P.U.R.3d 257, 261 (1961). The United opinion states: "The most important consideration leading to the conclusion that these sales are in interstate commerce is that the gas sold is part of a single, uniform stream flowing through United's interstate pipeline from the point of purchase in Louisiana, whether onshore or offshore, to United's customers in other states. Thus, the entire gas stream is, in the most liberal sense, 'in interstate commerce'. The removal of a portion of the gas thus flowing in interstate commerce does not change the gas removed from the stream into intrastate gas." Docket No. CP62-161 (Aug. 26, 1963). Alternatively, the Commission held the wholesale sales in question in interstate commerce owing to the wholly integrated nature of United's pipeline system. It said: "'The established course of business being predominantly interstate, the mere fact that some gas from the interstate stream is sold and delivered in the state of its origin affords that state no superior power to regulate or control the transaction.'" Ibid. Quoting from Kentucky Natural Gas Corp. v. Public Service Commission, 28 F. Supp. 509, 513 (D. Ky. 1939). Therein, due to the wholly integrated pipeline system, gas consumed in Kentucky was either Indiana or Kentucky gas depending upon pressures within the system. In regard to this holding see note 8 supra.

\(^{58}\) "In the light of these considerations, and because we think the gas United sells is clearly in the stream of interstate commerce, we conclude that the sales in question are subject to our jurisdiction." United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963).

\(^{59}\) "It would be possible for a pipeline to discriminate among producers by giving certain ones the privilege of selling to it the gas which by agreement would be deemed to be segregated from the interstate stream and to be resold and consumed in the state of production or used in compressor stations. This may increase the cost to interstate customers and at the same time put them at a competitive disadvantage in obtaining additional supplies of gas." Lo-Vaca Gathering Co., 40 P.U.R.3d 257, 266 (1961).

\(^{60}\) See note 59 supra.

\(^{61}\) "There is also an inter-relation between the rates for these sales in Lou-
regulatory scheme. These considerations might well be dispensed with by the simple submission that they are not within the expressed jurisdictional test prescribed by the act—the definition of interstate commerce—that the House of Representatives and Senate committees both found self-explanatory. Nonetheless, examination of these considerations is deemed warranted for it is submitted they fail on their merits as justification for jurisdiction.

Maintenance of a sensible federal regulatory scheme is perhaps the most forceful consideration seemingly provocative of a finding of jurisdiction. The price in any sale of natural gas ultimately consumed in an interstate market affects the price paid by the interstate consumer. Thus, "in interstate commerce" was readily extended to producers' sales under the destination theory. But, United's wholesale sales to Louisiana distributors could not be more clearly inapposite to the wholesale sales outside the state, for if Louisiana sets rates that are too low, and United's return is consequently reduced, its capital costs may rise. Increased capital costs would normally be reflected in higher interstate rates.

United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). In a footnote the Commission pointed out the Louisiana rate for the wholesale sales involved is "almost 9 cents per Mcf lower than that set by this Commission." It is significant the criticism levied here is part of the "interdependence-substantial impact" test earlier espoused by the Commission as an all-inclusive jurisdictional criterion. See 3d note 24 supra.

Other considerations mentioned in the United opinion not dealt with in the text are United's use of gas for the wholesale sales involved, which gas was purchased under producer rate schedules subject to FPC jurisdiction, without regard for the markets to which the gas was destined, and lack of authority to certify the wholesale sales at issue so that gas dedicated to interstate commerce might be used intrastate to the detriment of the former wholesale sales. Docket No. CP62-161 (Aug. 26, 1963). It is believed proper allocation of gas to the various interstate markets, causing United to live up to its interstate commitments is the proper solution for the considerations here raised.

62. "[W]e are compelled to ask whether a statutory scheme which would include wholesale sales at one end of a pipeline but would exclude the same sales, from a common stream, if made at the other end of a pipeline, would make sense. We think it would not." United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). The FPC refers the reader to H.R. REP. No. 709, 75th Cong., 1st Sess. 2, and cases cited therein (1937). See 2d ¶ note 5 supra. Public Service Commission v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927) and Missouri v. Kansas Gas Co., 263 U.S. 298 (1924) are the cases cited therein, none of which faced the issue whether a wholesale sale of gas or energy like United's to its Louisiana customers was in interstate commerce.

63. See note 49 supra.

64. H.R. REP. No. 709, 75th Cong., 1st Sess. 4 (1937); S. REP. No. 1162, 75th Cong., 1st Sess. 4 (1937). Federal Power Commissioner O'Connor (dissenting in part) in United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963) said: "Obviously the only self-explanatory interpretation of commerce between any point in a State and any point outside thereof is one which is confined to exactly those events—and which patently excludes the disputed sales involving only commerce between two points in the same State."

65. In United the Commission was not expressly fearful of this effect. See note 62 supra.
sales to which the fictitious “destined for interstate commerce” applies. The prices of United’s sales solely to consumers within the state of production could only indirectly affect interstate rates. The gas fictitiously in interstate commerce becomes destined for consumption in the state of production upon the wholesale sale in question and is in fact consumed in such state. Moreover, it clearly appears from Senate debate as it does from the act’s definition of interstate commerce that gas produced and sold at wholesale for consumption in the same state was excluded from the coverage of the act; therefore, it should not be subjected to control for the maintenance of the federal regulatory scheme.

66. Senate debate of the here-pertinent provisions of H.R. 6586, ultimately passed as the Natural Gas Act, appears in 81 Cong. Rec. 9312 (1937) as follows: “Mr. BORAH. Mr. President, as I understand, the bill is confined to the regulation of interstate commerce? Mr. WHEELER . . . . That is all, and nothing else.” Id. at 9314. “Mr. WHEELER . . . . The Federal Power Commission will have power to regulate the price of gas shipped and sold at wholesale in interstate commerce.” Id. at 9315. “Mr. WHEELER. It will be of the greatest benefit, as a matter of fact, to every large city, and every user of gas that is shipped wholesale. My State is not at all affected by the bill, because all our gas is produced in the State. Therefore, the bill does not affect us in the slightest degree; but the authorities of . . . every single city in the United States that imports gas, have written me and begged me and pleaded with me to try to get this bill passed.” Ibid. “Mr. WHEELER. This bill, of course, could not affect the price charged by the People’s Gas Co. [that sold to Chicago for consumption therein] for gas produced in the State of Illinois, but when gas is brought into a State and sold at wholesale, the Federal authorities may simply go to the extent of saying, “A reasonable price for this gas which is shipped at wholesale is so much”—just as they fix rates for railroads.” Ibid.

Such discussions appear limited in the legislative history of the act, probably because it was understood the act did not cover gas or wholesale sales of gas not traversing a state boundary. The definition of “interstate commerce” contained in the act is explicit. See note 49 supra. After quoting at length from H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937), see 2d note 5 supra, the Commission correctly says: “The report does not state whether the Committee considered gas sold for resale by interstate pipelines in the states in which it was purchased—intrastate or interstate—although federal regulation of such sales would clearly be within Congress’ power.” United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963). However true this may be, it is submitted the Senate debate above quoted shows it was considered in the Senate and there thought to be without the Commission’s jurisdiction. Furthermore, the above colloquy shows the error in the following statement made in the course of the United opinion: “In the absence of a direct statement of what Congress intended, we must attempt to determine what Congress would have said about this particular problem if it had been brought to its attention.” Ibid.

67. In regard to Houston’s wholesale sales it seems sufficient to say if El Paso failed to use all Houston’s gas in Texas, it would be time for the FPC to regulate that portion being ultimately consumed outside the state of production, but until that time the good faith provisions of the parties should prevail as an identifying fact.

Under 52 Stat. 826 (1938), 15 U.S.C. § 717i (1958) the Commission could ascertain where the gas is actually being consumed in regard to volume by requiring reports and records necessary to make such determination. That section provides as follows: “Every natural-gas company shall file with the Commission such annual and other periodic or special reports as the Commission may by
In *Lo-Vaca* the Commission expressed the fear that possible cost increments from discrimination would raise interstate rates, while in *United* it named irresponsible state ratemaking as another cause of this increment. Thus, it feared the competitive disadvantage to interstate customers that might result from lack of federal regulation of intrastate sales. But interstate rates might be determined from intrastate and interstate costs regardless of the actual rate for intrastate sales, thereby keeping interstate rates reasonable and unaffected by any state's ratemaking. By the Commission's failure to show that any previous increments in interstate rates resulted from insufficient intrastate rates, or that an independent allocation-of-cost determination was unworkable, these considerations lose force.

The Commission's fear that buyers might discriminate among suppliers presupposes some detriment flowing from the competitive selection of instate producers—a competition without which such producers might not seek the most efficient means of operation—which, notwithstanding state rate regulation, would cause higher state-wide natural gas rates. Moreover, Senate debate shows that the act's primary target as to discrimination was that practiced by interstate pipelines affiliated with instate industry against public distributors and various industries, and that wholesale rates of locally produced gas were to remain subject to state regulation. Thus this last important buttressing consideration is of questionable merit.

rules and regulations or order prescribe as necessary or appropriate to assist the Commission in the proper administration of this chapter. The Commission may prescribe the manner and form in which such reports shall be made, and require from such natural-gas companies specific answers to all questions upon which the Commission may need information. The Commission may require that such reports shall include, among other things, full information as to transportation, delivery, use, and sale of natural gas."

68. See note 59 *supra*.

69. See 1st ¶ note 61 *supra* and accompanying text.

70. It is submitted in the dissenting opinion, United Gas Pipe Line Co., Docket No. CP62-171 (Aug. 26, 1963) that these costs would be determined if the Commission were faced with a rate issue: "[T]he Federal Power Commission in prescribing interstate rates follows definite allocation-of-costs principles which insure that the interstate rates bear their fair share of system costs and no more." Cited were American Louisiana Pipe Line Co., 48 P.U.R.3d 321 (1963); United Gas Pipe Line Co., 13 F.P.C. 398 (1954); and Atlantic Seaboard Corp., 11 F.P.C. 43 (1952).

71. This determination is made by the FPC on its own judgment, independent from allegations from pipelines and state commissions. See United Gas Pipe Line Co., Docket No. CP62-161 (Aug. 26, 1963) (dissenting opinion).

72. See note 59 *supra* and accompanying text.

73. See colloquy of Senate debate of H.R. 6586, notes 50 and 66 *supra*. The court of appeals in *Lo-Vaca* appears to have acted consistently with the purpose of the act as gleaned from the legislative history.

74. Other considerations not given textual treatment that were mentioned in
That a jurisprudential shift in the commingling cases has occurred, greatly widening the ambit of "in interstate commerce," and thus the jurisdiction of the FPC, seems evident. The Commission's trend is toward a federal scheme of regulation with little regard given the wealth of legislative history preceding the Natural Gas Act, jurisprudential interpretations of "in interstate commerce" or the clearly restricted definition of "in interstate commerce." If such broad interpretations of this clause continue and gain judicial acceptance, it is believed it will have become a mere label for disguising what the Commission considers advantages flowing from federal regulation. Federal regulation could be avoided only by new pipeline construction wholly within states. The Commission's good faith in exerting its power for what it deems a reasonable federal scheme of regulation is not questioned; but in the words of Federal Power Commissioner Woodward:

"... Congress ... provides laws, of which the Natural Gas Act is an example, designed to reconcile diverse and conflicting interests in our nation and society in the interest of the whole people. It is essential to the attainment of the objectives of such legislation that the commands of Congress, and the courts' interpretations thereof, be vigorously obeyed."75

He concludes the desire for achievement should not be allowed to upset the preservation of our constitutional system by the assertion of authority or exertion of functions "which a preponderance of the guiding considerations shows are not ours."76

The Lo-Vaca reversal suggests state regulation will prevail; but the recent FPC decisions, evidencing a strong will to exercise federal control, provide grounds for concern whether expanded findings of "in interstate commerce" will continue and

the United opinion appear in 2d ¶ at note 61 supra. The Lo-Vaca opinion further stated: "It would be possible, as in this case, for a pipeline to offer to purchase gas at a higher price than we would otherwise allow in the area upon the assertion that it would use this gas in its compressors or would deliver it to its intrastate customers even though the gas would actually be received into its general system transportation facilities and used for every system purpose." 40 F.U.R.3d 237, 266 (1961). About this the Commission says its regulation of rates would be handicapped, but it is suggested there exists no jurisdiction to regulate such rates as they are not wholesale rates if the gas is used solely by El Paso whether in or out of the State of Texas. 52 Stat. 821 (1938), 15 U.S.C. § 717(b) (1958); City of Hastings v. FPC, 221 F.2d 31 (D.O. Cir. 1955).


76. Ibid.
become judicially accepted, and whether new jurisdictional tests of "in interstate commerce" lying outside the act's definition will emerge. If so, the FPC will have jurisdiction to the exclusion of state authorities without the necessity of finding burdens on interstate commerce in each case. Such a course would seem to suppress knowledge of the effects of industry practices and rate making upon producers, carriers, and consumers alike, and render litigation in this area less curative, causing proponents and opponents of federal or state power to suffer undisclosed inefficiencies, the ascertainment of which, it is submitted, would be welcomed by all.

David S. Bell*

MINERAL LEASE CANCELLATION FOR FAILURE TO PAY PRODUCTION ROYALTY

INTRODUCTION

Recent decisions of the Second Circuit in Bailey v. Meadows* and of the Third in Pierce v. Atlantic Refining Co.² cancelling mineral leases because of the lessee's failure to commence payment of production royalty have caused great concern in the Louisiana oil and gas industry. This comment will undertake both a conceptual and practical analysis of this problem.

BACKGROUND

The mineral lease is the instrument used most frequently in the commercial development of Louisiana's oil and gas resources. No special body of legislation governs this unique type of contract. Consequently, development of the law in this field has been left largely to the courts, which have analogically applied the Civil Code articles on predial leases to the mineral lease.³

In addition to the general requirements that a valid contract

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1. 130 So. 2d 501 (La. App. 2d Cir. 1961), writs denied.
2. 140 So. 2d 19 (La. App. 3d Cir. 1962), writs denied.